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April 28, 2003

REPRESENTATIVES PORTMAN AND CARDIN INTRODUCE H.R. 1776, THE "PENSION PRESERVATION AND SAVINGS EXPANSION ACT" OF 2003

[15939] April 28, 2003 TO: PENSION MEMBERS No. 18-03 PENSION OPERATIONS ADVISORY COMMITTEE No. 22-03 RE: REPRESENTATIVES PORTMAN AND CARDIN INTRODUCE H.R. 1776, THE “PENSION PRESERVATION AND SAVINGS EXPANSION ACT” OF 2003 On April 11, 2003, Representatives Rob Portman (R-OH) and Benjamin Cardin (D-MD) introduced H.R. 1776, the “Pension Preservation and Savings Expansion Act” of 2003 (hereinafter the “bill”). The bill is described as “the next generation of improvements to our nation’s pension and savings systems” and is expressly intended to build on the bipartisan legislative changes enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”). This memorandum briefly summarizes the bill’s provisions that are of most interest to the mutual fund industry. You may see a complete copy of the bill by going to the following website: http://www.house.gov/cardin/pension_preservation_act.pdf. I. Expansion/Acceleration of EGTRRA Changes A. EGTRRA Permanence The bill would make permanent all of the retirement and savings provisions enacted by EGTRRA, which are currently scheduled to sunset after 2010. These provisions would be effective for tax years beginning after December 31, 2003. Bill Section 101. B. Acceleration of EGTRRA Savings Limits Increases EGTRRA phased in increases to the contribution limits under section 401(k) plans, 403(b) arrangements, SIMPLE plans and 457 plans; and provided for phased-in catch-up contributions to salary reduction arrangements for individuals age 50 or older. The bill would increase the current limits under these plans to the maximum phased-in amounts under EGTRRA, e.g., a maximum deferral or contribution of $15,000 for section 401(k) and 457 plans and 403(b) arrangements, a maximum deferral of $10,000 for SIMPLE plans and a maximum catch-up contribution of $5,000, except for SIMPLE plans, to which the maximum 2 catch-up contribution would be increased to $2,500. All increases would be effective for tax years beginning after December 31, 2003. Bill Section 402. C. Acceleration of IRA Contribution Limits Acceleration of Increases in IRA Contribution Limits. EGTRRA phased-in increases to the IRA contribution limits, which are scheduled to reach a maximum contribution of $5,000 in tax year 2008 and thereafter. The bill would accelerate EGTRRA’s scheduled increases, raising the IRA contribution limit to $5,000 for tax year 2004 and thereafter. This provision would apply for taxable years beginning after December 31, 2003. Bill Section 601. Acceleration of Increases in IRA Catch-Up Contributions. EGTRRA enacted a provision permitting individuals aged 50 or older to make catch-up contributions to IRAs in the amount of $500 for tax years 2002-2005 and increasing to $1,000 in tax year 2006 and thereafter. The bill would accelerate these scheduled increases in permitted

catch-up contributions by raising the contribution limit to $1,000 for tax year 2004 and thereafter. This provision would apply for taxable years beginning after December 31, 2003. Bill Section 601. D. Expanding and Making Permanent the Saver's Credit EGTRRA enacted a nonrefundable tax credit for low- and moderate-income savers who make salary reduction contributions to employee plans or IRAs. This "savers' credit" was scheduled to sunset after 2006. The bill would make this credit permanent. In addition, the bill expands the availability of the credit by (1) increasing the percentage of savings contributions that may be claimed as a credit for individuals who are already within eligible AGI limits and (2) raising the AGI limits used to determine eligibility for the credit. This provision is effective for tax years beginning after December 31, 2003. Bill Sections 102 and 401. II. IRA Provisions A. Elimination of IRA Marriage Penalties The bill includes several provisions intended to eliminate "marriage penalties" for couples investing in IRAs and Roth IRAs. Acceleration of Eligibility for Deductible IRAs. Deductible contributions to IRAs are phased out when an individual or couple's AGI goes above certain limits. The bill would accelerate scheduled increases in the AGI limit for deductible IRA contributions to eliminate the "marriage penalty" embedded in these limits. Limits, which are currently $60,000-$70,000 for joint filers, would increase each year until they reach $100,000-$120,000 in the year 2010 and thereafter. This provision would apply for taxable years beginning after December 31, 2003. Bill Section 602. Eligibility For Active Pension Plan Participants. Under current law, if an individual is not an active participant in an employee plan but the individual's spouse does participate in an employee plan, then the non-active participant spouse's eligibility to make deductible IRA 3 contributions is phased out where joint AGI is between $150,000-$160,000. The bill would eliminate this marriage penalty by repealing this special income limitation. This provision would be effective for taxable years beginning after December 31, 2006. Bill Section 602. Roth IRA Eligibility. Under current law, eligibility to contribute to a Roth IRA is phased out for single filers with AGI between $95,000-$110,000 and for joint filers with AGI between $150,000-$160,000. The marriage penalty on Roth IRA eligibility would be eliminated by increasing the phase-out range for joint filers to those with AGI between $190,000-$220,000. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 602. B. Correcting IRA Distribution Mistakes The bill directs the Internal Revenue Service to establish an IRA correction procedure to address situations where an IRA owner or beneficiary received an incorrect distribution as a result of an error (either by the IRA owner or beneficiary or a third party, such as an IRA trustee). The correction procedure would not require a filing with the IRS for errors that can be self-corrected within a reasonable period of time. The IRS is authorized to develop appropriate safeguards to prevent abuse. The bill provides that the IRS should establish an IRA correction procedure no later than December 31, 2004. Bill Section 604. C. IRA Contributions for Disabled Americans The current law definition of "earned income" used to determine amounts that may be contributed to an IRA excludes income from investments and other sources, including legal judgments or settlements. Because this rule may have an adverse impact on the disabled, the bill would permit individuals who are disabled (within the meaning of Code section 72(m)(7)) and who have not attained age 70 ½ to make IRA contributions even if they do not satisfy the "earned income" requirement. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 603. III. Retirement Asset Distribution A. Changes to Required Minimum Distribution Rules Increase Age Limit. The bill would modify the existing rules applicable to required minimum distributions ("RMD"s). The required beginning date would be increased on a phased-in basis from age 70 ½ to age 75 by the year 2010. RMDs would be required to begin by age 72 for tax years 2004-2005, age 73 for tax years 2006-2007, age 74 for tax years 2008-2009 and age 75 for tax years 2010 and thereafter. Change Required Beginning Date. The bill would change the definition of "required beginning date" to mean December 31 of the later of the calendar year in which the employee attains the specified age or the calendar year in which the employee retires. An employee who retires in December would be treated as retiring in the following year. Reduce Excise Tax on Underdistributions. The bill would reduce the excise tax imposed on any amount not distributed as required by the RMD rules from 50% to 20%. 4 Changes to the RMD rules would be effective for tax years beginning after December 31, 2003. Bill Section 201. B. Annuitization Tax Incentive The bill would provide taxpayers with a tax incentive to annuitize -- in the form of either a fixed or a variable annuity -- at least a portion of their retirement benefit from a defined benefit plan, a defined contribution plan, and/or an IRA. More specifically, the bill generally would permit taxpayers to exclude from income each year an amount equal to 5 percent of the first $20,000 of lifetime annuity payments. The exclusion percentage would increase from 5 percent to 10 percent in 2008. Eligibility for the exclusion would be phased out for taxpayers with adjusted gross income between $75,0000 and $90,000; for taxpayers filing joint returns, the phase-out of benefits would occur at adjusted gross incomes between $150,000 and $180,000. The term “lifetime annuity payment” would be defined to include “a distribution which is a part of a series of substantially equal periodic payments (made not less frequently than annually) made over the life of the qualified distributee or the joint lives of the qualified distributee and the qualified distributee’s designated beneficiary.” This definition would include both fixed annuities and variable annuities (pursuant to an exception providing that “annuity payments shall not fail to be treated as part of a series of substantially equal periodic payments because the amount of the periodic payments may vary in accordance with investment experience, reallocations among investment options, actuarial gains or losses, cost of living indices, or similar fluctuating criteria”). The proposal’s scope extends beyond “lifetime annuity payments” from qualified plans (under section 401(a)). Specifically, rules similar to the lifetime annuity payment exclusion also would apply to distributions out of: (1) a section 403(a) plan; (2) a section 403(b) arrangement; (3) an IRA; and (4) a section 457 deferred