

MEMO# 18108

October 15, 2004

CONGRESS PASSES THREE BILLS CONTAINING PENSION INITIATIVES

[18108] October 15, 2004 TO: PENSION MEMBERS No. 53-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 71-04 RE: CONGRESS PASSES THREE BILLS CONTAINING PENSION INITIATIVES Congress recently approved three legislative bills that contain pension relief provisions: the "Guardsmen and Reservists Financial Relief Act of 2004 (the "Reservists Act")¹," nonqualified deferred compensation provisions enacted as part of the "American Jobs Creation Act of 2004 (the "American Jobs Act")²," and the "Working Families Tax Relief Act of 2004 (the "Working Families Act" or "WFA").³ To date, only the Working Families Act has been sent to the President and signed. Guardsmen and Reservists Financial Relief Act of 2004 The Reservists Act provides an additional exception to the ten-percent penalty tax under section 72(t) of the Internal Revenue Code for "any qualified reservist distribution." A distribution would qualify for such treatment if it were made (1) from any qualified retirement plan; (2) to an individual who was, by reason of being a member of a reserve component, ordered or called to active duty for a period in excess of 179 days or for an indefinite period; and (3) during the period beginning on the date of such order or call and ending at the close of the active duty period. The exception would apply to individuals ordered or called to active duty after September 11, 2001, and before September 12, 2005. The Reservists Act provides that employers who continue to pay individuals with respect to any period during which the individual is performing on active duty for more than 30 days all or a portion of the wages the individual would have received from the employer if he or she were performing services for the employer may treat such pay as a "differential wage 1 Go to http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_bills&docid=f:h1779eas.txt.pdf to see the Reservists Act. 2 Section 885 of the American Jobs Act, which adds new Code section 409A that applies to certain nonqualified deferred compensation plans, is attached. 3 Go to http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_bills&docid=f:h1308enr.txt.pdf to see the Working Families Act. 2 payment." Differential wage payments are treated as payments from an employer to an employee. Thus, for retirement purposes, a contribution to a qualified plan of any portion of a differential wage payment will not cause a plan to be disqualified. If an eligible individual elects to receive a distribution, he or she may not make an elective deferral or employee contribution during the six-month period beginning on the date of distribution. The Act also requires that distributions satisfy a nondiscrimination requirement that entitles all eligible employees to receive differential wage payments and to make plan contributions based on such payments. Finally, the Act provides for penalty-free withdrawals from retirement plans for victims of federally declared natural disasters. The special rule applies to individuals who have sustained a loss in excess of \$100 as a result of a federally declared disaster (as defined in the Act), provided that the distribution is made

(1) within a one-year period of the disaster-area declaration and (2) only to the extent that the distribution does not exceed the amount of the loss and is not compensated by insurance or otherwise. Revisions to Reservists Act Made In Response to Institute Comments The Institute supported H.R. 1779 and urged that certain modifications be made. As requested by the Institute, the Act facilitates the making of a qualified reservist distribution by treating an individual who is eligible to receive such a distribution as being severed from employment during the period of such order or call to active duty. Also as requested by the Institute, the Reservists Act clarifies that eligible participants in section 403(b) and 457(b) plans are included in the 72(t) and other relief provisions, as provided by the Act. American Jobs Creation Act of 2004 The American Jobs Act has added a new Code section 409A (attached), which requires that amounts deferred under certain nonqualified deferred compensation plans would be taxed immediately. Section 409A applies to elective and nonelective deferred compensation plans, including supplemental nonelective pensions (SERPs), bonus deferral plans, long-term incentive programs, stock appreciation rights (SARs), deferred stock units, and discounted stock options programs.⁴ Code section 409A is not intended to apply to (1) annual bonuses or other amounts actually paid within 2½ months after the close of the taxable year in which the relevant services were performed, (2) employee stock purchase programs (Code section 423), or (3) stock options with an exercise price that is not less than the fair market value of the shares on the date of grant and with no further deferral feature. Amounts that are required to be included in income must be reported on Form W-2. Additionally, section 409A requires annual reporting to the IRS of “amounts deferred” on the W-2 even if such amounts are not currently includible in income. ⁴ Section 409A does not apply to tax-qualified plans, tax-deferred annuities, IRAs, SEPs, SIMPLEs, 457(b) plans, and plans providing for vacation, sick leave, disability, compensatory time, and death payments. ³ If section 409A’s requirements are not satisfied, affected participants are immediately taxed on the amount deferred and are subject to (a) a 20 percent penalty and (b) interest at the underpayment rate plus 1% as if the deferred compensation had been included in the participant’s income on the earliest date that the employee was vested in the benefit. The new law applies to “amounts deferred” after December 31, 2004. An amount is considered deferred before January 1, 2005, if it is earned and vested before that date, provided that there is no material modification of the arrangement after October 3, 2004. Working Families Tax Relief Act of 2004 The Working Families Act, which was signed into law by President Bush on October 4, includes amendments related to the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”). Section 404 of the Working Families Act makes four technical amendments to pension provisions in EGTRRA: 1. Rounding rule for Section 415 limits. Section 611 of EGTRRA increases the dollar limits on qualified retirement plan benefits and contributions under Code section 415, and adds a new rounding rule for cost-of-living adjustments to the dollar limit on annual additions to defined contribution plans. The WFA provision clarifies that the pre-existing rounding rule applies for purposes of other Code provisions that refer to Code section 415 and do not contain a specific rounding rule. 2. Excise tax on nondeductible contributions. Section 614 of EGTRRA provides that the limits on deductions for employer contributions to qualified retirement plans do not apply to elective deferrals, and elective deferrals are not taken into account in applying the deduction limits to other contributions. The WFA provision makes a conforming change to the Code provision that applies an excise tax to nondeductible contributions. 3. SIMPLE plan contributions for domestic workers. Section 637 of EGTRRA provides an exception to the application of the excise tax on nondeductible retirement plan contributions in the case of contributions to a SIMPLE IRA or SIMPLE 401(k) plan that are nondeductible solely because they are not made in connection with a trade or business of the employer (e.g., contributions on behalf of a domestic worker). Section 637 of EGTRRA did not specifically

modify the present-law requirement that compensation for purposes of determining contributions to a SIMPLE plan must be wages subject to income tax withholding, even though wages paid to domestic workers are not subject to income tax withholding. The WFA provision revises the definition of compensation for purposes of determining contributions to a SIMPLE plan to include wages paid to domestic workers, even though such amounts are not subject to income tax withholding. 4. Rollovers among various types of retirement plans. Section 641 of EGTRRA expanded the rollover rules to allow rollovers among various types of tax-favored retirement plans. The WFA provision makes a conforming change to the cross- reference to the rollovers rules in the Code provision relating to qualified retirement annuities. 4 Lisa Robinson Assistant Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 18108, or call the ICI Library at (202) 326-8304 and request the attachment for memo 18108.

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