[COMMITTEE PRINT]

SUMMARY OF PROPOSALS FOR PRIVATE PENSION PLAN REFORM

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS

OF THE

COMMITTEE ON FINANCE

BY

THE STAFF

OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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Joint Committee on Internal Revenue Taxation

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I. GENERAL STATEMENT

Over the past 30 years, the private pension system has grown rapidly. About 30 million employees were covered by these plans in 1970 compared to 4 million in 1940 and 9.8 million in 1950.[1] (See Table 1.) By 1980, these pension plans are expected to cover 42 million employees.[2] The growth which has occurred is also evidenced in other ways. Between 1950 and 1970, total annual contributions made to pension plans by employees and employers rose from about $2.1 billion to about $14 billion. In 1950, 450,000 beneficiaries received $370 million from pension plans; in 1970, 4.7 million beneficiaries received $7.4 billion in pension payments. Moreover, pension plan assets soared from $12.1 billion in 1940 to $150 billion in 1972 (book value) and are expected to reach $225 billion by 1980.[3]

This rapid increase in pension plans over the past few decades has consisted overwhelmingly of plans which meet Internal Revenue requirements designed to insure that the plans will benefit the rank and file employees and not merely a few highly paid employees. Since 1942, the Internal Revenue Code has contained provisions which prohibit qualified pension plans from discriminating as to coverage or benefits in favor of highly paid employees. The Internal Revenue Code seeks to induce compliance with these nondiscriminatory requirements by giving favorable tax treatment where plans comply.

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[1] This includes employees covered by profit-sharing and stock bonus plans used for retirement purposes.

[2] See Public Policy and Private Pension Programs. A Report to the President on Private Employee Retirement Plans by the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, January 1965, p. vi.

[3] Ibid, and Securities and Exchange Commission, Private Noninsured Pension Funds, 1972 (Preliminary).

TABLE 1.—PRIVATE PENSION AND DEFERRED PROFIT-SHARING PLANS:[1] ESTIMATED COVERAGE, CONTRIBUTIONS, BENEFICIARIES, BENEFIT PAYMENTS, AND RESERVES, 1950, 1955, 1960–70

Year	Coverage,[2] end of year (in thousands)			Employer contributions (in millions)			Employee contributions (in millions)			Number of beneficiaries, end of year (in thousands)			Amount of benefit payments (in millions)			Reserves, end of year (in billions)		
	Total	Insured	Noninsured	Total	Insured	Noninsured	Total	Insured	Noninsured	Total	Insured	Noninsured	Total[3]	Insured	Noninsured[3]	Total	Insured	Noninsured
1950	9, 800	2, 600	7, 200	$1, 750	$720	$1, 030	$330	$200	$130	450	150	300	$370	$80	$290	$12. 1	$5. 6	$6. 5
1955	15, 400	3, 800	11, 600	3, 280	1, 100	2, 180	560	280	280	980	290	690	850	180	670	27. 5	11. 3	16. 1
1960	21, 200	4, 900	16, 300	4, 710	1, 190	3, 520	780	300	480	1, 780	540	1, 240	1, 720	390	1, 330	52. 0	18. 8	33. 1
1961	22, 200	5, 100	17, 100	4, 830	1, 180	3, 650	780	290	490	1, 910	570	1, 340	1, 970	450	1, 520	57. 8	20. 2	37. 5
1962	23, 100	5, 200	17, 900	5, 200	1, 240	3, 960	830	310	520	2, 100	630	1, 470	2, 330	510	1, 820	63. 5	21. 6	41. 9
1963	23, 800	5, 400	18, 400	5, 560	1, 390	4, 170	860	300	560	2, 280	690	1, 590	2, 590	570	2, 020	69. 9	23. 3	46. 6
1964	24, 600	6, 000	18, 600	6, 370	1, 520	4, 850	910	310	600	2, 490	740	1, 750	2, 990	640	2, 350	77. 7	25. 2	52. 4
1965	25, 300	6, 200	19, 100	7, 370	1, 770	5, 600	990	320	670	2, 750	790	1, 960	3, 520	720	2, 800	86. 5	27. 3	59. 2
1966	26, 300	6, 900	19, 400	8, 210	1, 850	6, 360	1, 040	330	710	3, 110	870	2, 240	4, 190	810	3, 380	95. 5	29. 3	66. 2
1967	27, 500	7, 700	19, 800	9, 050	2, 010	7, 040	1, 130	340	790	3, 410	930	2, 480	4, 790	910	3, 880	106. 2	31. 9	74. 2
1968	28, 000	7, 900	20, 100	9, 940	2, 240	7, 700	1, 230	340	890	3, 770	1, 010	2, 760	5, 530	1, 030	4, 500	117. 8	34. 8	83. 1
1969	29, 000	8, 700	20, 300	11, 420	3, 030	8, 490	1, 360	350	1, 010	4, 180	1, 070	3, 110	6, 450	1, 160	5, 290	127. 8	37. 2	90. 6
1970	29, 700	9, 300	20, 400	12, 580	2, 860	9, 720	1, 420	350	1, 070	4, 720	1, 220	3, 500	7, 360	1, 330	6, 030	137. 1	40. 1	97. 0

[1] Includes pay-as-you-go, multiemployer, and union-administered plans, those of nonprofit organizations, and railroad plans supplementing the Federal railroad retirement program. Excludes pension plans for Federal, State, and local government employees as well as pension plans for the self-employed. Insured plans are underwritten by insurance companies; noninsured plans are, in general, funded through trustees.

[2] Excludes annuitants; employees under both insured and noninsured plans are included only once—under the insured plans.

[3] Includes refunds to employees and their survivors and lump-sums paid under deferred profit-sharing plans.

Source: Compiled by the Office of the Actuary, Social Security Administration, from data furnished primarily by the Institute of Life Insurance and the Securities and Exchange Commission.

More specifically, where the pension plan qualifies under the Internal Revenue Code, employers, within certain limits, are permitted to deduct contributions made on behalf of covered employees; earnings on the plan's assets are exempt from tax; and covered employees defer payment of tax on employer contributions made on their behalf until they actually receive the benefits, generally after retirement when their incomes and hence applicable tax rates tend to be lower.

In order to qualify under the Internal Revenue Code, a pension plan must cover a specified percentage of employees [4] or cover employees under a classification found by the Internal Revenue Service not to discriminate in favor of employees who are officers, shareholders, supervisory employees, or highly compensated employees. Similarly, the contributions to the plan or benefits paid out by the plan cannot constitute a larger percentage of pay for higher-paid employees than for lower-paid employees.[5]

With the growth in private pension plans there has been increasing criticism of the pension plan system. The principal problem areas are discussed below. These are followed by a brief general discussion of the remedies which have been proposed. Part II of this pamphlet compares specific aspects of present law with proposals contained in the following bills that are the subject of the Subcommittee's hearings: S. 4 (as reported by the Senate Committee on Labor and Public Welfare), S. 1179 (introduced by Senator Bentsen), and S. 1631 (the administration's tax bill, introduced by Senator Curtis and others). A companion administration bill, S. 1557, is also discussed where its provisions deal with matters involved in present law or one of the other bills mentioned above. Part III of this pamphlet consists of a table briefly highlighting the major elements of present law and those bills.

A. Problem Areas

Inadequate coverage.—Despite the rapid growth in pension coverage in recent years to its 1970 level of about 30 million employees, one-half of all employees in private, nonagricultural employment are still not covered by pension plans. Pension plans are still relatively rare among small business firms and in agriculture. Moreover, it is claimed that even where employees work for a firm with a pension plan, the age and service requirements for participation and coverage in the plan may be overly restrictive.

Alleged discrimination against the self-employed and employees not covered by pension plans.—Another problem area is that present law discriminates against employees not covered by pension plans and against the self-employed. This is primarily because the personal retirement savings of individuals not covered by pension plans must be made out of after tax income, while those covered by pension plans are permitted to defer tax on their employer's pension contributions.

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[4] To qualify on this basis, the plan must cover 70 percent or more of all the employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are so eligible, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding 5 years, employees whose customary employment is for not more than 20 hours in any 1 week, and employees whose customary employment is for not more than 5 months in any calendar year (sec. 401(a)(3)(A) of the Internal Revenue Code).

[5] Under special "integration" rules, the pension benefits may be considered to be augmented by a specified percentage of social security benefits for purposes of determining the ratio of benefits to pay at any given income level and the employer is treated as having contributed a portion of the cost of those benefits.

Self-employed people also frequently maintain that they are discriminated against as compared with corporate executives and owner-managers of corporations in regard to the tax treatment of retirement savings. At present, there is no comprehensive limit on the amounts the employer can contribute on behalf of corporate executives and owner-managers of corporations; similarly, there is no limit on the amount of pension benefits that the latter can receive—so long as those contributions or benefits do not discriminate in favor of employees who are shareholders, officers, supervisors, or highly paid and do not constitute unreasonable compensation. As a result of legislation enacted in 1962 and amended in subsequent years, self-employed people can now be covered by pension plans but their deductible contributions to such plans on their own behalf are limited to 10 percent of earned income up to $2,500 a year.

Some self-employed people, including professional people, have been successful in securing the tax advantages associated with corporate pension plans by forming professional corporations. Although the Service for a long time refused to recognize the validity of such corporations for Federal tax purposes, the courts sided with the taxpayers and the Internal Revenue Service has agreed to generally recognize such corporations for pension purposes.[6]

Inadequate vesting.—Present law generally does not require a pension plan to give a covered employee vested rights to benefits—that is, the right to receive benefits even if he leaves or loses his job before retirement age.[7] Over two-thirds of the private pension plans provide vested rights to pension benefits before retirement. However, as a general rule, employees do not acquire vested rights until they have accumulated a fairly long period of service with the firm and/or are relatively mature. At present, only one out of every three employees participating in employer-financed pension plans has vested rights to benefits. Moreover, 58 percent of covered employees between the ages of 50 and 60, and 54 percent of covered employees 60 years of age and over, do not have vested pension rights.[8] As a result, even employees with substantial periods of service may lose pension benefits on separation from employment. Extreme cases have been noted in which employees have lost pension rights at advanced ages as a result of being discharged shortly before they would be eligible to retire. In addition, failure to vest more rapidly is charged with interfering with the mobility of labor, to the detriment of the economy.

Inadequate funding.—Another problem area is the significant portion of present pension plans which are not adequately funded—that is, they are not accumulating sufficient assets to pay benefits in the fu-

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[6] However, the 1969 Tax Reform Act made exclusive contributions on behalf of shareholder-employees who own more than 5 percent of an electing small business (subchapter S) corporation's stock subject to the same 10 percent-$2,500 limitations as apply to pension contributions on behalf of self-employed people.

[7] However, as noted below, vesting is required for employees under so-called H.R. 10 plans for owner-employees and may also be required in oher cases to prevent the plan from having a discriminatory effect.

[8] U.S. Treasury Department—Fact Sheet, Pension Reform Program, as reprinted in Material Relating to Administration Proposal Entitled the "Retirement Benefits Tax Act" Committee on Ways and Means, 93d Cong., 1st sess., p. 37, Table B.

ture to covered employees. As a result, there is concern that many employees now covered by pension plans may not actually receive pensions when they retire because the funds will not be available to pay for those pensions.

In general, pension plans that are qualified under the Internal Revenue Code must meet certain minimum funding requirements by irrevocably setting aside funds in a trust or through the purchase of insurance contracts. Contributions to such plans must be at least large enough to pay the normal pension costs (the pension liabilities created in the current year) plus the interest on unfunded accrued liabilities which generally are attributable to the past service of the covered employees. However, it is urged that this minimum funding requirement is not adequate because it is designed only to prevent the unfunded liabilities from growing larger and does not require any payment to reduce the amount of the outstanding unfunded liabilities, which may be substantial.

The available evidence suggests that many pension plans are adequately funded—but that a significant proportion of the plans have not been adequately funded. This is indicated, for example, by a survey made by the Senate Labor Subcommittee of 469 trustee-administered pension plans covering 7.1 million employees. In 1970, about one-third of the plans covering one-third of the participants reported a ratio of assets to total accrued liabilities of 50 percent or less; while 7 percent of the plans covering 8 percent of the participants reported a ratio of assets to accrued liabilities of 25 percent or less. (See Table 2.)

