[JOINT COMMITTEE PRINT]

DESCRIPTION OF BILLS RELATING TO ECONOMIC EQUALITY IN VARIOUS TAX, PENSION, AND RELATED FEDERAL LAWS

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

ON OCTOBER 25-26, 1983

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The bills described in this pamphlet have been scheduled for public hearings before the House Committee on Ways and Means on October 25–26, 1983. The bills relate to the issue of economic equality in various tax, pension, and related Federal laws.

The bills cover such issues as individual retirement accounts (IRAs), periods of employee service taken into account under pension plans, survivor benefits under pension plans, assignment of pension benefits, targeted jobs credit for displaced homemakers, increase in the zero bracket amount for heads of households, child and dependent care credit, and the earned income credit.

The first part of the pamphlet is a summary of the bills, arranged by topic. (The bill sponsors are noted in the summary.) The second part is a more detailed description of the bills, again arranged by topic.

I. SUMMARY

1. Individual Retirement Accounts

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2099—Ms. Ferraro, and Messrs. Guarini, Frenzel, and Others

H.R. 2468—Mr. Bereuter, Messrs. Duncan and Frenzel, Mrs. Kennelly, Mr. Jacobs, and Others

H.R. 2595— Mr. Drier and Others

H.R. 2772—Mrs. Kennelly, Messrs. Matsui and Duncan, and Others

H.R. 2984—Mr. Lujan and Others

H.R. 3266—Mr. Corcoran and Others

H.R. 3307—Mr. Sensenbrenner and Others

H.R. 3309—Messrs. Thomas, Moore, Duncan, Martin, and Others

H.R. 3333—Mr. Daub

H.R. 3554—Mr. Lewis and Others

Present law

Under present law, an individual generally is entitled to deduct from gross income the amount contributed to an individual retirement account or annuity (an IRA), within limits. Generally, the deduction for a year may not exceed the lesser of $2,000 or 100 percent of the individual's compensation.

If deductible contributions are made (1) to an individual's IRA and (2) to an IRA for the noncompensated spouse of the individual, then the annual deduction limit on the couple's joint return is increased to $2,250 (or 100 percent of compensation includible in gross income, if less), but no more than $2,000 may be deducted for a contribution to the IRA of either spouse. Under present law, in certain cases, alimony received by a divorced spouse can be taken into account under the limits on deductions for IRA contributions.

The bills

Overall limits.—H.R. 3266 would increase the maximum annual IRA deduction to the lesser of (1) 100 percent of compensation (earned income in the case of income from self-employment) or (2) $5,000, for taxable years beginning after December 31, 1985. The limit would be $3,000 and $4,000 for taxable years beginning in 1984 and 1985, respectively.

H.R. 3554 would repeal the 100-percent-of-compensation limit on deductions for contributions to an IRA. In addition, the bill would repeal the special deduction rules relating to (1) certain divorced individuals and (2) noncompensated spouses (the spousal IRA rules).

Limits on deduction for married or divorced individuals.—H.R. 2090, H.R. 2099 and H.R. 3333 would provide that, for purposes of determining the annual limits on deductible contributions to an IRA, the compensation taken into account in the case of a married couple would be that of the spouse whose compensation is greater. The deduction limit for the lower earning spouse would be determined without regard to any deductible IRA contributions made by the higher earning spouse. The bills would repeal the special rules of present law relating to married individuals whose spouses have no compensation during a taxable year.

H.R. 2984, H.R. 3307, H.R. 3309, and H.R. 3266 would provide that, for purposes of determining the annual limits on deductible contributions to an IRA, the compensation taken into account for an individual equals the sum of (1) the individual's compensation and (2) the compensation of the individual's spouse, reduced by the amount of deductible IRA contributions made by the individual's spouse.

H.R. 2090, H.R. 2099 and H.R. 3333 would permit alimony includible in gross income to be treated as compensation for purposes of the IRA deduction limit. The special rules under present law relating to certain divorced individuals would be repealed.

H.R. 2595 would provide that, for purposes of the spousal IRA rules, compensation does not include any money received for service pursuant to a summons to serve on any Federal or State jury.

H.R. 2772 would revise the spousal IRA rules to permit a spouse to elect (as prescribed under Treasury regulations) to have the spousal IRA rules apply. If the spouse makes the election, the spouse would be treated as having no compensation includible in gross income for the taxable year.

H.R. 2468 would revise the spousal IRA rules to permit a spouse, who has less than $250 of compensation includible in gross income for the taxable year, to elect (as prescribed under Treasury regulations) to have the spousal IRA rules apply. If the spouse makes the election, the spouse would be treated as having no compensation includible in gross income.

2. Periods of Employee Service Taken into Account Under Pension, Profit-Sharing, and Stock Bonus Plans

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2100—Ms. Ferraro, and Messrs. Rangel, Ford, and Others

H.R. 3554—Mr. Lewis and Others

H.R. 4032—Messrs. Erlenborn, Conable and Others

The bills would reduce from 25 to 21 the maximum age a pension, profit-sharing, or stock bonus plan can generally require an employee to attain as a condition of becoming a participant in the plan. Additionally, a plan would not be permitted to ignore service after age 21 for purposes of determining the vested portion of a participant's benefit. The bills would also provide rules relating to crediting of service for cases in which an employee is absent from work because of maternity or paternity. Under H.R. 4032, hours of absence on account of maternity or paternity would be taken into account in determining whether a break in service has occurred under the participation and vesting rules. Under H.R. 2090, H.R. 2100, and H.R. 3554, hours of approved maternity or paternity leave would be taken into account for all purposes of the participation and vesting rules (including benefit accruals).

3. Cash Out of Certain Accrued Benefits

H.R. 4032—Messrs. Erlenborn, Conable and Others

The bill would permit a pension, etc., plan to cash out a separated participant's benefit without the participant's consent if the value of the benefit does not exceed $3,500. The limit under present law is $1,750.

4. Joint and Survivor Annuity Requirements

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2100—Ms. Ferraro, and Messrs. Rangel, Ford, and Others

H.R. 3554—Mr. Lewis and Others

H.R. 4032—Messrs. Erlenborn, Conable and Others

Under H.R. 2090, H.R. 2100, and H.R. 3554, a pension, etc., plan would generally be required to provide a survivor annuity for a participant's surviving spouse if the participant dies before the annuity starting date and the participant has at least ten years of service for vesting purposes. Under H.R. 4032, a pension, etc., plan would generally be required to provide a survivor annuity for a participant's surviving spouse if the participant dies before the annuity starting date and has attained the later of (1) the earliest retirement age under the plan or (2) an age that is not more than 120 months before the normal retirement age under the plan.

Under all of the bills, the survivor benefit would be provided unless benefits in another form were elected. The amount of the survivor annuity would be computed as if the participant had survived until the day after the annuity starting date.

Under all of the bills, if a survivor annuity is payable, the spouse who was married to the participant on the annuity starting date would be entitled to the survivor benefit.

The rules of H.R. 2090, H.R. 2100, and H.R. 3554 would apply to any pension, etc., plan under which the normal form of benefit is an annuity. The rules of H.R. 4032 would apply to a pension, etc., plan that provides any benefit in the form of an annuity.

Under all of the bills, the election not to take a joint and survivor annuity would be effective only if made by both the participant and the participant's spouse.

5. Notice of Forfeitability of Benefits

H.R. 4032—Messrs. Erlenborn, Conable and Others

Present law requires that a plan furnish a participant with a statement of benefits under certain circumstances. H.R. 4032 would require that the statement include a notice that certain benefits may be forfeitable in the event the participant dies before a particular date.

6. Assignment or Alienation of Benefits

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2100—Ms. Ferraro, and Messrs. Rangel, Ford, and Others

H.R. 3554—Mr. Lewis and Others

H.R. 4032—Messrs. Erlenborn, Conable and Others

The bills would clarify that the Employee Retirement Income Security Act of 1974 (ERISA) does not prohibit the assignment or alienation of benefits in the case of certain judgments, decrees, or orders relating to child support, alimony payments, or marital property rights, pursuant to a State domestic relations law (a qualified domestic relations order). State law providing for the right to such payments would not be preempted by Federal law. The bills would require that a qualified domestic relations order identify the parties involved and provide specific instructions for determining the portion of plan benefits payable to an alternate payee (a spouse, former spouse, or child) under the order. H.R. 3554 and H.R. 4032 prescribe procedures to be followed by the plan administrator in determining whether a domestic relations order issued by a court is qualified and requiring the plan to provide distributions to the alternate payee in a form ordered by the court.

