

DESCRIPTION OF S. 1364
(EMPLOYEE BENEFITS SIMPLIFICATION AND EXPANSION ACT OF 1991)
AND PROPOSED MODIFICATIONS

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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a brief description of the provisions of S. 1364 ("Employee Benefits Simplification and Expansion Act of 1991") and proposed modifications. These provisions are scheduled for markup by the Senate Committee on Finance on March 3, 1992.

¹ This document may be cited as follows: Joint Committee on Taxation, Description of S. 1364 (Employee Benefits Simplification and Expansion Act of 1991) and Proposed Modifications (JCX-5-92), March 3, 1992.

DESCRIPTION OF S. 1364 AND PROPOSED MODIFICATIONS
(Employee Benefits Simplification and Expansion Act of 1991)

A. Nondiscrimination Provisions

1. Definition of highly compensated employee (sec. 101 of the bill)

Description of Bill

The bill provides that an employee is highly compensated if (1) at any time during the preceding year, the employee was a 5-percent owner; or (2) during the current year, the employee is (i) a 5-percent owner or (ii) earns more than \$50,000 (indexed; \$62,345 in 1992). If no employee is treated as highly compensated under this rule, the highest paid officer is treated as highly compensated except (1) for purposes of applying the nondiscrimination requirements applicable to qualified cash or deferred arrangements (sec. 401(k)) and employer matching and after-tax employee contributions (sec. 401(m)), and (2) for plans maintained by State and local governments and tax-exempt organizations.

The bill modifies the family aggregation rules to provide that if an employee is a family member of a 5-percent owner, the employee and the family member are treated as one highly compensated employee.

Effective date.--Years beginning after December 31, 1992. An employer may elect not to have the amendments made by this provision apply to years beginning in 1993.²

Proposed Modifications

Clarify that the determination of whether an employee earns in excess of \$50,000 (indexed) would be made based on the preceding, rather than the current, year's compensation. Similarly, the applicable dollar limit for determining if an employee is highly compensated is the prior year's limit.

Repeal the present-law rule that provides that certain family members are aggregated and treated as a single highly compensated employee.

² In the description of the bill, all effective dates that were originally years beginning after December 31, 1991, have been changed to years beginning after December 31, 1992, except as otherwise indicated.

2. Cost-of-living adjustments (sec. 102 of the bill)

Description of Bill

The bill provides that the adjustments with respect to a year are based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding year. Thus, adjusted dollar limits will be published before the beginning of the year to which they apply. Also, dollar limits are generally rounded to the nearest \$1,000, except that the limits that relate to elective deferrals and elective contributions to a simplified employee pension plan (SEP) are rounded to the nearest \$100.

Effective date.--Years beginning after December 31, 1992.

3. Election to treat base pay as compensation (sec. 103 of the bill)

Description of Bill

The bill provides that an employer may elect to define compensation as an employee's base pay. This election must apply to all employees of the employer, and may be revoked only with permission of the Secretary.

Effective date.--Years beginning after December 31, 1992.

4. Modification of additional participation requirements (sec. 104 of the bill)

Description of Bill

The bill provides that the minimum participation rule applies only to defined benefit plans (not defined contribution plans). Under the bill, a plan is not a qualified plan unless the plan, on each day of the plan year, benefits no fewer than the lesser of 25 employees or 40 percent of all employees of the employer. However, a plan maintained by an employer with only 2 employees must cover both.

Effective date.--Years beginning after December 31, 1991. An employer may elect to apply the provision modifying the minimum participation rule as if included in the Tax Reform Act of 1986.

Proposed Modification

Adopt provision of the bill, but also provide that, for purposes of the rule that permits the minimum participation requirement to be satisfied separately with respect to each line of business of an employer, an employer could demonstrate that a separate line of business exists even if that line of business employs less than 50 employees.

5. Nondiscrimination rules relating to qualified cash or deferred arrangements, matching contributions, and after-tax employee contributions (sec. 105 of the bill)

Description of Bill

a. Qualified cash or deferred arrangements

The bill adds an alternative safe harbor method of satisfying the special nondiscrimination test for qualified cash or deferred arrangements. Under the bill, the nondiscrimination test is deemed to be satisfied if the employer either (1) makes a matching contribution on behalf of each nonhighly compensated employee of at least (a) 100 percent of the employee's elective contributions up to 3 percent of compensation and (b) 50 percent of the employee's elective contributions up to 6 percent of compensation, or (2) makes a nonelective contribution to a defined contribution plan of at least 3 percent of each nonhighly compensated employee's compensation, without regard to whether the employee elects to contribute to the cash or deferred arrangement.

The matching contributions and the nonelective contributions must be 100-percent vested. In addition, the employer is required to notify employees of the employees' rights and obligations under the arrangement.

