

MEMO# 13453

April 27, 2001

JOINT COMMITTEE ON TAXATION RELEASES RECOMMENDATIONS ON SIMPLIFICATIONS TO RETIREMENT AND EDUCATION SAVINGS TAX INCENTIVES

[13453] April 27, 2001 TO: PENSION COMMITTEE No. 25-01 RE: JOINT COMMITTEE ON TAXATION RELEASES RECOMMENDATIONS ON SIMPLIFICATIONS TO RETIREMENT AND EDUCATION SAVINGS TAX INCENTIVES The Joint Committee on Taxation recently released the results of its study on the overall state of the Federal tax system. This study is required to include recommendations with respect to possible simplification proposals that the Joint Committee may deem advisable. The study includes various recommendations regarding simplifications to retirement and education savings tax incentives, including IRAs, 403(b) arrangements, 457 plans and the HOPE and Lifetime Learning credits. On April 26, 2001, the Joint Committee held a hearing on the results of its study. The Institute is planning to submit testimony to the Committee regarding its recommendations on simplifications to retirement and education savings tax incentives. The Joint Committee recommended the following simplifications relating to retirement saving and education tax incentives: I. IRAs • Eliminate the phase-outs relating to IRAs; • Eliminate the income limits on eligibility to make deductible IRA contributions, Roth IRA contributions and conversions of traditional IRAs to Roth IRAs; • Eliminate the ability to make nondeductible IRA contributions; • Conform the age restrictions on the ability to make IRA contributions; and • Impose a uniform basis recovery rule on traditional and Roth IRAs (distributions would be treated as attributable to basis first, until the entire amount of basis is recovered). II. Qualified Plans • Impose a single definition of compensation for all qualified retirement plan purposes, including determining plan benefits; • Modify the ratio percentage test under the minimum coverage rules to allow more plans to use the test; 2 • Disregard excludable employees in applying the minimum coverage and general nondiscrimination rules; • Specify in the Code the extent to which cross-testing may be used; • Impose a uniform vesting requirement for all qualified plans by applying the top-heavy vesting schedules to all plans; • Allow State and local government employers to adopt SIMPLE 401(k) plans; • Apply the same contribution rules to SIMPLE IRAs and SIMPLE 401(k) plans; • Apply the employee eligibility rules for SIMPLE IRAs to SIMPLE 401(k) plans; • Use a uniform definition of highly compensated employee and owner for all qualified retirement plan and employee benefit purposes; • Conform contribution limits applicable to tax-sheltered annuities to the contribution limits applicable to comparable qualified retirement plans; • Modify the required minimum distribution rules to provide that (1) no distributions are required during the participant's life; (2) if distributions commence during the participant's lifetime under an annuity form of distribution, the terms of the annuity will govern distributions after the

participant's death; and (3) if distributions either do not commence during the participant's lifetime or commence during the participant's lifetime under a nonannuity form of distribution, the undistributed accrued benefit must be distributed to the participant's beneficiary or beneficiaries within five years of the participant's death; • Apply uniform exceptions to the early withdrawal tax for all tax-favored retirement plans; • Change the age for permissible distributions for 401(k) plans to 55 from 59 ½; • Allow all State and local governments to maintain section 401(k) plans; • Redraft the statutory provisions applicable to 457 plans so that separate provisions apply to plans maintained by State and local governments and to plans maintained by tax-exempt organizations; and • Apply the attribution rules used in determining controlled group status under section 1563 to the rules used in determining ownership for all qualified retirement plan purposes. III. Taxation of Annuities • Redraft section 72 relating to taxation of annuities to eliminate "overly convoluted language" and improve the readability of the statutory language; and • Separate the provisions of section 72 that apply to qualified retirement plans from other provisions of the section and combine them with other rules governing the taxation of distributions from such plans. IV. Education Savings Incentives • Eliminate the phase-outs for the HOPE and Lifetime Learning credits; • Adopt a uniform definition of qualifying higher education expenses; • Combine the HOPE and Lifetime Learning credits into a single credit. The single credit would (1) utilize the present-law credit rate of the Lifetime Learning credit; (2) apply on a per-student basis; and (3) apply to eligible students as defined under the Lifetime Learning credit; and 3• Eliminate the restrictions on the use of education tax incentives based on the use of other education tax incentives and replace them with a limitation that the same expenses could not qualify under more than one provision. A copy of the relevant portions of the Joint Committee's study is attached. Kathryn A. Ricard Associate Counsel Attachment Attachment (in .pdf format)