INVESTMENT COMPANY INSTITUTE

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CONGRESS PASSES H.R. 1836, THE "ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001"

[13566] May 31, 2001 TO: PENSION MEMBERS No. 21-01 PENSION OPERATIONS ADVISORY COMMITTEE No. 35-01 RE: CONGRESS PASSES H.R. 1836, THE “ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001” On May 26, 2001, Congress passed H.R. 1836, the “Economic Growth and Tax Relief Reconciliation Act of 2001.” The Conference Report, which reconciled the House and Senate versions of the legislation, passed the House by a vote of 240 to 154 and the Senate by a vote of 58 to 33. The President is expected to sign H.R. 1836 (the “Bill”) into law in the near future. Title VI of the Bill, which contains the IRA and pension provisions, is substantially similar to legislation previously proposed by Representatives Portman and Cardin in the House and Senators Grassley and Baucus in the Senate. Significant provisions include those that increase contribution limits to 401(k), 403(b), 457, SIMPLE plans and IRAs, permit “catch-up” contributions to IRAs and employer-sponsored plans for individuals 50 and older, permit after- tax “Roth” contributions to 401(k) and 403(b) plans, enhance portability, and modify current top-heavy rules. The Bill also expands Education IRAs and Section 529 qualified tuition programs. As you are aware, many of the provisions in the Bill had been advocated by the Institute. This memorandum describes the pension and education savings provisions in the Bill that are most relevant to the mutual fund industry.1 Many of the provisions are effective as of January 1, 2002; specific effective dates, however, vary and are discussed below. Additionally, note that the Bill contains a “sunset” provision under which the Bill’s provisions cease to apply for taxable, plan or limitation years beginning after December 31, 2010. I. Individual Retirement Accounts (Title VI, Subtitle A) A. Increase in Annual Contribution Limit. The Bill increases the current $2,000 annual contribution limit to IRAs and Roth IRAs as follows: $3,000 in 2002 through 2004; $4,000 1 The relevant legislative language and the joint House/Senate explanatory statement regarding the Bill (“Explanatory Statement”) are available as an attachment to this memo at ICINet (http://members.ici.org). To obtain a copy of these materials, please call the ICI Library at (202) 326-8304 and request the attachment for memo 13566. 2in 2005 through 2007; $5,000 in 2008 and thereafter. Beginning in 2008, the limit is indexed for inflation in $500 increments. Bill Section 601. Explanatory Statement p. 106-111. B. Catch-Up Contributions to IRAs by Individuals Age 50 or Over. The Bill permits individuals who have attained age 50 to make additional “catch-up” IRA contributions of up to $500 in years 2002 through 2005, and $1,000 in 2006 and thereafter. Bill Section 601. Explanatory Statement p. 106-111. (See also Bill section 631 for catch-up contributions to employer-sponsored retirement plans.) C. Deemed IRAs. The Bill provides that if an eligible retirement plan (a qualified retirement plan, tax-shelter annuity or a governmental 457 plan) permits employees to make voluntary employee contributions

to a separate account or annuity that (i) is established under the plan, and (ii) meets the requirements applicable to either traditional IRAs or Roth IRAs, then the separate account or annuity is deemed a traditional IRA or a Roth IRA, as applicable, for purposes of the Code. Thus, the reporting requirements applicable to IRAs would apply and the deemed IRA (and contributions thereto) would not be subject to the Code rules on eligible retirement plans. Additionally, the deemed IRA would not be taken into account in applying such rules to any other contributions under the plan. The deemed IRA would be subject to ERISA's exclusive benefit and fiduciary rules to the extent otherwise applicable to the plan, but would not be subject to ERISA's reporting and disclosure, participation, vesting, funding, and enforcement requirements applicable to the eligible retirement plan. This provision is effective for plan years beginning after December 31, 2002. Bill Section 602. Explanatory Statement p. 106-111. II. Expanding Pension Coverage (Title VI, Subtitle B) A. Increased Contribution and Benefit Limits. Code Section 415(c) Limit. The Bill increases Code section 415's limitation on annual additions to defined contribution plans from $30,000 to $40,000. This amount is indexed for inflation in $1,000 increments (see also Bill Section 632, which increases the "25 percent of compensation" rule to 100 percent of compensation). Code Section 401(a)(17) Limit. The Bill increases section 401(a)(17)'s limit on the amount of compensation that may be taken into account under a plan for determining benefits from $170,000 under current law to $200,000, indexed for inflation in $5,000 increments. Code Section 402(g) Limit. The Bill increases the elective deferral limitation under section 402(g), beginning in 2002, in annual increments of $1,000 until the limit reaches $15,000 in 2006. Thus, the limit is $11,000 in 2002, $12,000 in 2003, etc., until it reaches $15,000 in 2006. 