

**MEMO# 12584**

September 8, 2000

# **SENATE FINANCE COMMITTEE UNANIMOUSLY APPROVES THE "RETIREMENT SECURITY AND SAVINGS ACT OF 2000"**

[12584] September 8, 2000 TO: PENSION COMMITTEE No. 67-00 PENSION OPERATIONS ADVISORY COMMITTEE No. 66-00 RE: SENATE FINANCE COMMITTEE UNANIMOUSLY APPROVES THE "RETIREMENT SECURITY AND SAVINGS ACT OF 2000" On September 7, 2000, the Senate Finance Committee approved by a unanimous vote of 19 to 0 the "Retirement Security and Savings Act of 2000" ("Bill" or "Senate Bill"). The Senate is expected to consider the Bill on September 22, 2000. The Bill is substantially similar to H.R. 1102, the "Comprehensive Retirement Security and Pension Reform Act of 2000" ("House Bill"), which was passed by the House of Representatives in July of this year by a vote of 401 to 25. For details on the House Bill, please refer to the Institute's memorandum describing its provisions.<sup>1</sup> This memorandum identifies provisions of the Senate Bill that differ from, or are in addition to, those in the House Bill. Although the bills are substantially similar, the Senate Bill diverges from the House Bill in a number of respects.<sup>2</sup> Notable differences include the following: the Senate Bill contains provisions that would (1) raise AGI limits for deductible IRA contributions, (2) raise income limits applicable to Roth IRA contributions for joint filers and IRA-to-Roth IRA conversions, (3) provide a percentage-based limit for "catch-up" IRA contributions, (4) permit the establishment of "deemed IRAs", (5) delay the effective date of the portability provisions, (6) simplify the rules on the rollover eligibility of hardship distributions, (7) establish a tax credit for contributions made by low- and middle-income individuals, and (8) establish a small business tax credit for qualified retirement plan contributions and plan start-up expenses. These and other differences between the Senate and House Bills are discussed in greater detail below.<sup>3</sup>

1 See Institute Memorandum to Pension Committee No. 53-00 and Pension Operations Advisory Committee No. 53-00, dated July 25, 2000. The House Bill and a description thereof are referenced throughout this memorandum. 2 A number of the provisions in the Senate Bill that did not appear in the House Bill were contained in previously introduced legislation, including H.R. 2488, the tax bill passed by Congress last year and vetoed by the President. See Institute Memorandum to Pension Members No. 31-99, Tax Committee No. 21-99, Transfer Agent Advisory Committee No. 53-99, Operations Committee No. 32-99 and Investment Advisers Committee No. 10-99, dated August 13, 1999. 3 Copies of the Description of the Chairman's Mark of the Retirement Security and Savings Act of 2000 ("Description") and Modifications to the Description of the Chairman's Mark ("Description Modifications") are attached. Proposed statutory language for the Senate Bill is not yet available. 2 • Increase in Income Eligibility Limits for Deductible IRA Contributions. The

Senate Bill would increase in stages the AGI limit on eligibility to make deductible IRA contributions. For joint filers, the phase-out range would be \$56,000 to \$66,000 in 2001; \$60,000 to \$70,000 in 2002; \$64,000 to \$74,000 in 2003; \$68,000 to \$78,000 in 2004; \$72,000 to \$82,000 in 2005; \$76,000 to \$86,000 in 2006; and \$80,000 to \$100,000 in 2007 and thereafter. For individuals, the phase-out range would be \$36,000 to \$46,000 in 2001; \$40,000 to \$50,000 in 2002; \$44,000 to \$54,000 in 2003; \$48,000 to \$58,000 in 2004; and \$50,000 to \$60,000 in 2005 and thereafter. (This proposal, in effect, would accelerate a prospective increase enacted by the Taxpayer Relief Act of 1997.) Description p. 5.