compensation plan. The bill also would include a recapture tax on any taxpayer who excluded lifetime annuity payments from income and then modified the payment stream so that some or all future payments are not lifetime annuity payments. Specifically, in the year in which such a modification occurs, the taxpayer would include in income an amount equal to all amounts previously excluded as lifetime annuity payments, plus interest. The lifetime annuity payment exclusion would apply to distributions made after December 31, 2003. Bill Section 305. D. Automatic Rollover Options EGTRRA enacted a provision that requires a plan that provides for mandatory “cash outs” of vested accrued benefits that do not exceed $5,000 to directly transfer such distributions to an IRA (“default IRA”) unless the participant elects to receive the distribution. This automatic rollover rule does not apply to amounts that equal $1,000 or less. Transfers to PBGC. For amounts subject to EGTRRA’s automatic rollover requirement, the employer would also be permitted to transfer such balances to the PBGC in lieu of a default 5 IRA. The bill also would permit balances of $1,000 or less to be transferred to the PBGC. For participants with balances greater than $5,000, an employer could transfer balances to the PBGC one year after the later of the date on which the benefit first became distributable or the participant’s severance from employment, unless the employee elects otherwise. This provision generally would be effective for tax years after December 31, 2004. Transfers under these rules would supersede any state escheat laws that might otherwise apply. This escheat rule would become effective upon enactment of the bill. Bill Section 202. Clarification of Fiduciary Duty. The bill would modify the fiduciary relief for a plan sponsor’s selection of a default IRA provided in EGTRRA. Specifically, the bill would amend section 404(c) of ERISA to provide that with respect to automatic rollovers of “cash out” amounts, the fiduciary would be subject to ERISA’s fiduciary requirements only with respect to the initial selection of the IRA and the investments thereunder. There would be no liability with respect to selections made consistent with DOL guidance. This provision would be effective for distributions made after the DOL has issued final regulations, which are required not later than three years after the date of enactment of EGTRRA (June 7, 2001). Bill Section 813. D. Lost Participants The bill would permit balances of lost participants in terminating defined contribution plans to be transferred to the PBGC. Current law only permits balances of lost participants in terminating defined benefit plans to be transferred to the PBGC. Transfers under these rules would supersede any state escheat laws that might otherwise apply. This escheat rule would become effective upon enactment of the bill. Bill Section 202. E. Substantially Equal Periodic Payments Current law imposes a 10% excise tax on distributions from a qualified retirement plan or IRA taken prior to the taxpayer attaining age 59 ½, unless the taxpayer elects to receive a series of substantially equal periodic payments, made at least annually for the life of the taxpayer or the joint lives of the taxpayer and a beneficiary. A taxpayer may select one of three different methods of calculating annual distributions under these rules. The Code generally imposes penalties if a taxpayer changes the method of calculating distributions within a five-year period beginning on the date of the first payment. In 2002, Treasury issued guidance permitting a one-time election to change methods of distribution without incurring the penalty that otherwise would be applicable. The bill would amend the rules governing substantially equal periodic payments to permit a taxpayer to change from one method of calculating distributions to another as often as he or she wishes, provided that the change results in an initial reduction in the amount of payments required to be made. The bill also would permit a rollover or transfer of all or a portion of the benefits being received as substantially equal periodic payments to another qualified retirement plan as long as distributions from both plans in combination continue to satisfy the substantially equal 6 periodic payment rules. This provision would be effective with respect to any series of payments commencing on or after the date of enactment. Bill Section 307. IV. Pension Portability A. Rollovers to Spouses Current law generally prohibits retirement assets from being rolled over or transferred between the accounts of spouses unless one of the spouses dies or upon divorce. The bill would permit amounts in one spouse's IRA to be transferred to the other spouse's IRA without resulting in current taxation to either spouse. This provision would be effective for years beginning after enactment. Bill Section 