457 Plan Contribution Limit. The contribution limit for section 457 plans conforms to the 402(g) limit (i.e., the limit would be $11,000 in 2002, $12,000 in 2003, etc., until it reaches $15,000 in 2006). In the three years prior to retirement, the limit for 457 plans is twice the otherwise applicable dollar limit. SIMPLE Plan Contribution Limit. The Bill increases the SIMPLE plan contribution limit in $1,000 increments beginning in 2002 until it reaches $10,000 in 2005. Thus, the SIMPLE plan 3contribution limit would be $7,000 in 2002 and $8,000 in 2003, etc., until it reaches $10,000 in 2005. The 402(g), 457 plan and SIMPLE plan limits are indexed for inflation in $500 increments. The modifications to these limits are effective for years beginning after December 31, 2001. Bill Section 611. Explanatory Statement p. 112-116. B. Plan Loans Available to Subchapter S Shareholders, Partners and Sole Proprietors. The Bill modifies the prohibited transaction rules to permit plan loans to sole proprietors, partners, and Subchapter S corporation shareholders, effective with respect to years beginning after December 31, 2001. Bill Section 612. Explanatory Statement p. 116-117. C. Top-Heavy Rule Modification. Effective for years beginning after December 31, 2001, the Bill modifies the top-heavy rules in a number of respects. First, the Bill provides that a plan consisting solely of a cash-or-deferred arrangement that satisfies the design-based safe harbor under sections 401(k)(12) and 401(m)(11) is not top-heavy. Second, the Bill provides that matching contributions may be taken into account for purposes of making the minimum contributions required under the top-heavy rules. Third, distributions made during the year ending on the date the top-heavy determination is made may be taken into account to satisfy the rule. Fourth, the Bill applies the current 5-year rule, which is applicable to distributions taken into account for purposes of determining the present value of accrued benefits or account values, is extended to in-service distributions. With respect to the "key employee" definition, the Bill (1) repeals the 4-year look-back rule for determining key employee status, (2) repeals the top-10 owner key employee category, and (3) provides that an employee is deemed a key employee only if he or she is a key employee during the preceding plan year. Thus, an employee is considered a "key employee" if, during the prior year, the employee was (1) an officer with compensation in excess of $130,000 (adjusted for inflation in $5,000 increments), (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of $150,000. The Bill does not modify the applicability of the family attribution rules, including for example, in determining whether an individual is a 5- percent owner for purposes of the top heavy rules. Bill Section 613. Explanatory Statement p. 117-122. D. Elective Deferrals Not Taken into Account for Deduction Limit. Effective for years beginning after December 31, 2001, elective deferrals are no longer considered employer contributions subject to Code section 404 deduction limits. Bill Section 614. Explanatory Statement p. 122-123. E. Repeal of Coordination Requirements for 457 Plans. Effective for years beginning after December 31, 2001, the Bill repeals the rule requiring individuals making 457 plan contributions to treat contributions to other types of plans as 457 contributions for purposes of applying the 457 plan contribution limit. Bill Section 615. Explanatory Statement p. 123-124. F. Modification of Definition of Compensation for Purposes of Deduction Limits. The Bill modifies Code section 404's definition of compensation to include elective deferral contributions, effective for years beginning after December 31, 2001. In addition, the Bill 4increases the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan from 15 percent to 25 percent of compensation of the employees covered by the plan for the year. Also, except to the extent provided in regulations, a money purchase pension plan is treated like a profit-sharing or stock bonus plan for purposes of the deduction rules. Bill Section 616. Explanatory Statement p. 126-127. G. Optional Treatment of Elective Deferrals as After-Tax “Roth” Contributions to 401(k) Plans and 403(b) Annuities. The Bill permits a 401(k) plan, 403(b) annuity or any other employer-sponsored plan described in section 401(a) to include a “qualified Roth contribution program” under which an individual may elect to have all or a portion of his or her elective deferrals under the plan treated as after-tax contributions. The proposal is effective for taxable years beginning after December 31, 2005. Under the program, the annual contribution limit for Roth