

MEMO# 10801

March 16, 1999

REPRESENTATIVES PORTMAN AND CARDIN INTRODUCE BIPARTISAN PENSION BILL

1 See Institute memorandum to Pension Committee No. 27-98, dated May 7, 1998. [10801]
March 16, 1999 TO: PENSION COMMITTEE No. 14-99 PENSION OPERATIONS ADVISORY
COMMITTEE No. 14-99 RE: REPRESENTATIVES PORTMAN AND CARDIN INTRODUCE
BIPARTISAN PENSION BILL

Representatives Portman (R-OH) and Cardin (D-MD) have introduced H.R. 1102, titled the "Comprehensive Retirement Security and Pension Reform Act of 1999." This bill contains significant pension reform proposals, including many items supported by the Institute, such as proposals that would modify top-heavy rules, restore various contribution limits to pre-1986 levels, create a catch-up contribution mechanism for 401(k)s and SIMPLE plans, enhance portability, reform required minimum distribution rules, provide for salary-reduction-only SIMPLE plans, and grant tax credits to small employers establishing retirement plans. Although differing in some detail, this bill is similar to one which Representatives Portman and Cardin introduced last year.¹ The bill is divided into five titles each focusing on a different theme as follows: (1) expanding coverage; (2) enhancing fairness for women and children, (3) increasing portability for plan participants, (4) strengthening pension security and enforcement, and (5) reducing regulatory burdens. Key provisions are discussed below. A full copy of the bill and related press materials are attached.

Title I: Expanding Coverage

1. Restoration Of Limits. With respect to defined contribution plans, section 101 of the bill would: (a) Raise the section 415(c) dollar limit from \$30,000 to \$45,000. (Section 202 of the bill would eliminate the 25% of compensation limit); (b) Raise the section 401(a)(17) contribution limit from \$160,000 to \$235,000; (c) Raise the section 402(g) limit on elective deferrals from \$10,000 to \$15,000; (d) Raise the limitation on section 457 contributions from \$8,000 to \$15,000. (Also, section 202(c) of the bill would eliminate the 33 1/3 % of compensation limit); (e) Raise the limitation on SIMPLE plan contributions from \$6,000 to \$10,000; and 2(f) Raise the IRA deductible contribution limit from \$2,000 to \$5,000. This increase would apply only to deductible contributions; the \$2,000 limit would continue to apply to individuals not qualified to fully deduct their IRA contributions (i.e., those making any nondeductible contributions) and to Roth IRA contributions. (g) Section 101 also increases the section 415(b) defined benefit plan dollar limit, which is presently \$130,000, to \$180,000. The limit would be actuarially reduced if the benefit begins before age 62 and actuarially increased when the benefit begins after age 65. For defined benefit plans of governments and tax-exempt organizations and for multi- employer plans, the bill provides that the limit on benefits beginning on or after age 55 would not be reduced below \$130,000.

2. Salary Reduction Only SIMPLE Plans. Section

103 permits the establishment of “salary- reduction-only” SIMPLE plans. In such plans, the contribution limit would be \$5,000. 3. Modification Of Top-Heavy Rules. Section 104 modifies Code section 416 top-heavy rules by repealing the family aggregation rules, simplifying the definition of “key employee,” permitting an employee’s elective contributions not to be taken into account in determining whether a plan is top heavy, and eliminating the section 416(g)(3) requirement to take into account distributions made during the last five years. Employers would be able to take into account matching contributions in order to satisfy the rule’s minimum contribution requirements. The bill also would clarify that the top-heavy rules do not apply to 401(k) plans satisfying the section 401(k)(12) and 401(m)(11) nondiscrimination safe harbors. 4. Section 404 Deduction Limits. Bill section 105 amends Code section 404 so that elective deferrals need not be taken into account when calculating the limitation on the deductibility of employer contributions to plans. Bill section 111 would increase the deduction limit applicable to stock bonus and profit-sharing plans from 15 percent to 25 percent. 5. Elimination Of IRS User Fees. Small employers would no longer be required to pay user fees for requests for ruling letters, opinion letters and determination letters from the Internal Revenue Service. See section 109 of the bill. 36. Automatic Contribution Trust Nondiscrimination Safe Harbor. Bill section 110 provides a new nondiscrimination safe harbor for 401(k) plans that have an “automatic contribution” (also popularly called a “negative election”) arrangement. Plans with such arrangements require each eligible employee to affirmatively elect out of, rather than into a salary deferral election. To qualify for the proposed safe harbor, automatic “elective” contributions must be made on behalf of at least 70 percent of non-highly compensated employees. The employer also must match non-highly compensated employee contributions in an amount equal to 50% of the contributions up to 5 percent of compensation, or make a contribution in the amount of 2 percent of compensation on behalf of each eligible employee. Such contributions would be immediately fully vested. 7. 401(k)(9) Compensation Definition. Bill section 110(d) would amend the definition of compensation to permit the use of “base pay” for purposes of the section 401(k) plan nondiscrimination safe harbors. Also, the safe harbor contribution requirements could be satisfied with respect to the plan year as a whole or separately with respect to each payroll period. See section 110(e) of the bill. 8. After-Tax “Plus” Contributions To 401(k) And 403(b) Plans. Bill section 112 creates a new Code section 402A under which employers could establish a “qualified plus contribution program.” This is similar to a proposal that will appear in an IRA expansion bill to be filed by Senator Roth (R-DE) and popularly referred to as the “Roth 401(k)” proposal. In this program an employee may elect to designate all or a portion of elective deferrals as “plus contributions.” These contributions, which employees would designate as not excludable from income, would be separately accounted for in a “plus contribution account” and offset against the 402(g) elective deferral limit. W-2 reports would be required to identify the amount of designated plus contributions. In a manner similar to Roth IRA distributions, qualified distributions from the “plus account” (including earnings) are not included in gross income. Such distributions, however, may be made only after a five-year holding period has been satisfied. If an individual or an individual’s spouse has a Roth IRA, the date of establishment of the Roth IRA may be used to satisfy the five-year requirement. Rollovers from “plus accounts” may be made to Roth IRAs. 9. Start Up Cost Tax Credit For Small Employers. Small employers would be able to obtain a tax credit in an amount up to 50% of the startup costs of establishing a pension plan up to \$1,000 for the first credit year and \$500 for each of the second and third years after the plan is established. Startup costs would include costs for retirement-related education of employees. See section 113 of the bill. Title II: Enhancing Fairness For Women and Children 1. Catch-up Contributions. The bill would increase the Code section 402(g) limit by \$5,000 (in addition to the general increase in the limit proposed at section 101 of the bill) for