7. Targeted Jobs Tax Credit for Displaced Homemakers

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2127—Mrs. Kennelly, Mr. Stark, and Others

H.R. 3554—Mr. Lewis and Others

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for an employer before January 1, 1985, is available to an employer on an elective basis for hiring individuals from one or more of nine target groups. The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 of qualified second-year wages paid to a member of a targeted group.

H.R. 2090 and H.R. 2127 would add displaced homemakers as a targeted group for purposes of the targeted jobs tax credit. A displaced homemaker would be defined as an individual who: (1) has not worked in the labor force for a substantial number of years but has, during those years, worked in the home providing unpaid services for family members; (2) has been dependent on public assistance or on the income of another family member but is no longer supported by that income, or is receiving public assistance on account of dependent children in the home; and (3) is a member of an economically disadvantaged family and is experiencing difficulty in obtaining or upgrading employment.

H.R. 3554 would add displaced homemakers as a targeted group for purposes of the targeted jobs tax credit. A displaced homemaker would be defined as an individual who: (1) has not worked in the labor force for a substantial number of years but has, during those years, worked in the home providing unpaid services for family members; and (2) has been dependent on public assistance or on the income of another family member but is no longer supported by that income, or is receiving public assistance on account of dependent children in the home. The credit would be available whether or not a displaced homemaker began work before January 1, 1985.

8. Increase in Zero Bracket Amount for Heads of Households

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2126—Mrs. Kennelly, Mr. Stark, and Others

Present law provides special tax rates, which are approximately midway between the rate schedules applicable to single persons and to married couples filing jointly, for individuals who are heads of households. The zero bracket amount for heads of households is $2,300, the same as the zero bracket amount for single taxpayers. The zero bracket amount for married taxpayers who file jointly is $3,400.

H.R. 2090 and H.R. 2126 would increase the zero bracket amount for heads of households to $3,400, and would make corresponding changes in the rate brackets of the head-of-household rate schedule.

9. Child and Dependent Care Provisions

H.R. 1603—Ms. Ferraro and Mrs. Kennelly, and Messrs. Guarini, Ford, Rangel, Shannon, Matsui, Stark, and Others

H.R. 1991—Mr. Conable, Mrs. Kennelly, and Messrs. Shannon, Downey, Heftel, and Others

H.R. 2090—Mrs. Schroeder, Mrs. Kennelly, and Messrs. Conable, Downey, Guarini, Heftel, Matsui, Stark, Ford, Rangel, and Others

H.R. 2093—Ms. Mikulski, Messrs. Shannon, Downey, and Others

H.R. 2696—Ms. Mikulski and Others

H.R. 3554—Mr. Lewis and Others

Present law

Present law provides a nonrefundable tax credit for a portion of employment-related dependent care expenses paid an individual who maintains a household that includes one or more qualifying individuals. The maximum credit is equal to 30 percent of employment-related expenses (up to a maximum of $2,400, if there is one qualifying individual, and $4,800, if there are two or more qualifying individuals) of individuals with $10,000 or less of adjusted gross income. Accordingly, the maximum credit is $720 if there is one qualifying individual or $1,440 if there are two or more qualifying individuals. The maximum 30-percent credit rate is reduced (but not below 20 percent) by one percentage point for each $2,000 (or fraction thereof) of adjusted gross income above $10,000.

Under present law, organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and that meet certain other requirements are exempt from Federal income tax. The Internal Revenue Service takes the position that an organization that is organized and operated exclusively to provide care to children in order to allow a parent of a child to be gainfully employed is not an educational organization because its principal activity is not to provide education to children, but to provide day care facilities for the benefit of the parents.

Increased child and dependent care credit.—H.R. 1603, H.R. 1991, and H.R. 2090 would increase the percentage of employment-related expenses that qualify for the child and dependent care credit.

The percentage amount of the credit would be increased to 50 percent for individuals who have $10,000 or less of adjusted gross income. Thus, the maximum credit would be $1,200 (50 percent of $2,400), if there is only one qualifying individual, or $2,400 (50 percent of $4,800), if there are two or more qualifying individuals. The rate at which the credit would be phased down would be slowed so that the 50-percent credit rate would be reduced (but not below 20 percent) by one percentage point for each full $1,000 of adjusted gross income above $10,000.

Credit made refundable.—H.R. 1603, H.R. 2090, and H.R. 2093 would make the child and dependent care credit refundable. Thus, the credit could exceed an individual's tax liability for a taxable year.

In addition, H.R. 1603 would provide that no part of the credit allowable to a taxpayer could be counted as income for purposes of determining the taxpayer's eligibility for any other entitlement program including, but not limited to, medicaid, aid to facilities with dependent children, food stamps, and child care food.

Credit available to individuals performing volunteer services.—H.R. 2696 would treat the performance of volunteer service as gainful employment for purposes of the child and dependent care credit. Under the bill, volunteer service would mean service performed for a "qualified public service organization" if the service is performed away from the taxpayer's residence and without remuneration. If an individual provides volunteer services to a qualified public service organization, H.R. 2696 would treat the volunteer service as gainful employment and the individual as having earned income for any month of not less than $200, if there is one qualifying individual with respect to the taxpayer and $400, if there are two or more qualifying individuals.

H.R. 3554 would treat the performance of substantial volunteer services by a spouse during any month as gainful employment for purposes of the child and dependent care credit. Under the bill, the spouse would be deemed to have earned income for the month of not less than $200, if there is one qualifying individual with respect to the individual, and $400, if there are two or more qualifying individuals. In the case of a husband and wife, this rule would apply only with respect to one spouse for any month. H.R. 3554 would define substantial volunteer services to mean the performance of at least 48 hours of service during a month for an organization that is eligible to receive tax deductible charitable contributions.

Tax treatment of dependent care organizations.—H.R. 1603, H.R. 1991, and H.R. 2090 would provide that an organization is organized for educational purposes and, therefore, may be tax-exempt if (1) the organization is organized and operated to provide nonresidential dependent care of individuals, (2) substantially all of the dependent care is provided by the organization to enable individuals to be gainfully employed, and (3) the services provided by the organization are available to the general public. Also, H.R. 1603 would permit the tax exemption (and permit the organization to receive tax deductible contributions) if substantially all of the dependent care is provided by an organization to enable individuals to seek gainful employment.

10. Earned Income Credit

H.R. 1603—Ms. Ferraro and Mrs. Kennelly, and Messrs. Guarini, Ford, Rangel, Shannon, Matsui, Stark, and Others

Under present law, an eligible individual is allowed a credit against tax equal to 10 percent of the first $5,000 of earned income. The maximum amount of the credit is $500. The amount of the credit is phased out as adjusted gross income of an individual (or earned income, if greater) increases from $6,000 to $10,000. Present law provides that the earned income credit is treated as earned income for purposes of determining eligibility for the Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI) programs.

H.R. 1603 would provide that an eligible individual would be allowed a credit against tax equal to the sum of (1) 10 percent of the first $5,000 of earned income, (2) $50 for each additional dependent child of the individual, and (3) an additional $50 for each dependent child under six years of age in the case of a single working parent or a two working parent family. In addition, the provision would reduce the rate at which the credit is phased out as income rises. Under the provision, the earned income credit would not be counted in advance to determine eligibility for AFDC.

II. DESCRIPTION OF THE BILLS

A. Individual Retirement Accounts

Present Law

Under present law, an individual generally is entitled to deduct from gross income the amount contributed to an individual retirement account or annuity (an IRA).[1] The limit on the deduction for a taxable year generally is the lesser of $2,000 or 100 percent of compensation (earned income in the case of income from self-employment).

Under a spousal IRA, an individual also is allowed a deduction for contributions to an IRA for the benefit of the individual's spouse if (1) the spouse has no compensation for the year, (2) the spouse has not attained age 70½, and (3) the couple files a joint income tax return for the year. If deductible contributions are made (1) to an individual's IRA and (2) to an IRA for the noncompensated spouse of the individual (a spousal IRA), then the annual deduction limit on the couple's joint return is increased to $2,250 (or 100 percent of compensation includible in gross income, if less). The annual contribution may be divided as the spouses choose, so long as the contribution for neither spouse exceeds $2,000.

