MEMO# 13485

May 7, 2001

INSTITUTE SUBMITS TESTIMONY ON JOINT COMMITTEE ON TAXATION'S REPORT ON TAX SIMPLIFICATIONS

[13485] May 7, 2001 TO: PENSION COMMITTEE No. 30-01 RE: INSTITUTE SUBMITS TESTIMONY ON JOINT COMMITTEE ON TAXATION'S REPORT ON TAX SIMPLIFICATIONS The Institute has submitted a written statement to the Senate Finance Committee on its recent hearing on the Joint Committee on Taxation's study on the overall state of the Federal tax system.1 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. The Institute's testimony generally supports the Joint Tax Committee's efforts in recommending simplification of various retirement and education savings vehicles. Although the Joint Committee made various recommendations regarding retirement and education saving vehicles, the Institute focused its testimony on four basic areas: (1) IRA eligibility rules; (2) individual account plan rules; (3) required minimum distribution rules ("RMDs"); and (4) education savings vehicles. I. IRA Eligibility Rules The Joint Committee recommends eliminating phase-outs relating to IRAs and eliminating the income limits on the eligibility to make deductible IRA contributions, Roth IRA contributions and conversions of traditional IRAs to Roth IRAs. The Joint Committee also recommends that the age restrictions on eligibility to make IRA contributions should be the same for all IRAs. Further, the Joint Committee recommends eliminating the nondeductible IRA. The Joint Committee's report states that the IRA recommendations would reduce the number of IRA options and conform the eligibility criteria for remaining IRAs, thus simplifying taxpayers' savings decisions. The Institute's testimony strongly supports the Joint Committee's recommendation to repeal the IRA's complex eligibility rules, which primarily serve to deter lower and moderate income individuals from participating in the program. We state that a return to the "universal" IRA would result in increased savings by middle and lower-income Americans. We emphasize, however, that the nondeductible IRA should only be eliminated if the other recommended changes are made. 1 See Institute Memorandum to Pension Committee No. 25-01, dated April 27, 2001. 2II. Individual Account Plan Rules The Joint Committee's report recommends conforming the contribution limits of tax- sheltered annuities to the contribution limits of comparable qualified retirement plans. The Joint Committee notes that conforming the limits would reduce the recordkeeping and computational burdens related to tax-sheltered annuities and eliminate confusing differences between tax-sheltered annuities and qualified retirement plans. The Joint Committee also recommends allowing all State and local governments to maintain 401(k) plans. This, according to the Joint Committee's report, would eliminate distinctions between the types of plans that may be offered by different types of employers and simplify planning decisions. We indicate that the Institute supports

these efforts to reduce the complexity associated with retirement plans – especially for workers trying to understand the differences between 401(k), 403(b) and 457 plans. The ability of workers to understand the differences among plan types becomes even more important as Congress considers enacting portability provisions.2 The Institute's testimony states our strong support for portability and other efforts by Congress to simplify and conform rules that apply to different plan types in order to assist workers in understanding their retirement plans. III. Required Minimum Distribution Rules The Joint Committee suggests various significant changes to the RMD rules applicable to tax-qualified retirement plans and IRAs. Specifically, the Committee recommends that the RMD rules should be modified so that: (1) no distributions are required during the life of a participant; (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. The Joint Committee states that the elimination of RMDs during the life of the participant and the establishment of a uniform rule for post-death distributions would significantly simplify compliance by plan participants and their beneficiaries, as well as plan sponsors and administrators. In our testimony, we indicate that we support the Joint Committee's efforts toward simplification of the RMD rules. However, we note that the specific recommendation must be further considered to assure that there are no unintended consequences. For example, a rule that would require distribution of the entire account balance subject to the RMD rules within five years of the death of the participant could result in harmful consequences for the participant's beneficiary or beneficiaries. We note that the Internal Revenue Service recently released proposed regulations that significantly simplify the rules applicable to RMDs. Under the proposed regulations, in general, a beneficiary would be permitted to take RMDs over his or her lifetime. In cases where a participant names a spouse or child as beneficiary, the ability of that beneficiary to take RMDs over his or her life expectancy would generally be preferable to a 2 H.R. 10, the "Comprehensive Retirement Security and Pension Reform Act of 2001" and S. 742, the "Retirement Security and Savings Act of 2001." 3requirement that the entire account be distributed within five years of the death of the participant. IV. Education Savings Vehicles The Institute's testimony supports the Joint Committee's recommendations with respect to simplifying education savings tax incentives. Specifically, the Committee recommends the following simplifications: (1) eliminating the income-based eligibility phase-out ranges for the HOPE and Lifetime Learning credits; (2) adopting a uniform definition of qualifying higher education expenses; (3) combining the HOPE and Lifetime Learning credits into a single credit; and (4) eliminating the restrictions on the use of education tax incentives based on the use of other education tax incentives and replacing them with a limitation that the same expenses could not qualify under more than one provision. A copy of the Institute's written statement is attached. Kathryn A. Ricard Associate Counsel Attachment Attachment (in .pdf format)
