

MEMO# 17058

February 6, 2004

ADMINISTRATION RE-PROPOSES SAVINGS AND RETIREMENT INITIATIVE

[17058] February 6, 2004 TO: BOARD OF GOVERNORS No. 11-04 FEDERAL LEGISLATION MEMBERS No. 4-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 13-04 PUBLIC COMMUNICATIONS COMMITTEE No. 8-04 RE: ADMINISTRATION RE-PROPOSES SAVINGS AND RETIREMENT INITIATIVE The President's FY 2005 budget, released on February 2, again calls for the creation of three new savings vehicles: a Lifetime Savings Account (LSA), a Retirement Savings Account (RSA), and an Employer Retirement Savings Account (ERSA). The proposals are similar to last year's in most respects, and are described briefly below. Lifetime Savings Accounts are individual savings accounts that could be used for any type of saving. Taxpayers, regardless of age or income, would be able to make nondeductible contributions to an LSA of up to \$5,000 per year (indexed for inflation) - reduced from the \$7,500 limit in last year's proposal. No tax would be imposed on either earnings or distributions from an LSA. Distributions could be made at any time and for any reason. Also, LSAs would not be subject to required minimum distribution rules during the taxpayer's lifetime. Retirement Savings Accounts are individual accounts that could be used only for retirement savings. The RSA would effectively consolidate traditional IRAs, Roth IRAs, and nondeductible IRAs into a single account, which would be subject to rules generally similar to the rules currently applicable to Roth IRAs. RSAs would not be subject to income limits or required minimum distribution rules. Taxpayers, regardless of age or income, would be able to make nondeductible contributions to an RSA of up to \$5,000 per year (indexed for inflation) - reduced from the \$7,500 limit in last year's proposal. No tax would be imposed on either earnings or qualified distributions from an RSA after age 58, or in the event of death or disability. Traditional and nondeductible IRAs could be converted into RSAs at any time, but there would be no conversion requirement. If a taxpayer converted to an RSA prior to January 1, 2006, then he or she would be able to spread the tax on the conversion over a four-year period. For conversions on or after January 1, 2006, the total taxable amount would be included in the taxpayer's gross income for the year of conversion. Traditional and nondeductible IRAs not converted to RSAs would not be able to accept any new contributions, except for rollover 2 contributions. New traditional IRAs could be created solely to accommodate rollovers from employer plans. Existing Roth IRAs would be unaffected, except that they would be renamed RSAs. The President's ERSA proposal would consolidate 401(k), SIMPLE 401(k), Thrift Savings, 403(b), and governmental 457 plans, as well as SARSEPs and SIMPLE IRAs, into a single employer-sponsored account. Any employer could sponsor this new ERSA plan. Beginning in 2004, existing 401(k) and Thrift plans would become ERSAs. Existing SIMPLE IRAs, SARSEPs, 403(b), and governmental 457 plans could continue indefinitely, but could not accept any future contributions after 2005. An employee would be able to make a pre-tax contribution to an ERSA of up to \$13,000 per year (increasing to \$15,000 by 2006) plus, once the employee reaches age 50, a catch-up

contribution of \$3,000 (increasing to \$5,000 by 2006). ERSAs would be subject to simplified versions of the existing rules applicable to 401(k) plans. The current-law nondiscrimination tests would be repealed and replaced with either a single test for satisfying the nondiscrimination rules, or, alternatively, a design-based plan structure that would be deemed to be nondiscriminatory. A special rule for small employers (those with fewer than 10 employees making at least \$5,000 during the prior year) would allow them to fund their ERSAs by contributing to a custodial account, similar to a current-law IRA, provided the contributions meet the design-based ERSA safe harbor requirements. In addition to the above savings vehicles, the President's budget proposal also continues to include an account called an Individual Development Account (IDA). Under the proposal, qualified financial institutions would establish and maintain an IDA program for low-income savers. The financial institution would receive a credit for funding dollar-for-dollar matching contributions of up to \$500 for married filing jointly individuals making less than \$40,000 (other income limits apply to single and head of household). Qualified distributions could be made for higher education, first-time home purchase, and small business capitalization. The Institute strongly supports the Administration's proposal and is seeking its enactment. We will keep you informed of further developments. Matthew P. Fink President

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