contributions is the Code section 402(g) limit reduced by other elective deferrals. Roth contributions to 401(k) plans are treated the same as other elective deferrals for purposes of the nondiscrimination requirements. A plan offering a Roth program must maintain separate recordkeeping for Roth contributions and related earnings. Qualified distributions from the Roth program are not includible in income. A qualified distribution is one made after the five-taxable year period beginning with the first taxable year in which a participant made a Roth contribution and (i) made on or after the participant attains age 59 ½, (ii) made to a beneficiary or a participant’s estate upon the death of the participant, or (iii) made upon disability of the participant. Excess deferrals under section 402(g) attributable to a designated Roth contribution must be distributed on or before April 15 following the close of the taxable year in which the excess deferral is made. Bill Section 617. Explanatory Statement p. 128-130. H. Nonrefundable Credit for Elective Deferrals and IRA Contributions. The Bill provides 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 is $2,000; the maximum credit rate (which would vary based on AGI) is 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 are eligible for the credit. The credit is in addition to any deduction or exclusion that would otherwise apply to the contribution and is 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 is required to report annually to Congress on the status and effect of the credit. The provision is effective for taxable years beginning after December 31, 2001 and before January 1, 2007. Bill Section 618. Explanatory Statement p. 132-134. I. Credit for Pension Plan Start-up Costs of Small Employers. The Bill provides 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, SEP or payroll deduction IRA program. The credit applies 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 is not deductible. To be eligible for the 5credit, the plan must cover at least one nonhighly compensated employee; if the credit is for the cost of a payroll deduction IRA, the arrangement must be made available to all employees with at least 3 months of service. The credit would be effective with respect to costs paid or incurred in taxable years beginning after December 31, 2001, with respect to plans established after such date. Bill Section 619. Explanatory Statement p. 136. J. Elimination of User Fees for Determination Letter Requests for Small Employers. Effective for letter requests made after December 31, 2001, the Bill eliminates the user fee charged by the IRS for any determination letter regarding the qualified status of a plan for eligible small employers (employers with 100 or fewer employees and with at least one nonhighly compensated employee participating in the plan) for the initial five years the plan is in existence. Specifically, the elimination of the user fee applies for all years before the later of (1) the fifth plan year the pension plan is in existence, or (2) the end of any remedial amendment period with respect to the plan beginning within the first 5 plan years. The provision applies only to requests by employers for determination letters concerning the qualified plans they maintain; sponsors of prototype or similar plans marketed to participating employers are not eligible for this user fee reduction. Bill Section 620. Explanatory Statement p. 124-126. K. Treatment of Nonresident Aliens Engaged in International Transportation Services. The Bill modifies a special rule relating to compensation paid to a nonresident alien in connection with the individual's temporary presence in the U.S. as a regular member of a crew of a foreign vessel engaged in transportation between the U.S. and a foreign country. The provision excludes such compensation for purposes of nondiscrimination and other requirements applicable to employee benefit plans, effective with respect to remuneration for service performed in plan years beginning after December 31, 2001. Bill Section 621. Explanatory Statement p. 131-132. III. Enhancing Fairness for Women (Title VI, Subtitle C) A. Catch-Up Contributions for Individuals Age 50 or Over. The Bill permits individuals who have attained age 50 before the end of the plan year to make additional elective contributions to 401(k), 403(b), SEP, SIMPLE and 457 plans. The catch-up limit for 401(k), 403(b), SEP and 457 plans are $1,000 for 2002, $2,000 for 2003, $3,000 for 2004, $4,000 for 2005, and $5,000 for 2006 and thereafter. The catch-up amount for a SIMPLE is $500 for 2002, $1,000 for 2003, $1,500 for 2004, $2,000 for 2005, and $2,500 for 2006 and thereafter. These limits are indexed for inflation in $500 increments in 2007 and thereafter. The catch-up contributions are not subject to specific nondiscrimination rules. A plan that provides for catch-up contributions, however, must allow all eligible individuals participating in the plan to make catch-up contributions in order to satisfy the general section 401(a)(4) requirement with respect to benefits, rights and features. For purposes of this rule, all plans of related employers are treated as a single plan. Finally, an employer may make matching contributions with respect to catch-up contributions, which would be subject to the normally applicable nondiscrimination rules. The provision is effective for years beginning after December 31, 2001. Bill Section 631. Explanatory Statement p. 137-140. (See also Bill Section 601, which permits a catch-up opportunity for IRA owners). 