Under present law, in certain cases, alimony received by a divorced spouse can be taken into account under the limits on deductions for IRA contributions. If the requirements of the Code are met, then the IRA deduction limit is not less than the lesser of (1) $1,125 or (2) the sum of the individual's compensation and certain alimony includible in the individual's gross income for the year. This deduction limit applies, however, only if (1) an IRA was established for the benefit of the individual at least five years before the beginning of the calendar year in which the decree of divorce or separate maintenance was issued and (2) for at least three of the most recent five taxable years of the former spouse ending before the taxable year in which the decree was issued, the former spouse paying the alimony was allowed a deduction under the spousal IRA rules for contributions for the benefit of the individual.[2]

Explanation of the Bills

1. Overall limits

H.R. 3554

H.R. 3554 would repeal the 100-percent-of-compensation deduction limit for contributions to an IRA. In addition, the bill would repeal the special deduction rules relating to (1) certain divorced

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[1] Code sec. 219.
[2] Code sec. 219(b)(4).

individuals and (2) noncompensated spouses (the spousal IRA rules). Under the bill, an individual could deduct up to $2,000 for contributions to an IRA without regard to whether the individual or the individual's spouse had compensation (or earned income) includible in gross income. The deduction could be applied against gross income from dividends, interest, or any other source.

H.R. 3554 would be effective for taxable years beginning after December 31, 1983.

H.R. 3266

H.R. 3266 would increase the maximum annual IRA deduction limit to the lesser of (1) 100 percent of compensation (earned income in the case of income from self-employment) or (2) $5,000, for taxable years beginning after December 31, 1985. The limit would be $3,000 and $4,000 for taxable years beginning in 1984 and 1985, respectively.

H.R. 3266 would be effective for taxable years beginning after December 31, 1983.

2. Compensation of higher earning spouse used to compute deduction limit

H.R. 2090, H.R. 2099 and H.R. 3333

H.R. 2090, H.R. 2099 and H.R. 3333 would provide that, for purposes of determining the annual limits on deductible contributions to an IRA, the compensation taken into account in the case of a married couple would be that of the spouse whose compensation is greater. For example, if one spouse had includible compensation of $10,000 for a year and the other spouse had no includible compensation, the maximum IRA deduction for a year would be determined as if the spouse with no compensation had compensation of $10,000 for the year. The deduction limit for the lower earning spouse would be determined without regard to any deductible IRA contributions made by the higher earning spouse. The bills would repeal the special rules of present law relating to married individuals whose spouses have no compensation during a taxable year.

H.R. 2090 would be effective for taxable years beginning after December 31, 1983. H.R. 2099 would be effective for taxable years beginning after December 31, 1982. H.R. 3333 would be effective for taxable years ending after the date of enactment.

H.R 2984, H.R. 3307, H.R. 3309, and H.R. 3266

H.R. 2984, H.R. 3307, H.R. 3309, and H.R. 3266 would provide that, for purposes of determining the annual limits on deductible contributions to an IRA, the compensation taken into account for an individual would be the sum of (1) the individual's compensation and (2) the compensation of the individual's spouse, reduced by (3) the amount of deductible IRA contributions made by the individual's spouse. This rule would apply only if (1) the individual files a joint return for the taxable year and (2) the individual's compensation is less than the compensation of the individual's spouse.

H.R. 2984, H.R. 3309, and H.R. 3266 would be effective for taxable years beginning after December 31, 1983. H.R. 3307 would apply for taxable years beginning after December 31, 1982.

3. Alimony treated as compensation

H.R. 2090 and H.R. 2099

H.R. 2090 and H.R. 2099 would permit alimony includible in gross income to be treated as compensation for purposes of the IRA deduction limit. The special rules under present law relating to certain divorced individuals would be repealed.

H.R. 2090 would be effective for taxable years beginning after December 31, 1983. H.R. 2099 would be effective for taxable years beginning after December 31, 1982.

H.R. 3333

H.R. 3333 would revise the rules relating to alimony taken into account for purposes of computing the IRA deduction limit to provide that the special rule also would apply if, for at least three of the most recent five taxable years of the former spouse ending before the taxable year in which the divorce decree was issued, the former spouse was allowed a deduction under the spousal IRA rules for contributions that were based on the compensation of the former spouse.

H.R. 3333 would be effective for taxable years ending after the date of enactment.

4. Juror fee not treated as compensation

H.R. 2595

H.R. 2595 would provide that, for purposes of the spousal IRA rules, compensation does not include any money received for services pursuant to a summons to serve on any jury, State or Federal. Under the bill, a spouse with no compensation, other than amounts received for jury service, would not be prevented from having contributions made on the spouse's behalf to a spousal IRA.

H.R. 2595 would be effective on the date of enactment.

5. Election of spousal IRA available without regard to certain compensation

H.R. 2468

H.R. 2468 would revise the spousal IRA rules to permit a spouse who has less than $250 of compensation includible in gross income for a taxable year, to elect (as prescribed under Treasury regulations) to have the spousal IRA rules apply. If the spouse made the election, the spouse would be treated as having no compensation includible in gross income. No election would be required if the spouse in fact has no includible compensation for the taxable year.

For example, if an individual has includible compensation of $200 for the taxable year, if the individual's spouse has compensation of $30,000 for the year, and if the individual's spouse makes a deductible contribution of $1,000 to an IRA for the year, the individual could elect to be treated as having no includible compensation and, therefore, the individual's spouse could contribute $1,250 to the spousal IRA.

H.R. 2468 would be effective for taxable years beginning after December 31, 1982.

H.R. 2772

H.R. 2772 would revise the spousal IRA rules to permit a spouse to elect (as prescribed under Treasury regulations) to have the spousal IRA rules apply. If the spouse makes the election, the spouse is treated as having no compensation includible in gross income for the taxable year. No election would be required if the spouse in fact has no includible compensation for the taxable year.

For example, if an individual had includible compensation of $500 for the taxable year, if the compensation of the individual's spouse for the year were $30,000, and if the individual's spouse made a deductible contribution of $1,000 to an IRA for the year, the individual could elect to be treated as having no includible compensation and, therefore, the individual's spouse could contribute $1,250 to a spousal IRA.

H.R. 2772 would be effective for taxable years beginning after December 31, 1983.

B. Periods of Employee Service Taken Into Account under Pension, Profit-Sharing, and Stock Bonus Plans

Present Law

In general

If a pension, profit-sharing, or stock bonus plan qualifies under the tax law[3], then (1) a trust under the plan is generally exempt from income tax, (2) employers are generally allowed deductions (within limits) for plan contributions for the year for which the contributions are made even though participants are not taxed on plan benefits until the benefits are distributed, (3) benefits distributed as a lump sum distribution are accorded special long-term capital gain or 10-year income averaging treatment, or may be rolled over, tax-free, to an individual retirement account (IRA) or another qualified plan, and (4) limited estate and gift tax exclusions may be available.

Minimum participation, vesting, and benefit accrual requirements

In general

Under a pension, etc., plan, benefits are provided to participants under plan formulas that determine the amount of the benefit a participant may earn, the portion of that benefit that has been earned, and the portion of the earned benefit that is nonforfeitable. Accordingly, plans provide rules for determining whether an employee is a plan participant (the employee participation rules), for measuring benefits (the benefit formula), for determining the portion of the benefit that has been earned (the benefit accrual rules), and for determining the nonforfeitable percentage of a participant's benefit (the vesting schedule).

Under present law, a pension, etc., plan must satisfy certain minimum standards relating to the conditions under which employees may be excluded from plan participation, to the formula under which plan benefits are accrued, and to the vesting schedule. The

[3] Sec. 401(a) of the Code.

participation standards limit the permissible exclusions based on the age and period of service completed by an employee.[4] The benefit accrual standards are based upon the number of years of plan participation. The vesting standard is generally based upon the number of years of service with the employer that the employee has completed.

Participation

Under present law[5], a qualified pension, etc., plan generally may not require an employee to complete more than one year of service or attain an age greater than 25 as a condition of plan participation.[6]

In general, for purposes of the participation requirements, the term "year of service" generally means a consecutive 12-month period during which an employee has worked at least 1,000 hours.[7] The first 12-month period is measured from the date the employee enters service. Accordingly, an employee has fulfilled the year of service requirement if at least 1,000 hours of service are completed by the first anniversary date of employment. Later 12-month periods may be based on the plan year.