301. B. Rollovers to Non-Spouse Beneficiaries Under current law, non-spouse beneficiaries of a participant in a defined contribution plan generally receive a lump sum distribution of benefits that cannot be rolled over into an IRA and is subject to immediate taxation. In contrast, non-spouse beneficiaries of an IRA owner may continue to hold the assets in an IRA in the name of the decedent and are not subject to immediate taxation. The bill would equalize the treatment of these two groups of non-spouse beneficiaries by permitting the non-spouse beneficiary of a participant in a defined contribution plan to transfer the plan assets to an IRA held in the name of the decedent. This provision would be effective with respect to distributions made after December 31, 2003. Bill Section 303. C. Rollovers from Flexible Spending Accounts The bill would permit up to $500 in amounts available but not used during the plan year for eligible expenses under a cafeteria plan or flexible spending arrangement to be contributed to a 401(a) plan, a 403(b) arrangement, a 457(b) plan or an IRA. Such a transferred amount would be treated as an elective contribution and would be subject to the rules otherwise applicable to elective contributions. This provision would be effective for tax years after December 31, 2003. Bill Section 404. D. Portability for State and Local Government Employees EGTRRA enacted a provision allowing State and local government employees to use funds from their section 403(b) arrangement or 457 plan to purchase service credits. The bill makes technical corrections to the EGTRRA changes to clarify that (1) provisions regarding nonqualified service do not apply to the use of funds from section 403(b) arrangements or

457 plans, (2) State-to-state transfers may be made from any governmental plan, (3) the defined benefit plan's distribution rules apply to the transferred amounts, and (4) individuals may purchase service credits both to increase benefits attributable to past service as well as to purchase credits with respect to new service. This provision would apply retroactively to transfers made after December 31, 2001. Bill Section 903. E. Other Portability Provisions Direct Rollovers to Roth IRAs. The bill would permit individuals to roll over amounts from a qualified plan directly to a Roth IRA. Under current law, an individual must roll over 7 such amounts to a traditional IRA and then convert it to a Roth IRA. All existing limitations on Roth IRAs, such as the $100,000 income limitation on Roth conversions, would continue to apply. This provision would be effective for distributions made after December 31, 2003. Bill Section 304. Rollovers of After-Tax Amounts. The bill would clarify that after-tax amounts in a section 403(b) arrangement may be rolled over into a 401(k) plan and vice versa. This provision would be effective for distributions after December 31, 2003. Bill Section 306. Plan Mergers and Transfers. The bill directs Treasury (within one year after the date of enactment of the bill) to prescribe rules that would permit a plan sponsor to transfer plan assets from one type of plan to another (e.g., an employer who offered a 403(b) now wants to offer a 401(k) plan) as long as participant and spousal rights are protected. This provision would be effective for tax years beginning after the year in which Treasury prescribes the required rules governing these transfers. Bill section 312. V. Small Business Plan Coverage A. SIMPLEs Additional Nonelective Employer Contributions. The bill would permit employers to make additional nonelective contributions up to 10% of compensation (current law limits nonelective contributions to 2% of compensation) to SIMPLE plans for their employees. Employers could make these additional nonelective contributions whether or not they were also making matching contributions. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 501. Conforming Matching Contribution Rules For SIMPLE IRAs and SIMPLE 401(k)s. Current law permits employers to make matching contributions at a rate of less than 3 percent, but not less than 1 percent for no more than 2 years in a five-year period ending in the current taxable year. This rule applies to SIMPLE IRAs but not with respect to SIMPLE 401(k)s. The bill would conform the SIMPLE matching contribution rules by providing the same matching contribution rule for SIMPLE 401(k)s. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 502. Salary-Reduction Only SIMPLE Plans. Current law generally requires employers to make either a matching contribution or a nonelective contribution to SIMPLE plan participants. The bill would permit a small employer that has not maintained any type of retirement plan in the previous 2 years to maintain a salary-reduction only SIMPLE plan. Under this arrangement, the employer would not be required to make any contributions to the plan and employees would be permitted to make elective deferrals of up to $5,000. This provision would be effective for taxable years beginning after December 31, 2004. Bill Section 503. Mid-Year Changes. Current law prohibits an employer from making a mid-year change from a SIMPLE plan to another type of qualified retirement plan. The bill directs Treasury to establish rules (no later than December 31, 2004) under which employers could make such mid- year changes. Bill Section 504. 