6B. Equitable Treatment for Contributions of Employees to Defined Contribution Plans. The Bill (1) increases the section 415(c) limit on annual additions from 25 percent of compensation to 100 percent, (2) increases the 33 1/3 percent of compensation limitation on deferrals under 457 plans to 100 percent, and (3) repeals the exclusion allowance applicable to contributions to section 403(b) annuities. Thus, such annuities are subject to the limits applicable to tax-qualified plans. The Bill also directs Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to eliminate the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance. With respect to the increase in the defined contribution plan limit under section 415(c), the Explanatory Statement provides that the conferees intend that the Secretary of Treasury will use the Secretary's existing authority to address situations where qualified nonelective contributions are targeted to certain participants with lower compensation in order to increase the average deferral percentage of nonhighly compensated employees. The provision is generally effective for years beginning after December 31, 2001. Special effective dates are provided for the modifications to 403(b) plans. Bill Section 632. Explanatory Statement p. 141-144. C. Faster Vesting of Certain Employer Matching Contributions. The Bill requires employer matching contributions (as defined in Code section 401(m)(4)(A)) to be vested on a 3- year cliff or 6-year graded vesting schedule, generally effective for contributions made for plan years beginning after December 31, 2001. Bill Section 633. Explanatory Statement p. 144-145. D. Modification to the Minimum Required Distribution Rules. Effective on the date of enactment, the Bill directs the Secretary of Treasury to modify the life expectancy tables under the regulations relating to minimum distribution requirements under Code sections 401(a)(9), 408(a)(6) and (b)(3), 403(b)(10) and 457(d)(2) to reflect current life expectancy. Bill Section 634. Explanatory Statement p. 145-147. E. Clarification of Division of 457 Plan Assets in Divorce. The Bill applies the tax rules for qualified plan distributions pursuant to a qualified domestic relations order ("QDRO") (Code section 402(e)(1)(A)) to 457 plans, and clarifies that the plan does not violate any restrictions on distributions when making payments to an alternate payee under a QDRO. This provision applies to transfers, distributions, and payments made after December 31, 2001. Bill Section 635. Explanatory Statement p. 147-148. F. Provisions Relating to Hardship Withdrawals. The Bill provides that any distribution "made upon hardship of the employee" is ineligible for rollover and subject to the withholding rules applicable to ineligible rollover distributions. This provision modifies the rule enacted by the Internal Revenue Service Restructuring and Reform Act of 1998, which excluded the portion of a hardship distribution attributable to an employee's elective deferral from the definition of "eligible rollover distribution." The provision applies to distributions made after December 31, 2001. The Explanatory Statement provides that the Secretary of Treasury has the authority to issue transitional guidance with respect to this provision to provide sufficient time for plans to implement the new rule. 7The Bill also directs the Secretary of the Treasury to revise regulations addressing 401(k) hardship distributions to reduce from 12 to 6 months the period during which an employee must be prohibited from making contributions after taking a distribution on account of hardship. The revised regulations are to be effective for years beginning after December 31, 2001. Bill Section 636. Explanatory Statement p. 148-150. G. Pension Coverage for Domestic and Similar Workers. Under the Bill, the 10- percent excise tax on nondeductible contributions does not apply to contributions to a SIMPLE plan or SIMPLE IRA that are nondeductible solely because the contributions are not made in connection with an employer's trade or business. Thus, for example, employers of household workers are able to make contributions to such plans without imposition of the excise tax. However, as under present law, the contributions remain nondeductible. Bill Section 637. Explanatory Statement p. 150-151. IV. Increasing Portability for Participants (Title