In general, all years of service with the employer maintaining the plan must be taken into account for purposes of the minimum participation requirements. No credit need be provided, however, for periods during which an employee is considered to have a break in service. In some cases, an employee who returns to an employer after a break in service may lose credit for pre-break service.

A plan may provide that a 1-year break in service occurs in a 12-month measuring period in which the employee does not complete more than 500 hours of service.[8] If an employee has incurred a 1-year break in service, the plan may require a 1-year waiting period before reentry. Upon reentry, the employee's pre-break and post-break service are generally required to be aggregated, and the employee is required to receive full credit for the reentry waiting period service if any part of the employee's benefit derived from employer contributions was vested or if the number of 1-year breaks in service is less than the number of years of service completed before the break.[9] If the employee completes more than 500 hours of service but fewer than 1000 hours of service, the employee has neither a 1-year break in service nor a year of service.

Vesting

The rules for plan qualification generally require that a plan meet one of three alternative minimum vesting schedules.[10] Under

[4] In addition, the Code provides minimum coverage rules for qualified pension, etc., plans. These rules are designed to require that qualified plans provide participation to a broad cross-section of employees.

[5] Sec. 410(a) of the Code.

[6] Accordingly, an employee may not generally be excluded from plan participation on the basis of length of service if the employee has completed one year of service and may not generally be excluded on the basis of age if the employee has attained age 25. An employee who has completed one year of service and who has attained age 25 may, however, be excluded from plan participation on other grounds (for example, a plan may be limited to employees within a particular job classification).

[7] Sec. 410(a)(3) of the Code.

[8] Sec. 410(a)(5) of the Code.

[9] Sec. 410(a)(5) of the Code.

[10] Sec. 411(a) of the Code.

these schedules, an employee's right to benefits derived from employer contributions become nonforfeitable (vest) to varying degrees upon completion of specified periods of service with an employer.[11]

Under one of the schedules, full vesting is required upon completion of 10 years of service (no vesting is required before the end of the 10th year).[12] Under a second schedule, vesting begins at 25 percent after completion of five years of service and increases gradually to 100 percent after completion of 15 years of service.[13] Under these two vesting schedules, all years of service with the employer maintaining the plan after attainment of age 22 generally must be taken into account for purposes of determining an employee's vested percentage. The third schedule takes both age and service into account, but in any event requires 50 percent vesting after 10 years of service and an additional 10 percent vesting for each year thereafter until 100 percent vesting is attained after 15 years of service.[14] Under this schedule, all years of service with the employer (including years of service prior to age 22) must be taken into account for purposes of determining an employee's vested percentage if, during those years, the employee participated in the plan.

Break in service rules also apply under the vesting rules. The break in service rules applicable in determining the number of years of service taken into account for vesting purposes under a defined benefit plan[15] are similar to the rules applicable for purposes of determining the number of years taken into account for purposes of determining plan participation. A special break in service rule applies for purposes of the vesting rules in the case of a defined contribution plan.[16] Post-break service is not taken into account under such a plan in determining the vested percentage for employer contributions made before the break in service.[17]

Benefit accruals

Present law[18] requires that a participant in a pension, etc., plan accrue (earn) the benefit provided by the plan at certain minimum rates. The accrual rules are designed to limit backloading of benefits. Under a backloaded accrual schedule, a larger portion of the benefit is earned each year in later years of service. Accordingly, under a plan with backloaded accruals, an employee who separates from service before reaching retirement age earns a disproportionately lower share of the benefit.[19]

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[11] An employee's right to benefits derived from employee contributions is immediately nonforfeitable.

[12] Sec. 411(a)(2)(A) of the Code.

[13] Sec. 411(a)(2)(B) of the Code.

[14] Sec. 411(a)(2)(C) of the Code.

[15] Other than certain defined benefit plans funded solely with insurance contracts.

[16] This special rule also applies for certain defined benefit plans funded solely with insurance contracts.

[17] Sec. 411(a)(6)(C) of the Code.

[18] Sec. 411(b) of the Code.

[19] For example, a plan's benefit formula might provide a benefit equal to 2 percent of average compensation multiplied by the number of years of plan participation. Under the minimum standards, a plan's accrual formula might provide that 2 1/7 percent of this benefit is earned for each of the first 20 years of service and that 2 6/7 percent of the benefit is earned for each of the next 20 years of service. An employee who separated after 20 years of service would have earned 42 6/7 percent (2 1/7 percent X 20) of a benefit equal to 40 percent (2 percent X 20) of average compensation. The benefit earned would be 17 1/7 percent of the employee's average compensation (42 6/7 percent X 40 percent of average compensation). If the benefit accrual had been equal for each year of plan participation (2 1/2 percent of the benefit per year of participation), the benefit earned would have been 20 percent of average compensation (20 X 2.5 percent X 40 percent).

Maternity or paternity leave

For purposes of the minimum participation, vesting, and benefit accrual requirements, a plan is not required to give an employee credit for periods of time during for which the employee is not compensated for maternity or paternity leave. A plan is not required to credit more than 501 hours of service for paid maternity or paternity leave.

Explanation of the Bills

Maximum age condition

H.R. 2090, H.R. 2100, H.R. 3554, and H.R. 4032

The bills would provide that a pension, etc., plan may not require, as a condition of participation, completion of more than one year of service or attainment of an age greater than 21 (whichever occurs later).[20]

Under the bills, a plan would not be permitted to ignore years of service after age 21 for purposes of the minimum vesting requirements.

The provisions of H.R. 2090, H.R. 2100, and H.R. 3554 relating to maximum age conditions would apply for plan years beginning more than ninety days after the date of enactment.

In the case of a plan that is not in existence on the date of enactment, the provisions of H.R. 4032 relating to maximum age conditions would apply on the date of enactment. For other plans, these provisions of H.R. 4032 would generally apply to plan years beginning after December 31, 1984. For collectively bargained plans, these provisions of H.R. 4032 would apply as of the first plan year beginning after the earlier of the expiration of certain collective bargaining agreements or January 1, 1987.

Maternity or paternity leave

H.R. 2090, H.R. 2100, and H.R. 3554

For purposes of the minimum participation, vesting, and benefit accrual requirements, the bills would provide that an employee would be deemed to have performed 20 hours of service for each week of approved maternity or paternity leave, whether or not the employee is paid during the leave. Approved maternity or paternity leave would mean any period (up to 52 weeks under H.R. 2090 and H.R. 2100, and up to 12 weeks under H.R. 3554) during which an employee is absent from work by reason of pregnancy or the birth of a child of the employee or for purposes of caring for a child of the employee, if the employer approves the leave. This credit of 20 hours per week, however, would not be required unless the employee continues to perform services for the employer after the end of the leave or offers to perform services but is not reemployed by the employer.

[20] The bills would not change the special rule permitting a requirement of age 30 under a plan maintained exclusively for the benefit of employees of certain tax exempt educational organizations (sec. 410(a)(1)(B)(ii) of the Code).

Under H.R. 2090 and H.R. 2100, if the period of approved leave exceeded 25 weeks during a 12-month measuring period, the employee would be credited with more than 500 hours and would not incur a break in service solely because of the leave. If the period of approved leave extended for at least 50 weeks, then under H.R. 2090 and H.R. 2100, the employee would be credited with a full year of service for participation and vesting purposes and at least a partial year of service for benefit accrual purposes.

Under H.R. 3554, a maximum of 240 hours could be credited because of approved maternity or paternity leave. The hours would be required to be taken into account under the plan for participation, vesting, and benefit accrual purposes. Unless the employee has 260 other hours of service during the year, the employee would have a 1-year break in service.

The provisions of H.R. 2090, H.R. 2100, and H.R. 3554 relating to maternity or paternity leave would be effective for plan years beginning more than one year after the date of enactment.

H.R. 4032

Under the bill, certain hours during which an employee is absent from work on account of maternity or paternity would be required to be taken into account by a plan in determining the employee's hours of service for purposes of determining whether a break in service has occurred under the participation or vesting rules. Credit for maternity or paternity hours would generally be required to be credited in the year of the birth or adoption. If the credit is not required to prevent a break in service in that year, however, the hours would be required to be credited in the next year. A plan could provide that no credit is given unless the employee furnishes such timely information as it may reasonably require to establish that the absence was for the reasons enumerated in the bill.

The bill would require that hours of service taken into account in determining whether a break in service has occurred include hours of service which would have been taken into account but for the employee's absence from work for any continuous period (1) by reason of the birth of a child of the employee, (2) by reason of the adoption of a child by the employee, or (3) for purposes of caring for such a child during the period following such a birth or adoption.