8 Elimination of Higher Penalty on Certain SIMPLE Distributions. Current law imposes a 25 percent penalty on early withdrawals from SIMPLE plans during the first two years of plan participation. The bill would repeal this 25 percent penalty and replace it with a 10 percent penalty that would be generally applicable to early withdrawals. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 505. Rollovers to and from SIMPLE Plans. The bill expands the portability rules applicable to SIMPLE plans to allow rollovers from any type of qualified retirement plan into a SIMPLE IRA. The same rules governing rollovers from other IRAs would apply to rollovers from SIMPLE IRAs. This provision would be effective for years beginning after December 31, 2003. Bill

Section 506. B. SEPs Definition of Compensation. Current law uses different definitions of "compensation" for purposes of certain SEP rules. The rules governing limitations on employer deductions for SEP contributions is generally 25 percent of the aggregate compensation of the employer's employees. For this purpose, the employees' compensation includes salary reduction contributions. In contrast, for purposes of the limit on the amount of contributions that can be made on behalf of employee under a SEP, the amount is equal to the lesser of 25 percent of taxable compensation or $40,000 (indexed). This rule has the effect of making the amount of compensation used to determine contributions on behalf of the employee less than the compensation used to determine employer deductions. The bill would amend the definition of "compensation" used for purposes of the limit on contributions that can be made on behalf of employees to a SEP to be gross compensation. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 507. Reverse Match Salary Reduction SEP. The bill would permit salary reduction contributions to SEPs, subject to all rules otherwise applicable to SEPs. These salary reduction contributions could not exceed two times the amount of employer contributions. If more than 25 employees were eligible or would have been eligible to participate at any time during the prior year, then a salary reduction SEP cannot be offered. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 810. Level Dollar Contributions to SEPs. Under current law, SEP contributions generally must bear a uniform relationship to the compensation (not exceeding $200,000, as indexed) of each employee maintaining a SEP. The bill provides that SEP contributions would also be considered nondiscriminatory if contributions were a uniform dollar amount on behalf of each employee. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 811. Tax on Nondeductible Contributions. EGTRRA enacted a provision excluding SIMPLE plans and IRAs from a 10 percent excise tax on nondeductible contributions that are nondeductible solely because the contributions are not a trade or business expense under Code section 162. The bill would apply this same exception to SEPs. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 812. 9 Rollovers to and from SEP Plans. The bill expands the portability rules applicable to SEP plans to allow rollovers from any type of qualified retirement plan into a SEP IRA. The same rules governing rollovers from other IRAs would apply to rollovers from SEP IRAs. This provision would be effective for years beginning after December 31, 2003. Bill Section 506. C. Payroll Tax Exemption for Small Business Under current law, employer contributions to a retirement plan on behalf of an employee are excluded from both income and employment taxes (except for certain salary reduction contributions, which are subject to employment taxes). However, employer contributions to a retirement plan on behalf of self-employed individuals are not excluded from employment taxes. The bill would exclude self-employed individuals' retirement plan contributions from employment taxes. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 508. VI. Diversification and Education A. Diversification of Company Stock The bill would provide participants and beneficiaries of defined contribution plans with expanded rights to divest their accounts of employer securities (as defined in ERISA section 407(d)(1)). Plans subject to this requirement would include defined contribution plans holding employer securities that are readily tradable on an established securities market. "Stand alone" employee stock ownership plans (ESOPs) would not be subject to the rule. In the case of employer securities attributable to employee elective deferrals and contributions, plans would be required to allow individuals to divest their accounts of such securities and direct them into other investment alternatives — which must consist of no less than 3 investment options other than employer securities. The bill would require plans to allow such elections to be made no less frequently than quarterly. For employer securities attributable to (1) employer matching contributions, (2) qualified nonelective contributions under section 401(m)(4)(C) and (3) contributions under section 401(k)(12)(C), the bill would require plans to allow individuals with 3 years of service to divest their accounts of such employer securities. For other types of employer contributions, individuals with 5 years of service would be allowed to divest their accounts of these employer securities. As with employee elective deferrals, plans must offer at least 3 investment options to which proceeds attributable to employer contributions could be directed. The provision generally would be effective for plan years beginning after December 31, 2003. The bill would provide a transition rule under which plans would be permitted to allow diversification out of employer securities. Specifically, the diversification rights with regard to the amount of employer securities held in the account would be phased in according to the following schedule: for plan year 2004: 20 percent of employer securities in the individual's account; 2005: 40 percent; 2006: 60 percent; 2007: 80 percent; and 2008 and thereafter: 100 percent. Bill Section 1103. 10 B. Treasury Study on Lessening Market Volatility Effects on DC Savings The bill provides that within one year following the date of enactment, Treasury is directed to conduct and transmit a study to evaluate possible ways to lessen defined contribution losses due to volatility in the economic markets. The bill directs Treasury to investigate the following issues: (1) the extent to which both long-and short-term stock market volatility affects defined contribution savings; (2) the effect that this volatility has on the continuation and creation of defined contribution plans; (3) investment alternatives and lifetime distribution options for defined contribution plans that may help to ameliorate market risks; and (4) what legislative or administrative steps may be taken to lessen defined contribution plan losses in the future. Bill Section 205. C. Investment Education Notices The bill would require plan administrators to provide investment education notices that set forth (1) an explanation of generally accepted investment principles, including principles of risk management and diversification, and (2) a discussion of the risks of holding substantial portions of a portfolio in the security of any one entity, such as employer securities. Such notices, which must be written in a manner calculated to be understood by the average plan participant, would be provided to participants at the time of enrollment and not less than on a quarterly basis thereafter. Plans subject to the notice requirement would include section 401(a) qualified plans, section 403(a) plans, section 403(b) arrangements, and governmental section 457 plans that also allow participants to direct investments (or hypothetical investments) under the plan. Additionally, the bill would direct the Secretary of the Treasury, in consultation with the Secretary of Labor, to issue guidance and model notices under the provision.1 The provision generally would be effective for plan years beginning after December 31, 2003. Bill Section 1101. D. Qualified Retirement Planning Services The bill would permit employees to pay for "qualified retirement planning services" (as defined in Code section 132(m)) on a pre-tax basis by making payroll deductions. This benefit 1 The bill, as introduced, also contains an amendment to the Code that would require the provision of a 30-day advance notice for pension "blackout periods." Bill Section 1102. A provision substantially similar to this, however, was enacted as part of the Sarbanes-Oxley Act of 2002. See Institute Memorandum to Pension Members No. 35-02 and Pension Operations Advisory Committee No. 51-02, dated July 30, 2002. Notably, the bill would add an excise tax for failure to provide such notices to participants and beneficiaries. 