VI, Subtitle D) A. Rollovers of Retirement Plan and IRA Distributions. Effective for distributions made after December 31, 2001, eligible rollover distributions from qualified retirement plans, section 403(b) annuities and governmental section 457 plans generally may be rolled over to any of such plans or arrangements. Similarly, taxable amounts in a traditional IRA (i.e., all but account basis) may be rolled over into a qualified plan, section 403(b) annuity or governmental section 457 plan. No plan, however, is required to accept rollovers. Distributions from a qualified plan are not eligible for capital gains or income averaging treatment if there was a rollover to the plan that would not have been permitted under current law. Direct rollover and withholding rules are extended to section 457 plans. Amounts distributed from a section 457 plan are subject to the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan; section 457 plans accepting such rollovers must separately account for such rollover amounts. In addition, hardship distributions from governmental section 457 plans are not considered eligible rollover distributions. The section 402(f) rollover notice, which is required of all plans, must describe the extent to which distribution rules and tax consequences may differ from plan to plan. However, the Bill provides that no penalty would be imposed on a plan for failure to provide the information required under the provision with respect to any distribution made before the date that is 90 days after the date the Treasury Secretary issues a new safe harbor rollover notice, if the plan administrator makes a reasonable attempt to comply with the notice requirement. Bill Sections 641 and 642. Explanatory Statement p. 151-156. B. Rollover of After-Tax Contributions. Effective for distributions made after December 31, 2001, the Bill permits the rollover of after-tax contributions from a qualified plan to another qualified plan or a traditional IRA. Plan-to-plan rollovers of after-tax monies must be direct rollovers. Plans accepting such rollovers must separately account for them. 8After-tax contributions in an IRA (including those rolled from a qualified plan and nondeductible contributions to an IRA) are not permitted to be rolled over from the IRA to a qualified plan, 403(b) annuity or 457 plan. In the case of a distribution from an IRA that is rolled over into those plan types, the distribution is attributed first to taxable amounts (i.e., all amounts other than after-tax contributions). Additionally, the Explanatory Statement provides that the IRS is directed to issue rules with respect to reporting and mechanisms to address mistakes relating to rollovers and to develop forms (for example, by expanding the Form 8606) to assist individuals in tracking after- tax contributions rolled over to an IRA. Bill Section 643. Explanatory Statement p. 151-156. C. Hardship Exception to 60-Day Rollover Rule. The Bill authorizes the Secretary of Treasury to waive the 60-day rollover requirement if the failure to waive such requirement would be against “equity or good conscience,” including cases of casualty, disaster or other events beyond the reasonable control of the individual. The provision applies to distributions after December 31, 2001. Bill Section 644. Explanatory Statement p. 156-157. D. Anticutback Rule Relief with Respect to Forms of Distribution. The Bill permits the transfer of a participant’s accrued benefit from one defined contribution plan to another even though the transferee plan does not provide all of the forms of distribution available under the transferor plan. Such transfers are permitted if (i) the transfer is either the result of a merger or consolidation of plans or is in the form of a direct transfer, (ii) the terms of each plan permit the transfer, (iii) the transferee plan permits distributions in the form of a single lump sum distribution, and (iv) the transfer is by voluntary election of the plan participant. The Bill also provides that a defined contribution plan is not treated as violating the anticutback rule (Code section 411(d)(6)) if the plan is amended to eliminate a form of distribution previously available as long as a lump sum distribution is available (for those benefit accruals that would have been protected under section 411(d)(6)). The proposal is effective for years beginning after December 31, 2001. Furthermore, Treasury is directed to issue regulations that allow a plan amendment that reduces or eliminates benefits or subsidies which create significant burdens or complexities for plans and participants, provided that the rights of any participant is not adversely affected in a more than de minimis manner. Such regulations must be issued by December 31, 2003. Bill Section 645. Explanatory Statement p. 157-160. E. Repeal of Same Desk Rule. Effective for distributions after December 31, 2001, the Bill modifies the distribution restrictions applicable to 401(k) plans, 403(b) arrangements and 457 plans to permit distribution upon “severance from employment,” rather than from “separation from service.” Bill Section 646. Explanatory Statement p. 160-161. F. Purchase of Service Credit in Governmental Defined Benefit Plans. The Bill permits state and local government employees to transfer assets (in a trustee-to-trustee transfer) from their 403(b) arrangement or 457 plan to purchase service credits under their defined benefit plan, effective for trustee to trustee transfers after December 31, 2001. Bill Section 647. Explanatory Statement p. 161-162. 