In the case of a plan that is not in existence on the date of enactment, the provisions of H.R. 4032 relating to maternity or paternity would apply on the date of enactment. For other plans, these provisions of H.R. 4032 would generally apply to plan years beginning after December 31, 1984. For collectively bargained plans, these provisions of H.R. 4032 would apply as of the first plan year beginning after the earlier of the expiration of certain collective bargaining agreements or January 1, 1987.

C. Cash Out Of Certain Accrued Benefits

Present Law

Under present law,[21] in the case of an employee whose plan participation terminates, a pension, etc., plan may involuntarily "cash out" the benefit (*i.e.*, pay out the balance to the credit of a plan participant without the participant's consent) if the present value of the benefit does not exceed $1,750. If a benefit is cashed-out under this rule and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which benefits were cashed out unless the employee "buys back" the benefit.

Generally, a cash-out distribution from a qualified pension, etc., plan can be rolled over, tax free, to an IRA or to another qualified plan.[22]

Explanation of the Bill

H.R. 4032

The bill would increase the limit on cash-outs to $3,500 from $1,750. The provision would be effective for years ending after the date of enactment.

D. Joint and Survivor Annuity Requirements

Present Law

Under present law,[23] if the normal form of benefits under a plan is a life annuity or if a participant elects benefits in the form of a life annuity under a plan and the participant is married for the one year period ending on the date the annuity payments begin, the benefit must be paid in the form of a qualified joint and survivor annuity unless the participant elects an annuity in another form.[24] A joint and survivor annuity provides benefits for the joint lives of the participant and another individual and, after the death of either, provides a benefit for the life of the survivor. Under a qualified joint and survivor annuity, benefits are payable for the joint lives of the participant and the participant's spouse and if the spouse is the survivor, the survivor benefit must not be less than one-half of the benefits payable during the joint lives of the couple.

In the case of an employee who is eligible to retire before the normal retirement age under the plan, and who has not retired, the employee must be eligible to elect a qualified joint and survivor benefit. The survivor benefit is not required to be provided, however, unless the employee affirmatively elects benefits in that form. Thus, under present law, if the plan provides that no benefits will be paid with respect to a participant who dies while still employed

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[21] Sec. 411(a)(7)(B) of the Code.

[22] If an employee's benefit has been cashed out, the employee may be able to "buy back" the years of service with respect to which the cash out was made if the employee resumes plan participation. See sec. 411(a)(7)(C) of the Code.

[23] Sec. 401(a)(11) of the code.

[24] For example, a participant may elect a benefit in the form of a single life annuity. If a single life annuity is elected, benefit payments generally end with the death of the participant.

but after attaining the plan's early retirement age, the plan need not provide a survivor annuity to the participant's spouse unless the participant, prior to death, had made an affirmative election with respect to the survivor annuity. Moreover, the plan need not make this survivor annuity option available until the time the employee attains the earliest retirement age under the plan or is within 10 years of normal retirement age (whichever is later).

The employee must be afforded a reasonable opportunity to elect out of the joint and survivor benefit before benefit payments begin. A plan may provide that any election, or revocation of an election, with respect to joint and survivor benefits is not effective if the participant dies within a period of time (not in excess of two years) after making the election or revocation (except in the case of accidental death if the accident that causes death occurs after the election).

The Internal Revenue Service has issued regulations under which a plan need not provide a survivor annuity to a surviving spouse if the spouse was not married to the participant for at least the one year period before the annuity starting date and for at least the one year period before the date of death.[25]

Explanation of the Bills

H.R. 2090, H.R. 2100, and H.R. 3554

Under the bills, a pension, etc., plan would be required to provide a survivor annuity for a participant's surviving spouse if (1) the participant died before the annuity starting date, (2) the participant completed at least ten years of service for vesting purposes, (3) the participant and the surviving spouse were married at the time of the participant's death, (4) the normal form of benefit under the plan is an annuity, and (5) no election is made to take benefits in a different form. The survivor annuity would be required to begin not later than the survivor annuity starting date [26] and would be required to continue for the life of the surviving spouse. In addition, the payments under the survivor annuity could not be less than the payments that would have been made to the surviving spouse if the participant had terminated employment on the date on which the death occurred, had survived until the annuity starting date, and had died on the following day.

The bills would require that unless benefits in a different form were elected, if a participant was married when benefit payments began and the participant's spouse at that time survives the participant, a survivor annuity must be paid to the survivor whether or not the survivor was married to the participant at the time of death.

Under the bills, the election not to take a qualified joint and survivor annuity would be effective only if it is made by the participant and the spouse of the participant in writing (witnessed by a

[25] Treas. Reg. sec. 1.401(a)-11(d)(3).

[26] Under the bills, the survivor annuity starting date would be (1) the date the participant's benefit payments would have begun if the participant had survived to the earliest retirement date under the plan, (2) the date of death of the participant (if later), or (3) any other date selected by the surviving spouse in accordance with the procedures of the plan, but not later than the participant's annuity starting date if the participant had survived until normal retirement age under the plan.

plan representative or a notary public). In addition, the bills would repeal the rule that permits a plan to disregard any election, or revocation of an election, not to take a qualified joint and survivor annuity if the participant dies within two years after the election or revocation.

The bills would provide that a participant who was not an active participant on or after the effective date of the bills could elect to receive benefits in the form of a qualified joint and survivor annuity if the election is made before the annuity starting date.

The provisions of the bills relating to joint and survivor annuities would be effective with respect to plan years beginning more than one year after the date of enactment.

H.R. 4032

The bill would require that benefits payable under a pension, etc., plan be paid in a form having the effect of a qualified joint and survivor annuity if (1) the employee has attained the earliest retirement age under the plan or is within 10 years of attaining the normal retirement age under the plan, (2) the plan provides for the payment of benefits in the form of an annuity (whether the annuity is the normal form of benefit or an optional form),[27] (3) the participant and the surviving spouse were married for at least one year before payment of benefits begins, and (4) no election has been made to take benefits in a different form.

Under the bill, a plan would be required to permit a participant to elect benefits in a form other than a form having the effect of a qualified joint and survivor annuity. The election would be required to be made available with respect to the period beginning with the later of (1) the time the participant attains the earliest retirement age under the plan, or (2) 10 years before the normal retirement age under the plan.

The bill requires that each participant be allowed a reasonable time within which to make the election and that each participant be furnished with a written explanation of the terms and conditions of the joint and survivor benefit and the effect of an election to take benefits in a different form.

The rules relating to the election not to take a qualified joint and survivor annuity would provide that the election is not effective unless it is made by the participant and the participant's spouse. The bill would authorize a plan to provide reasonable conditions relating to the election, including a requirement that the election be in writing and witnessed by a plan representative or a notary public. The bill would not permit a plan to disregard an election or revocation merely because it is made within two years before the death of the participant.

H.R. 4032 would provide that if a spouse's consent to an election is witnessed by a notary public or an authorized plan representative, the plan's good faith payment of a benefit in accordance with that election would discharge its obligation with respect to both the participant and the participant's spouse to the extent of the payment.

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[27] The bill would reverse the result in *BBS Associates, Inc.* v. *Commissioner*, 74 T.C. 118 affd ———.

In addition, the bill would require that, unless benefits in a different form were elected, if a participant was married for at least one year when benefit payments began and the participant's spouse at that time survives the participant, a survivor annuity must be paid to the survivor whether or not the survivor was married to the participant during the one-year period preceding the participant's death.

The provisions of the bill relating to joint and survivor annuity benefits would apply to designated participants under a plan when the plan's provisions conform with the new requirements or when they are required to conform to the new provisions (if earlier). In the case of a plan that is not in existence on the date of enactment, the plan would be required to conform to the new rules when the plan is established. For other plans, conformity with the new rules would generally be required for plan years beginning after December 31, 1984. For collectively bargained plans, these provisions of the bill would apply as of the first plan year beginning after the earlier of the expiration of certain collective bargaining agreements or January 1, 1987.

A participant is a designated participant if (1) the participant has not died before the effective date of the new rules, or (2) the annuity starting date for the participant was not later than the effective date of the new rules.