11 would be available to highly compensated employees only if it is available on substantially the same terms to each member of the employee group normally provided education and information regarding the employer's retirement plan. The provision would be effective for plan years beginning after December 31, 2003. Bill Section 1104. VII. Plan Administration Provisions A. Reducing Vesting Schedules. The bill would conform the vesting rules for non-elective contributions to the existing rule for employer matching contributions. Accordingly, all employer contributions generally would be required to vest under either a 3-year cliff vesting schedule or a 6-year graded vesting schedule. The provision generally would be effective for plan years beginning after December 31, 2003. Bill Section 302. B. Qualified Domestic Relations Orders Under current law, benefits under a qualified retirement plan can be assigned to an alternate payee under a “qualified domestic relations order” (“QDRO”). The plan must pay benefits in accordance with the QDRO if the plan administrator determines that the QDRO satisfies the requirements of ERISA and the Code. Subsequent QDROs. The bill would clarify that a subsequent QDRO that is issued after or revises a prior QDRO will be treated as a valid QDRO, but only for amounts payable after the subsequent QDRO is determined to be qualified. This provision applies to transfers made after December 31, 2003. Bill Section 308. Delayed QDROs. The bill would clarify that a QDRO that is otherwise qualified will be treated as a valid QDRO without regard to the time at which the order is issued. This provision applies to transfers made after December 31, 2003. Bill Section 309. VIII. Retiree Health Provisions A. Funding Retiree Medical Premiums with Pre-Tax Pension Payments The bill would permit retirees to elect to use retirement plan distributions on a pre-tax basis to pay for their share of the cost of retiree medical coverage. This proposal would apply to distributions from a section 401(a) qualified plan, a section 403(a) plan, a section 403(b) arrangement or governmental 457(b) plan. This proposal would not apply to distributions from IRAs (including IRAs that are part of a SIMPLE or SEP plan). In order to qualify for pre-tax treatment, the distribution would have to be used to pay all or part of the premium of a retiree health plan maintained by the retiree’s former employer. Prior to tax year 2010, the bill imposes a limitation on the amount of pre-tax retirement plan distributions that could be used for to pay for retiree health care ($500 in 2004-2005, $1,000 in 2006-2007 and $2,000 in 2008-2009). This provision is effective with respect to amounts paid for health coverage in taxable years beginning after December 31, 2003. Bill Section 1401. 12 B. Allowing 401(k) Sponsors to Pre-Fund Retiree Medical The bill would expand the availability of section 401(h) accounts so that they could be maintained as part of a profit-sharing or stock bonus plan. Current law permits 401(h) accounts only as part of a defined benefit or money purchase pension plan. Current law also limits contributions to section 401(h) accounts so that the sum of the cumulative employer contributions to the account, plus the cumulative employer contributions for life insurance protection under the plan, cannot exceed 25 percent of the total employer contributions to the plan (other than contributions to fund past service credits). Under the bill, this 25 percent limitation would apply to profit-sharing plans and stock bonus plans for taxable year 2010 and thereafter. This limit is reduced for prior years (to 5 percent in 2004-2005, 10 percent in 2006-2007 and 20 percent in 2008-2009). This provision is effective for taxable years after December 31, 2003. Bill Section 1402. IX. Regulatory Simplification The bill includes a number of provisions intended to simplify the rules governing qualified retirement plans. Excise Tax on Excess Contributions. Current law imposes a 10 percent excise tax on excess contributions and excess aggregate contributions. An exception to this tax is allowed for corrective distributions made within the first 2 ½ months of the following plan year. Such distributions of excess contributions generally are included in the employee’s gross income in the employee’s taxable year in which the contributions were made. The bill would extend the corrective distribution period with respect to the 10 percent excise tax to apply to corrective distributions made within the first 6 months of the following plan year. Amounts of up to $1,000 would be taxable in the year of receipt without regard to when the corrective distribution was made. Amounts exceeding $1,000 that are distributed prior to the end of the 6 month exception period would be taxable in the employee’s taxable year when the contribution was made. This provision is effective for taxable years beginning after December 31, 2003. Bill Section 801. Paperless Technologies. The bill directs Treasury and DOL to permit the use of new technologies for various purposes related to qualified retirement plans no later than

