DESCRIPTION OF TAX BILLS

(S. 2232, S. 2860, and S. 2918)

Relating to

CERTAIN PENSION PLAN PROVISIONS

Scheduled for a Hearing

on

September 27, 1982

Before the

Subcommittee on Savings, Pensions, and Investment Policy

of the

Senate Committee on Finance

Prepared by the Staff

of the

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CONTENTS

INTRODUCTION

This document provides a description of the three tax bills scheduled for a hearing on September 27, 1982, before the Senate Finance Subcommittee on Savings, Pensions, and Investment Policy. The three bills are: (1) S. 2232 (introduced by Senator Helms), relating to exclusion from gross income of qualified plan distributions that were made within two taxable years and rolled over into an individual retirement account (relief of John W. Pope); (2) S. 2860 (introduced by Senators Danforth and Chafee), relating to the effective date of the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980; and (3) S. 2918 (introduced by Senator Chafee and others), relating to amendment of the Code provisions to permit more investments by employee benefit plans in residential mortgages.

The first part of the document is a summary of the bills. This is followed in the second part with a more detailed description of the bills, including present law, issues, effective dates, and revenue effects.

I. SUMMARY

1. S. 2232--Senator Helms

Qualifying Rollover Contributions

If a lump sum distribution is paid to an employee under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over within 60 days to another qualified plan or to an IRA (an individual retirement account, annuity or bond).

A distribution to an employee from a qualified plan is not a lump sum distribution unless (1) the distribution consists of the balance to the credit of the employee under the plan, and (2) the distribution is made within one taxable year of the recipient.

The bill provides special relief for certain pension plan distributions received by Mr. John W. Pope during 1976 and 1977 and transferred by him to an individual retirement account.

Under the bill, the transfers would be treated as a tax-free rollover.

2. S. 2860--Senators Danforth and Chafee

Liability of Employers Withdrawing from Multiemployer Pension Plans

Prior to the enactment of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), an employer's obligation to contribute to a multiemployer pension plan generally ended when the employer withdrew from the plan, unless, within 5 years after the withdrawal, the plan terminated with insufficient assets to provide benefits at the level guaranteed by the Pension Benefit Guaranty Corporation (PBGC).

Under MPPAA, an employer who withdraws from a multiemployer pension plan generally is liable for a portion of the plan's unfunded obligations determined at the time of the withdrawal. Although the provisions of MPPAA generally became effective on September 26, 1980, the date of enactment, the withdrawal liability provisions were made effective retroactively to withdrawals which occurred on or after April 29, 1980.

The bill provides that withdrawal liability will be imposed only with respect to withdrawals occurring on or after September 26, 1980.

3. S. 2918--Senators Chafee, Bentsen, Wallop, Mitchell, Danforth, Boren, Grassley, Matsunaga, Symms, Baucus, Durenberger, and others

Investments in Residential Home Mortages by Employee Benefit Plans

The self-dealing rules under both the Internal Revenue Code and the non-Code provisions of the Employee Retirement Income Security Act of 1974 prohibit certain transactions between an employee benefit plan and certain related persons (a party in interest or a disqualified person). Also, they prohibit use of plan assets or income for the benefit of a related person. However, present law permits a plan to make mortgage commitments and loans on residential dwellings, which might otherwise constitute a prohibited transaction, if certain conditions are met. Included among the conditions is the requirement that the decision to issue the mortgage be made by an independent real estate manager. In addition, financing must be provided through an established mortgage lender which is independent of the plan and is engaged in making or purchasing mortgage investments in the normal course of business. The lender must also have approval to participate in Federal or State residential mortgage programs.

Although present law exempts such residential mortgage loans from the prohibited transaction rules, such loans must be consistent with ERISA's prudent man standard for plan investments as well as the Act's other fiduciary standards.

The bill would exempt qualified mortgage transactions from the prohibited transaction rules if the transaction is in accordance with customary practices in the residential mortgage industry.

The bill's provisions also would supersede any State laws relating to qualified mortgage transactions engaged in by employee benefit plans.

II. DESCRIPTION OF BILLS

1. S. 2232--Senator Helms

Qualified Rollover Contributions

Present law

If a lump sum distribution is paid to an employee (or the spouse of a deceased employee) under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over, within 60 days, to another qualified plan or to an IRA (an individual retirement account, annuity, or bond).

A distribution from a qualified plan is not a lump sum distribution unless it consists of the balance to the credit of the employee under the plan, and is made within one taxable year of the recipient.

Issue

The issue is whether a distribution made to Mr. John W. Pope, consisting of payments made in December 1976, and January 1977, which is not a lump sum distribution because it was not paid within one taxable year, should be eligible for tax-free rollover treatment.