individuals who are age 50 and over. The same catch-up provision also would apply to SIMPLE plans and 457 plans. See section 201 of the bill.

2. Elimination of 25% Of Compensation Limitation. The Code section 415 25%-of- compensation limit is eliminated. See section 202 of the bill.

43. Faster Vesting Of Employer Matches. Matching contributions made under section 401(m) would be required to be vested under a 3-year cliff schedule or a 5-year graded schedule. See section 203 of the bill.

4. Simplify Minimum Distribution Rules. Treasury would be required to “simplify and finalize” regulations relating to minimum required distribution rules, modify the regulations to reflect increases in life expectancy and revise required distribution methods to assure that under reasonable assumptions the amount of required minimum distribution does not decrease over a participant’s life expectancy. Individuals that have already selected distribution methods under current regulations would be permitted a “fresh start” under revised regulations. See section 205 of the bill.

5. \$100,000 Exclusions From Required Minimum Distribution Rules. Code section 401(a)(9) would be revised to exclude from the rule \$100,000 accumulated in an individual’s defined contribution plans and \$100,000 accumulated in an individual’s IRAs (other than Roth IRAs, which are not presently subject to the rule). See section 205(b) of the bill.

6. Repeal Of The “At Least As Rapidly” Minimum Distribution Rule. Code section 401(a)(9)(B)(i), currently requires minimum distributions at death to be distributed “at least as rapidly” as under the method being used at time of death. This requirement would be repealed. See section 205(c) of the bill.

7. Reduction Of Excise Tax. Code section 4974 excise tax would be reduced from 50% to 10%. See section 205(c) of the bill.

8. Treatment Of 457 Plan Benefits Upon Divorce. Bill section 206 would make section 414(p) QDRO rules applicable to 457 plans.

Title III: Increasing Portability For Plan Participants

1. Rollovers Among Various Plan Types. Bill section 301 would amend “eligible rollover distribution” rules, including Code sections 402(c), 402(f) and 401(a)(31), to permit the rollover of pre-tax account assets to and from 457, 403(b) and 401(k) plans.

2. Rollovers Of IRAs To Workplace Plans; Rollovers Of After-Tax Contributions. Bill sections 302 and 303 permit the rollover of IRA assets into employer-sponsored plans, except that account basis (nondeductible IRA contributions or after-tax contributions from plans rolled into IRAs) could not be so rolled over. Individuals, however, would be permitted to roll after- tax contributions to plans into IRAs. The bill also provides a method for applying section 72 to IRA distributions in a year in which a portion of IRA assets has also been rolled into an eligible retirement plan.

53. Hardship Exception To 60-Day Rule. Bill section 303(b) amends Code section 402(c) to permit Treasury to waive the 60-day rule where application of the rule would “be against equity and good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual.”

4. Treatment Of Forms Of Distribution For Certain Plan Transfers. Bill section 304 amends Code section 411(d)(6) anticutback rules to permit plan transfers from one defined contribution plan to another in cases where not all forms of distribution are preserved so long as the participant (and in the case of a plan where section 417 is applicable, the participant’s spouse) consents.

5. Elimination Of Forms Of Distribution In Defined Contribution Plans And Additional Anticutback Rule Relief. Bill section 304 further amends Code section 411(d)(6) to permit the elimination of forms of distribution previously available in a defined contribution plan if a single sum payment is available for the same or a greater portion of the account balance as the form of distribution being eliminated. The bill would clarify the authority of Treasury to issue regulatory relief from the anticutback rule for any plan amendment that does not adversely affect the rights of participants in a material manner. Treasury would further be directed to issue final regulations under section 411(d)(6) to apply no later than to plan years beginning after December 31, 2001.