In general, the older plans are better funded than the newer ones. Over one-half of the plans covered by the study which were 6 years old or less had an assets-liabilities ratio of 50 percent or less, while 35 percent of the plans in existence for 17 years to 21 years had such an assets-liabilities ratio.

TABLE 2.—FUNDING OF PRIVATE PENSION PLANS: ASSETS AT MARKET VALUE, AS PERCENT OF PRESENT VALUE[1] OF TOTAL ACCRUED RETIREMENT BENEFITS, BY PLAN AND BY PARTICIPANT: AS OF 1970

	By plan		By participant	
	Number[2]	Percent	Number	Percent
Assets as percent of accrued benefits:				
25 percent or less	33	7	541,801	8
26 through 50	118	25	1,798,945	25
51 through 75	104	22	2,134,601	30
76 through 100	117	25	1,211,298	17
101 through 125	55	12	949,975	13
126 through 150	20	4	134,252	2
151 through 175	8	2	52,498	1
Over 175	14	3	276,835	4
Total	469	100	7,100,205	100

[1] Present value of accrued benefits is actuarially determined.
[2] Sample consists of 469 trustee-administered plans. Comparable data were not available for insured plans.

NOTE.—The sum of individual items may not equal totals because of rounding.
Source: Senate Committee on Labor and Public Welfare Report on S. 3598, The Retirement Income Security for Employees Act of 1972, 92d Cong., 2d Sess., p. 97.

TABLE 3.—FUNDING OF PRIVATE PENSION PLANS: ASSETS AT MARKET VALUE AS PERCENT OF PRESENT VALUE[1] OF TOTAL ACCRUED RETIREMENT BENEFITS, BY AGE OF PLAN: AS OF 1970

	Age of plans[2]													
	6 years or less		7 to 11 years		12 to 16 years		17 to 21 years		22 to 26 years		27 to 31 years		Over 31 years	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Assets as percent of accrued benefits:														
25 percent or less	9	21	7	9	10	8	2	2	4	8			1	5
26 through 50	13	31	24	30	36	29	34	33	4	8	6	13	1	5
51 through 75	9	21	18	22	31	25	24	23	8	15	9	20	5	24
76 percent and over	11	26	32	39	48	38	43	42	36	69	30	66	14	68
Total	42	100	81	100	25	100	103	100	52	100	45	100	21	100

[1] Present value of accrued benefits is actuarially determined.
[2] Sample consists of 469 trustee-administered plans.

NOTE.—The sum of individual items may not equal totals because of rounding.

Source: Senate committee on Labor and Public Welfare Report on S. 3598, The Retirement Income Security for Employees Act of 1972, 92d Cong. 2d. sess., p. 98.

Loss of pension benefits due to plan terminations.—Concern has also been expressed over the possible loss of pension benefits as a result of termination of pension plans. The Studebaker Case, which has been widely publicized, illustrates how pension benefits can be lost as a result of termination of a plan. When Studebaker closed its South Bend, Indiana, plant in 1964, the employees were separated and the pension plan was terminated. The plan provided fairly generous vested rights and the funding apparently would have been adequate had the firm remained in business and the plan continued in operation. However, at termination, the plan had not yet accumulated sufficient assets to meet all its obligations. As a result, full pension benefits were paid only to employees already retired and to employees age 60 or over with 10 years or more of service. Little or no benefits were paid to large numbers of other employees, many of whom had vested rights.

A joint study by the Treasury Department and the Department of Labor indicates that there were 683 plan terminations in the first 7 months of 1972.[9] These terminations resulted in the loss of $20 million of benefits (present value) by 8,400 pension participants in 293 of the terminated plans. The average loss of benefits for participants amounted to $2,400. Participants losing benefits represented about four one-hundredths of one percent of workers covered by pension plans. The data, of course, cover terminations occurring over a relatively short period of time.

Misuse of pension funds and disclosure of pension operations.—There also has been concern about the administration of pension plans. It has been charged that all too frequently pension funds have not been used in the best interest of covered employees. There have been cases of extreme misuse of pension funds.

Also, questions have been raised as to whether a pension plan should be permitted to invest heavily in the employer's securities instead of diversifying investments. Present law permits such investments in the employer's securities.

The Welfare and Pension Plans Disclosure Act, which is administered by the Labor Department, was adopted in 1958 to protect the interests of welfare and pension plan participants and beneficiaries by requiring disclosure of information regarding such plans. This Act requires the plan administrators to file with the Secretary of Labor and to send to participants upon written request a description and annual report of the plan. The Act was amended in 1962 to make theft, embezzlement, bribery and kickbacks Federal crimes where they occur in connection with welfare and pension plans. The 1962 amendment also conferred limited investigatory and regulatory powers upon the Secretary of Labor. However, it is maintained that further revision of the Welfare and Pension Plans Disclosure Act is required—for example, to require more detailed and more effective disclosure and to spell out the degree of responsibility of fiduciaries of pension funds, the types of persons who should be allowed to act as fiduciaries, and the standards of accountability that should be required of fiduciaries.

The Internal Revenue Code (sec. 503 (b)) seeks to prevent abuses in the use of qualified pension funds by prohibiting qualified pension plans from engaging in certain specified prohibited transactions such

[9] Department of the Treasury and the Department of Labor Study of Pension Plan Terminations, 1972—Interim Report, February 1973.

as lending funds without adequate security and a reasonable rate of interest to the creator of the plan, his family, or corporations controlled by him. Other prohibited transactions include payment of excessive salaries, purchase of property for more than an adequate consideration, sale of property for less than an adequate consideration, or any other transactions which result in a substantial diversion of funds to such individuals. Special additional rules apply to trusts benefitting owner-employees. However, it has been charged that this prohibited transaction provision is not effective because the penalty for noncompliance is the disqualification of the pension plan from tax benefits for a period of time, which is unfavorable to the covered employees who have had no part in any wrongdoing.

B. Proposed Remedies

A number of legislative proposals have been made to remedy the deficiencies of pension plans. This includes S. 4 (which has been reported favorably by the Senate Committee on Labor and Public Welfare), S. 1179 (introduced by Senator Bentsen), and the administration's proposal, "The Retirement Benefits Tax Act" (S. 1631 introduced by Senator Curtis and others).

In general, these legislative proposals would retain the present tax treatment of pension plans which is designed to encourage the growth and development of nondiscriminatory pension plans. Moreover, the proposals would make no change in the present voluntary nature of pension plans in that employers would retain the right either to have or not to have a pension plan for their employees. However, the proposals would require the pension plans that are established to comply with certain specified requirements which are designed to insure that they will operate in the best interest of covered employees. While the specific requirements vary from proposal to proposal, S. 4, S. 1179, and S. 1631 all contain provisions to:

Age and service coverage requirements.—Prohibit plans from imposing overly restrictive age and service requirements for participation. S. 4, for example, generally provides that no pension plan is to require as a condition for eligibility to participate a period of service longer than one year or an age older than 25 whichever occurs later. The comparable maximum limits for participation are set at one year of service and age 30 under S. 1179 and at three years of service and age 30 under S. 1631.

Vested rights.—Require plans to grant covered employees vested rights to benefits either not later than a specified period of service or not later than a specific combination of years of service and attained age. The minimum required vesting would be gradual—that is, a portion of the benefits would be vested after the fulfillment of the specified initial requirement and the remaining benefits would be vested gradually over a specified period of time. Specifically, S. 1631 would require 50 percent of the employee's benefits derived from employer contributions to be vested by the time the sum of his age and years of participation in the plan total 50; the remaining 50 percent would have to be vested at least as fast as on a pro rata basis over the next five years of participation. S. 4 would require at least 30 percent of the benefits to be vested after eight years of participation and the remaining 70 percent over not more than the next seven years. S. 1179 would require at least 25 percent of benefits to be vested after five years of participation and the remaining 75 percent over not more than the next 15 years.

Under S. 4, the new vesting requirements would apply to benefits regardless of whether such benefits were acquired before or after the effective date of the provision (3 years after enactment). For example, if an employee had 15 years of covered service prior to the effective date of the provision, he would have to be given 100 percent vested rights to the benefits earned up to that date. Under S. 1179, the new vesting requirements would apply only to benefits accrued after the effective date of the provision (3 years after enactment) except for covered employees 45 years of age and older. Vesting for the latter employees would apply to all benefits accrued, including benefits accrued before the effective date of the provision. Under S. 1631, the new vesting requirements generally would apply only to benefits accrued after the effective date (generally January 1, 1975, in the case of a plan in existence on December 31, 1972). However, years of participation in the plan prior to the effective date would be taken into consideration in determining if the employee was entitled to vesting. For example, an employee 40 years of age who had 10 years of participation in the plan prior to the effective date would not have to be given vested rights to the benefits accrued prior to the effective date; however, he would have to be given a vested right for benefits accrued after the effective date since his age and total years of participation (including participation before the effective date) entitle him to 50 percent vesting after the effective date.

Under S. 4 and S. 1179, the regulatory authority (the Secretary of Labor under S. 4 and the Secretary of the Treasury under S. 1179) would be given the authority to postpone the vesting requirements for a period of up to 5 years from the effective date of the vesting provision where compliance with the vesting requirements would cause substantial economic injury to the employer and participants or beneficiaries.

The relative additional costs of financing pension plans under the vesting requirements imposed by the different plans are shown in table 4.

TABLE 4.—RANGE OF INCREASE IN PENSION PLAN COSTS FOR MANDATORY VESTING PROVISIONS

[Percent]

	Present vesting: None	Present vesting: Moderate	Present vesting: Liberal	All plans
Percentage of pension plan members covered under such plans	23	56	21	100
Range of present plan cost as a percent of payroll	1.8-10.4	2.2–11.8	2.2–11.9	1.8–11.9
Range of increase in cost as a percent of payroll:				
S. 4—30 percent at 8 years, graded, all past service vested	.2–1.4	.1–.3	0–0	0–1.4
S. 1631—Rule of 50, no past service vested	.2–.7	0–.3	0–.2	0–.7
Range of increase in cost as a percent of present plan cost:				
S. 4—30 percent at 8 years, graded, all past service vested	5-53	1–8	0–1	0–53
S. 1631—Rule of 50, no past service vested	3–28	0–12	0–5	0–28
Note: Cost estimates for S. 1179 are not yet available, but it is believed that this bill will have slightly lower cost effects than S. 4.				

Source: "Summary of Report, Study of the Cost of Mandatory Vesting Provisions Prepared for the Senate Subcommittee on Labor," by Donald S. Grubbs, Jr., as reprinted in S. Rept. 93–127, the report of the Committee on Labor and Public Welfare on S. 4, p. 79.

Funding.—Require pension plan funding to meet certain specified standards. This would generally require contributions to be sufficient to cover the current costs attributable to pension coverage in the pertinent year plus the funding of all unfunded past service liabilities over some specified period of time. Specifically, S. 4 and S. 1179 would require all unfunded past service liabilities to be funded over not more than 30 years, while S. 1631 would require the portion of unfunded past service liabilities that is vested to be funded at a rate not less than 5 percent per year.

In general, S. 4 and S. 1179 would require faster funding than S. 1631 of plans which have not provided substantial vested rights to benefits prior to the effective dates of the legislation. This is because S. 1631 bases the funding requirement as to past service liabilities on the amounts that have been vested but requires only benefits accrued after the effective date of the provision to be vested even in the case of employees who have had long periods of service prior to the effective date. In contrast, S. 4 and S. 1179, because they base the funding requirements on accrued liabilities, would require the funding of substantial benefits accrued prior to the effective date by long-service employees. However, because it would require vested unfunded liabilities to be funded at the rate of 5 percent per year, S. 1631 could initially require relatively faster funding than S. 4 and S. 1179 for plans which are characterized by relatively full vesting (perhaps because the plan previously granted generous vesting on a voluntary basis).

Experience deficiencies in funding (i.e., instances in which the funding is deficient because experience proves that the actuarial assumptions on which the funding is based are deficient) would generally have to be funded over a 5-year period under S. 4. Under S. 1179, such experience deficiencies would have to be made up at least ratably over the average remaining working life of the covered employees. Under S. 1631, experience deficiencies in funding vested liabilities would have to be made up at a 5-percent-per-year rate.