9G. Disregard of Rollovers When Applying Cash-Out Rules. Effective for distributions after December 31, 2001, the Bill permits plans to disregard amounts that had been rolled over into the plan when determining the present value of an individual participant's accrued benefit for purposes of making involuntary distributions from the plan. (Under current law, involuntary distributions are permitted if the accrued benefit does not exceed $5,000.) Bill Section 648. Explanatory Statement p. 162-163. (See also Bill Section 657 for automatic rollovers of certain mandatory distributions.) H. Minimum Distribution and Inclusion Requirements for Section 457 Plans. The Bill provides that amounts deferred under a 457 plan are includible in income when paid. Furthermore, the Bill repeals the special required minimum distribution rules applicable to section 457 plans. Thus, such plans are subject to the required minimum distribution rules applicable to qualified plans. The provision is effective for distributions after December 31, 2001. Bill Section 649. Explanatory Statement p. 163-164. V. Strengthening Pension Security and Enforcement (Title VI, Subtitle E) A. Automatic Rollovers of Certain Mandatory Distributions. The Bill makes a direct rollover the default option for involuntary distributions that exceed $1,000 and that are eligible rollover distributions from qualified retirement plans. The distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly. The plan administrator must provide a written explanation stating that an automatic direct rollover will be made unless the participant elects otherwise. The plan administrator also is required to notify the participant in writing (as part of the general written explanation or separately) that the distribution may be transferred to another IRA. The Bill also amends ERISA's fiduciary rules so that, in the case of an automatic direct rollover, the participant is treated as exercising control over the assets in the IRA upon the earlier of (1) the rollover of any portion of the assets to another IRA, or (2) one year after the automatic rollover. Additionally, the Bill directs the Secretary of Labor, not later than 3 years after the date of enactment, to issue safe harbors under which the designation of an institution and investment of funds in accordance with the legislation are deemed to satisfy the requirements of ERISA section 404(a). Furthermore, the Bill authorizes and directs the Secretary of Treasury and Secretary of Labor to give consideration to providing special relief with respect to the use of low-cost individual retirement plans for purposes of the provision and for other uses that promote the preservation of assets for retirement income purposes. The provision is effective for distributions made after final regulations are prescribed by the Secretary of Labor (not later than three years after the date of enactment). Bill Section 657. Explanatory Statement p. 181-182. B. Investment of Employee Contributions in 401(k) Plans in Employer Securities or Real Property. The Bill modifies 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. Bill Section 655. Explanatory Statement p. 175-176. 10 C. Various Defined Benefit Plan and Multiemployer Plan Provisions. Subtitles E and F of Title VI contain various provisions relating primarily to defined benefit plans and multiemployer plans. These include provisions that (1) require a notice of significant reduction in plan benefit accruals, impose an excise tax on failure to provide such notice, and direct Treasury to prepare a report on the effects of conversions of traditional defined benefit plans to cash balance or hybrid formula plans (Bill Section 659); (2) repeal the 160 percent of current liability funding limit over a phase-in period (Bill Section 651); (3) modify the maximum contribution deduction rules and apply them to all defined benefit plans (Bill Section 652); (4) provide excise tax relief for sound pension funding (Bill Section 653); (5) exempt multiemployer plans from the 100 percent of compensation limitation in Code section 415(b)(1) and modify the aggregation rules relating to the compensation limitation (Bill Section 654); (6) clarify the treatment of contributions to multiemployer plans (Bill Section 658); and (7) modify plan valuation timing requirements (Bill Section 661). D. ESOP Provisions. Subtitles E and F of Title VI contain