6. Modification Of Same Desk Rule; Repeal Of Business Sales Requirement. Bill section 305 modifies the “same desk rule” of Code section 401(k)(2)(B) by replacing the phrase “separation from service” with the phrase “severance

from employment.” Similar changes would be made to sections 403(b) (7) and (11) and section 457(d)(1). Further, the business sales requirement at section 401(k)(2)(B) is repealed.

7. Disregard Of Rollovers For Cash-out Rule. Bill section 307 amends section 411(a)(11) rules relating to restrictions on mandatory distributions to permit plans to determine the present value of nonforfeitable accrued benefits without regard to benefit amounts attributable to rollovers. Additionally, bill section 506 would index the \$5,000 limit on mandatory cash-outs for inflation in \$500 increments.

Title IV: Strengthening Pension Security And Enforcement

1. Periodic Benefit Statements. Bill section 403 would require the furnishing of benefit statements to participants and beneficiaries at least one each year in the case of a defined contribution plan, and upon written request of the participant or beneficiary in the case of a defined benefit plan.

2. Notice Of Significant Reduction In Benefit Accruals. Defined benefit plans (and other plans subject to ERISA section 302 funding standards) that are significantly reducing the rate of future benefit accruals are required to provide a notice to each affected participant and alternate payee, and to each employee organization representing them. The notice would be required to include the plan amendment or a summary of the amendment, its effective date and a description of the reduction. This provision is intended to address concerns arising from the conversion of defined benefit plans to cash balance plans. See section 407 of the bill.

Title V: Reducing Regulatory Burdens

61. Intermediate Sanctions For Inadvertent Failures. Section 501 would assure that a plan would not be tax-disqualified if good faith efforts to maintain tax qualified status are evidenced, the plan has “inadvertently failed” to satisfy a tax qualification requirement, and either (1) the plan “substantially corrects” the failure before becoming subject to a plan examination or (2) the plan substantially corrects the failure after becoming subject to a plan examination and pays a penalty, as determined by Treasury. Under the proposal, the penalty assessed is not to exceed “an amount that bears a reasonable relationship to the severity” of the plan’s failure to maintain compliance. Further, where a plan is disqualified, any resulting income inclusion would not be applicable to nonhighly compensated employees.

2. Repeal Of Multiple Use Test. Code section 401(m)(9) is amended to repeal the multiple use test. See section 502 of the bill.

3. Nondiscrimination “Safety Valve.” Plans would be deemed to satisfy the Code section 401(a)(4) nondiscrimination test if able to satisfy a “facts and circumstances” test upon determination by the Treasury. Treasury is directed to issue implementing regulations. See section 503 of the bill.

4. Reform Of The Line Of Business Rules. Bill section 504 repeals the “gateway test” at Code section 410(b)(5). Treasury also is directed to simplify the separate line of business rules under Code section 414(r).

5. Coverage Test Flexibility. Bill section 505 amends Code section 410(b) to enable plans failing the coverage test to request that Treasury determine whether the plan satisfies the test by applying pre-TRA ’86 standards.

6. Notice And Consent Period For Distributions. Section 514 of the bill would extend to one year the 90-day notice period under Code section 417, and direct Treasury to similarly modify notice periods in regulations issued under sections 402(f), 411(a)(11), and 417.

7. Employees Of Tax-Exempt Entities. Section 517 of the bill directs Treasury to modify regulations at section 1.410(b)-6(g) to provide that employees of certain tax-exempt entities that are eligible to make contributions under section 403(b) salary reduction arrangements may be treated as excludable with respect to a 401(k) plan. They would be excludable to the extent that (1) no employee of the entity is eligible to participate in the 401(k) plan and (2) at least 95% of the remaining employees are eligible to participate in the 401(k) plan. This is intended to correct for testing issues that arise from the Small Business Job Protection Act of 1996 extension of the availability of the 401(k) plan to certain tax-exempt entities.

8. Clarification Of Treatment Of Employer-Provided Retirement Advice. Section 132(e) of the Code would be amended to clarify that the provision of retirement planning services by an employer to employees would be treated as a “de

minimis fringe” benefit. See section 520 of the bill. 9. Excess Benefit Plans. Section 3(36) of ERISA is amended to expand the meaning of the term “excess benefit plan” to include a plan maintained solely for the purpose of providing employees benefits in excess of the section 401(a)(9)(B), 401(k) and (m), 402(g), 403(b), 408(k) and (p) or 415 limits “or any other limitation on contribution or benefits.” See Section 522 of the bill. 710. Reporting Simplification. Bill section 525 directs Treasury to modify annual filing requirements for one-participant plans in order that such plans with assets of \$500,000 or less need not file an annual return. In the case of plans with fewer than 25 employees, Treasury is directed to provide for the filing of a simplified annual return. 11. Model Plans For Small Business. Bill section 526 directs Treasury to issue model defined contribution and defined benefit plans that “fit the needs of small businesses.” Russell G. Galer Senior Counsel Enclosure

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.