

**MEMO# 3963**

September 30, 1992

## **PENSION PROVISIONS OF SENATE TAX BILL**

September 30, 1992 TO: PENSION MEMBERS NO. 23-92 OPERATIONS MEMBERS NO. 33-92 TRANSFER AGENT ADVISORY COMMITTEE NO. 53-92 RE: PENSION PROVISIONS OF SENATE TAX BILL \_\_\_\_\_ The Senate late yesterday approved its version of H.R. 11, which contains a number of the pension provisions that were included in H.R. 4210, the tax legislation vetoed by the President earlier this year. (See Institute Memorandum to Pension Members No. 5-92, dated March 27, 1992.) Anyone interested in obtaining copies of relevant Committee Report and bill language may do so by calling the undersigned at (202) 955- 3516. Individual Retirement Arrangements (IRAs) The Senate bill would expand eligibility for deductible IRA contributions. Under the bill, taxpayers covered by retirement plans could fully deduct IRA contributions if their adjusted gross incomes were under \$80,000 for individuals, or \$120,000 for joint filers, effective after December 31, 1993. The IRA deduction would be subject to a last-dollar offset to the limit on elective deferrals to section 401(k) and similar plans. One spouse's coverage under a retirement plan would not affect the other spouse's eligibility for the deduction, and the income limitations and the maximum deductible amount would be indexed for inflation. The provision would also permit the establishment of special IRAs, the contributions to which would not be deductible, but withdrawals from which would be tax free if attributable to contributions held for more than five years. Contributions to special IRAs would also be subject to the income limitations and the last-dollar offset to the 401(k) plan limit. Penalty-free transfers from deductible IRAs to special IRAs would be permitted after December 31, 1992, subject to the income limitations, and would qualify for favorable tax treatment if accomplished before January 1, 1994. Penalty-free withdrawals from IRAs, section 401(k) plans and section 403(b) arrangements would be permitted for purchases - 1 - of new American made automobiles during 1992 and 1993, and for first-time home purchases, educational expenses, and medical expenses, and from IRAs for the long-term unemployed, effective after December 31, 1992. In addition, contributions to IRAs after December 31, 1993, other than rollover contributions, could not be withdrawn without penalty under the current exception for taxpayers over age 59-1/2 unless they had been held in the account for at least five years. Pension Simplification The bill also contains the pension simplification provisions of H.R. 4210, with the exception of the liberalization of the rollover rules and authorization of direct transfers from qualified plans to IRAs, which were enacted earlier this summer as part of the Unemployment Compensation Amendments Act of 1992. (See Institute Memorandum to Pension Members No. 18-92, Operations Members No. 24-92, and Transfer Agent Advisory Committee No. 33-92, dated July 7, 1992.) The Senate version of H.R. 11 includes modification of the rules concerning salary reduction simplified employee pensions (SARSEPs) that were not included in the House version. (See Institute Memorandum to Pension Members No. 17-92, dated July

6, 1992.) The Senate bill would also conform the eligibility requirements for all SEPs to those applicable to qualified plans by providing that contributions to a SEP must be made with respect to each employee who has at least one year of service with the employer. In addition, the Senate bill would authorize the establishment of a new type of plan for small employers called the PRIME account, which was proposed by Senator Packwood in early 1991. A PRIME account would be an individual retirement plan under which employees of employers with fewer than 100 employees could make elective pre-tax contributions of up to \$3,000 per year, with a 100 percent employer matching contribution up to 3 percent of the employee's compensation. The SEP and the PRIME account provisions would be effective for taxable years beginning after December 31, 1993.

**Technical Corrections to 20 Percent Mandatory Withholding on Nonperiodic Distributions** The bill also would make certain technical corrections to the pension provisions of the Unemployment Compensation Amendments Act of 1992. Under the technical corrections, neither hardship withdrawals, withdrawals for first-time home purchases or educational expenses, excess deferrals or contributions under 401(k) plans, excess aggregate contributions under section 401(m), nor deemed distributions with respect to plan loans that are in default would be eligible for rollover or subject to mandatory withholding. The bill would also provide a de minimis exception to the direct rollover requirement so that a plan would - 2 - not be required to permit a direct rollover of, or withhold upon, - 3 - a distribution of \$500 or less. A similar rule would apply to distributions pursuant to qualified domestic relations orders. The deadline for plan amendments would be extended to the first day of the first plan year beginning on or after January 1, 1995.

**Prohibition of State "Source Tax" on Periodic Distributions** In addition, the bill would prohibit a state from imposing income tax on certain periodic pension distributions made to an individual who is not a resident or domiciliary of the state. A distribution from a qualified plan, a section 403(b) arrangement or an IRA to a nonresident would be exempt from state income taxation if it were part of a series of substantially equal periodic payments (not less frequently than annually) for the life or life expectancy of the recipient and his or her beneficiary, or over a specified period of 10 years or more. The prohibition against state taxation of nonresidents generally would not apply to nonperiodic distributions; however, an individual who had attained age 59-1/2 could make a one-time election to exempt up to \$25,000 (indexed) from such taxation.

**Pension Information Reporting** Under the bill, penalty provisions applicable to information reports with respect to pension payments would be conformed to those applicable to other information reports. \* \* \*

We will keep you informed of further developments concerning pension legislation. Kathy D. Ireland Associate Counsel - Pension