[JOINT COMMITTEE PRINT]

DESCRIPTION OF S. 75, S. 94, S. 209, AND S. 557

RELATING TO

DEDUCTIONS FOR INDIVIDUAL RETIREMENT SAVINGS AND TREATMENT OF TAX-QUALIFIED EMPLOYEE PLANS

SCHEDULED FOR A HEARING

BY THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE

COMMITTEE ON FINANCE

ON APRIL 3, 1979

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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I. INTRODUCTION

The bills discussed in this pamphlet, S. 75, S. 94, S. 209, and S. 557, have been scheduled for a hearing on April 3, 1979, by the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance. The bills relate to deductions for individual retirement savings and the treatment of tax-qualified employee plans.

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bills. The description indicates the present law treatment and problems related to present law, an explanation of what changes each bill would make, its effective date, and its estimated revenue effect.

II. DEDUCTIONS FOR INDIVIDUAL RETIREMENT SAVINGS

A. PRESENT LAW AND PROBLEMS

Present law

An employee generally is entitled to deduct the amount contributed to an individual retirement account or individual retirement annuity or used to purchase retirement bonds (referred to collectively as "IRAs"). The limitation on the deduction for a taxable year is generally the lesser of 15% of compensation for the year or $1,500. The $1,500 contribution limit is increased to $1,750 for a year if (1) the contribution is equally divided between an employee and the spouse of the employee, and (2) the spouse has no compensation for the year. However, no IRA deduction is allowed for a taxable year to an individual who is an active participant during any part of the taxable year in a qualified retirement plan, a tax-sheltered annuity maintained by a tax-exempt institution, or a governmental plan (whether or not qualified).

Many qualified plans provide for contributions by both the employer and the employee. In many such cases, the employee contributions are mandatory (i.e., required as a condition of employment, a condition of participation in the plan, or a condition of obtaining additional employer-derived benefits). In other cases, employee contributions are voluntary, and the amount, within limits, is left to the discretion of the employee. A plan also can provide for both mandatory and voluntary employee contributions. In any case, neither employer nor employee contributions to a qualified retirement plan may discriminate in favor of employees who are officers, shareholders, or highly compensated. Generally, in the case of voluntary employee contributions within certain limits, there is no discrimination so long as there is an equal opportunity for all employees to make such contributions. Income allocable to an employee's contributions to a qualified plan is generally not taxed to the plan or the employee prior to the time the income is distributed or made available to the employee or the employee's beneficiary. However, the employee is not entitled to a deduction or exclusion for employee contributions to the plan.

In the case of tax-sheltered annuities (including custodial accounts investing in shares of a regulated investment company) purchased by certain tax-exempt institutions for their employees or purchased by schools for teachers, employees are entitled to an exclusion, within limits, from gross income for amounts contributed on a salary reduction basis.

Problems

Under present law, an active participant in a qualified plan may not make a deductible IRA contribution, even though the employer's contribution to the plan on his or her behalf might be negligible or the individual might never vest in a retirement benefit because of frequent changes in jobs. Also, because deductible contributions to an IRA may not exceed 15 percent of an individual's compensation, a homemaker who does not earn compensation is not allowed to make deductible IRA contributions.

B. DESCRIPTION OF THE BILLS

The following bills have been introduced in the Senate to extend the availability of IRA deductions and to allow a deduction for employee contributions to a qualified plan.

1. S. 75 (Senators Dole, Nelson, Moynihan, and Gravel)

Description of provision

Under the bill, an active participant in a qualified pension, profit-sharing, or stock bonus plan could make a deductible contribution either to that plan or to an IRA. However, deductions for contribution generally would not be available to participants in government plans, in tax-sheltered annuities, or to self-employed individuals. A deduction would be allowed for an employee contribution to certain pre-ERISA group retirement trust maintained by tax-exempt labor organizations.

The deduction limitation would be the lesser of 10 percent of compensation or $1,000. In the case where an individual who is eligible for a deduction makes a contribution to a qualified plan, a deduction for a contribution to an IRA would be allowed only to the extent that the amount contributed to the plan is less than the deduction limitation.

An active participant in a qualified plan would be automatically eligible to make a deductible contribution to the plan or to an IRA if his or her compensation is less than the annual compensation paid for step 1 of GS–14 ($32,442 at this time). Thus, the compensation level, below which an individual would have to meet no requirements to be eligible to deduct a contribution to a qualified plan or to an IRA, generally would be adjusted annually.