The bill also modifies the method of determining excess contributions under the present-law nondiscrimination test. Under the bill, excess contributions are allocated among highly compensated employees beginning with the employees with the highest dollar amount of contributions.

b. Employer matching contributions

Under the bill, the special nondiscrimination test for employer matching contributions (but not for after-tax employee contributions) is deemed satisfied if (1) the plan meets the nonelective contribution or matching contribution requirements applicable to the cash or deferred arrangement safe harbor, (2) employees are notified of the plan, and (3) matching contributions are not made with respect to employee

contributions of elective deferrals in excess of 6 percent of compensation.

Effective date.--Plan years beginning after December 31, 1992.

Proposed Modification

Adopt provision of the bill, but also provide that, in applying the present-law nondiscrimination test, the amount that highly compensated employees can defer in a year is based on the previous year's average deferral percentage (ADP) for nonhighly compensated employees. A special rule would apply in the first year a cash or deferred arrangement is maintained. A corresponding change would be made to the nondiscrimination test applicable to employer matching and after-tax employee contributions.

B. Distributions

1. Rollovers of qualified plan distributions (sec. 201 of the bill)

Description of Bill

The bill allows an employee or surviving spouse to roll over any portion of a qualified plan distribution, other than (1) a minimum required distribution or (2) a distribution attributable to after-tax employee contributions. If any portion of a lump-sum distribution is rolled over, averaging is not available with respect to the rest of the distribution.

Effective date.--Distributions after December 31, 1991.

Proposed Modification

Modify the bill to provide that an employee or surviving spouse of an employee would be permitted to roll over any portion of a qualified plan distribution received, other than a distribution that is (1) a minimum required distribution, (2) attributable to after-tax employee contributions, or (3) part of a stream of periodic payments payable over a period of 10 years or more, or over the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and his or her beneficiary.

Effective date.--Distributions after date of enactment.

2. Rules relating to lump-sum distributions (sec. 201 of the bill)

Description of Bill

Income averaging

The bill repeals 5-year forward income averaging for lump-sum distributions. The bill retains the special grandfather rules under the Tax Reform Act of 1986 for individuals who had attained age 50 by January 1, 1986.

Excise tax on excess distributions

The bill technically repeals the special higher ceiling (i.e., \$750,000) applicable to lump-sum distributions for purposes of determining whether an individual receives excess distributions during any calendar year.

Effective date.--Distributions after December 31, 1992.

Proposed Modifications

Excise tax on excess distributions

Provide that a taxpayer may elect to determine whether he or she receives excess distributions during any calendar year by applying the special higher ceiling (i.e., \$750,000 in 1992) that applies to lump-sum distributions under present law. Not more than one such election may be made with respect to any taxpayer. A taxpayer that has applied the \$750,000 limit under present law may not elect to have this provision apply. The provision would be effective for distributions after December 31, 1992.

\$5,000 death benefit exclusion

Repeal the exclusion from gross income of up to \$5,000 of employer-provided death benefits effective for distributions after December 31, 1992.

Recovery of basis

Provide that the portion of an annuity distribution from a qualified retirement plan that represents nontaxable return of basis generally is determined under a method similar to the present-law simplified alternative method provided by the Internal Revenue Service (IRS Notice 88-118). However, the simplified method would not apply if the primary annuitant has attained age 75 on the annuity starting date unless there are at least 5 years of guaranteed payments under the annuity. The provision would be effective for annuity starting dates after December 31, 1992.

3. Trustee-to-trustee transfers (sec. 202 of the bill)

Description of Bill

The bill generally requires that distributions in excess of \$500 be transferred directly to an IRA or to a qualified defined contribution plan that provides for the acceptance of the transfer. Annuity distributions, distributions after age 55, distributions on account of the death of the employee (other than distributions to the surviving spouse), and hardship distributions are not subject to the transfer requirement.

Effective date.--Distributions in plan years beginning after December 31, 1993.³

³ This provision of the bill was originally effective for distributions in plan years beginning after December 31, 1992.

4. Minimum required distributions (sec. 203 of the bill)

Description of Bill

The bill provides that, except in the case of 5-percent owners of an employer and IRA owners, distributions are required to begin by the April 1 of the calendar year following the later of the calendar year in which (1) the employee attains age 70-1/2⁴ or (2) the employee retires. As under present law, distributions to 5-percent owners and IRA owners are required to begin by the April 1 following the year in which the individual attains age 70-1/2.

The benefits of participants who continue to work for an employer after attaining age 70-1/2 are required to be actuarially increased to take into account the period after age 70-1/2 during which the employee receives no benefits under the plan.

Effective date.--Years beginning after December 31, 1992.