Explanation of the bill

The bill provides special relief for certain pension plan distributions received by Mr. John W. Pope from the Variety Wholesalers, Inc., pension plan during 1976 and 1977. Mr. Pope transferred amounts recovered from the plan to an IRA. Under the bill, the transfers would be treated as qualifying rollover contributions. Thus, to the extent the payments were, in fact, rolled over to an IRA within 60 days of receipt, the distribution will not be includible in Mr. Pope's income.

In addition, the bill provides an extension of the usual period of limitation for filing a claim for credit or refund of taxes paid (generally, three years after the later of (1) the date prescribed for filing the tax return, or (2) the date the return was actually filed). Under the bill, the statutory period of limitation is extended to permit Mr. Pope to file a claim for credit or refund attributable to changes made by the bill within one year of the date of enactment.

Effective date

The bill is effective upon enactment.

Revenue effect

It is expected that the bill would have a negligible impact on revenues.

2. S. 2860--Senators Danforth and Chafee

Liability of Employees Withdrawing from Multiemployer Pension Plans

Present law

The liability of an employer who withdraws from a multiemployer pension plan for a portion of the plan's unfunded pension obligations is determined pursuant to title IV of the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, prior to its amendment by the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), an employer's liability generally ended when the employer withdrew from the plan unless, within 5 years after the withdrawal, the plan terminated with insufficient assets to provide benefits at the level guaranteed by the Pension Benefit Guaranty Corporation (PBGC). In the event of such a termination, each employer who maintained the plan during the 5-year period preceding the termination was potentially liable to the PBGC for a share of the insufficiency. An employer's liability generally was limited, however, to 30 percent of its net worth.

MPPAA amended ERISA to provide that an employer who totally or partially withdraws from a multiemployer pension plan generally is liable for a portion of the plan's unfunded obligations determined at the time of the withdrawal (computed under one of several alternative specified methods). Employers in the building and construction or entertainment industries are relieved of withdrawal liability if certain requirements are met. A *de minimis* exception is provided for relatively small liabilities.

Although the provisions of MPPAA generally became effective on September 26, 1980, the date of enactment, the withdrawal liability provisions were made effective for withdrawals which occurred after April 28, 1980 (the date of Senate Finance Committee markup on a bill extending prior law).

Issue

The issue is whether withdrawal liability should be imposed on employers who withdrew from a multiemployer plan after April 28, 1980, but before September 26, 1980.

Explanation of the bill

The bill provides that withdrawal liability would be imposed under the provisions added by MPPAA only with respect to an employer's withdrawal from a multiemployer plan occurring after September 25, 1980. Liability for withdrawals occurring before

September 26, 1980, would be determined pursuant to the 5-year rule originally provided by ERISA. Thus, for an employer who withdraws before September 26, 1980, liability generally would be imposed only if the plan terminates before the earlier of April 29, 1985, or the expiration of 5 years after the date of the withdrawal, with insufficient assets.

In addition, the bill provides that (1) any liability previously imposed under MPPAA with respect to withdrawals occurring after April 28, 1980, but before September 26, 1980, would be voided, and (2) any amounts paid by an employer to a plan sponsor as a result of the imposition of such liability with respect to a withdrawal occurring prior to September 26, 1980, would be refunded (not of reasonable administrative expenses).

Effective date

The bill would be effective upon enactment.

Revenue effect

It is expected that the bill would have a negligible impact on revenues.

3. S. 2918.--Senators Chafee, Bentsen, Wallop, Mitchell, Danforth, Boren, Grassley, Matsunaga, Symms, Baucus, Durenberger, and others

Investments in Residential Home Mortgages by Employee Benefit Plans

Present law

Prohibited transactions

Standards relating to acts of self-dealing with respect to employee benefit plans are provided in both Internal Revenue Code provisions added or amended by the Employee Retirement Income Security Act of 1974 (ERISA) and in the non-Code provisions of ERISA. Under ERISA's non-Code provisions, a fiduciary with respect to an employee benefit plan may not cause the plan to engage in a prohibited transaction with a party in interest (ERISA sec. 406(a)). A prohibited transaction includes any direct or indirect (1) sale or exchange, or leasing of property, between a plan and a party in interest; (2) lending of money or other extension of credit between the plan and a party in interest; (3) furnishing of goods, services, or facilities between the plan and a party in interest; or (4) transfer to, or use by or for the benefit of, a party in interest of any assets of the plan. Parties in interest include, among others, persons providing services to the plan and employees of employers maintaining the plan.

Under the Code provisions of ERISA, an excise tax is imposed on a prohibited transaction involving a disqualified person (Code sec. 4975). Parties in interest generally are also disqualified persons, except that an employee of an employer maintaining a tax-qualified plan generally is a disqualified person only if the employee is an officer, director, highly compensated, or owns a 10-percent interest in the employer.

Both the Code and non-Code provisions of ERISA include an exemption to the prohibited transaction rules under which a plan generally is permitted to make a loan to a plan participant if certain requirements are met. Generally, the loan must bear a reasonable rate of interest, be adequately secured, provide a reasonable repayment schedule, and be made available on a basis which does not discriminate in favor of employees who are officers, shareholders, or highly compensated (ERISA sec. 408(b) and Code sec. 4975(d)).