Where it is determined that the employer is not able to contribute enough to the pension plan to meet the funding requirements, S. 4 and S. 1179 arrange for the employer to be given an additional 5-year period to make this contribution. Such deferments cannot be given more than five consecutive times.

Under S. 4 and S. 1179, the generally applicable minimum funding requirements would not apply to multi-employer plans. Instead, the regulatory authority (the Secretary of Labor under S. 4 and the Treasury Department under S. 1179) would be given the authority to promulgate regulations regarding the minimum funding requirements of such plans. The funding period for the multi-employer plans would reflect an adequate basis for funding the plans' benefit commitments and would take into account the particular situation pertaining to the plan industry and circumstances. S. 4 further indicates that in no event could the regulatory authority prescribe a funding period for such multi-employer plans which is less than 30 years.

In addition to the above revisions, which would be made by all three bills (S. 4, S. 1179, and S. 1631), some of these bills propose other changes in the pension area.

Insurance for plan terminations.—An insurance program to protect employees against loss of vested pension benefits in the event that their pension plans terminate would be established by S. 4 (the Senate Labor and Public Welfare Committee's bill) and S. 1179 (Senator Bentsen's bill). The insurance protection would apply to 50 percent of the highest average monthly pay over a five-year period with a dollar ceiling of $500 a month under S. 4 and $1,000 a month under S. 1179. The insurance programs would be financed by premiums paid by those financing the pension plans, ranging from 0.2 percent to 0.4 percent of their unfunded vested liabilities.

Portability.—A voluntary portability program would be established by S. 4. Under this program, employees who change jobs would have the option of transferring amounts equal to the current values of their vested pension rights from their old pension fund to a central fund which would then transfer those amounts to the plans of their new employers or, at the options of the employees, would make payments to the employees when they retire and which would also keep records of employees' pension rights accumulated under different plans. This program would cover only employees in employer plans which elect to participate as members in the portability system. Although they would not establish a similar central portability fund, S. 1179, and S. 1631 seek the portability objective by providing that covered employees who transfer vested pension rights from one plan to another can do so free of tax when the employees change jobs.

Tax benefits of self-employed.—The tax benefits associated with the establishment of pension plans by self-employed people would be increased by the administration bill which would raise the maximum tax deductions permitted for contributions for self-employed persons under owner-employee plans from the present level of 10 percent of earned income up to $2,500 a year to 15 percent of earned income up to $7,500 a year. The Treasury Department has estimated that the revenue cost of this change will be $110 million a year.

Tax benefits for individual retirement plans.—Individuals would be permitted by S. 1631, the administration bill, to establish their own individual retirement plans and to deduct amounts contributed to such plans up to 20 percent of earned income or $1,500 a year whichever is less. This tax deduction would also be extended to employee contributions to pension plans. The maximum allowable deduction would be reduced by the employer contributions made on behalf of the employee. Similar provision for individual retirement savings and employee contributions to pension plans is made in S. 1179, but in this case, the tax allowance for individual retirement savings would be granted in the form of a tax credit equal to 25 percent of the contribution or $375 a year, whichever is less. The Treasury estimates that the initial cost of its proposals on this point would be $300 million a year and would increase to $350 million in the second year, to $410 million in the third year, and to $480 million in the fourth year. The Treasury estimates that the initial cost of the tax credit proposal in S. 1179 would be $400 million a year, and that the cost would increase to $600 million in the fourth year.

Fiduciary and reporting requirements.—The Welfare and Pension Plans Disclosure Act is strengthened under S. 4. Plans are required to disclose information regarding their activities in greater detail than previously, more severe penalties are placed on malfeasance and abuse of pension funds, the obligations of trustees are spelled out in greater detail and pension plans (but not profit-sharing plans) are prohibited from investing more than a specified percentage of their assets in the securities of the employer. Broadly similar measures are proposed by the administration in S. 1557, the Employee Benefits Protection Act. In addition, the administration bill, S. 1631 (the Retirement Benefits Tax Act) would make acts prohibited by the Employee Benefits Protection Act prohibited transactions and would require trustees, employers, and officers of the firm who are responsible for such prohibited transactions to pay an excise tax of 5 percent of the amounts involved in the transactions. An additional tax of 200 percent of the amount involved in the prohibited transaction would be imposed if the violation were not corrected by 90 days after notice.

C. Administration of New Requirements

The legislative proposals also differ substantially in the provision made for administering the new pension requirements that they would impose. Under S. 1179 and S. 1631, the new pension requirements would be administered by the Internal Revenue Service, which now administers the substantive pension provisions dealing with the qualification of plans under the Internal Revenue Code. S. 4, however, departs from this traditional practice and provides that the Department of Labor would administer the new provisions. This would involve a dual system of administration in which the present rules regarding qualification which include such aspects as coverage, vesting, funding, and prohibited transactions would be administered by the Internal Revenue Service while the new additional requirements regarding these items as well as plan termination insurance would be administered by the Department of Labor.

Historically, the substantive requirements regarding non-discrimination, which are designed to insure that pension plans will benefit the rank and file of employees have been enforced through the tax laws which are administered by the Internal Revenue Service. As a result, the Internal Revenue Service is already required to examine the coverage of pension plans and pension contributions and benefits as well as funding and vesting practices in order to determine that plans operate so as to conform to these nondiscrimination requirements. Also, the Service has administered the fiduciary standards embodied in the prohibited transactions provisions since 1954.

Senator Bentsen's bill, S. 1179, and Senator Curtis' bill, S. 1631, which embodies the administration proposals, would continue this precedent by having the Internal Revenue Service administer the new coverage, vesting, and funding requirements.[10] Similarly, the Labor Department which has been administering the Welfare and Pension Plans Disclosure Act would continue to administer a strengthened Act.

In contrast, under S. 4, the Labor Department would administer the new substantive requirements regarding coverage, vesting, funding, fiduciary standards, and plan termination insurance as well as the

[10] In addition, S. 1179 would set up a private nonprofit corporation chartered by the Federal Government to administer the termination plan insurance that it would institute.

disclosure provisions which up to now have been its area of jurisdiction under the Welfare and Pension Plans Disclosure Act. In effect, this means that the substantive provisions regarding coverage, vesting, fiduciary standards, and funding under pension plans would be administered by both the Internal Revenue Service and the Labor Department.

Accordingly, S. 4, in effect, would require two government agencies to administer the same broad areas of pension operation. While there undoubtedly would be attempts to coordinate the work of the two agencies, the dual administration approach involves inherent problems. These are discussed below.

Dual staffs.—Two staffs of two different governmental agencies would be employed in the work of regulating the vital areas of vesting, funding, fiduciary standards, and coverage. This, in turn, would involve duplication in regulation since, as a practical matter, the Internal Revenue Service would be required to examine the overall operation of plans in order to determine compliance with the nondiscrimination and prohibited transactions provisions of the Internal Revenue Code.

Dual reports.—Employers and plan administrators would be required to file two sets of reports dealing with the same broad areas of pension operation with the two different governmental agencies. To some extent the duplication in reporting might be reduced by coordination procedures but since the reports deal with different legal provisions which have somewhat different objectives, much dual reporting would still be required. For example, employers requesting determination letters from the Internal Revenue Service indicating that their plans qualify under the Internal Revenue Code would have to file information regarding such plans with the Internal Revenue Service. Annual reports regarding plan operations would also continue to be filed with the Internal Revenue Service to substantiate the deductions and the exemption of earnings of the pension fund. At the same time, administrators of plans would be required to submit broadly similar information to the Department of Labor in order to receive certification for their plans and to continue such certification.

Differences in coverage.—Although S. 4 would require the Department of Labor and the Internal Revenue Service to engage in considerable duplication in regulatory efforts, there would be gaps in the regulation by the Department of Labor. For example, S. 4 would generally not cover plans which cover not more than 25 participants plans of firms which are not in industry or in an activity affecting commerce, plans covering self-employed people even though such plans also cover employees, plans of exempt organizations, and governmental plans (including the United States Civil Service system). Many of these plans, however, seek qualification under the Internal Revenue Code so that the Internal Revenue Service would continue to administer the pension rules for them.

Conflicting requirements.—Because of differing requirements, plans which meet the requirements of one agency might not meet the tests of the other. For example, the application to a particular plan of the Labor Department requirements regarding vesting might conflict with the Internal Revenue Service requirements because they could, in a particular plan, result in discrimination in favor of executives and highly paid employees. Similarly, while the new age and service coverage requirement in S. 4 is generally stricter than the present age and service coverage provisions, it is only one part of the entire coverage rules which have to be met and the Internal Revenue Service would, therefore, still have to concern itself with all the coverage aspects of the plan including the new coverage requirement. Moreover, considerable differences in evaluating the extent of funding in particular plans could arise as a result of different evaluations of the actuarial assumptions by the Labor Department and the Internal Revenue Service.

Qualifications under one set of requirements and not the other.—Since the Internal Revenue Service is continually engaged in auditing plans and tax returns, it is highly likely that particular pension plans might be examined by investigatory agents of both the Internal Revenue Service and the Labor Department in a short period of time. The results of these duplicatory investigations could be quite inconsistent. In view of the different rules enforced by the two agencies, the Internal Revenue Service might give the plan, its trust, and fiduciary a clean bill of health while the Department of Labor might find violations. On the other hand, the Labor Department might find the situation satisfactory and the Internal Revenue Service might find violations with regard to the particular rules that it enforces.

Change in enforcement procedures.—S. 4 would also adopt a fundamental change in the approach toward enforcing the pension provisions. For over three decades, withdrawal of the tax advantages associated with qualification has been the basic method of enforcing the nondiscrimination rules of the Internal Revenue Code, which are designed to insure that pension plans are actually for the benefit of the rank and file of employees. In general, this has been an effective tool since the withdrawal of qualification can result in the denial of deductions for employer contributions to the plan and the loss of the exemption of the plan's earnings. The fact that such drastic penalties may be imposed for noncompliance provides a substantial inducement to meet the required tests for qualification. In contrast, under S. 4 the Labor Department would have to get a court order to enforce compliance where plans are not living up to these requirements. It is not clear how large an investigation staff would be required for this. In part this is because it is not clear whether employers would make changes voluntarily (as they do to avoid loss of tax deduction) or whether in the case of many of the requirements they would wait until an investigation is made by the Labor Department personnel.

II. ANALYSIS OF PENDING LEGISLATION

A. Plan Participation—Age and Service Requirements

Present law.—In general, in the case of an employer pension and profit-sharing plan, the Internal Revenue Code does not require the plan to comply with any specific eligibility conditions relating to age or service in order to qualify. Existing administrative practice allows plans to be limited to employees who have (1) attained a designated age, or (2) have been employed for a designated number of years, so long as the effect is not discriminatory in favor of officers, shareholders, supervisory, or highly-compensated employees (sec. 401(a)

(3)(B) of the Internal Revenue Code). Also, under administrative practice, a plan may exclude employees who are within a certain number of years of retirement (for example, five or less) when they would otherwise become eligible, if the effect is not discriminatory. On the other hand, in the case of a plan for owner-employees,[1] the plan must provide that no employee with three or more years of service may be excluded (sec. 401(d)(3) of the code).

S. 4.—A plan would not be permitted to require, as a condition of participation, more than one year of service or attainment of an age greater than 25, whichever occurs later. However, any plan which provides full immediate vesting would be permitted to require as much as three years of service or attainment of age 30, whichever occurs later (sec. 201 of the bill). The bill would not change the Internal Revenue Code provisions described above. As a result: (1) the bill would provide more stringent Labor Department standards than those of the tax law in the case of corporate plans and H.R. 10 plans without owner-employees (i.e., where no one has more than a 10-percent interest in the partnership)—but only as to plans with more than 25 participants; (2) the bill would provide essentially the same standards as the tax law in the case of owner-employee plans with more than 25 participants; and (3) the bill would not provide new standards for plans with fewer than 26 participants.

The effect of the bill, therefore, is to require each plan to determine which set of standards is the more stringent as to it, and then to obey that set of standards.

S. 1179.—A plan would not be permitted to require, as a condition of participation, more than one year of service, or an age greater than 30 (sec. 321 of the bill); however, no change would be made in the three-year rule for owner-employee plans, described above.

