

**MEMO# 10180**

August 5, 1998

# **SENATORS GRAHAM AND GRASSLEY INTRODUCE BIPARTISAN PENSION REFORM LEGISLATION**

1 See Institute Memorandum to Pension Committee No. 27-98, dated May 7, 1998. [10180]  
August 5, 1998 TO: PENSION COMMITTEE No. 52-98 RE: SENATORS GRAHAM AND  
GRASSLEY INTRODUCE BIPARTISAN PENSION REFORM LEGISLATION

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Senators  
Graham (D-FL) and Grassley (R-IA) recently introduced the "Pension Coverage and Portability Act," S. 2339. This bill contains significant pension reform proposals that would expand pension coverage for small businesses, enhance pension fairness for women and families, increase pension portability, strengthen pension security and enforcement, encourage retirement education and reduce the administrative complexity facing employers who sponsor pension plans. The bill also contains many provisions similar to those included in H.R. 3788, the "Retirement Security for the 21st Century Act," introduced by Representatives Portman and Cardin earlier this year.<sup>1</sup> The bill contains many of the Institute's legislative priorities regarding pension reform including: (1) enhancing pension portability; (2) elimination of the 25% of compensation limitation on defined contribution plan contributions; (3) modification of the top-heavy rules; (4) increase in the contribution limit applicable to SIMPLE plans; and (4) modification of Code section 401(a)(9) minimum distribution rules. The most significant provisions are summarized below: I. Expanding Coverage for Small Business -- Title I of S. 2339 A. Plan loans for self-employed individuals. The bill would permit owners of partnerships and S corporations to receive plan loans subject to the rules applicable to owners of incorporated businesses. B. Payroll deduction IRAs. The bill would clarify that employers may establish an automatic payroll deduction plan to enable employees to contribute directly to an IRA. This type of arrangement would be available to employers who do not sponsor a qualified retirement plan. In addition, the bill would clarify that employers establishing payroll deduction IRA plans would not incur fiduciary liability under Title I of ERISA. C. SAFE annuities and trusts. The bill would establish a simplified defined benefit plan for small employers that have less than 100 employees and that do not sponsor a qualified retirement plan. The Secure Assets for Employees ("SAFE") would be funded through an individual retirement annuity or through a trust with limited investments. SAFE trusts would not be - 2 - permitted to hold securities which are not readily tradable on an established securities exchange. SAFE plans would have individual accounts for each participant. D. Modification of top-heavy rules. The bill would modify the top-heavy rules to repeal the family aggregation rules, delete the top 10 owner rule from the definition of key employee, increase the compensation to \$80,000 that an officer must have to be treated as highly compensated at the employer's election, exclude salary reduction contributions from determination of whether a plan is top-heavy, and count

matching contributions toward satisfaction of the top-heavy contribution requirements. The look-back rules would be shortened from five years to one year, elective deferrals made by key employees would be disregarded in determining minimum contributions required to be made on behalf of non-key employees and plans meeting the 401(k) safe harbor would be exempt from the top-heavy rules. E. Salary reduction only SIMPLE plans. The bill would permit small employers to establish a salary reduction only SIMPLE plan, with a contribution limit of \$4,000. F. Small employer pension plan credit. The bill would provide pension plan start-up credits for small employers. For employers with 50 employees or less, the credit would include up to 50% of the qualified employer contributions per year for up to five years (not to exceed 3% of employee compensation) and up to \$500 per year for the start-up expenses incurred during the first three years of the plan. For employers with 51 - 100 employees, the credit would be limited to start-up expenses of up to \$500 for the first three years. The effective date of this provision would be for plans established after April 30, 1998. G. Increased contribution limits applicable to SIMPLE plans. The maximum contribution limit to a SIMPLE plan would be increased from \$6,000 per year to \$8,000 per year. H. Standardize the 401(a)(17) compensation cap for SIMPLE IRAs and SIMPLE 401(k)s. In order to standardize the maximum allowable contribution for a SIMPLE IRA and a SIMPLE 401(k), the bill would eliminate the "3% of compensation up to \$160,000" limitation currently applicable to SIMPLE 401(k) plans. I. Elective deferrals not taken into account for purposes of deduction limits. The bill would exclude elective deferrals, as defined under section 402(g)(3), from the deduction limits as applied to other contributions. J. Negative election trusts. The bill would create a new 401(k) safe harbor for a Negative Election Trust ("NET"). A NET would not be subject to the 401(k) nondiscrimination tests if the following requirements are met: (1) salary reduction contributions of at least 3% of compensation for all newly eligible employees who choose not to opt out of the 401(k) plan; (2) elective contributions are made on behalf of at least 70% of non-highly compensated employees; (3) a 50% match (up to 5% of compensation) for all non-highly compensated employees; (4) all contributions are fully vested; and (5) employer provides reasonable notice to employees regarding the NET and gives the employee a reasonable opportunity to opt out of the NET. Comparable provisions would be included for 403(b) arrangements. II. Increasing Pension Access and Fairness for Women -- Title II of S. 2339 2 Therefore, if the taxpayer has made a nondeductible contribution to a traditional IRA or a contribution to a Roth IRA, he or she would not be permitted to roll over amounts from an IRA to an eligible retirement plan. - 3 - A. Section 415(c)(1) 25% of compensation limit. The bill would repeal the "25% of compensation" limit on annual contributions to defined contribution plans. B. Faster vesting for employer matching contributions. The bill would require that employer contributions to defined contribution plans vest according to a three-year cliff schedule or a six-year graded schedule. C. Spousal Notice. The bill would amend Code section 417 to require plans to provide a participant's spouse with a copy of the same written notice that a participant receives regarding survivor benefits and options under the plan. Plans would be required to mail such notices. D. Minimum required distribution rule safe harbor. The bill would raise the minimum required distribution commencement date under section 401(a)(9) to 75 from 70 1/2. In addition, distributions up to \$300,000 from defined contribution plans and IRAs would be exempt from the 401(a)(9) distribution rules. The bill would aggregate all defined contribution plans maintained by the same employer, all IRAs (other than Roth IRAs) and all Roth IRAs separately, for purposes of the rule. In addition, the bill would reduce the excise tax on incorrect minimum required distributions to 10% from 50%. III. Increasing Portability of Pension Plans -- Title III of S. 2339 A. Rollovers among various types of plans. The bill would permit participants in a 401(k), 403(b), or governmental 457 plan or an IRA to roll over such accounts to a 401(k), 403(b) or governmental 457 plan when changing jobs. This provision would be subject to individual