- **Increase in Income Limits on Roth IRA Contributions for Joint Filers.** The Senate Bill would raise the AGI limit on eligibility to make Roth IRA contributions by joint filers from a phase-out range of \$150,000-\$160,000 to \$190,000-\$220,000, effective for taxable years beginning after December 31, 2000.<sup>4</sup>
- **Catch-Up Contributions to IRAs.** The Senate Bill would provide that individuals who have attained age 50 before the end of the taxable year may make an annual IRA contribution 50 percent greater than the otherwise maximum annual contribution limit. The House Bill, by contrast, would establish only a temporary catch-up for such individuals.<sup>5</sup>
- Description p. 6 (House Bill 101; House Bill Description p. 2-4).
- **Catch-Up Contributions to Plans.** Individuals who have attained age 50 before the end of the plan year would be permitted to make elective deferrals to 401(k)s, 403(b)s, SIMPLEs and 457 plans in addition to those permitted under their plan in amounts equal to 50 percent of the annual maximum dollar amount permitted. Unlike the House Bill's catch-up provision, catch-up contributions under the Senate Bill would not be subject to nondiscrimination testing. The Senate Bill would phase-in the catch-up amount over five years in 10 percent increments beginning in taxable years after December 31, 2000, until 2005, when the annual permitted catch-up amount would be equal to 50 percent of the applicable maximum annual limit. This phase-in schedule differs from that provided in the House Bill. Description p. 28-29 (House Bill 301; House Bill Description p. 18-19).
- **Increase in Income Limits for Roth IRA Conversions for Joint Filers.** The Senate Bill would modify the income limit for joint filers on conversions from traditional IRAs to Roth IRAs from \$100,000 (currently applicable to both individual and married taxpayers filing jointly) to \$200,000. The proposal would be effective for taxable years beginning after December 31, 2000. Description Modifications p. 1.
- **Deemed IRAs under Employer Plans.** The Senate Bill would enable employers to allow employees to make IRA or Roth IRA contributions to a separate account within their employer-sponsored retirement plan. The account would be treated as an IRA, and <sup>4</sup> This provision was added to the Bill during Senate Finance Committee consideration of the Bill on September 7th, and therefore, is not discussed in the descriptive materials. <sup>5</sup> The House Bill would permit catch-up contributions of up to \$5,000 beginning in 2001 with the maximum contribution limit conforming to the general IRA contribution limit in 2004. <sup>3</sup> would not be subject to plan testing requirements. The account would be exempt from ERISA, except for ERISA sections 403(c), 404, and 405 (relating to exclusive benefit, fiduciary and co-fiduciary liability), which would continue to apply. This provision would apply to plan years beginning after December 31, 2001. Description p. 6.
- **Tax-Free IRA Withdrawals for Charitable Purposes.** The Senate Bill would exclude qualified charitable distributions from IRAs from the gross income of the distributee if the distributions are made to qualified charitable organizations. A "qualified" charitable distribution must meet a number of requirements; for example, the distribution must be made after age 70 ½. The amount otherwise allowable as a deduction to an individual as a charitable contribution would be reduced by the amount of qualified charitable distributions for that year. The provision would become effective for distributions made after December 31, 2000. Description p. 6-7.
- **"Roth 401(k)" Contributions.** The Senate Bill would change the name of the House Bill's "after-tax plus" contributions (under 401(k) plans and 403(b) annuities) to "Roth 401(k)" contributions.<sup>6</sup>
- **Limit on Annual Additions to Defined**

Contribution Plans. The Senate Bill would index the section 415(c) \$30,000 limit on annual additions to a defined contribution plan in \$1,000 increments. The House Bill would raise the limit to \$40,000 in 2001, in addition to indexing the limit in \$1,000 increments. Description p. 9 (House Bill 201; House Bill Description p. 7-8).

- **Top-Heavy Rules.** The Senate Bill would modify the top-heavy rules in a manner similar to the House Bill, with the following differences: First, an employee would not be considered a “key employee” by reason of officer status unless the employee earns more than the compensation limit for determining “highly compensated” status (\$85,000 for 2000) (rather than the \$150,000 threshold provided in the House Bill); second, the compensation limit would be determined without regard to the top-paid group election; third, the Senate Bill would look to the preceding plan year to determine “key employee” status, rather than the current plan year. Description p. 14-15 (House Bill 203; House Bill Description p. 8-12).
- **Tax Credit for Low- and Middle-Income Savers.** The Senate Bill would provide a nonrefundable tax credit to eligible taxpayers for elective contributions to 401(k) plans, 403(b) plans, 457 plans, SIMPLEs, SEPs, traditional or Roth IRAs, and for voluntary after-tax employee contributions to qualified retirement plans. The maximum annual contribution eligible for the credit would be \$2,000; the maximum credit rate (which would vary based on AGI) would be 50 percent of the contribution. Only joint filers with AGI of \$50,000 or less, heads of household with \$37,500 or less, and individual filers with \$25,000 or less would be eligible for the credit. The credit would be in addition to any deduction or exclusion that would otherwise apply to the contribution and would be available to persons age 18 or older, other than full-time students or persons claimed as a dependent on another taxpayer’s return. In addition, Treasury 6 This provision was added to the Bill during Senate Finance Committee consideration of the Bill on September 7th, and therefore, is not discussed in the descriptive materials. 4would be required to report annually to Congress on the status and effect of the credit. The provision would be effective for years beginning after December 31, 2000 and before January 1, 2006. Description p. 23-25; Description Modifications p. 1-2.
- **Small Business Tax Credit for Qualified Retirement Plan Contributions.** The Senate Bill would provide a nonrefundable tax credit for small employers (50 employees or less) equal to 50 percent of employer contributions made to qualified retirement plans (excluding SIMPLE IRAs and SEPs) on behalf of nonhighly compensated employees. The credit would be available up to a maximum of 3 percent of the employee’s compensation. The amount for which the tax credit is received would not be deductible. The employer would be subject to a number of conditions to qualify for the credit, including a requirement to make at least a 1 percent nonelective contribution to qualify for the credit and a requirement to establish an accelerated vesting schedule. The credit would be effective for years beginning after December 31, 2000 with respect to plans established after such date. Description p. 25-27.
- **Small Business Tax Credit for New Retirement Plan Expenses.** The Senate Bill would provide a nonrefundable tax credit for 50 percent of the administrative and retirement-education expenses of a small employer (100 employees or less) that adopts a new qualified defined benefit or defined contribution plan, SIMPLE plan, or SEP. The credit would apply to 50 percent of the first \$1,000 in such expenses for the plan for each of the first 3 plan years. The amount for which the tax credit is received would not be deductible. To be eligible for the credit, the plan would have to cover at least one nonhighly compensated employee; if the credit is for the cost of a payroll deduction IRA, the arrangement would have to be made available to all employees with at least 3 months of service. The credit would be effective for years beginning after December 31, 2000 with respect to plans established after such date. Description p. 27-28.
- **Required Minimum Distribution Rules.** The Senate Bill contains the same required minimum distribution provision as the House Bill, with the following difference: the Treasury Department would be directed to update, simplify and finalize the RMD rules by December 31, 2001. By contrast, the House Bill