E. Notice of Forfeitability of Benefits

Present Law

Under present law, the administrator of a pension, etc., plan is required to furnish to a plan participant a statement indicating the participant's total accrued benefits and nonforfeitable accrued benefits if the participant requests such a statement. A participant is not entitled to more than one statement during any 12-month period. In addition, present law requires a plan administrator to furnish a statement to each plan participant who (1) separates from service during a plan year, (2) is entitled to a vested deferred benefit under the plan, and (3) did not receive retirement benefits under the plan during the year. This statement must contain specified information relating to the benefit.

Explanation of the Bill

H.R. 4032

Under the bill, any statement provided to a plan participant of total accrued benefits and nonforfeitable accrued benefits or any statement provided to a separated plan participant who has a vested deferred benefit must include a notice to the participant that certain benefits may be forfeited if the participant dies before a particular date.

In the case of a plan that is not in existence on the date of enactment, the provisions of H.R. 4032 relating to notice of forfeitability of benefits would apply on the date of enactment. For other plans, these provisions of H.R. 4032 would generally apply to plan years beginning after December 31, 1984. For collectively bargained plans, these provisions of H.R. 4032 would apply as of the first plan year beginning after the earlier of the expiration of certain collective bargaining agreements or January 1, 1987.

F. Assignment or Alienation of Benefits

Present Law

Under present law, with limited exceptions, benefits under a pension, etc., plan may not be assigned or alienated. A plan that does not prohibit such assignment and alienation is not a qualified plan under the Code, and State law permitting such an assignment or alienation is generally preempted by ERISA. Under present law,[28] certain provisions of ERISA supersede (preempt) State laws relating to pension, etc., plans.

Several cases have arisen in which courts have been required to determine whether the ERISA preemption provision applies to family support obligations (*e.g.*, alimony, separate maintenance, and child support obligations). In some of these cases, the courts have held that ERISA was not intended to preempt State domestic relations law permitting the attachment of vested benefits for the purpose of meeting these obligations.[29] Some courts have held that the ERISA preemption does not prevent application of State law permitting attachment of nonvested benefits for the purpose of meeting family support obligations.[30] There is a divergence of opinion among the courts as to whether ERISA preempts State community property laws insofar as they relate to the rights of a married couple to benefits under a pension, etc., plan.[31]

The IRS has ruled that the anti-assignment requirement is not violated when a plan trustee complies with a court order requiring the distribution of benefits of a participant in pay status to the participant's spouse or children in order to meet the participant's alimony or child support obligations.[32] The IRS has not taken any position with respect to this issue in cases in which the participant's benefits are not in pay status.

Explanation of the Bills

H.R. 2090 and H.R. 2100

The bills would eliminate the prohibition against assignment or alienation of benefits in a pension, etc., plan in the case of a judgment, decree, or order (including an approval of a property settlement agreement) relating to child support, alimony payments, or marital property rights, pursuant to a State domestic relations law (whether of the common law or community property type). The provision would apply only to a judgment, decree, or order that (1) creates or recognizes the existence of an individual's right to receive

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[28] Sec. 514 of ERISA.

[29] *See, e.g., American Telephone and Telegraph Co. v. Merry*, 592 F.2d 118 (2d Cir. 1979); *Cody v. Riecker*, 594 F.2d 314 (2d Cir. 1979).

[30] *See, e.g., Weir v. Weir*, 415 A.2d 638 (1980); *Kikkert v. Kikkert*, 427 A.2d 76 (1981).

[31] In *Stone v. Stone*, 633 F.2d 740 (9th Cir. 1980), the court held that ERISA was not intended to preempt community property laws and that a court order requiring a division of retirement benefits did not violate the anti-assignment provisions. In *Francis v. United Technology Corp*, 458 F.Supp. 84 (N.D. Cal. 1978), however, the court held that ERISA's preemption provision prevents the application of State community property law permitting attachment of plan benefits for family support purposes.

[32] Rev. Rul. 80-27, 1980-1 C.B. 8.

all or a portion of the benefits to which a participant or a participant's designated beneficiary would otherwise be entitled; (2) clearly identifies the participant, the amount or percentage of the benefits to be paid to the individual, the number of payments to which the judgment, etc., applies, and the name and mailing address of the individual; and (3) does not require the plan to alter the effective date, timing, form, duration, or amount of any benefit payments under the plan or to honor any election that is not provided under the plan or that is made by a person other than a participant or beneficiary.

In addition, under the bills, the general preemption rule of ERISA would not apply with respect to any judgment, decree, or order pursuant to a State domestic relations law (whether of the common law or community property type).

The provisions of H.R. 2090 and H.R. 2100 relating to divorce, etc., proceedings would be effective on the date of enactment.

H.R. 3554

In general.—The bill would establish procedures to be followed by a plan administrator who receives a domestic relations order and by an alternate payee (a spouse, a former spouse, or a child of a plan participant or beneficiary) with respect to benefits payable under the plan. If a domestic relations order is not a qualified domestic relations order, the bill provides that the order is not to affect benefits under the plan.

Under the bill, the administrator of a plan that receives a domestic relations order would generally be required to determine whether the order is a qualified domestic relations order not later than 90 days before the date benefits subject to the order commence. If the administrator determines that the order is a qualified domestic relations order (or fails to make any determination within the time prescribed), the administrator would be required to send a notice of benefit commencement to the alternate payee specified in the order (and to another person if requested by the alternate payee in writing). The bill authorizes the plan administrator to postpone benefit payments covered by the order for up to 60 days after receipt of the order.

Notice of benefit commencement.—Under the bill, the notice of benefit commencement would (1) specify the date on which payment of benefits is scheduled to begin, (2) request that the alternate payee contact the plan administrator in writing within 60 days after the date the notice was mailed to confirm or correct the name and address of the alternate payee, and (3) describe the effect of a failure to acknowledge the receipt of the notice. The bill provides that if the alternate payee does not acknowledge the administrator's notice, then the plan administrator is to retain the benefit payments that would otherwise be payable to the alternate payee until the earlier of (1) the end of the 1-year period following the time acknowledgement was required, or (2) the date on which the alternate payee provided the administrator with an accurate address, in writing.

The bill provides that if the alternate payee acknowledges the notice of the administrator within 60 days after the notice is mailed, then the plan would be required to make payment of the benefits in accordance with the order (taking into account changes of address submitted by the alternate payee). The bill would authorize the plan administrator to postpone benefit payments pending the expiration of the 60-day period or until the alternate payee acknowledges the notice (if earlier).

Information not provided by alternate payee.—If the address is not provided before the end of the 1-year period, the bill provides that the administrator is to pay the retained benefits and subsequent benefit payments to the persons otherwise eligible to receive them (but for the order). The bill permits the alternate payee to reestablish the right to benefits by providing the plan administrator with a written notice of an accurate address. Under the bill, if such a notice is provided, benefits payable after the reestablishment would be required to be paid as provided in the order but the alternate payee would not have the right to benefit payments made before the reestablishment.

Nonqualified orders.—If the plan administrator determines that an order is not a qualified domestic relations order, under the bill, the plan administrator would be required (as soon as practicable) to provide the alternate payee (and another person if requested by the alternate payee in writing) a written notice setting forth the reasons for the failure of the order to qualify. The bill provides that if the commencement date of benefits affected by the order occurs sooner than 60 days after the administrator's determination that the order is not qualified, then benefits are to be suspended until the earlier of (1) 60 days after the date of the administrator's determination, or (2) the date on which the administrator determines that a later-received domestic relations order is a qualified order. The bill authorizes a Federal or State court to require that a plan extend the period of suspension.

Action by alternate payee.—The bill would authorize the alternate payee to bring an action against any person (including the plan) for failure to meet the requirements of the provision.

Relief of plan administrator.—The bill provides that any determination made, action taken, or payment made by a plan administrator (or another person acting on behalf of the plan) in the reasonable belief that the requirements of the bill have been met would not be subject to penalties or liability based on the determination, etc. The bill specifies that this relief provision would prevent recovery of benefits paid pursuant to a reasonable determination by the payor that the requirements for the relief have been met.

Domestic relations order.—The bill defines a domestic relations order as any judgment, decree, order, or marital settlement agreement relating to child support, alimony payments, or marital property rights which is made pursuant to the domestic relations laws of any State or foreign government.