Prohibited transaction exemption 82-87

The Code and non-Code provisions of ERISA also provide for the granting of other exemptions from the prohibited transaction rules (ERISA sec. 408(a) and Code sec. 4975(d)). Authority to promulgate such exemptions generally is assigned to the Secretary of Labor.

On May 18, 1982, the Secretary of Labor promulgated a prohibited transaction exemption (PTE 82-87) which permits an employee benefit plan to make mortgage commitments and loans on residential dwellings without being deemed to have entered into a prohibited transaction. The exemption applies to (1) the issuance of a commitment by a plan to provide mortgage financing to purchasers of residential dwelling units, either by making or participating in loans made directly to purchasers or by purchasing mortgage loans or participation interests in mortgage loans originated by a third party; (2) the receipt by the plan of a fee in exchange for issuing the commitment; (3) the actual making or purchase of a mortgage loan or participation interest pursuant to a commitment; (4) the direct making or purchase by one or more employee benefit plans of a mortgage loan or a participation interest other than where a commitment has been issued; and (5) if certain requirements are met, the sale, exchange or transfer of a mortgage loan or participation interest by a plan prior to the maturity date of the instrument whether or not acquired pursuant to the exemption.

Included among the conditions set forth in PTE 82-87 is the requirement that a decision to issue a mortgage commitment be made on behalf of the plan by a qualified real estate manager which is independent of the plan. In addition, the financing for residential dwelling units to be purchased must be provided through an established mortgage lender. The lender must be independent of the plan and be engaged in making or purchasing mortgage investments in the normal course of business. The lender must also (1) have approval from the Department of Housing and Urban Development (HUD) to participate in mortgage insurance programs under the National Housing Act; (2) have been approved to act as a seller/servicer for programs sponsored by the Federal Home Loan Mortgage Corporation (FHLMC) or Federal National Mortgage Association (FNMA); or (3) by a State housing agency or independent State authority.

Loan transactions eligible for relief under the exemption are mortgage loans on residential dwellings of one to four units which, at origination, were eligible for purchase through an established program by the FHLMC, FNMA, or Government National Mortgage Association (GNMA). The terms of any loan or commitment must be at arm's length, that is, at least as favorable to the plan as would be the terms of similar agreements between unrelated parties.

PTE 82-87 provides limited relief from ERISA's Code and non-Code prohibited transaction provisions. The exemption requires that decisions regarding plan investments (including investments in residential mortgages) must be made by appropriate plan fiduciaries, and must be consistent with the requirement that the plan be for the exclusive benefit of employees and their beneficiaries, the prudence rules governing plan investments, and ERISA's other fiduciary standards.

Issue

The issue is whether certain mortgage transactions between an employee benefit plan and a party-in-interest (or a disqualified person) shouldbe exempted from ERISA's prohibited transactions of ERISA.

Explanation of the bill

The bill would exempt qualified mortgage transactions from the prohibited transaction standards of ERISA. Qualified mortgage transactions generally include those transactions described in PTE 82-87. However, the bill would also exempt from the prohibited transaction rules (1) the servicing of a residential mortgage loan (or a participation interest therein) by an employee benefit plan, including (but not limited to) collecting mortgage payments, assuring that taxes and insurance premiums for the residential dwelling units are paid, and making decisions relating to, and handling, foreclosures; (2) the purchase or sale, or commitment to purchase or sell an interest in a pool consisting solely of residential mortgage loans, but only if conducted in accordance with the practices customary in the residential mortgage industry; (3) the formation and operation by one or more employee benefit plans of a pool or pools of residential mortgage loans; or (4) the purchase or sale, or commitment to purchase or sell a mortgage-backed security.

For purposes of the bill, a residential mortgage pool is an aggregation of funds or residential mortgage loans aggregated for the purpose of investment by one or more employee benefit plans, pursuant to terms and conditions customary in the residential mortgage industry. A mortgage-backed security is defined in the bill as a certificate representina a fractional undivided interest in a mortgage pool, or a participation in a mortgage pool, which is held in trust and is secured by mortgages or deeds of trust on residential property, including undistributed cash and property which had secured such obligations and has been acquired by foreclosure.

Under the bill, a qualified mortgage transaction is exempted from ERISA's prohibited transaction provisions if the transaction is at arm's length. For this purpose, arm's length means in accordance with customary practices in the residential mortgage industry.

The bill's exemption for residential mortgage loans includes mortgages on structures consisting of two or more residential dwelling units.

The bill's provisions would supersede any State laws relating to qualified mortgage transactions engaged in by employee benefit plans.

Effective date

The bill would take effect upon enactment.

Revenue effect

The bill would be expected to have a negligible impact on revenue.