S. 1631.—A plan would not be permitted to require, as a condition of participation, more than three years of continuous service or attainment of an age greater than 30, but the plan could exclude an employee who was within five years of normal retirement age at the time he would otherwise become eligible for participation (sec. 2(a)(2) of the bill).

An owner-employee plan would be required to cover every employee with three years or more of continuous service, every employee with two years of continuous service who was at least 30 years old, and every employee with one year of continuous service who was at least 35 (sec. 2(b)(2) of the bill).

B. Vesting

Present law.—A qualified pension or profit-sharing plan must now provide that an employee's rights are to become nonforfeitable (i.e., "vested") if the plan terminates or the employer discontinues his contributions. The employee's rights also must become fully vested when he attains the normal or stated retirement age. With these exceptions, there is no requirement that an employee be given nonforfeitable rights to his accrued benefits before retirement, although the absence of such pre-retirement vesting is taken into account in determining whether

[1] An owner-employee is a sole proprietor or a partner with a greater than 10-percent interest in capital or profits (sec. 401(c)(3) of the Code).

the plan meets the nondiscrimination tests of the Internal Revenue Code (sec. 401(a)(4) of the code).

Under an owner-employee plan, the rights of employees must vest immediately (sec. 401(d)(2)(A) of the code).

S. 4.—A plan would generally be required to give each employee vested rights to at least 30 percent of his deferred pension benefits (or 30 percent of his interest, in the case of a profit-sharing retirement plan) after 8 years of participation in the plan. Thereafter, each year the minimum vesting percentage would be increased by an additional 10 percentage points, so that no later than the end of 15 years of participation, the employee would be entitled to 100-percent vested rights in his benefits (or interest, in the case of a profit-sharing retirement plan) (sec. 202(a)(1) of the bill).

The vesting standards that would be established by the bill would allow later vesting than under existing tax law governing H.R. 10 plans which include owner-employees. Since the bill would not amend the tax law, the more stringent of the two requirements presumably would apply and owner-employee plans would continue to have to meet current requirements.

The plan could require 3 of the 8 years minimum service under the plan to be continuous and generally could ignore service prior to age 25 (sec. 202(b) of the bill). A plan could provide a different vesting formula from the minimum formula set forth in the bill if the Secretary of Labor determines, upon application by a plan, that its vesting provisions are "as equitable" as that minimum formula (sec. 202(e) of the bill). In the case of a class year plan, it would be required that a participant be fully vested in employer contributions on his behalf not later than the end of the fifth year following the year for which those contributions were made (sec. 202(a)(3) of the bill).

The vesting requirements would apply to accrued benefits for service rendered before and after the effective date of the vesting provisions (sec. 202(a) of the bill), which would be 3 years after the date of enactment (sec. 701(b) of the bill). However, in the case of a plan established or amended after the effective date of the bill, only service rendered after that establishment or amendment need be considered in applying the vesting requirements to the new benefits or interests. Also, the Secretary of Labor would be given the authority to postpone application of the vesting requirements to a plan for up to 5 years from the effective date of those requirements (i.e., 8 years from date of enactment) where there is a showing that the vesting requirements would increase the employer's costs or contributions under the plan to an extent that "substantial economic injury" would result to the employer and to the interests of the participants (sec. 216 of the bill).

S. 1179.—A plan would be required to give each employee vested rights to at least 25 percent of his accrued benefits after 5 years of participation in the plan. Thereafter, each year the minimum vesting percentage would be increased by an additional 5 percentage points, so that no later than the end of 20 years of participation, the employee would be entitled to 100-percent vested rights in his benefits (sec. 322 of the bill).

The plan could require 2 of the 5 years minimum service under the plan to be continuous and generally could ignore service prior to age

30. In the case of a class year plan, it would be required that a participant be fully vested in employer contributions on his behalf not later than the end of the fifth year following the year for which those contributions were made.

The vesting requirements would not have to apply to service rendered before the effective date of the vesting provisions, which would be 3 years after the date of enactment (sec. 328 of the bill). However, any participant who has attained age 45 on the effective date would have to receive credit for service rendered before that date. Also, the Secretary of the Treasury or his delegate would be given authority to postpone application of the vesting requirements to a plan for up to 5 years from the effective date of those requirements (i.e., 8 years from the date of enactment) where there is a showing that "substantial economic injury" would result if earlier compliance were to be required.

No change would be made in the present law's full immediate vesting requirement for owner-employee plans.

S. 1631.—A plan would be required to satisfy the "rule of 50." That is, a participant's right in at least 50 percent of his accrued benefits derived from employer contributions (as defined in the bill) must vest no later than the end of the year in which the sum of his age and his years of participation in the plan total 50, except that a minimum of 3 years of continuous services with the employer could be required before vesting. The remaining 50 percent of accrued benefits would have to vest not less rapidly than ratably over the next 5 years (sec. 2(a)(2) of the bill).

In the case of an owner-employee plan, a similar "rule of 35" would apply (sec. 2(b)(1) of the bill).

In general, vesting would not be required for an existing plan which is "winding down," that is, if the benefits paid to retirees for a given year exceed the benefit accruals for active participants and if the present value of accrued plan liabilities exceeds the fair market value of plan assets. This exception is not to apply for the fifth plan year before any plan amendment providing additional or increased benefits, and is not to apply for all plan years thereafter.

Generally, service prior to 1975 is to be considered for determining whether the employee is entitled to a level of vesting, but not for determining the amount of the benefits to be vested. In the case of plans in effect on December 31, 1972, vesting would apply to benefits accrued for plan years beginning on or after January 1, 1975, or after the expiration of any collective bargaining agreement in effect on December 31, 1972, whichever occurs later. In the case of plans initiated after December 31, 1972, the vesting requirements are to begin immediately.

C. Funding

Present law.—Contributions to a qualified pension [2] plan must be made in amounts at least equal to the current pension liabilities ("normal pension costs") plus the interest due on unfunded accrued pension liabilities ("past service costs") (regs. § 1.401–6(c)(2)(ii)).

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[2] The minimum funding requirement of present law applies only to pension and not to profit-sharing or stock bonus plans. The proposed minimum funding provisions of S. 4 and S. 1631 apply only to pension plans. However, the funding provisions of S. 1179 apply to all qualified plans. This section on present law will be addressed solely to pension plans.

There is no present requirement that contributions be made to amortize the principal amount of unfunded accrued pension liabilities.

If an employer does not make the minimum required contributions to a qualified pension plan, under administrative practice the deficiency may be added to unfunded past service costs. However, the plan also may be considered terminated, and immediate vesting of the employee's rights may be required (sec. 401(a)(7) of the code).

The amount to be contributed to a qualified pension plan generally is determined by the cost of benefits to be paid,[3] less the value of plan assets.[4] Plan costs are estimated by actuarial calculations, and all actuarial methods, factors, and assumptions used must together be reasonable and appropriate in the individual employer's situation (regs. § 1.404 (a)–3(b)). When applying for a determination that a plan is qualified, the actuarial methods, factors, and assumptions which are used generally must be reported to the Internal Revenue Service, along with other information to permit verification of the reasonableness of the actuarial methods used; changes in actuarial assumptions and methods must be reported annually to the Service; and in some cases actuarial certifications must be submitted to the Service every five years (regs. § 1.404(a)–4(b)).

Experience may show that actual costs are more or less than the estimates. Where actual costs are greater than estimates, there are "experience deficiencies"; where they are less, there are "experience gains." Under administrative practice, if there is an experience deficiency, then depending on its cause, additional contributions necessary to fund the deficiency may be deducted currently, or the deficiency may be added to past service costs and deducted on an amortized basis. Experience gains may reduce the plan cost currently, or reduce costs under one of the spreading methods used to determine the amounts deductible (described below in limitations on contributions).

S. 4.—In addition to requiring the funding of normal pension costs annually, the bill (generally, sec. 210) would require funding of initial past service costs not less rapidly than ratably over 30 years from the date the plan is established[5]; in the case of a past service cost liability existing on the effective date of these provisions—3 years after enactment—over 30 years from the effective dtae. Experience deficiencies generally would have to be funded over not more than five years; a longer period would be permitted if the five-year period requires contributions greater than the allowable tax deductions. These requirements would apply to all plan liabilities, not just vested liabilities. It is intended that assets would be valued at fair market value to determine whether plan assets are sufficient to cover accrued liabilities.

The initial unfunded accrued pension liabilities of a plan would be determined by an actuary certified by the Secretary of Labor. These liabilities would be reported to the Secretary, with a report of the

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[3] In determining costs, an employer must take into account factors such as expected mortality, interest, employee turnover, and changes in compensation levels.

[4] Under administrative rulings, the value of plan assets may be determined by using any valuation basis, if it is consistently followed and results in costs that are reasonable. Consequently, a number of methods of asset valuation may be used, including cost and fair market value.

[5] A plan amendment which results in a substantial increase in unfunded liabilities would be funded as it were a new plan.

actuarial assumptions used, the basis for using these assumptions, and other pertinent actuarial information required by the Secretary. Additionally, a plan would have to be reviewed every five years by a certified actuary, and his report would be submitted to the Secretary. The Secretary would be authorized to establish reasonable limits on actuarial assumptions and to certify actuaries who are permitted to perform services regarding registered plans (sec. 101(b) of the bill).

Separate funding rules would be established by the Secretary for multi-employer plans; the funding period for such plans would be not less than 30 years (sec. 217(d) of the bill).

If an employer demonstrates that he could not make a required annual contribution, under certain conditions the Secretary of Labor could allow the annual contribution to be amortized not less rapidly than ratably over no more than five years; the Secretary could grant five consecutive waivers of this type (sec. 217 of the bill).

If an employer failed to contribute to the plan in accordance with the minimum requirements, the Secretary of Labor could petition the appropriate United States district court for an order requiring compliance with the funding requirement (sec. 601 of the bill).

The bill also would specify the order of priority of classes of beneficiaries for payment of plan assets upon termination of the plan (sec. 214 of the bill). The order of priority would be subject to the provisions of the Internal Revenue Code and regulations relating to limitations applicable to the 25 highest paid employees of the employer. However, apparently the order of priorities of the bill would not be subject to the further requirement of the Internal Revenue Code that allocation upon termination not otherwise discriminate in favor of officers, shareholders, supervisors or highly compensated employees. Consequently, the requirements of the bill and the Internal Revenue Code could conflict in some cases.

S. 1179.—New minimum funding requirements and actuarial reporting requirements would be established as a condition for qualifying a retirement trust under the Internal Revenue Code. The funding and actuarial requirements generally would be similar to those under S. 4. However, with respect to experience deficiencies, funding would be not less rapidly than ratably over a period that is no longer than the average remaining working life of the employees covered by the plan on the date the deficiency was determined (sec. 323 of the bill).

If the minimum funding requirements were not met, the plan could be terminated if necessary to protect the interests of participants, and the employer could be required to include in income deductions attributable to maintaining and operating the plan for up to five years preceding termination (sec. 324 of the bill).

The bill would specify the order of priority of payment of plan assets upon termination, but the order of priority would be subject to the nondiscrimination rules of the Internal Revenue Code.

The funding requirements would go into effect 3 years after enactment (sec. 328 of the bill).

S. 1631.—New minimum funding requirements would be established under the Internal Revenue Code for qualified defined benefit pension plans. In general, the minimum contribution requirement would be an amount equal to the sum of normal pension costs, interest on past service costs, and 5 percent of unfunded, vested past service costs. The fair market value of plan assets would be used in computing unfunded plan liabilities. In effect, then, experience deficiencies as to vested liabilities would be funded at the same rate as vested past service costs. In lieu of this minimum funding requirement the Secretary of the Treasury could authorize the use of another minimum funding standard that results in a satisfactory rate of funding (sec. 2(a) of the bill).

Additionally, the 5-percent-of-compensation limit on deductions for pension plans (sec. 404(a)(1)(A) of the code) would be eliminated and the other limitations would not apply to the extent that the contributions do not exceed the minimum funding requirement (sec. 7(g) of the bill).