Qualified domestic relations order.—Under the bill, a domestic relations order would qualify if it (1) specifically identifies the participant whose benefits are subject to the order, the portion of the benefits to be paid to the alternate payee, the number or duration of payments subject to the order, and the name and mailing address of the alternate payee; (2) does not require the plan to alter the commencement date, timing, form, duration, or total amount of any benefit payments under the plan, or to honor any election not provided by the plan or which is not made by an eligible person; and (3) determines the amount to be paid to the alternate payee on a basis that does not conflict with any prior qualified domestic relations order with respect to another alternate payee.

Effective dates.—The provisions of H.R. 3554 relating to domestic relations orders would apply to orders issued at least 90 days after the date of enactment. Under the bill, no plan would be required to be amended to conform to the requirements of the provisions relating to domestic relations orders before the end of the third year after the date of enactment.

H.R. 4032

In general.—The bill would eliminate the prohibition against assignment or alienation of benefits in a pension, etc., plan in the case of certain qualified divorce distributions. Under the bill, a qualified divorce distribution is the payment of benefits to any individual by reason of a judgment, decree, or order (including an approval of a settlement agreement) relating to child support, alimony payments, or marital property rights, which is made pursuant to a State domestic relations law (including community property law).

Qualified domestic relations order.—The bill defines a qualified domestic relations order as a domestic relations order that (1) specifically identifies the participant whose benefits are subject to the order, the portion of the benefits to be paid to the alternate payee (any spouse, former spouse, or child of a participant or beneficiary under the plan), the number or duration of payments subject to the order, and the name and mailing address of the alternate payee; and (2) does not require the plan to alter the commencement date, timing, form, duration, or total amount of any benefit payments under the plan, or to honor any election not provided by the plan or which is not made by an eligible person.

H.R. 4032 would also require a plan to adopt reasonable administrative procedures and would require the plan to notify the parties of those procedures after the plan has received a court order.

Time of payment.—The bill provides that a qualified domestic relations order may provide for a distribution to the alternate payee beginning with the earliest retirement date on which the participant could retire under the plan, in any form of benefits that would be available to the participant under the plan. A plan would not be required, however, to offer a joint and survivor benefit to the alternate payee.

Discharge of plan obligation.—Under H.R. 4032, if a plan pays a benefit to a participant or to an alternate payee based on the plan's good faith determination that a domestic relations order is or is not a qualified domestic relations order, then the plan's obligation to both the participant and the alternate payee would be discharged to the extent of the payment.

Tax treatment.—Qualified divorce distributions would generally be taxable to the recipient spouse when paid. For purposes of determining the portion of benefits includible in the gross income of the participant and the spouse, the bill would also require that the employee's investment in the contract be prorated (pursuant to regulations to be issued by the Secretary of the Treasury) between the qualified divorce distribution and any other benefits under the plan.

In addition, the bill provides that qualified divorce distributions would be eligible for the special tax treatment under the 10-year forward income averaging rules. To the extent that an amount received as a qualified divorce distribution from a qualified plan is rolled over to an IRA or to another qualified plan, the amount would not be includible in gross income at the time of the qualified divorce distribution.

Effective dates.—The provisions would generally be effective on the date of enactment. A special effective date is provided, however, in the case of a plan that does not provide for the distribution of benefits to an alternate payee in a form required by a domestic relations order. Under those circumstances, during the period beginning on the date of enactment and ending on the earlier of (1) the effective date of any plan amendment that is adopted in compliance with the domestic relations order provisions of the bill or (2) the regular effective date of those provisions of the bill. During this period, a plan may treat a domestic relations order as a nonqualified order if the order provides for a distribution to an alternate payee in a form of benefits that is not available under the plan on the day before the date of enactment.

G. Targeted Jobs Credit to Include Displaced Homemakers

Present Law

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for an employer before January 1, 1985, is available to employers on an elective basis for hiring individuals from one or more of nine target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 through 24; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; and (9) disadvantaged youths aged 16 or 17 for summer employment (effective for those who begin work for an employer after April 30, 1983).

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. (For qualified summer youth employees, the credit is equal to 85 percent of the first $3,000 of qualified wages.) The employer's deduction for wages, however, must be reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program.

For purposes of determining the years of employment of an employee and whether the $6,000 cap has been reached with respect to any employee, all employees of any corporation that is a member of a controlled group of corporations are treated as if they are employees of a single corporation. Under the controlled group rules, the amount of credit allowed to the group generally equals the credit that would be allowed if the group were a single company. Comparable rules are provided for partnerships, proprietorships, and other trades or business (whether or not incorporated) under common control.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward fifteen years.

Explanation of the Bills

H.R. 2090 and H.R. 2127

H.R. 2090 and H.R. 2127 would add displaced homemakers as a targeted group for purposes of the targeted jobs tax credit. A displaced homemaker would be defined as an individual who:

(1) has not worked in the labor force for a substantial number of years but has, during those years, worked in the home providing unpaid services for family members;

(2) has been dependent on public assistance or on the income of another family member but is no longer supported by that income, or is receiving public assistance on account of dependent children in the home; and

(3) is a member of an economically disadvantaged family and is experiencing difficulty in obtaining or upgrading employment.

H.R. 2090 and H.R. 2127 would apply to amounts paid or incurred after enactment to displaced homemakers who begin to work for the employer after that date.

H.R. 3554

H.R. 3554 would add displaced homemakers as a targeted group for purposes of the targeted jobs tax credit. A displaced homemaker would be defined as an individual who:

(1) has not worked in the labor force for a substantial number of years but has, during those years, worked in the home providing unpaid services for family members; and

(2) has been dependent on public assistance or on the income of another family member but is no longer supported by that income, or is receiving public assistance on account of dependent children in the home.

Under the bill, the credit also would apply with respect to displaced homemakers who begin work for the employer after December 31, 1984. Accordingly, the rule of present law under which the credit is not available with respect to an individual who begins work for an employer after December 31, 1984, would not apply to a displaced homemaker.

The provision would apply to amounts paid or incurred after enactment to displaced homemakers who begin to work for the employer after that date.

H. Increase in Zero Bracket Amount for Heads of Households

Present Law

Present law provides special tax rates, which are approximately midway between the rate schedules applicable to single persons and to married couples filing jointly, for individuals who are heads of households. In order to qualify for these rates, an individual must be unmarried and generally must maintain a household that includes the individual and a dependent relative. The head-of-household rate schedule was established because of Congress' concern that unmarried taxpayers who are required to maintain a household for other individuals have financial responsibilities that are greater than those of other unmarried individuals.

The zero bracket amount for heads of households is $2,300, the same as the zero bracket amount for single taxpayers. The zero bracket amount for married taxpayers who file joint returns is $3,400.

Explanation of the Bills

H.R. 2090 and H.R. 2196 would increase the zero bracket amount for heads of households to $3,400, and would make corresponding changes in the rate brackets of the head-of-household rate schedule.

The bills would be effective for taxable years beginning after December 31, 1983.

I. Child and Dependent Care Provisions

Present Law

Child and dependent care credit

Present law provides a nonrefundable tax credit for a portion of employment-related dependent care expenses paid by an individual who maintains a household that includes one or more qualifying individuals. A qualifying individual is: (1) an individual who is under the age of 15 who is a dependent of the taxpayer; (2) a physically or mentally incapacitated dependent; or (3) a physically or mentally incapacitated spouse.

Employment-related expenses are expenses for household services and expenses for the care of a qualifying individual incurred to enable the taxpayer to be gainfully employed. Employment-related expenses that are incurred for services provided outside the taxpayer's household may be taken into account if incurred for the care of an individual under the age of 15, who is a dependent of the taxpayer, or if incurred for the care of a physically or mentally incapacitated spouse or dependent of the taxpayer who regularly spends at least eight hours a day in the taxpayer's household.[33]

The amount of employment-related expenses that may be taken into account for purposes of the credit generally may not exceed earned income in the case of an unmarried individual, or the earned income of the lesser-earning spouse, in the case of a married couple. Also, the amount of employment-related expense taken into account is limited to $2,400, if there is one qualifying individual, and $4,800, if there are two or more qualifying individuals.

The maximum credit is 30 percent for individuals who have $10,000 or less of adjusted gross income. Thus, the maximum credit is $720, if there is only one qualifying individual, or $1,440, if there are two or more qualifying individuals.

The 30-percent credit rate is reduced (but not below 20 percent) by one percentage point for each $2,000 (or fraction thereof) of adjusted gross income above $10,000. (For this purpose, a married couple's combined adjusted gross income is the relevant amount, because married couples generally must file a joint return in order to claim the credit.) For example, an individual with $11,000 of adjusted gross income is entitled to a credit equal to 29 percent of employment-related expenses. Individuals with more than $28,000 of adjusted gross income would be entitled to a credit equal to 20 percent of employment-related expenses. For those individuals, the maximum credit is $480 (if there is one qualifying individual) or $960 (if there are two or more qualifying individuals).