would provide a January 1, 2001 effective date for the final regulations. Description p. 33-35 (House Bill 304, 409; House Bill Description p. 23-25).

- **Hardship Distributions.** The Senate Bill would provide that any hardship distribution made pursuant to the terms of a plan would not be eligible for rollover. This provision would be effective for distributions made after December 31, 2000. However, Treasury would be provided the authority to issue transitional guidance in order to provide sufficient time for plans to implement the new rule. The Senate Bill, like the House Bill, also would direct Treasury to revise regulations to reduce from 12 to 6 months the period during which an employee may not make contributions after receiving a hardship distribution. Description p. 36-37 (House Bill 306; House Bill Description p. 26-27).
- **Excise Tax on Nondeductible Contributions for Domestic and Similar Workers.** The Senate Bill would exempt SIMPLE plan or IRA contributions from the 10-percent excise tax on nondeductible contributions if such contributions are treated as nondeductible solely because the contributions are not a trade or business expense under section 162. For example, employers of household workers would be able to make contributions to such plans without imposition of the excise tax. Description p. 38-39.
- **Effective Date of Portability Provisions.** The Senate Bill would delay to January 1, 2002 the effective date for the portability provisions. The House Bill would provide a January 1, 2001 effective date. Description p. 38-42 (see House Bill 401-403; House Bill Description p. 27-31).
- **Notice of Significant Reduction in Plan Benefit Accruals.** The Senate Bill would require that an administrator of a defined benefit plan furnish a written notice concerning a plan amendment that would significantly reduce the rate of future benefit accrual. The Senate Bill also would amend the Code and ERISA to prevent “wear away” effects. By contrast, the House Bill would only direct Treasury to prepare a report on the effects of conversions of traditional defined benefit plans to cash balance or hybrid formula plans. Description p. 50-54 (House Bill 504).
- **Investment of Employee Contributions in 401(k) Plans in Employer Securities or Real Property.** The Senate Bill would modify the effective date of the provision in the Taxpayer Relief Act of 1997 that excludes certain elective deferrals from limitations on plan investment in employer securities or real property. Description p. 55-56.
- **Annual Report Dissemination.** The Senate Bill provides that a summary annual report, which is presently required to be provided to participants and beneficiaries, only be made available for examination and be furnished only upon request. Description p. 73.
- **Treatment of Employer-Provided Retirement Advice.** In addition to clarifying the tax treatment of retirement planning expenses (as provided in the House Bill), the Senate Bill also would direct Treasury to conduct a study of the rules permitting individuals to access their IRAs or qualified retirement plans prior to retirement and a study of investment decisions made by IRA owners and participants in self-directed qualified retirement plans. Description Modifications p. 3 (House Bill 605; House Bill Description 48-49).
- **Modifications to the SAVER Act.** The Senate Bill would amend the SAVER Act regarding the administration of future National Summits on Retirement Savings and the appointment of Summit delegates. Description Modifications p. 5.

Additional provisions in the Senate Bill that are not in the House Bill include those relating to terminated defined benefit plans, the notice and consent period regarding distributions, and provisions governing ESOPs. In addition, the Senate Bill does not contain a number of provisions that appear in the House Bill, including those that would eliminate IRS user fees for certain determination letter requests and amend certain PBGC-related ERISA provisions.<sup>7</sup>

7 Additionally, a provision modifying the rules on forms of distribution appears in different form in the Senate Bill than that in the House Bill. The difference is presumably due to the recent issuance by the IRS of final regulations on the anticutback rule. See Institute Memorandum to Pension Members No. 44-00, Pension Operations Advisory Committee No. 63-00, and May 4th and June 12th Conference Call Participants, dated September 5, 2000.

6 Finally, the Senate Bill would provide that all provisions of, and amendments made by, the

Bill cease to apply for years beginning after December 31, 2004, pursuant to the Congressional Budget Act of 1974. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format)

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