December 31, 2004. Treasury and DOL are directed to allow the use of paperless technologies for: (1) notices, elections, and spousal consents required under Code sections 401(a)(11) and 417 and section 205 of ERISA; (2) providing information to satisfy the conditions for a hardship distribution under Code section 401(k)(2)(B)(i)(IV); and (3) other plan transactions for which the Secretaries determine that the use of paperless technologies is appropriate. 13 Bill Section 803. Intermediate Sanctions for Inadvertent Plan Failures. The bill provides that qualified retirement plans would not be disqualified for violations of applicable rules provided that the plan made a good faith effort to comply with the qualification requirements and substantially corrects any failure. If the violation is corrected before an audit, then no penalty would apply. If the failure is corrected after the plan becomes subject to audit, a reasonable fee will be imposed. Additionally, non-highly compensated employees would not be required to include amounts in income that are attributable to plan disqualification. This provision would become effective upon enactment of the bill. Bill Section 806. Qualified Pre-Retirement Survivor Annuities. The bill would permit the continued validity of pre-retirement survivor annuity waivers after the electing individual attains age 35. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 807. Indexing of $5,000 “Cash-Out” Amount. The bill would provide for indexing the $5,000 cash-out limit for plan distributions. This provision would be effective for taxable years beginning after December 31, 2003. Bill Section 808. Nondiscrimination and Catch-Up Contributions. The bill would incorporate the nondiscrimination rules applicable to catch-up contributions into Code section 401(a)(4) and clarify that employees covered under collective bargaining agreements and employees of a qualified separate line of business would not be considered in determining compliance with the requirement that benefits, rights and features of a plan be “universally available” to all eligible plan participants. This provision would be effective for taxable years after December 31, 2001 (i.e., EGTRRA’s general effective date) Bill Section 809. X. Miscellaneous A. Supplemental Security Income Eligibility The bill would exclude retirement plan balances of up to $75,000 for purposes of determining eligibility for supplemental income payments for the aged, blind or disabled under Title XVI of the Social Security Act. This provision would be effective upon enactment of the bill. Bill Section 311. C. Plan Amendments The bill provides that amendments to a plan or annuity contract made pursuant to changes in the law made by the bill, Title VI of EGTRRA, or regulations under either the bill or Title VI of EGTRRA would not be required to be made until on or before the last day of the first plan year beginning on or after January 1, 2006. Except as provided by Treasury, amending a plan under these provisions would not result in a failure to meet the requirements of section 411(d)(6). In the case of a governmental plan, the date for amendment is extended to the first plan year beginning on or after January 1, 2008. Operational compliance would still be required with respect to all plans as of the applicable effective date of any amendment made by the bill. Bill Section 1501. 14 D. 30 –Year Treasury Rate Replacement The bill would replace the existing 30-year Treasury Rate for all purposes that the rate is currently used with respect to retirement plans. The new rate would be an interest rate based on “amounts conservatively invested in long-term corporate bonds,” as determined by Treasury (the Corporate Bond Rate). This provision generally would be effective for taxable years beginning after December 31, 2003. However, the bill provides for phase-ins for certain purposes, such as lump sum distributions. Bill Sections 705 and 1201. E. Byrd Provisions Dropped From EGTRRA Title XII of the bill would enact various ERISA provisions that were excluded from the EGTRRA for procedural reasons.2 These provisions, for example, would (1) simplify the Form 5500 filing requirement for small plans, (2) direct the Treasury Department to improve the Employee Plans Compliance Resolution System, (3) extend to all governmental plans a moratorium of certain nondiscrimination rules applicable to state and local government plans, and (4) modify the notice and consent period for distributions (e.g., under Code sections 402(f), 411(a)(11) and 417). In addition, the bill would direct the Secretary of Labor, in consultation with the Secretary of the Treasury, to study small employer retirement plans, as well as require the Labor Department submit a report on the effect of the legislation within 5 years after the bill's date of enactment. Lisa Robinson Assistant Counsel 2 See, e.g., Institute Memorandum to Pension Committee No. 18-01 and Pension Operations Advisory Committee No. 27-01, dated March 23, 2001 (summarizing pension reform legislation sponsored by Representatives Rob Portman (R- OH) and Ben Cardin (D-MD)).

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