provisions relating to prohibitions of allocations of stock in S Corporation ESOPs, and ESOP dividend reinvestments. Bill Sections 656, 662. VI. Reducing Regulatory Burdens (Title VI, Subtitle F) A. Employees of Tax-Exempt Organizations and 401(k) Plan Formation. The Bill rectifies problems created by an IRS rule implemented before Congress permitted tax-exempt entities to form 401(k) plans. Specifically, Congress permitted tax-exempt entities to establish 401(k) plans through the Small Business Job Protection Act of 1996 ("SBJPA"). Previously implemented IRS rules provide that employees of tax-exempt entities could be excluded from the 401(k) coverage rules, if an affiliated entity established a 401(k) plan, because employees of the tax-exempt entity could not participate in the plan. The Bill directs Treasury to modify its rule to accommodate the SBJPA change as follows: employees who are eligible to make elective deferrals under 403(b) arrangements may be treated as excludable for purposes of the 401(k) plan if no employee of that relevant organization is eligible to participate in the 401(k) plan and 95 percent of the employees who are not employees of that organization are eligible to participate in the 401(k) plan. Bill Section 664. Explanatory Statement p. 187-188. B. Clarification of Treatment of Employer-Provided Retirement Advice. Effective for years beginning after December 31, 2001, the Bill provides that qualified retirement planning advice or information provided to an employee and his or her spouse are excludable from income and wages as an excludable fringe benefit. Such services, however, must be made available on a substantially equal basis to employees normally provided education and information regarding the employer's retirement plan. Bill Section 665. Explanatory Statement p. 188-189. C. Repeal of the Multiple Use Test. The Bill would repeal the multiple use test under Code section 401(m) for years beginning after December 31, 2001. Bill Section 666. Explanatory Statement p. 192-193. 11 VII. Education Savings Provisions (Title IV) A. Education IRAs (Bill Section 401; Explanatory Statement p. 38-43) Increased Contribution Limit. The Bill increases the annual contribution limit to an Education IRA from $500 per designated beneficiary to $2,000. Bill Section 401(a). Phase-out of Contribution Limit. The Bill increases the income-eligibility limits for married taxpayers contributing to Education IRAs by increasing the phase-out range for married taxpayers filing a joint return to twice the range for single taxpayers. Thus, the phase- out range for married taxpayers filing a joint return is increased from $190,000 to $220,000 of modified adjusted gross income. Bill Section 401(b). Expansion of Qualified Education Expenses. The Bill expands the definition of qualified education expenses for which account distributions may be used to include qualified elementary and secondary education expenses. Bill Section 401(c). Special Needs Beneficiaries. Under current law, contributions to an Education IRA are not permitted once the beneficiary reaches age 18. The Bill eliminates this age limitation for beneficiaries with "special needs." The Explanatory Statement provides that the conferees intend that Treasury regulations will define this term to include an individual who because of a physical, mental, or emotional condition requires additional time to complete his or her education. Bill Section 401(d). Entities Eligible to Contribute to Accounts. The Bill clarifies that corporate and nonprofit entities may contribute to Education IRAs, and are not subject to the income limitations applicable to individual contributors. Bill Section 401(e). Extension of Time to Contribute and to Remove Excess. The Bill extends the time by which contributions must be made to an Education IRA for a given taxable year from December 31st to April 15th, adopting language similar to that applicable to traditional IRAs. The Bill also provides that excess contributions made for a taxable year may be removed up until June 1st of the year following that year without incurring a 10-percent penalty tax for the distribution. Bill Section 401(f). Coordination with HOPE and Lifetime Learning Credits and Qualified Tuition Programs. The Bill alters the manner in which Education IRA distributions are coordinated with credits received under the HOPE and Lifetime Learning Credits programs and any qualified tuition programs in a given year. Specifically, the Bill allows an individual to claim a HOPE or Lifetime Learning Credit and take a qualified distribution from an Education IRA on behalf of the same student in the same tax year, as long as the credit and distribution are used for different educational expenses. Similarly, the Bill permits contributions to be made to both an Education IRA and a qualified tuition program on behalf of the same beneficiary in the same year. If distributions from Education IRAs and qualified tuition programs exceed the beneficiary’s qualified higher education expenses for the year (after reduction by amounts used in claiming the HOPE or Lifetime Learning Credit), the beneficiary must allocate the expenses between the distributions to determine the amount includible in income. Bill Section 401(g). 