⁴ Age 70-1/2 would be changed to age 70 under another provision of the bill, described below.

C. Miscellaneous Provisions

1. Modification to definition of leased employee (sec. 301 of the bill)

Description of Bill

The bill replaces the "historically performed" test with a new rule defining who must be considered a leased employee. Under the bill, an individual is not considered a leased employee unless the services are performed under the control of the service recipient.

Effective date.--Years beginning after December 31, 1983.

Proposed Modification

Clarify that the provision is not intended to expand the scope of the leased employee rule.

2. Half-year requirements (sec. 302 of the bill)

Description of Bill

The bill changes age 70-1/2 to age 70, and age 59-1/2 to age 59 for purposes of the qualified plan rules.

Effective date.--Years beginning after December 31, 1992.

3. Plans for self-employed individuals (sec. 303 of the bill)

Description of Bill

The bill eliminates the special aggregation rule for plans maintained by self-employed individuals.

Effective date.--Years beginning after December 31, 1992.

4. Full-funding limitation of multiemployer plans (sec. 304 of the bill)

Description of Bill

The bill provides that multiemployer plans are not subject to the 150 percent of current liability full funding limitation and that an actuarial valuation need only be performed every 3 years in the case of a multiemployer plan.

Effective date.--Years beginning after December 31, 1991.

Proposed Modification

Modify the multiemployer full funding limit in the Internal Revenue Code.

5. Affiliation requirements for employers jointly maintaining a voluntary employees' beneficiary association (VEBAs) (sec. 305 of the bill)

Description of Bill

The bill provides that employers are affiliated for purposes of the VEBA requirements under the regulations if (1) the employers are in the same line of business, (2) the employers act jointly to perform tasks that are integral to the activities of each of the employers, and (3) these joint activities are sufficiently extensive that maintenance of a common VEBA is not a major part of such joint activity. This clarification of present law applies retroactively.

Effective date.--Years beginning before, on, or after the date of enactment.

Proposed Modification

In addition to the requirements that must be satisfied under the bill, add the requirement that a substantial number of the employers who contribute to the VEBA are exempt from tax under the Internal Revenue Code.

Effective date.--Clarify that the provision is intended to be a clarification of present law.

6. Treatment of governmental plans (sec. 306 of the bill)

Description of Bill

The bill makes a number of modifications to the limits on contributions and benefits as applied to plans maintained by State and local governments. The bill exempts participants of State and local government defined benefit plans from the 100 percent of high 3-year average compensation limitation. Also, benefits provided under a "qualified excess benefit arrangement" (which is treated as a nonqualified deferred compensation plan for tax purposes) are not taken into account for purposes of applying the limits on contributions and benefits. Survivor and disability benefits provided under State and local government plans are also exempt from the limits on contributions and benefits.

The bill also provides that the compensation of participants in such plans includes, in addition to the usual amounts, amounts contributed pursuant to a salary reduction agreement that are not includible in the participant's income.

Under the bill, governmental plans are treated as satisfying the limits on contributions and benefits for all taxable years beginning before the date of enactment.

Effective date.--Taxable years beginning after date of enactment.

7. **Simplified employee pensions (SEPs) (sec. 307 of the bill)**

Description of Bill

a. Salary reduction SEPs

The bill provides that employers with 100 or fewer employees may maintain salary reduction SEPs and repeals the 50-percent participation requirement for such SEPs. The bill also provides that the safe harbors available to qualified cash or deferred arrangements under the bill apply to salary reduction SEPs if employees are notified of the provisions of the SEP.

b. Eligibility requirements

The bill replaces the 3-out-of-5 years service requirement under present law with a requirement that employees who have at least 1 year of service must be eligible to participate.

Effective date.--Years beginning after December 31, 1992.

8. **Contributions on behalf of disabled employees (sec. 308 of the bill)**

Description of Bill

Under present law, an employer may elect to continue making contributions on behalf of employees other than highly compensated employees who become disabled. The bill extends present-law treatment to disabled highly compensated employees if continuing contributions to the plan are available to all disabled participants. The employer need not make an election to have the special rule apply.

Effective date.--Years beginning after December 31, 1992.

9. In-service distributions from rural cooperative plans
(sec. 309 of the bill)

Description of Bill

The bill conforms the rules for distributions from cash or deferred arrangements maintained by rural cooperatives to the rules applicable to other cash or deferred arrangements by permitting distributions after the attainment of age 59-1/2.⁵

Effective date.--Effective as if included in section 1011(k)(9) of the Technical and Miscellaneous Revenue Act of 1988.