If the annual compensation of an individual covered by a qualified plan equals or exceeds that paid for step 1 of grade GS–14, and if his or her compensation is within the top one-third of the compensation paid to all other plan participants, then under the bill the individual would be considered to be "highly compensated" and would be allowed the deduction only if the employer certifies that certain discrimination standards have been met. Generally, under the bill, highly compensated individuals would be eligible to make a deductible contribution of up to $1,000 to a qualified plan, or to an IRA, if $1,000 divided by their total compensation is not more than one and one-half times the percentage of total compensation contributed by all participants who are not highly compensated.

Example: Corporation X has three employees covered by a qualified private plan. For 1980, employee A earns $40,000, employee B earns $30,000, and employee C earns $10,000. A would be eligible to make a $1,000 deductible contribution (2½ percent of A's compensation) to the plan or to an IRA, if B and C together contribute at least $667 to the plan or to IRAs ($667/($30,000+$10,000)×1½=2½ percent).

Under the bill, an individual would be entitled to a single deduction limitation for a taxable year. For example, a single $1,000 limit would apply to an individual who makes voluntary contributions of $1,000 each to separate qualified retirement plans maintained by two employers.

Employee contributions made either to an IRA or to the employer's plan generally would be treated as contributions made by the employer. However, contributions would not be treated as employer contributions for purposes of determining the employer's deduction for its own contributions to the plan or, for example, for purposes of applying the vesting and antidiscrimination rules under the Code.

Effective date

The provisions of the bill would be effective for taxable years beginning after the date of enactment.

Revenue effect

It is estimated that the provisions of the bill would reduce budget receipts by $490 million in fiscal year 1980, by $1,045 million in fiscal year 1981, by $1,170 million in fiscal year 1982, and by $1,355 million in fiscal year 1984.

2. S. 94 (Senators Bentsen and Matsunaga)

Description of provision

The bill generally would permit a married individual with little or no compensation from employment (for example, a homemaker) to make deductible contributions to an IRA if the individual's spouse has compensation.

Under the bill, in the case of such an individual, the annual limit on the deduction for an IRA contribution would be 15 percent of the greater of the compensation of the individual or the individual's spouse. The deduction could not exceed $1,500. Also, the bill would repeal the spousal IRA provisions.

Effective date

The bill would be effective for taxable years beginning after December 31, 1978.

Revenue effect

It is estimated that the provisions of the bill would reduce budget receipts by $35 million in fiscal year 1979, by $510 million in fiscal year 1980, by $620 million in fiscal year 1981, and by $1,020 million in fiscal year 1984.

3. Section 203 of S. 209 (Senators Williams and Javits)

Description of provisions

The bill (sec. 203) generally is the same as S. 75, except that (1) the highly compensated group to which the discrimination test applies would be determined based on the annual compensation paid for step 1 of GS–12 ($23,087 at this time), and (2) an employee would be allowed a deduction for a contribution to a qualified plan which provides for mandatory employee contributions only if the plan was in existence on January 1, 1978.

Effective date

The provisions of the bill (sec. 203) would be effective for taxable years beginning after the date of enactment.

Revenue effect

It is estimated that section 203 of the bill would reduce budget receipts by $480 million in fiscal year 1980, by $1,025 million in fiscal year 1981, by $1,145 million in fiscal year 1982, and by $1,330 million in fiscal year 1984.

4. S. 557 (Senator Bentsen)

Description of provision

The bill would allow an individual who is an active participant in a qualified private pension, profit-sharing, or stock bonus plan a deduction for an amount contributed by the individual to the qualified plan or to an IRA. The amount of the allowable deduction would be the lesser of 15 percent of compensation or $1,500 (the usual IRA contribution limit).

Effective date

The bill would be effective for taxable years beginning after December 31, 1978.

Revenue effect

It is estimated that the provisions of the bill would reduce budget receipts by $280 million in fiscal year 1979, by $1,505 million in fiscal year 1980 (part of which is due to the retroactive effective date), by $1,390 million in fiscal year 1981(and by $1,720 million in fiscal year 1984.

III. TREATMENT OF TAX-QUALIFIED EMPLOYEE PLANS

A. PRESENT LAW AND PROBLEMS

Present law

Under present law, employers are allowed a deduction, within limits, for contributions made to tax-qualified employee plans. Generally, benefits provided by a qualified plan are not taxed to employees or their beneficiaries until the benefits are distributed or made available. Under present law, generally, a distribution from a qualified retirement plan is eligible for tax-free rollover treatment or for other favorable income tax treatment (i.e., 10-year averaging and capital gains treatment) only if the balance to the credit of an employee is paid within one taxable year. In addition, the distribution must generally be made (1) on account of the employee's death, or (2) on account of the employee's separation from service. If any employer maintains more than one qualified plan, plans of the same type (i.e., pension, profit-sharing or stock bonus), are treated as a single plan for the purpose of determining whether the balance to the credit of an employee is paid within one taxable year.