12 Effective Date of Education IRA Provisions. The Education IRA provisions are effective for taxable years beginning after December 31, 2001. B. Qualified Tuition Programs (Section 529 Plans) (Bill Section 402; Explanatory Statement p. 44-47) Expansion to Private Educational Institutions. The Bill expands the qualified state tuition program provisions to enable private educational institutions to establish such programs under Code section 529. The Bill, however, requires that programs established by private institutions be in the form of tuition credit or certificate programs, and not “savings account plans.” As under the current rule, only qualified state institutions would be permitted to establish “savings account plans.” Additionally, the Bill requires that a private eligible educational institution establishing a qualified tuition program must hold its assets in a trust created or organized in the U.S. for the exclusive benefit of designated beneficiaries that complies with the requirements of Code section 408(a)(2) and (5) (relating to trust requirements for IRAs). Bill Section 402(a). Repeal of “More Than De Minimis Penalty” Provision and Imposition of 10-Percent Tax. The Bill repeals the current rule that a qualified state tuition program must impose a “more than de minimis” monetary penalty on any refund of earnings not used for qualified higher education expenses of the beneficiary. The Bill imposes a 10-percent tax (as is currently applicable to nonqualified distributions from Education IRAs) on the amount of a distribution from a qualified tuition plan that is includible in gross income. Bill Section 402(a). Exclusion from Gross Income. The Bill provides that distributions used for qualified higher education expenses are excludible from gross income. However, with respect to distributions from programs established by eligible private educational institutions, the provision excluding distributions from gross income would become effective January 1, 2004. Bill Section 402(b). Coordination with HOPE and Lifetime Learning Credits and Education IRAs. Similar to the coordination provision for Education IRAs, the Bill allows an individual to claim a HOPE or Lifetime Learning Credit and receive distributions from a qualified tuition program on behalf of the same student in the same tax year, as long as the credit and distribution are used for different educational expenses. The Bill also permits contributions to be made to both an Education IRA and to a qualified tuition program on behalf of the same beneficiary in the same year. Bill Section 402(b). Rollovers and Designated Beneficiary Changes. The Bill clarifies that the rollover of credits or other amounts between qualified tuition programs for the same beneficiary are permissible if limited to one transfer within any 12-month period. Furthermore, the Bill provides that first cousins are considered “members of the family” for purposes of designated beneficiary changes permitted under section 529(c)(3)(C). This “member of the family” definition also applies to Education IRAs. Bill Section 402(c), (d). Adjustment of Limitation on Room and Board Distributions. The Bill provides that the maximum room and board allowance is the amount applicable to the student in calculating costs of attendance for Federal financial aid programs under section 472 of the Higher 13 Education Act of 1965, as in effect on the date of enactment, or, in the case of a student living in housing owned or operated by an eligible educational institution, the actual amount charged the student by the educational institution for room and board. This definition also applies to Education IRAs. Bill Section 402(e). Special Needs Beneficiaries. The Bill modifies the definition of qualified higher education expenses to include expenses of a special needs beneficiary, which are necessary in connection with his or her enrollment or attendance at the eligible education institution. The definition of these expenses, as well as the definition of a special needs beneficiary, are consistent with that for Education IRAs. Bill Section 402(f). Effective Date of Section 529 Plan Provisions. Except as otherwise noted above, the provisions relating to Section 529 qualified tuition plans are effective for taxable years beginning after December 31, 2001. Thomas T. Kim Assistant Counsel Note: The relevant legislative language and the joint House/Senate explanatory statement regarding the Bill ("Explanatory Statement") are available as an attachment to this memo at ICINet (http://members.ici.org). To obtain a copy of these materials, please call the ICI Library at (202) 326-8304 and request the attachment for memo 13566.