

MEMO# 9910

May 7, 1998

REPRESENTATIVES PORTMAN AND CARDIN FILE PENSION REFORM BILL

[9910] May 7, 1998 TO: PENSION COMMITTEE No. 27-98 RE: REPRESENTATIVES PORTMAN AND CARDIN FILE PENSION REFORM BILL

Representatives Portman (R-OH) and Cardin (D-MD) recently filed H.R. 3788, the "Retirement Security for the 21st Century Act." This bill contains significant proposals that seek to reform the employer-sponsored retirement plan system by expanding coverage, enhancing fairness for women and children, increasing benefit portability, strengthening pension security and reducing regulatory burdens. The bill contains many of the Institute's legislative priorities, including (1) enhancing retirement account portability; (2) permitting "catch-up" contributions to 401(k) plans; (3) raising the 402(g) salary deferral limit and other qualified plan limitations; (4) eliminating the section 415(c) "25% of compensation" limitation on defined contribution plan contributions; (5) modifying the top-heavy rules; (6) increasing the SIMPLE and 457 plan salary deferral limits; and (7) modifying Code section 401(a)(9) required minimum distribution rules. The most significant proposals in the bill are summarized below.

I. Expanding Coverage -- Title I of H.R. 3788

A. Raising various income and salary deferral limitations.

1. The section 415 dollar limits applicable to defined contribution and defined benefit plans is modified. With regard to defined contribution plans, the "25% of compensation limit" is eliminated (see below discussion of Title II of bill), and the \$30,000 limitation is raised to \$45,000.

2. The section 401(a)(17) compensation limit is raised from \$150,000 (which, currently adjusted for inflation, is set at \$160,000) to \$235,000. The cost-of-living adjustment for this amount is changed to increase in \$5,000, rather than \$10,000 increments.

3. The 402(g) elective deferral limit is raised to \$15,000.

4. The 457 plan annual deferral limit is raised to \$15,000.

5. The SIMPLE plan deferral limit is increased to \$10,000.

B. Plan loans. Subchapter S owners, partners and sole proprietors participating in a retirement plan, would no longer be prohibited from using the plan's loan feature.

C. Salary Reduction Only SIMPLE Plans. Small employers would be able to establish a SIMPLE plan in which there is no required employer contribution. Employees could elect to defer up to \$5,000 annually into the plan. Employers offering a regular SIMPLE plan would be permitted to elect annually to change the plan into a salary reduction only plan upon appropriate notice to employees of the election.

D. Top-Heavy Rule Reform. H.R. 3788 substantially reforms the top heavy rule. First, the family aggregation rules as they apply to the "5-percent owner" definition under section 416(i)(1)(B)(i)(I) are repealed. Second, the definition of "key employee" is simplified by eliminating the 4-plan year look back provision, increasing to \$150,000 the amount of compensation an officer must have to be treated as highly compensated, and deleting the "top 10 compensated employees" rule. Third, elective salary deferral contributions would not be taken into account in determining whether a plan is top heavy. Fourth, plans deemed top heavy would be permitted to take

into account employer matching contributions to meet the minimum contribution requirements imposed on top heavy plans. Finally, 401(k) plans that use the nondiscrimination safe harbor formulas set forth at sections 401(k)(12) and 401(m)(11) would not be subject to the top heavy rule at all.

E. Employer Deduction Limitation Adjusted. Elective deferrals to retirement plans would no longer be taken into account under Code section 404, which limits the deductibility of employer contributions to certain retirement plans.

II. Enhancing Fairness For Women and Children -- Title II of H.R. 3788

A. Catch-up Provision For Elective Deferrals. The bill would permit individuals who have attained the age of 50 to make additional contributions of \$5,000 to 401(k) plans. Therefore, individuals 50 or older would be permitted to make annual contributions of \$20,000 to such plans as the bill would increase the annual 402(g) limitation to \$15,000. The elective deferral limitation applied to SIMPLE, 457 plans and certain other salary deferral plans would be similarly increased.

B. Section 415(c)(1) 25% of Compensation Limit. The bill would repeal the "25% of compensation" limit applied to employee contributions to defined contribution plans.

C. Faster Vesting For Employer Matching Contributions. The bill would require that employer matching contributions vest on either a 3-year cliff schedule or a 1-5 year graded vesting schedule.

D. Minimum Distribution Rule Reform. The bill would amend section 401(a)(9) to change the required minimum distribution age from 70 1/2 to 75, would exempt the first \$300,000 of defined contribution and IRA assets from the rule, and would reduce the excise tax on failure to make minimum required distributions from 50% to 10%. The bill directs the Treasury to simplify and finalize proposed regulations issued in 1987, modify the regulations to reflect increases in life expectancy and revise the distribution methods so that the required minimum distributions do not decrease over a participant's life expectancy. Also, the bill proposes to repeal the "at least as rapidly" rule (at section 401(a)(9)(B)(i), pertaining to distributions after death), where required minimum distributions had already begun before death.