employer election. Rollovers of IRA account balances to a 401(k), 403(b) or governmental 457 plan would be limited to IRA accounts that represent deductible IRA contributions only.<sup>2</sup> The bill would also require that the 402(f) notice be expanded to include an explanation of distribution restrictions and tax consequences under the receiving plan. B. After-tax rollovers. The bill would permit rollovers of after-tax employee contributions to IRAs and other retirement plans. The bill would give the IRS the authority to extend the 60-day requirement for rollovers under certain circumstances. In a detailed explanation of the bill, which is not attached, it is clear that the receiving trustee is not required to track or report the basis. The taxpayer would be required to track and report basis. C. Anti-cutback rule relief. The bill would allow employees to elect to transfer assets from one defined contribution plan to another without requiring the transferee plan to preserve the optional form of benefits provided under the transferor plan, assuming certain requirements are met. D. Cash-out rule modification. The bill would exclude rollover amounts from the balance calculation under the section 411(a)(11) cash-out rule. IV. Strengthening Pension Security and Enforcement -- Title IV of S. 2339 - 4 - A. Civil penalties for fiduciary breach. The bill would permit the Department of Labor to waive certain penalties for fiduciary breach under section 502(l) of ERISA. B. 401(k) credit cards. The bill would prohibit loans from 401(k) plans through credit cards. V. Encouraging Retirement Education -- Title V of S. 2339 A. Periodic benefit statements. The bill would require defined contribution plans to furnish account statements to participants at least once a year. Defined benefit plans would be required to furnish account statements to participants once every three years. B. Small Business Administration education efforts. The Small Business Administration would be required to submit a report to Congress with recommendations regarding increasing educational efforts concerning retirement savings and small business coverage issues. VI. Reducing Red Tape -- Title VI of S. 2339 A. Intermediate sanctions for inadvertent plan failures. The bill would provide that no sanctions or penalties would be imposed on plan sponsors for plan violations that are discovered and corrected prior to an audit. B. Simplification of the cash-out rule. The bill would require the IRS to amend existing regulations to repeal the look-back rule, which requires plan sponsors to "look-back" to see if the participant's balance ever exceeded \$5,000 for purposes of the cash-out rule. C. Section 457 inapplicable to certain mirror plans. The bill would provide that for tax-exempt organizations and state and local governments, section 415 and 401(a)(17) mirror plans would be disregarded for purposes of section 457. D. Notice and consent periods. The bill would substitute a "one-year" requirement for the "90-day" requirement regarding the notice and consent rules for distributions of vested benefits in excess of \$5,000. E. Repeal of Multiple-Use test. The bill would eliminate the multiple use test, the rule that prevents a 401(k) plan from using the maximum difference allowed between highly compensated employees' average matching and employee contributions and the same contributions for the non-highly compensated employees. Copies of the bill and summary report are attached. Kathryn A. Ricard Assistant Counsel Attachments