D. Portability

Present law.—Under administrative practice, when an employee changes jobs, his interest in his former employer's qualified retirement plan may be transferred to the retirement plan of his new employer without the employee being taxed on the transfer. This can be done if both his former and new employers agree to the transfer, if the transfer may be made under the terms of both plans and trusts involved, and if the administrative requirements governing the method of transfer are met.[6] However, transfers of employee interests between qualified plans upon changes in employment do not appear to be usual.

S. 4.—A program would be established to facilitate the transfer of employees' vested pension credits between retirement plans of employers who choose to participate in the program. Under the program, when an employee leaves a participating employer (before the time that payments would be made to the employee under the plan), the employee could direct that an amount equal to the current discounted value of his vested rights under the plan of this employer be paid into a central portability fund (the Voluntary Portability Program Fund) administered by the Secretary of Labor. Upon receipt of payment, a separate account would be established for the employee in this central fund. He then could choose to maintain an account in the central fund, or could direct that amounts credited to his account be used to purchase actuarially equivalent pension credits in a new plan in which he participates. If amounts were left in the central fund, at age 65 the employee could direct the purchase of a single premium annuity contract. Alternatively, the amounts could be paid to a designated beneficiary upon the employee's death (sec. 301 *et seq.* of the bill).

Amounts maintained in the central portability fund could be deposited in financial institutions insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, but not more than 10 percent of the total could be deposited in any one financial institution (sec. 303 of the bill).

The portability provisions would go in effect one year after enactment of the bill (sec. 701(b) of the bill).

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[6] Generally, for the participant to avoid tax, the transfers of funds must be directly from one qualified trust to another qualified trust. However, if the funds are first paid to the participant, he may be able to avoid tax if he pays them to the new qualified trust under a legally enforceable agreement entered into before he received the funds from the first trust. See Rev. Rul. 55–368, 1955–1 C.B. 40.

S. 1179.—An employee who changes employment would not be taxable on the transfer of his interest in the retirement plan trust of his former employer (or from his individual retirement account [7]) to a retirement trust of his new employer (or to his individual retirement account) (sec. 326 of the bill).

S. 1631.—An employee, on leaving employment, would not be taxed on the receipt of a lump-sum distribution from a qualified retirement plan if he reinvests the funds in another qualified retirement plan (or a qualified individual retirement account) within 60 days after the close of the taxable year in which he receives payment (sec. 5 of the bill).

E. Plan Termination Insurance

Present Law.—Present law does not require pension plans to insure their liabilities.

S. 4.—A "Pension Benefit Insurance Fund" would be created, to be administered by the Secretary of Labor (sec. 401 *et seq.* of the bill). All pension plans subject to the bill's provisions would be required to purchase plan termination insurance from the Fund. A plan not subject to the bill (e.g., a plan covering no more than 25 participants) could also be permitted to purchase insurance, at the discretion of the Secretary of Labor, if it meets the standards, rules, and regulations that would be required by the bill.

The insurance would cover unfunded vested liabilities incurred before or after the bill's enactment. Participants and beneficiaries of a plan would be protected against loss of vested benefits from termination of the plan, within specified dollars or percentage-of-salary limits; but benefits are not to be available to any participant who owns as much as 10 percent of the voting stock of the employer contributing to the plan or a like interest in a partnership contributing to the plan.

In general, the benefits of the insurance would not be available unless the plan (or the plan amendment creating or increasing the participant's rights) has been in effect at least three years before the insured loss.

For the first three years after the effective date of these provisions (one year after the bill's enactment) premiums need not exceed 0.2 percent of a plan's unfunded vested liabilities incurred before enactment if the median ratio of plan assets to those liabilities was 75 percent during the five years preceding enactment, or, for a plan established during those five years, if the plan reduced those liabilities at the rate of at least five percent yearly since the plan's establishment. If unfunded vested liabilities incurred before enactment do not meet these standards, the annual premium for the first three years may not exceed 0.4 percent of those liabilities and may not be less than 0.2 percent of those liabilities.

The bill also provides a 0.2-percent limitation for the first three years on premiums based on unfunded vested liabilities incurred after enactment. It sets a 0.2-percent premium limitation on unfunded vested liabilities incurred by multi-employer pension plans. In addition, the bill permits special assessments made to cover administrative costs.

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[7] Individual retirement accounts are discussed below, at J. Deduction for Personal Savings Retirement Plans.

After the three-year period, the insurance rates may be changed by the Secretary based upon experience and other relevant factors, after giving appropriate notice to the Congress and the public.

The moneys of the Fund would be invested only in obligations of the United States, or in obligations guaranteed as to both principal and interest by the United States.

Upon termination of a pension plan, the Secretary of Labor would determine how plan assets should be liquidated and the proceeds applied to the payment of vested benefits. The Secretary would be given specific authority to transfer the funds of the plan to the common fund of the insurance program, to purchase single-premium life annuities with the funds of the terminated plan, or to take other appropriate action to provide for the payment of vested benefits. Notice would be required to be given prior to the termination of every covered plan. The person or persons responsible for any failure to give that notice would be personally responsible for any losses incurred by the Pension Benefit Insurance Fund in connection with the termination. Personal liability for losses of the Fund also would be imposed on anyone who terminates a plan with intention to avoid or circumvent the purposes of the bill or in violation of the requirements of the bill or of the Welfare and Pension Plan Disclosure Act. The Fund would be authorized to recover from solvent employers or their successors for all benefits paid by the Fund on account of the termination; the employer's liability, however, is not to exceed 50 percent of his net worth.

S. 1179.—In many respects, the insurance system created by the bill bears a close resemblance to that created by S. 4.

The bill provides for a "Pension Guarantee Corporation" that would be a nongovernmental, nonprofit membership corporation composed of the pension plans purchasing insurance and would be administered by a 7-member Board of Directors. The directors would be the Secretaries of Treasury and Labor and five persons chosen by the President—two who are associated with employee organizations, two who are associated with employers, and one from the general public.

All pension, profit-sharing, stock bonus, and bond purchase plans which qualify for tax benefits under the Internal Revenue Code would be required to purchase plan termination insurance.

Participants and beneficiaries of a plan would be protected against loss of vested benefits from termination of the plan, within specified dollar or percentage-of-salary limits; but benefits are not to be available to any participant who owns as much as 10 percent of the voting stock of the employer (or a like interest in the employer that is unincorporated).

In general, the benefits of the insurance would not be available unless the plan has been in effect at least five years before the insured loss. If the loss arises out of benefits created or increased by a plan amendment, the amendment must have been in effect at least three years before the loss.

Premium limitations are provided that are essentially the same as those for S. 4, described above.

The bill creates two funds, one for multiemployer plans and one for other plans. The premiums are to be paid into the appropriate fund and each fund's liabilities are to be borne by it and not the other fund. Differences in experience would be expected to lead to differences in rates of premiums.

Upon termination of a pension plan, the bill would allow the insurance program administrators to determine how plan assets should be liquidated and the proceeds applied to the payment of vested benefits. The administrators would be given specific authority to transfer funds to the appropriate common fund of the insurance program (i.e., the fund for multiemployer plans or the fund for other plans), to purchase single-premium life annuities with the funds of the terminated plan, or to take other appropriate action to provide for the payment of vested benefits.

The moneys of the funds may be invested in obligations of the United States or in obligations guaranteed as to both principal and interest by the United States.

Finally, the bill would allow the Secretary of the Treasury to make interest-bearing loans to the Pension Guarantee Corporation if those loans should be needed for the protection of participants in member plans and the maintenance of confidence in the private retirement system.

S. 1631.—No provision is made for plan termination insurance.

F. Fiduciary Standards

Present Law.—A retirement plan trust may be qualified under the Internal Revenue Code only if it is impossible under the trust instrument for trust funds to be used for any purpose other than the exclusive benefit of the employees or their beneficiaries (sec. 401(a)(2) of the code). In addition, a retirement plan trust will not be exempt from taxation if it engages in any specifically defined "prohibited transactions" (sec. 503(a)(1)(B) of the code).

Under administrative rulings, an investment generally meets the "exclusive benefit" requirement if it meets the following standards: the cost of the investment does not exceed fair market value, a fair return commensurate with the prevailing rate is provided, sufficient liquidity is maintained to permit distributions, and the safeguards and diversity that a prudent investor would adhere to are present. On purchasing stock or securities of the employer, or lending funds to the employer, the trust must notify the Internal Revenue Service so that it may determine whether the exclusive benefit requirement is met.

"Prohibited transactions" include the lending of funds without adequate security and a reasonable rate of interest to the creator of the plan, his family, or corporations controlled by him. Other prohibited transactions include payment of excessive salaries to interested persons, providing trust services on a preferential basis to interested persons, substantial purchases or sales of property from interested persons for other than adequate consideration, and engaging in any other transaction which results in a substantial diversion of trust assets to an interested person (sec. 503(b) of the code). If the trust engages in any prohibited transaction, it will lose its tax-exempt status for at least one year; upon meeting certain requirements the trust may reacquire tax-exempt status.

Special rules govern trusts benefiting owner-employees who control the business with respect to which the plan is established. In this case, generally the trust cannot make any loan, pay compensation for services, or make services available on a preferential basis to an owner-employee or certain related parties. The same prohibition applies to trust purchases from or sales to these interested persons (see 503(g) of the code).

In many cases, pension plan trustees also will be subject to local laws governing the actions of fiduciaries.

S. 4.—The Welfare and Pension Plans Disclosure Act would be amended to provide standards of conduct for fiduciaries [7] of employee benefit plans covered under the bill (sec. 510 of the bill). These standards would generally supersede State law governing fiduciaries' conduct (sec. 609 of the bill).

Generally, a fiduciary would be required to act in the same way that a prudent man in a similar situation and under other like conditions would act (sec. 510 of the bill). In addition, a fiduciary would be prohibited from engaging in certain transactions with interested parties.[8] He could not rent or sell property to, or rent or purchase property from, an interested party; could not lend trust assets to an interested party; could not furnish trust goods, services, or facilities to an interested party; and could not permit the transfer of any trust property to or its use by or for the benefit of an interested party. Furthermore, a fiduciary could not deal with the trust in his own interest or for his own account, could not represent another party with regard to the trust nor act on behalf of a party adverse to the trust or to the interests of its participants or beneficiaries, and could not receive any consideration from any party dealing with the trust in connection with a transaction involving the trust.

Specific exemptions would be provided from this list of prohibited activities, in recognition of established business practices. Thus, a fiduciary could receive his normal benefits as a participant under the plan, could receive reasonable compensation for services and for reimbursement of actually incurred expenses, and could be an officer, agent or employee of an interested party. Furthermore, a pension trust generally could invest 10 percent of the value of its assets in securities issued by the employer, and certain profit-sharing trusts could invest in these securities without limit. Additionally, under certain conditions, securities could be purchased from or sold to interested parties, loans could be made to participants or beneficiaries of the plan, and an interested party could be paid for office space and other services. In addition, the Secretary of Labor could provide for exemption of any fiduciary from certain specifically prohibited transactions if the exemption were in the interest of the trust fund, the participants and the beneficiaries.

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[7] A fiduciary is defined as any person who exercises any power of control, management, or disposition with respect to any property of any employee benefit fund or has authority or responsibility to do so (sec. 502(a) of the bill).

[8] The bill defines "party in interest" generally as fiduciaries and employees of the employee benefit plan, employers or their controlling or controlled parties, employee organizations with members covered by the plan, officers or employees of employers or of employee organizations, and relatives or partners of these persons (sec. 502(f) of the bill).

The fiduciary standards that would be established by the bill would in some cases allow fiduciaries of certain owner-employee plans to engage in transactions now prohibited under the tax laws (sec. 503(g) of the code). Additionally, investments in securities of the employer may be allowed under the bill when forbidden by the tax laws. Also, the Secretary of Labor could exempt fiduciaries from certain transactions otherwise prohibited under the bill, but this exemption would not affect the prohibitions of the tax laws. Since the bill would not change the Internal Revenue Code, the tax laws presumably would continue to apply where they exercise more restraint on fiduciary actions than the bill would.

A fiduciary who breached any of these duties would be personally liable to the trust for losses sustained by it on account of the breach, and would have to pay to the trust any profits which he received from use of trust assets. Exculpatory clauses would be prohibited. Co-fiduciaries could, in certain cases, be held liable for breaches of another co-fiduciary.