Problems

If an employee is covered by two or more tax-qualified plans of the same type and the plans are maintained by the same employer, a total distribution from one of the plans will not be eligible for tax-free rollover treatment or other special tax treatment if the other plan (or plans) does not make a total distribution in the same taxable year. For example, where an employee is covered by two multiemployer plans, a pension plan, and a money purchase pension plan,[1] a total distribution from the money purchases pension plan would not be eligible for rollover treatment or for favorable income tax treatment as a result of the Code provision which aggregates qualified plans of the same type for the purpose of determining whether a distribution is eligible for rollover treatment or for favorable income tax treatment.

Under a multiemployer plan, an employee's benefit is based upon service with any of the employers who maintain the plan. Consequently, where an employee has separated from the service of one of the employers and, as of a particular time, the employee has not become employed by another of the employers who maintains the plan, it may be difficult to determine whether the employee has separated from service for purposes of the rules providing for tax-free rollovers or other favorable income tax treatment.

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[1] Generally, a plan under which an employer contributes a specified percentage of compensation to an account maintained for an employee.

Shortly after the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), the number of new plans adopted decreased substantially and the number of plan terminations increased. Although recent statistics indicate that this trend may have been reversed, only about 50 percent of the private sector, non-agricultural work force is covered under private qualified retirement plans. Some believe that additional tax incentives should be provided to small employers to encourage plan formation.

B. DESCRIPTION OF THE BILL

S. 209 (SENATORS WILLIAMS AND JAVITS)[1]

Description of provisions

Section 201

The bill (sec. 201) would change the aggregation of plans rule with respect to multiemployer plans. For the purpose of determining whether the balance to the credit of an employee has been distributed from a multiemployer plan, and thus may be eligible for rollover treatment or for other favorable income tax treatment, all multiemployer defined-benefit plans [2] of the employer would be treated as a single plan, and all multiemployer defined contribution plans [3] maintained by the employer would be treated as a single plan.

Section 202

Under section 202 of the bill, an employee who receives a distribution from a multiemployer plan, which would otherwise qualify for rollover treatment or for other special income tax treatment, would meet the requirement that the distribution must be made on account of separation from service if such employee has not worked in service covered by the multiemployer plan for a period of 6 months after severing his employment relationship with any employer maintaining the plan.

Section 204

Under section 204 of the bill, a small business employer who contributes to a qualified plan would be allowed a tax credit for certain taxable years based on the amount of the employer's deductible contribution. A credit of 5 percent of the deductible contribution would be allowed for the first taxable year for which the employer is allowed a deduction for a contribution to the plan. The available credit would be reduced to 3 percent of the deductible contribution made for each of the next two taxable years and 1 percent of the deductible contribution made for each of the two taxable years thereafter.

In determining the amount of the credit, a deduction attributable to a contribution of certain employer securities would be disregarded. Also, no credit would be allowable for a taxable year to an employer who terminates a qualified plan during the year. A small business

[1] Sections 201, 202, and 204.

[2] A defined benefit plan provides a fixed or determinable benefit for each participant.

[3] A defined contribution plan (e.g., a money purchase pension plan) provides that an employee's benefit is the employee's account balance.

employer would be defined as one having a monthly average of fewer than 100 employees during the taxable year preceding the taxable year in which the credit is first claimed. In addition, if the employer is a corporation, its earnings and profits for the taxable year immediately preceding the taxable year in which the credit is first claimed could not exceed \$50,000. In the case of a partnership or unincorporated trade or business, the net profits of the employer for the taxable year immediately preceding the taxable year in which the credit is first claimed could not exceed \$50,000.

Effective date

Sections 201 and 204 of the bill would be effective for taxable years beginning after the date of enactment. Section 202 of the bill would be effective for plan years beginning after the date of enactment.

Revenue effect

It is estimated that section 201 of the bill would reduce budget receipts by less than $5 million annually.

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It is estimated that section 204 of the bill would reduce budget receipts by $5 million in fiscal year 1980, by $25 million in fiscal year 1981, by $50 million in fiscal year 1982, and by $90 million in fiscal year 1984.

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