III. Increasing Portability For Participants -- Title III of H.R. 3788

A. Plan to Plan Rollovers & Rollovers of IRAs into Plans. The bill would permit individuals to roll over assets to and from 401(k) plans, 403(b) accounts, section 457 plans sponsored by state and local government employers, and IRAs. The bill would treat rollover distributions from government-sponsored 457 plans as "eligible rollover distributions" under section 402(c)(4) and also treat such 457 plans as "eligible retirement plans" into which eligible rollover distributions may be made under section 402(c)(8)(B). The rules regarding notice to participants and the mandatory 20% withholding would not apply to 457 plans. However, distributions over \$50,000 from a 457 plan attributable to a large rollover from another eligible retirement plan other than a 457 plan, would be subject to the section 72(t) 10% penalty on premature distributions. The bill would similarly permit the distribution of 403(b) assets into an eligible retirement plan and the rollover of "eligible rollover distributions" from other plan types into a 403(b) account. Section 408(d) (relating to rollover contributions) would be amended to include defined contribution plans, 403(b) arrangements, 457 plans and defined benefit plans. Section 402(f) notices would be expanded to include a description of the restrictions and tax consequences which will be different when rolling over to a different plan type.

B. Rollover of After-tax Contributions. The bill would permit the rollover of after-tax employee contributions to an IRA or other eligible retirement plans.

C. Hardship Exception to 60-day Rollover Rule. The bill would permit the IRS to waive the 60-day rollover requirement in equitable cases, including instances of casualty, disaster or other events beyond the reasonable control of individuals subject to the rule.

D. Plan-to-Plan Transfers. The bill would permit employees to elect to transfer assets from one plan to another without requiring the transferee plan to preserve the optional forms of benefit under the transferor plan if certain requirements are satisfied. In addition, a form of distribution in a defined contribution plan may be eliminated if (1) a single sum distribution is available to the

participant at the time the form of distribution is eliminated and (2) such single sum distribution is based on the same or greater portion of the participant's account as the form of distribution being eliminated. E. "Same Desk" Rule Modification. Current law limits distributions from 401(k), 403(b) and 457 plans to when a participant "separates from service." The rule has been interpreted in a way that inhibits the movement of individual account assets between the plan of a former and new employer following a corporate transaction in which the participant continues to work in the same job, but for the new employer. The bill would resolve this problem by replacing the "same desk" rule with a standard allowing distribution upon "severance from employment."

IV. Strengthening Pension Security and Enforcement -- Title IV of H.R. 3788 A. Defined Benefit Plan Full Funding Limit. The bill repeals the 150 percent of current liability limitation (section 412(c)(7)), effective in 2003. B. Missing Participant Program. The Pension Benefit Guaranty Corporation's "missing participant" program would be extended to multiemployer plans and defined contribution plans. With regard to qualified plans not subject to ERISA Title IV (i.e., defined contribution plans), plan administrators may elect, upon plan termination, to provide information to PBGC regarding missing participants and transfer the participant's accrued benefit to the PBGC. C. Periodic Benefit Statements. The bill would amend ERISA to require that defined contribution plan participants and beneficiaries receive an annual benefit statement, which may be delivered in written or electronic form. Defined benefit plan participants and beneficiaries would continue to receive annual statements only upon written request. D. ERISA Section 502(l) Civil Penalty Provisions Modified. The bill would amend ERISA section 502(l) to make the assessment of penalty discretionary by the Secretary of Labor, rather than mandatory. The bill would permit the Secretary to refrain from imposing the penalty in certain circumstances, and to assess a penalty of less than 20% of the applicable recovery amount. V. Reducing Regulatory Burdens -- Title V of H.R. 3788 A. Protection From Disqualification for Timely Correction of Errors. The bill would protect from tax disqualification plans that make a good faith effort to substantially correct inadvertent failures to comply with the qualification rules of section 401(a) before the plan becomes subject to an IRS examination, or if it in fact substantially corrects such compliance errors after becoming subject to an examination. If errors are corrected after the initiation of an examination, the IRS may also impose a penalty in amounts that bear a reasonable relationship to the severity of the plan's compliance error. Similar rules would apply to 401(k) and 403(b) error correction. Furthermore, to the extent a plan was disqualified, the bill would protect nonhighly compensated employees from taxation for receipt of resulting plan distributions. B. Multiple Use Test Repeal. The bill would repeal the "multiple use test" set forth under section 401(m)(9). C. Nondiscrimination Rule Relief. The bill would restore the section 401(a)(4) "facts and circumstances" standard, in addition to the current numerical tests. Satisfaction of this standard, pursuant to conditions to be prescribed in regulations, would provide a "safety valve" for plans unable to satisfy the numerical tests. D. Separate Lines of Business Rules. The section 410(b)(5) "gateway test" would be repealed and the IRS instructed to simplify section 414(r) regulations relating to separate lines of business. E. Modification of the Involuntary Cash-out Rule. The current \$5,000 cash-out limitation would be indexed for inflation in \$500 increments. Also, the bill would direct the Treasury to modify the existing regulations under sections 411(a)(11) and 417(e) to repeal the "look back" rule, which requires the plan sponsor to look back to determine if the individual's account previously exceeded \$5,000. A copy of an executive summary of the bill's provisions and a copy of the bill are attached. Russell G. Galer Senior Counsel Kathryn A. Ricard Assistant Counsel Attachments

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