The bill also would prohibit persons convicted of certain listed crimes from serving in a responsible position in connection with an employee benefit plan for a period of five years after conviction or the end of imprisonment.

S. 1179.—S. 1179 includes no provisions dealing with fiduciary responsibility.

S. 1631.—The prohibited transactions provisions, described above under *Present Law*, would be repealed (sec. 6(a) of the bill). In lieu of these rules, excise taxes would be imposed on the amount involved in a prohibited transaction, and the current list of prohibited transactions would be expanded. The taxes would be payable by participating interested parties, and would be 5 percent of the amount involved in the prohibited transaction. An additional tax of 200 percent of the amount involved would be owed if the transaction were not corrected within the period allowed (generally 90 days from notice) (sec. 6(b) of the bill).

A taxable transaction would be any prohibited transaction specifically listed in the proposed Employee Benefits Protection Act, S. 1557 (sec. 6(b) of the bill). The transactions specifically prohibited in S. 1557 are substantially the same as the transactions specifically prohibited by S. 4, with generally the same exceptions. Additionally, in most other respects regarding fiduciary conduct, S. 1557 is substantially the same as the provisions of S. 4.

G. Reporting and Disclosure

Present law: reporting to government agencies.—Every employer who maintains a funded retirement plan must annually file a return with the Internal Revenue Service, regardless of whether the plan is qualified or whether a deduction is claimed for the current year (regs. § 1.404(a)–2A). This return generally includes information on the nature and coverage of the plan and certain actions and changes that affected the plan. Information regarding contributions and computations for deductions must also be included. Every employer (or trust fiduciary) also must annually file with the Service a financial statement of the retirement plan fund, including a statement of assets and liabilities and a statement of receipts and disbursements.

The trustee of a qualified retirement trust must file an annual return with the Internal Revenue Service that discloses whether the trust engaged in transactions which may have been "prohibited transactions," and a statement describing the transactions also must be filed. (Prohibited transactions include certain dealings between the trust and interested parties, and are discussed in section F, Fiduciary Standards).

The Welfare and Pension Plans Disclosure Act also provides for disclosure and reporting of retirement fund transactions. Under this Act, most private employers (except certain tax-exempt organizations) engaged in interstate commerce or in an industry or activity affecting such commerce who have retirement plans covering more than 25 participants must file a description of the plan with the Secretary of Labor when the plan is established or amended (29 U.S.C. §§ 303, 305). Further, if a covered plan includes at least 100 participants, an annual report must be filed providing information about contributions, benefits paid, number of employees covered, assets, and liabilities of the plan (29 U.S.C. § 306). The annual report also is to include statements regarding certain transactions between the trust and interested parties, and is to include certain actuarial information. The Internal Revenue Service will accept the annual report filed with the Labor Department as satisfying some of the requirements for filing with the Service.

Present law: disclosure to employees.—Under Treasury regulations, employees must be informed of the establishment of a qualified retirement plan and its basic provisions (regs. § 1.401-1(a)(2)). This may be done by furnishing each employee with a copy of the plan, but where this is not feasible substitute methods may be used. Satisfactory substitutes must describe the essential features of the plan, and may be in the form of a booklet given to the employees or a notice posted on the company's bulletin board. Substitutes must state that the complete plan may be inspected at a designated place and times on the company's premises.

Under the Welfare and Pension Plans Disclosure Act, the plan description and annual reports filed with the Labor Department must be available for examination by participants and beneficiaries in the principal office of the plan. Additionally, upon written request, a copy of the plan description and summaries of the annual reports must be mailed to participants and beneficiaries (29 U.S.C. § 307).

S. 4.—The Welfare and Pension Plans Disclosure Act would be amended to require that additional information be provided in the plan descriptions and annual reports filed with the Labor Department (secs. 505 and 506 of the bill). Furthermore, annual reports generally would be required for any private funded employee benefit plan which covers more than 25 (rather than 100) participants, and coverage would be extended to most tax-exempt organizations (secs. 503 and 507 of the bill). Annual reports also would include the opinion of an independent auditor based on an annual audit (sec. 506(c) of the bill).

Annual reports would include additional information on all investments, and include separate detailed schedules for transactions involving securities, other investment assets, loans, and certain leases (sec. 506 of the bill). Additionally, annual reporting would be required for all transactions involving interested parties. Detailed actuarial information also would be required, in order to allow evaluation of the funding of the plan.

In addition to current requirements on disclosure to employees, each new participant would receive a summary of the plan's important provisions, including an explanation of plan benefits and the circumstances which would disqualify a person from receiving benefits (sec. 507 of the bill). Every three years a revised summary of the plan's provisions would be provided to participants. (Plan summaries would be required to be written in a manner calculated to be understood by the average participant.) Participants also would be entitled to obtain copies of all the underlying plan documents. When a participant terminates service with a vested pension right, he would be given a certificate setting forth the benefits to which he is entitled (sec. 108 of the bill).

S. 1179.—S. 1179 includes no provisions regarding disclosure or reporting.

S. 1557.—S. 1557 is a companion measure to S. 1631; it would amend the provisions of the Welfare and Pension Plans Disclosure Act regarding disclosure and reporting. The disclosure and reporting provisions of S. 1557 are substantially the same as in S. 4. Additionally, S. 1557 would require that a statement of accrued benefits be given to participants or beneficiaries upon request (sec. 8(c) of the bill).

H. Enforcement

Present law.—Plans which meet the requirements of the Internal Revenue Code (e.g., exclusively for benefit of employees, nondiscriminatory in regard to coverage and benefits, limits on contributions for owner-employees under H.R. 10 plans) receive special tax treatment to foster their growth. It is not necessary, in order to receive this special tax treatment, that a prior determination be obtained from the Internal Revenue Service. However, to assist employers in their development of plans or plan amendments, the Internal Revenue Service is willing to issue determination letters that proposed plans or amendments qualify for the special tax treatment. As a practical matter, since taxpayers generally wish to be assured in advance that their plans or amendments will qualify, they obtain prior determinations from the Internal Revenue Service. Such a determination is with respect to the qualification of the plan (sec. 401 of the code) and tax-exempt status of the related trust (sec. 501 of the code).

Under the Internal Revenue's published procedures, this determination generally takes the form of a determination letter from a district director. The district director may request technical advice from the national office on issues arising from a request for a determination letter. Also, the applicant may request national office consideration of the matter if the district director does not act within 30 days from notice of intent to make such a request, or acts adversely.

Standards are set forth under which the national office is to determine whether it will entertain a request for consideration of a case. One situation where a request will be entertained is where the contemplated district office action is in conflict with a determination made in a similar case in the same or another district. The procedure provides for a conference in the national office, if it is requested by the applicant. In addition, determination letters issued by the district director are subject to post review procedure in the national office.

The Internal Revenue Service, besides granting prior determinations, also administers the tax provisions of the Internal Revenue Code relating to the continued qualification of pension and profit-sharing plans.[9] If a plan does not comply with the requirements of the Internal Revenue Code, these special tax benefits are lost. Thus, to a considerable extent, the provisions of the Code in this area are self-enforcing (i.e., those in charge of a plan have an interest in seeing to it that the plan continues to comply with the antidiscrimination requirements, that the plan does not engage in prohibited self-dealing transactions, and that it otherwise acts in such a manner to preserve the complex of tax benefits to both the employer and the participants and their beneficiaries).

In addition, the Department of Labor administers the Welfare and Pension Plan Disclosure Act of 1958 (P.L. 85–832, as amended by P.L. 87–420), discussed above, under Reporting and Disclosure.

S. 4.—An Office of Pension and Welfare Plan Administration would be established within the Department of Labor to implement the specified standards of vesting, funding, and reinsurance, as well as disclosure and fiduciary standards (sec. 101 *et seq.* and sec. 601 *et seq.* of the bill). Plans covered by the bill would have to be registered with the Secretary of Labor, who would issue certificates of registration to plans which qualify under the bill.

The Secretary of Labor would be empowered to enforce the provisions of the bill by petitioning the Federal courts to compel a pension or profit-sharing retirement plan to comply with the provisions of the bill. He would be given the right to seek relief in the Federal courts to compel the return of assets to the fund, to require payments to be made, to require the removal of a fiduciary, and to obtain other appropriate relief.

In addition, civil actions may be brought by plan participants to seek relief against violations committed by a fiduciary.

A plan administrator in discharging his duties with respect to the assets of the fund would be subject to the standards of care under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use. The failure of an administrator to comply with these standards would result in the administrator being personally liable to the fund for any losses to the fund resulting from the administrator's breach of his fiduciary responsibilities and by the administrator paying to the fund any profits which have inured to him through use of fund assets.

The Secretary of Labor would be empowered to examine the books and records of any plan or fund in order to determine compliance with the provisions of the Act.

S. 1179.—The Internal Revenue Service would administer the provisions of the bill using the same enforcement procedures that are available to it under existing law; that is, by determining as to any plan whether it is, or continues to be, qualified for the special tax benefits available under the Internal Revenue Code. In order to

[9] It should be noted that qualified pension, etc., plans are taxable on unrelated business income, as are other exempt organizations (sec. 511 *et seq.* of the code).

upgrade the administration of the pension plan provisions of the code, the bill would establish within the Internal Revenue Service an Office of Pension Plan Administration, headed by an Assistant Commissioner of the Internal Revenue Service (secs. 201 and 202 of the bill).

In addition, the bill provides for additional enforcement measures where there is a failure to make the required contributions. The Secretary of the Treasury, or his delegate, may order that a plan be terminated if, after notice and opportunity for a hearing, termination is considered necessary to protect the interests of the participants. Also, if a plan is terminated, any tax deductions attributable to contributions to the plan for the five taxable years immediately preceding the year of termination may be disallowed by including them in the employer's income in the year the plan is terminated (sec. 324 of the bill).

S. 1631.—The Internal Revenue Service would administer the provisions of the bill using the same enforcement procedures that are available to it under existing law; that is, by determining as to any plan whether it is, or continues to be, qualified for the special tax benefits available under the Internal Revenue Code. In addition, the bill would impose an excise tax on the amount involved in a prohibited transaction. The tax would be imposed on any party in interest who is a participant in the prohibited transaction (see discussion under Fiduciary Standards, above).

I. Limitation on Contributions

Present law.—Under present law, different rules are provided for employer and employee contributions in the case of plans for self-employed individuals (H.R. 10 plans), "regular" corporations and electing small business corporations (subchapter S).[10] These are described below.

H.R. 10 plans.—The amount of deductible contributions to an H.R. 10 plan on behalf of a self-employed person cannot exceed the lesser of 10 percent of his earned income or $2,500 (sec. 404(e) of the code). In addition, limited nondeductible contributions may be made in certain cases. Contributions for employees of self-employed individuals must be at least proportionate to contributions for self-employed (sec. 404(e) of the code).

"Regular" corporate plans.—In the case of a "regular" corporate plan there are no limitations on how much may be contributed by the employer. There are, however, limitations on the amount of the contribution that is deductible. Different limitations apply to profit-sharing and stock bonus plans and to pension plans.

In the case of profit-sharing or stock bonus plans, the amount of the contribution that is allowable as a deduction is not to exceed 15 percent of compensation to employees covered under the plan. Contributions in excess of the 15-percent limitation may be carried over to future years. In addition, within certain limits, to the extent that an employer does not make the full 15-percent contribution in one year he may increase the amount of his deductible contribution in a future year.

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[10] All the types of plans must, in addition to the rules described below, meet the general reasonable compensation tests (sec. 162 of the code).

In the case of pension plans, the amount of the contribution that is deductible is not to exceed 5 percent of the compensation to employees covered under the plan, plus the amount of the contribution in excess of 5 percent of compensation to the extent necessary to fund normal pension costs and remaining past service costs of all employees under the plan. In the alternative, the taxpayer may compute the limit on his deductible contributions by limiting his deduction to his normal cost for the plan plus 10 percent of the past service cost of the plan (sec. 404(a) of the code).

Where an employer contributes to two or more retirement plans which are governed by different limits on deductions (pension, profit sharing or stock bonus, or employee annuities), the total amount annually deductible under all the plans cannot be more than 25 percent of compensation otherwise earned by the plan beneficiaries. If any excess is contributed, it may be deducted in the following year; the maximum deduction in the following year (for carryover and current contributions together) is 30 percent of compensation. An unlimited carryover is available for additional excess amounts.