10. Reports of pension and annuity payments (sec. 310 of the bill)⁶

Description of Bill

The bill incorporates into the general penalty structure the penalties for failure to provide information reports to the IRS and to participants relating to pension payments. Generally, the penalty is \$50 for each return with respect to which a failure occurs, up to a maximum of \$250,000 per year. The bill does not require reports of pension and annuity payments of less than \$10.

Effective date.--Returns and statements required to be filed after December 31, 1992.

11. Repeal of limitation on ability of tax-exempt employers to maintain cash or deferred arrangements (sec. 311 of the bill)

Description of Bill

The bill permits nongovernmental tax-exempt organizations to maintain qualified cash or deferred arrangements.

Effective date.--Years beginning after December 31, 1989.

⁵ Age 59-1/2 would be changed to age 59 under another provision of the bill, described above.

⁶ This provision is also included in section 702 of S. 1394, the Tax Simplification Act of 1991.

Proposed Modification

Effective date.--Years beginning after December 31, 1992.

12. Date for adoption of plan amendments (sec. 312 of the bill)

Description of Bill

The bill provides that if any provision of the bill requires a plan amendment, the amendment is not required to be made before the first plan year beginning on or after January 1, 1993, if (1) during the period after the provision takes effect, the plan is operated in accordance with the requirements of the provision, and (2) the plan amendment applies retroactively to the provision's effective date.

Effective date.--Date of enactment.

D. Additional Provisions

1. Alternative full funding limitation

Description of Bill

No provision.

Proposed Modification

Provide that an employer may elect to disregard the 150 percent of current liability full funding limitation if each plan in the employer's controlled group is not top heavy and the average accrued liability of active participants is at least 80 percent of the plan's total accrued liability (the "alternative full funding limitation"). The Secretary would be required to adjust the 150 percent of current liability full funding limitation (but not below 140 percent) for employers that do not use the alternative full funding limit to ensure that the election by employers to disregard the 150-percent limit does not result in a substantial reduction in Federal revenues for any fiscal year.

Effective date.--Date of enactment.

2. Duties of master and prototype plan sponsors

Description of Bill

No provision.

Proposed Modification

Authorize the IRS to define the duties of organizations that sponsor master and prototype, regional prototype, and other preapproved plans. Also provide that the Secretary could relax the rules prohibiting cutbacks in accrued benefits when an employer replaces an individually designed plan with a preapproved plan.

Effective date.--January 1, 1993.

3. Disaggregation of union plans

Description of Bill

No provision.

Proposed Modification

Provide that employers may elect to take employees covered by a collective bargaining agreement into account in applying the coverage tests to a nonunion plan (sec. 410(6)),

in applying the general nondiscrimination rule to a nonunion plan (sec. 401(a)(4)), and in determining separate lines of business (sec. 414(a)) if the union employees benefit under the same plan on the same terms.

Effective date.--Years beginning after December 31, 1992.

4. Uniform retirement age

Description of Bill

No provision.

Proposed Modification

Provide that, for purposes of the general nondiscrimination rule (sec. 401(a)(4)), the social security retirement age (as defined under sec. 415(b)(8)) is treated as a uniform retirement age, and that subsidized early retirement benefits and joint and survivor annuities that are based on social security retirement age are treated as being available on the same terms.

Effective date.--Years beginning after December 31, 1992.

5. Use of excess assets of black lung benefit trusts for retire health care benefits

Description of Bill

No provision.

Proposed Modification

Allow excess assets in qualified black lung benefit trusts to be used to pay accident and health benefits or premiums for insurance for such benefits (including administrative and other incidental expenses relating to such benefits) for retired coal miners and their spouses and dependents. The amount of assets available for such purpose would be subject to a yearly limit as well as an aggregate limit. The yearly limit would be the amount of assets in excess of 110 percent of the present value of the liability for black lung benefits determined as of the close of the preceding taxable year of the trust. The aggregate limit would be the amount of assets in excess of 110 percent of the present value of the liability for black lung benefits determined as of the close of the taxable year of the trust ending prior to the effective date, plus earnings thereon. Each of these determinations would be required to be made by an independent actuary.

The amounts used to pay retiree accident or health benefits would not be includible in the income of the company, nor would a deduction be allowed for such amounts.

Effective date.--Taxable years beginning after December 31, 1991.

6. Special coverage rule for airline pilots

Description of Bill

No provision.

Proposed Modification

Extend the present-law treatment of plans maintained for union pilots to plans maintained for nonunion pilots who are employed by one or more common carriers or by carriers transporting mail for, or under contract with, the United States Government.

Effective date.--Years beginning after December 31, 1992.

7. Establish commission on retirement income policy

Description of Bill

No provision.

Proposed Modification

Establish a commission to study national retirement income policy. The commission would be directed to submit a report to the Congress by Labor Day 1994, the 20th anniversary of the enactment of the Employee Retirement Income Security Act of 1974.