Tax treatment of dependent care organizations

Under present law, organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and that meet certain other requirements are exempt from Federal income tax. One of these requirements prohibits any of the net income of the organization from inuring to the benefit of any private shareholder or individual. In addition, contributions to such organizations are deductible for Federal income, gift, and estate tax purposes (secs. 170(c)(2), 2055(a), and 2522(c)).

The Internal Revenue Service takes the position that an organization that is organized and operated exclusively to provide care to children in order to allow a parent of a child to be gainfully employed is not an educational organization because its principal activity is not to provide education to children, but to provide day care facilities for the benefit of the parents.

[33] Expenses incurred for services provided outside the taxpayer's household by a dependent care center may be taken into account only if the center complies with all applicable State and local laws and regulations. For purposes of this provision, a dependent care center is any facility that provides care for more than six individuals (other than residents) and receives a fee, payment, or grant for providing services for any of the individuals.

Explanation of the Bills

1. Increased child and dependent care credit

H.R. 1603, H.R. 1991, and H.R. 2090

H.R. 1603, H.R. 1991, and H.R. 2090 would increase the percentage of employment-related expenses that qualify for the child and dependent care credit.

The percentage amount of the credit would be increased to 50 percent for individuals who have $10,000 or less of adjusted gross income. Under the bills, the maximum credit would be $1,200 (50 percent of $2,400) if there is only one qualifying individual, or $2,400 (50 percent of $4,800) if there are two or more qualifying individuals. The phase-out of the credit would be slowed so that the 50-percent credit rate would be reduced (but not below 20 percent) by one percentage point for each full $1,000 of adjusted gross income above $10,000. For example, an individual with $11,000 of adjusted gross income would be entitled to a credit equal to 49 percent of employment-related income. Similarly, an individual with $20,000 of adjusted gross income would be entitled to a credit equal to 40 percent of employment-related expenses.

Individuals with $40,000 or more of adjusted gross income would be entitled to a credit equal to 20 percent of employment-related expenses. For these individuals, the maximum credit would be $480 (if there is one qualifying individual) or $960 (if there are two or more qualifying individuals). This is the same credit amount available under present law to individuals with more than $28,000 of adjusted gross income.

The changes to the child and dependent care credit under H.R. 1991 and H.R. 2090 would be effective for taxable years beginning after December 31, 1983. The changes under H.R. 1603 would be effective on the date of enactment.

2. Credit made refundable

H.R. 1603, H.R. 2090, and H.R. 2093

H.R. 1603, H.R. 2090, and H.R. 2093 would make the child and dependent care credit refundable. Accordingly, under the bills, the credit could exceed an individual's tax liability for a taxable year.

In addition, H.R. 1603 would provide that no part of the credit allowable to a taxpayer could be counted as income for purposes of determining the taxpayer's eligibility for any other entitlement program including, but not limited to, medicaid, aid to families with dependent children, food stamps, and child care food. The bill would provide that the dependent care credit is not counted against the earned income credit. Under the bill, the Secretary of the Treasury would be directed to revise the income tax forms in order to enable eligible individuals to claim the child and dependent care credit on the short form income tax return (Form 1040A).

H.R. 2090 and H.R. 2093 would be effective for taxable years beginning after December 31, 1983. HR. 1603 would be effective on the date of enactment.

3. Credit available to individuals performing volunteer services

H.R. 2696

H.R. 2696 would treat the performance of volunteer service as gainful employment for purposes of the child and dependent care credit. Under the bill, volunteer service would mean service performed for a "qualified public service organization" if the service is performed away from the taxpayer's residence and without remuneration.

A "qualified public service organization" means any organization that (1) is tax-exempt and operates for religious, charitable, scientific, testing for public safety, literary, educational, etc., or for social welfare purposes;[34] (2) is a department or agency of the United States, any State, or political subdivision and is operated solely for charitable, scientific, testing for public safety, literary, educational, etc., purposes; (3) performs any function related to the public safety, including any police, firefighting, ambulance, rescue, or civil defense function and meets the minimum requirements for such an organization established by the State in which the functions are performed or by the Secretary of the Treasury; or (4) is nonpartisan, is operated to promote human welfare though the advancement of electoral or legislative reforms, and meets standards prescribed by the Secretary of the Treasury. In the case of an organization that is described in (3) or (4), the organization would be a qualified public service organization only if (1) no part of the net earnings of the organization inures to the benefit of any private shareholder or individual and (2) the Secretary of the Treasury determines that the organization significantly contributes to the promotion of human welfare.

If an individual provides volunteer services to a qualified public service organization, the bill would treat the volunteer service as gainful employment and the individual as having earned income for any month of not less than $200, if there is one qualifying individual with respect to the taxpayer and $400, if there are two or more qualifying individuals.

The bill would be effective for expenses incurred after December 31, 1982, in taxable years beginning after that date.

H.R. 3554

H.R. 3554 would treat the performance of substantial volunteer services by a spouse during any month as gainful employment for purposes of the child and dependent care credit. Under the bill, the spouse would be deemed to have earned income for the month of not less than $200, if there is one qualifying individual with respect to the individual, and $400, if there are two or more qualifying individuals. In the case of a husband and wife, this rule would apply only with respect to one spouse for any month.

The bill would define substantial volunteer services to mean the performance of at least 48 hours of service during a month for an organization described in sec. 170(c) of the Code.

[34] Secs. 501(c)(3) and 501(c)(4).

The provision would be effective for months beginning after the date of enactment.

4. Tax treatment of dependent care organizations

H.R. 1603 and H.R. 2090

H.R. 1603 and H.R. 2090 would provide that organizations are organized for educational purposes and, therefore, may be tax exempt if (1) the organization is organized and operated to provide nonresidential dependent care of individuals, (2) substantially all of the dependent care is provided by the organization to enable individuals to be gainfully employed, and (3) the services provided by the organization are available to the general public. Also, H.R. 1603 would permit the tax exemption (and permit the organization to receive tax deductible contributions) if substantially all of the dependent care is provided by an organization to enable individuals to seek gainful employment.

H.R. 1603 would be effective on the date of enactment. H.R. 2090 would be effective for taxable years beginning after December 31, 1983.

J. Earned Income Credit

Present Law

Under present law, an eligible individual is allowed a credit against tax equal to 10 percent of the first $5,000 of earned income. The maximum amount of the credit is $500. The amount of the credit is phased out as adjusted gross income of an individual (or earned income, if greater) increases from $6,000 to $10,000. Specifically, the allowable earned income credit for any taxable year is limited to the excess of $500 over 12.5 percent of the excess of adjusted gross income (or earned income, if greater) over $6,000. Thus, the credit is zero for families with incomes over $10,000.

Present law provides that the earned income credit is treated as earned income for purposes of determining eligibility for the Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI) programs, the earned income credit is treated as if it were received in advance payments during the taxable year for which it is available.

Explanation of the Bill

H.R. 1603

H.R. 1603 would provide that an eligible individual would be allowed a credit against tax equal to the sum of (1) 10 percent of the first $5,000 of earned income, (2) $50 for each additional dependent child of the individual, and (3) an additional $50 for each dependent child under six years of age in the case of a single working parent or a two working parent family. In addition, the provision would reduce the rate at which the credit is phased out as income increases. Thus, the allowable credit for any taxable year is limited to the excess of the maximum amount of the credit over 10 percent of the excess of adjusted gross income over $6,000.

For example, if an eligible individual has four dependent children (none of whom are under six years of age), the maximum amount of the credit would be $700 ($500 plus (4 × $50)). If the individual's adjusted gross income for the year is $10,000, the individual would be entitled to a credit equal to the excess of (1) the maximum amount of the credit ($700) over (2) 10 percent of the excess of adjusted gross income over $6,000 ($10,000—$6,000). Accordingly, the individual would be entitled to a credit of $300 ($700—10 percent of $4,000 ($10,000—$6,000)). Under present law, an individual with adjusted gross income of $10,000 is not eligible for any earned income credit.

Under the provision, the earned income credit would not be counted in advance to determine eligibility for AFDC.

The provision would be effective on the date of enactment.

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