Subchapter S plans.—The limitations on the deductibility of contributions to a subchapter S corporation plan are the same as those in "regular" corporate plants. However, a shareholder-employee (an employee who owns more than 5 percent of the outstanding stock of such a corporation) must include in his gross income the amount by which the deductible contributions paid on his behalf exceeds the lesser of 10 percent of his compensation or $2,500 (sec. 1379 of the code).

Professional corporations.—Generally, lawyers, doctors, accountants and certain other professional groups in the past have been unable to carry on their professions through the form of corporations because of the personal nature of their responsibility or liability for the work performed for a client or patient. Consequently, their contributions to retirement plans were limited by the rules governing self-employed persons. In recent years, however, most States have adopted special incorporation laws which provide for what are generally known as "professional corporations." These have been used increasingly by groups of professional persons, primarily to obtain the more favorable tax treatment for pensions generally available to corporate employees. The Treasury Department in the so-called Kintner regulations held that professional corporations were not taxable as corporations. A number of court cases, however, have overturned the regulations and the Service has now acquiesced and generally recognizes these professional corporations as corporations for income tax purposes. The formation of professional corporations, while maintaining the personal relationship between the shareholder-employee and the patient or client, has had the effect of indirectly overcoming the limitations Congress intended to impose with respect to deductible amounts which may be set aside for pensions in these cases. In 1969, the Finance Committee felt it was inappropriate to permit what are essentially, in most respects, self-employed persons to avoid the pension limitations prescribed by Congress.

The committee amendments to the Tax Reform Act of 1969 provided that shareholder-employees of a professional service organization were to include in their gross income the amounts of contributions paid on their behalf which are deductible under qualified pension, profit-sharing, and stock bonus plans under the Internal Revenue Code to the extent that these amounts exceeded 10 percent of the compensation received by the shareholder-employee from the organization, or $2,500, whichever is less. However, the Treasury opposed these amendments on the ground that there should be equality of treatment between corporate employees and self-employed persons. Treasury officials stated at that time that this objective may involve the imposition of some form of limitation on contributions or benefits for high-paid corporate employees, at least for shareholder-employees. Further, Treasury felt it was preferable to wait until the following year to deal with this issue, when it expected to have comprehensive recommendations on professional service corporations, along with other employee benefit plan recommendations. On this basis, the Senate voted to delete from the Tax Reform Act of 1969 the committee's recommendation on professional corporations.

S. 4.—The bill would not change the rules in the Internal Revenue Code on the limitations on contributions.

S. 1179.—The bill would not change the rules in the Internal Revenue Code on the limitations on deductible contributions.

S. 1631.—The bill would increase the limitation on deductible contributions on behalf of a self-employed individual (H.R. 10 plans) or a shareholder-employee (subchapter S plans) to the lesser of $7,500 or 15 percent of his earned income (sec. 4 of the bill).

The bill would also require an employee to include in his gross income the amount of the employer's contributions made on the employee's behalf under a money purchase pension plan to the extent that the contributions are in excess of 20 percent of the employee's compensation during the taxable year. Amounts included in gross income under this provision would be treated as part of the employee's investment in the contract for purposes of computing the taxable income of the employee upon a distribution to the employee (sec. 7(h) of the bill).

In the case of pension plans, the 5-percent of compensation limitation on deductible contributions would be eliminated and the other limitations would not apply to the extent that the contributions with respect to a pension plan do not exceed the minimum funding standards (sec. 7(g) of the bill).

J. Deduction for Personal Savings Retirement Plans

Present law.—There is no deduction for amounts contributed by an employee to a qualified pension plan (except to the extent that tax-excludable contributions made in connection with salary-reduction plans, described below, may be viewed as employee contributions), although the income earned on such amounts is not taxed until it is distributed.[11] There is also no deduction for amounts paid by an individual for his own retirement savings outside the scope of a qualified plan.

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[11] At one time the Congress took the position that a contribution to an H.R. 10 plan on behalf of a self-employed person was made half by the employer and half by the self-employed person; no deduction was allowed for half the contribution (presumably, the half "contributed by" the self-employed person). This limitation (sec. 404(a)(10) of the Code) was repealed for taxable years beginning after December 31, 1967.

S. 4.—The bill would not change the rules in the Internal Revenue Code on the treatment of personal savings retirement plans.

S. 1179.—A credit would be allowed against tax for contributions by an employee to an employer retirement plan, or to his own qualified retirement account, equal to the lesser of 25 percent of such contributions or $375. This credit would be reduced by an amount equal to 25 percent of any employer contributions to a qualified pension plan which were made on behalf of the employee (which contributions could, at the employee's option, be deemed to be 7 percent of his earned income) and 25 percent of the FICA tax which would have been imposed on any earned income not subject to social security or the railroad retirement system had this income been subject to this tax. Also, in the case of contributions to a personal retirement savings account (but not in the case of employee contributions to an employer plan) the contribution base, with reference to which the credit would be determined, could not exceed the lesser of 20 percent of earned income or $1,500. In the case of a married couple, each spouse would be entitled to claim the credit, and the limitations would be applied separately to each spouse.

In general, contributions to such a retirement account would not be permitted to exceed the 20-percent-$1,500 limit noted above, and then could be made only by the employee and the employee's spouse. A qualified retirement account would be treated as a qualified owner-employee plan, for purposes of the Code's provisions on exempt organizations (such as the prohibited transactions and unrelated business income provisions) and procedure and administration (such as the requirement for fiduciary returns).

Penalties would be imposed on premature distributions (generally, distributions before the employee or spouse reaches age 59½) and distributions would be required to begin from a personal retirement savings account by the time the individual attains the age of 70½ (sec 341 *et seq.* of the bill).

S. 1631.—A deduction would be allowed for contributions made by an employee to an employer retirement plan, or to his own qualified retirement account; generally, the deduction would not exceed the lesser of 20 percent; generally, the deduction would not exceed the maximum deductible amount for an employee would be reduced by any payments made on his behalf by an employer to a qualified pension plan (which contributions could, at the employee's option, be deemed to be 7 percent of his earned income). In the case of an employee who had earned income which was not subject to social security or the railroad retirement system, the maximum deductible amount would also be reduced by the tax which would have been imposed on such income had it been subject to this tax. In the case of a married couple, each spouse would be entitled to claim the deduction and the limit would be applied separately to each spouse.

In most other respects, S. 1631 is similar to S. 1179, except that S. 1631 imposes an annual 10-percent excise tax on amounts retained in the individual retirement account in excess of those amounts necessary so that the account may be distributed ratably over the life expectancy of the employer or the employee and spouse, after they reach the age of 70½ (sec. 3 of the bill).

K. Salary Reduction Plans—Tax-Sheltered Annuities

Present law.—As a general rule, employees may not deduct contributions to pension plans which are made out of their own funds ("employee contributions"). However, employees of tax-exempt charitable, educational, religious, etc., organizations, and teachers and other employees of public educational institutions may exclude from income amounts paid by their employers to purchase nonforfeitable annuity contracts (in many cases, the source of those amounts is the employees' agreement to take salary reductions or forego increases). The amount of salary reduction which can be used in this way is determined in accordance with a statutory formula; generally, salary reductions may be up to 20 percent of compensation, times years of service, reduced by amounts previously contributed by the employer for annuity contracts on a tax excluded basis to the employee (sec. 403(b) of the Code).

Antidiscrimination provisions that apply generally to qualified plans do not apply to tax-sheltered annuities.

Legislative history.—Section 403(b) was added to the Code by the Technical Amendments Act of 1958 (Public Law 85–866). Prior to enactment, in certain cases tax-exempt organizations were paying all, or almost all, the compensation of certain employees in the form of "tax-free" premiums for annuities. Usually these were part-time employees who derived their principal income from other employment and wanted to defer taxes on income, which they intended to save, from these exempt organizations. The Internal Revenue Service had attempted by regulation to limit this tax deferred compensation to amounts which were supplemental to the employee's normal compensation, but there was some uncertainty about the validity of these regulations. Therefore, Congress adopted the statutory exclusion formula in section 403(b) in order to resolve the matter. This provision was amended in 1961 (Public Law 87–370) to make it clear that the provision applied to employees of public educational institutions.

L. Salary Reduction Plans—6-Percent Plans

Present law.—Under administrative rulings, until recently, employees of organizations not covered by section 403(b) were permitted to participate in salary reduction plans. If the plan met certain nondiscrimination requirements, the Internal Revenue Service had taken the position in rulings that, under certain circumstances, the amount of the salary reduction would be treated as an employer contribution to a qualified pension plan, not taxable to the employees (until benefits were received from the plan). The maximum amount that could be so treated was 6 percent of compensation.

On December 6, 1972, the Service issued a proposed regulation which would change this result by providing that an amount contributed to a retirement plan will be considered to have been contributed by the employee "if at his individual option such amount was so contributed in return for a reduction in his basic or regular compensation or in lieu of an increase in such compensation." Under the proposed regulations, which would operate prospectively, amounts contributed under a salary reduction agreement, not covered by section 403(b), which affects basic or regular compensation would not be excludable from income by the employee. The Service has invited written comments or suggestions on the proposed regulations and will provide an opportunity for persons to comment orally at a public hearing.

M. Lump-Sum Distributions

Present law.—Retirement benefits generally are taxed as ordinary income under the annuity rules (sec. 72 of the code) when the amounts are distributed, to the extent they do not represent a recovery of the amounts contributed by the employee. However, an exception to this general rule under prior law provided that if an employee's total accrued benefits were distributed or paid in a lump-sum distribution from a qualified plan within one taxable year on account of separation from employment or death (or death after separation from service), the taxable portion of the payment was treated as a long-term capital gain, rather than ordinary income.

The capital gains treatment accorded these lump-sum distributions allowed employees to receive substantial amounts of deferred compensation at more favorable tax rates than other compensation received currently. The more significant benefits under this treatment apparently accrued to taxpayers with adjusted gross incomes in excess of $50,000, particularly in view of the fact that a number of lump-sum distributions of over $800,000 have been made.

To correct this problem, the Tax Reform Act of 1969 provided that part of a lump-sum distribution received from a qualified employee's trust within one taxable year on account of separation from service or death (or death after separation from service) is to be given ordinary income treatment, instead of the capital gains treatment it had been given under prior law. The ordinary income treatment applies to the taxable portion of the distribution (i.e., the total distribution less the employee's contribution) which exceeds the sum of the benefits accrued during plan years beginning before 1970, and the portion of the benefits accrued thereafter which does not consist of employer contributions (sec. 402(a)(5) of the code).

The 1969 Act provides a special limitation in the form of a 7-year "forward" averaging formula which applies to the portion of the lump-sum distribution treated as ordinary income. An employee (or beneficiary) is eligible for the special 7-year forward averaging provision if the distribution is made on account of separation from service or death (or death after separation from service)[12] and if he has been a participant in the plan for 5 or more taxable years before the taxable year in which the distribution is made.

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[12] Self-employed taxpayers, on the other hand, continue to be eligible for their special 5-year forward averaging only on lump sum distributions received on account of death, disability as defined in sec. 72(m)(7) of the code or if received after the age of 59½.

In 1971 the Treasury issued proposed regulations under the 1969 Act describing the computation of tax on total distributions from qualified plans. These proposed regulations were criticized as requiring payment of more tax than the statute required. On May 4, 1973, the Treasury withdrew the regulations proposed in 1971 and issued a new set of proposed regulations describing the computation of tax on total distributions. Generally, these new proposed regulations appear to meet the criticisms of the old proposed regulations. However, it appears that under the newly proposed regulations there are some circumstances in which a taxpayer would pay less tax under the rules of the 1969 Act than under previous rules, and it is not clear that this was the goal Congress intended to reach. Treasury has invited written comments on the newly proposed regulations, and also has stated that persons who wish to comment orally will be given an opportunity to do so.

S. 4.—See D. Portability, above, for proposals affecting lump-sum distributions under certain circumstances.

S. 1179.—No part of any distribution from a qualified individual retirement account (see J. Deduction for Personal Savings Retirement Plans, above) would be eligible for long-term capital gain treatment (sec. 342 of the bill).

(See D. Portability, above, for proposals affecting lump-sum distributions under certain circumstances.)

S. 1631.—No part of any distribution from a qualified individual retirement account (see J. Deduction for Personal Savings Retirement Plans, above) would be eligible for long-term capital gain treatment.

(See D. Portability, above, for proposals affecting lump-sum distributions under certain circumstances.)

III.—COMPARISON OF MAJOR PROVISIONS OF PRESENT LAW, S. 4, S. 1179, AND S. 1631

Item	Present law	S. 4 (Williams–Javits)	S. 1179 (Bentsen)	S. 1631 (The administration bill)
Short Title		Retirement Income Security for Employees Act.	Comprehensive Private Pension Security Act of 1973.	Retirement Benefits Tax Act.
Prinicipal Administering Agency	Internal Revenue Service	Labor Department	Internal Revenue Service	Internal Revenue Service.
General Coverage of Bill	All qualified pension and profit-sharing plans.	All pension and profit-sharing plans, except those of Government, religious organizations, those with 25 or fewer participants, those benefiting the self-employed; also certain other exceptions.	All qualified pension and profit-sharing plans.	All qualified pension and profit-sharing plans.
Plan Participation	Employer Plans—Plans may be limited to employees who have (1) attained a designated age, or (2) been employed for a designated number of years, so long as effect is not discriminatory in favor of officers, shareholders and highly compensated employees. Plans may also exclude employees who are near retirement age when they would otherwise become eligible.	Generally, plans could not require more than one year of service or an age greater than 25; plans which provide full immediate vesting for all participants could require 3 years of service and an age of 30.	Employer Plans—1 year of service and age of 30.	Employer Plans—3 years of continuous service and an age of 30; plans could exclude employees who are within 5 years of retirement age when they would otherwise become eligible.
	Self-employed plans—Plan must cover all employees with 3 or more years of service.		Self-employed plans—Same as present law.	Self-employed plans—Must cover all employees with 3 years of continuous service; all those age 30 with 2 years of service, and all those age 35 or older with one year or more of service.
Vesting	Employer plans—Employees must receive vested rights when they retire or upon plan termination; also vesting provisions may be considered in determining if plan discriminates.	30-percent vesting after 8 years of participation; thereafter vesting increases at a rate of 10 percent per year; in lieu of this schedule Secretary of Labor could approve other equally "equitable" vesting formulas. Vesting would apply to benefits accrued before and after effective date of provision (3 years after enactment). Secretary of Labor could postpone required vesting for 5 years to prevent "substantial economic injury." Contributions under a class-year plan must vest in full within 5 years.	Employer plans—25-percent vesting after 5 years of participation with additional vesting at a rate of 5 percent per year. Vesting would apply to benefits accrued before the effective date of the provision (3 years after enactment) in the case of employees 45 and older. The Internal Revenue Service could postpone required vesting for 5 years to prevent "substantial economic injury." Contributions under a class-year plan must vest in full within 5 years.	Employer plans—"Rule of 50" would apply under which there would be 50% vesting when an employee's age and years of participation in the plan totalled 50, if the employee also had 3 years of continuous service. Remaining benefits would vest, at least ratably, over the next 5 years. Generally, vesting requirements would not apply with respect to benefits accrued before enactment (but preenactment years of participation would be considered in determining if the employee was entitled to vesting).
	Self-employed plans—Rights of all plan participants must vest immediately.		Self-employed plans—Same as present law.	Self-employed plans—A "rule of 35" would apply.

Funding	Must fund at least normal pension costs and interest on unfunded accrued liabilities. No amortization of principal amount of unfunded accrued liabilities is required. Actuarial methods, factors and assumptions must together be reasonable and must be reported.	Normal pension costs would be funded annually and accrued unfunded liabilities (whether or not vested) would ities (whether or not vested) would have to be funded at least ratably over a 30-year period. Substantial increased liabilities resulting from a plan amendment would be funded over 30 years. Experience deficiencies would generally have to be funded over a 5-year period. Actuarial assumptions would be set by Secretary of Labor. Secretary of Labor could waive the requirement for a particular year upon a showing of hardship, and allow the year's deferred contribution to be made up ratably over a 5-year period.	Generally similar to S. 4, but would be condition for qualifying under the Internal Revenue Code. Experience deficiencies would have to be made up at least ratably over a period no longer than the average remaining working life of covered employees. Secretary life of covered employees. Secretary of Treasury could grant waivers of the requirements.	Minimum contributions would equal normal costs, interest on past service costs, and 5 percent of vested unfunded liabilities. Secretary of Treasury could permit alternative funding schedule which results in a satisfactory rate of funding.
Portability	Under administrative practice, an employee's pension rights may be transferred from one plan to another if both old and new employers consent and the terms of both plans and trusts permit such transfers. To avoid tax, however, the transfer of funds must generally be made directly between qualified trusts.	Would create a Federal clearinghouse to facilitate portability of vested pension credits. Program would be voluntary both for employers and employees. At his option, an employee would leave amounts transferred on his behalf under the portability program on deposit with the Federal portability fund.	Would amend the law to specifically permit tax-free transfer of employee pension rights between plans.	Would amend the tax law to permit tax-free lump-sum distributions from a qualified retirement plan if the proceeds are reinvested in another qualified plan within 60 days after the close of the taxable year in which such a distribution was received.
Plan Termination Insurance	None	Federal insurance program would be established protecting an employee's rights to accrued vested benefits equal to the lesser of 50% of his highest average monthly wage earned over a 5-year period, or $500 a month. Generally, employers would pay a premium for this coverage equal to 0.2 percent of unfunded vested liabilities in the case of multiemployer plans or 75 percent funded plans and up to 0.4 percent in the case of other plans. In addition, the employer would be liable to reimburse the insurance fund upon plan termination in an amount not in excess of 50 percent of net worth.	Federal insurance program would protect employee's rights to a pension equal to the lesser of 50 percent of his highest average monthly wage over a 5-year period, or $1,000 a month. Premiums would initially be up to 0.2 percent of vested unfunded liabilities in the case of multiemployer plans or 75 percent funded plans, and up to 0.4 percent in the case of other plans.	None.

III.—COMPARISON OF MAJOR PROVISIONS OF PRESENT LAW, S. 4, S. 1179, AND S. 1631—Continued

Item	Present law	S. 4 (Williams-Javits)	S. 1179 (Bentsen)	S. 1631 (The administration bill)
Reporting and disclosure	Reporting—Internal Revenue Service: All employers with funded plans must file annual returns on plan financial status, contributions and deductions, and changes; trustees of qualified plans must report prohibited transactions. Labor Department: Plans covered under the Welfare and Pension Plans Disclosure Act must file plan description when plan is established. Covered plans with over 100 participants must file an annual report on contributions, benefits, employees covered, assets and liabilities, interested party transactions and certain other matters.	Reporting—Labor Department: Annual reports would be required from plans covering more than 25 participants and would include independent auditor's statement. Annual reports would include more detailed information concerning investments, transactions involving interested parties and actuarial information.	None	Reporting—A companion bill, S. 1557, contains requirements substantially similar to those in S. 4.
	Disclosure—Under the tax law, employees must be informed of the establishment of a qualified plan and its basic provisions; a copy of the plan must be available for inspection. Under the WPPDA, the material filed with the Secretary of Labor must be available for inspection and upon request, copies or summaries of this material must be mailed to plan participants and beneficiaries.	Disclosure—New participants would receive summary of important plan provisions, especially those concerning plan benefits and circumstances which would disqualify the individual from receiving benefits. Revised summary would be provided every 3 years. Summaries would have to be written in a manner calculated to be understood by the average participant. When a participant with vested benefits terminates service, he would receive a certificate concerning his rights.		Disclosure—S. 1557 is substantially similar to S. 4. Also would require a statement of accrued benefits be given to participants or beneficiaries upon request.
Fiduciary Standards	The assets of a qualified plan must be used exclusively for the benefit of employees and their beneficiaries. Additionally, pension trusts engaging in specified "prohibited transactions" with certain interested persons may lose their qualified status. Generally, these include loans, payment of compensation, providing trust services, or purchases or sales of property between the trust and an interested person, other than on arms-length basis.	Would amend the WPPDA to impose a "prudent man" standard on pension trust fiduciaries. Additionally, fiduciaries could not engage in specified transactions. These include rentals, sales or purchases of property, loans, providing trust goods, services or facilities, or otherwise permitting the transfer of trust property to interested parties. Exceptions are made for certain established business practices.	None	Prohibited transaction rules (presently resulting in loss of exemption where violated) would be repealed. However, excise taxes of 5 and 200 percent would be imposed on persons engaging in self-dealing type transactions, similar to those specifically prohibited under S. 4.

Personal Retirement Savings Plan.	Generally, there is no tax deduction for amounts paid by an individual toward his own personal retirement savings, or for employee contributions to an employer pension plan.	None	Would allow a credit against tax for employee contributions to an employer retirement plan or to a personal retirement savings account. Credit could not exceed lesser of (1) 25 percent of such contributions or (2) $375. The maximum allowable credit would be reduced by 25 percent of any employer contributions to a qualified retirement plan and would be further reduced by 25 percent of any FICA tax savings if the individual had earned income not subject to this tax. In the case of a married couple, both husband and wife could claim the credit. The personal retirement savings account would be managed by a bank or other trustee. Generally, no benefits could be paid before age 59½ (except in the event of death or disability) and benefit payments would have to begin by age 70½.	Similar to S. 1179 except that a deduction (rather than a credit) would be allowed for such contributions equal to the lesser of (1) 20 percent of earned income or (2) $1,500. These limits would be scaled down dollar for dollar to reflect employer contributions to a qualified retirement plan, or any FICA or Railroad Retirement tax savings of the employee.
Contribution Limits	Employer Plans—Deductible contributions to pension plans generally may not exceed (1) 5 percent of pay of covered employees plus any sum necessary to fund current and past service costs on an actuarial basis, or (2) normal service costs plus 10 percent of past service costs. Profit-sharing contributions may be deducted up to 15 percent of payroll of covered employees. Credit and contribution carryovers are permitted.	Would not amend the Internal Revenue Code. Certain funding requirements would be reduced if necessary to enable the employer to receive his tax deduction.	None	Employer Plans—Would repeal the 5% limitation. Deductions would be permitted for any amount necessary to meet minimum funding requirements. Money Purchase Plans—Contributions to such plans in excess of 20% of annual compensation would have to be included in gross income by the employee.
	Self Employed Plans—Deductible contributions on behalf of self-employed persons (and shareholder-employees of subchapter S corporations) may not exceed the lesser of 10 percent of earned income, or $2,500. In plans where covered employees may make voluntary contributions, the owner-employees may make proportionate contributions, on a nondeductible basis, up to the lesser of 10 percent of earned income or $2,500.			Self-Employed Plans—The limits on deductible contributions would be increased to the lesser of 15 percent of earned income or $7,500. Excludible contributions on behalf of shareholder-employees of subchapter S corporations would be increased to similar levels. Limits on nondeductible contributions would be correspondingly increased for owner-employees.

III.—COMPARISON OF MAJOR PROVISIONS OF PRESENT LAW, S. 4, S. 1179, AND S. 1631—Continued

Item	Present law	S. 4 (Williams–Javits)	S. 1179 (Bentsen)	S. 1631 (The administration bill)
Enforcement	Largely self-policing since plans not meeting the requirements for qualification under present law are not tax exempt; therefore, employer contributions to such plans are generally not tax deductible unless rights under the plan are nonforfeitable and the amounts contributed are includible in income by the employee.	The provisions of the bill would be enforced in the Federal Courts as the result of legal actions brought by the Secretary of Labor, or concerned employees. A special office would be created in the Department of Labor to administer the provisions of S. 4.	Generally, the same as under present law. However, a special Office of Pension Plan Administration would be created in the Service. For funding violations, the pension plan could be terminated by the Service, and the deduction for contributions made to the plan for the 5 preceding years may then be disallowed.	Generally, the same as under present law. However, penalty taxes could be imposed on interested persons engaging in self-dealing transactions with the fund, whereas, under present law, the only sanction is loss of tax exemption.