

MEMO# 11184

August 13, 1999

CONGRESS PASSES THE TAXPAYER REFUND AND RELIEF ACT OF 1999 INCLUDING PENSION, IRA, AND EDUCATION SAVINGS PROVISIONS

1 The House version of the bill, H.R. 2488 (the "Financial Freedom Act of 1999"), was passed by the House on July 22, 1999. See Institute Memorandum to Pension Committee No. 46-99 and Pension Operations Advisory Committee No. 36-99, dated July 28, 1999, for a discussion of pension proposals in the House bill. The Senate amendment to the House bill, S. 1429 (the "Taxpayer Refund Act of 1999"), was passed by the Senate on July 30, 1999. See Institute Memorandum to Pension Committee No. 50-99 and Pension Operations Advisory Committee No. 38-99, dated August 2, 1999, for a discussion of pension proposals in the Senate bill. H.R. 2488 also contains additional tax proposals of interest to the mutual fund industry. See Institute Memorandum to Accounting/Treasurers Members No. 22-99, Closed-End Investment Company Members No. 30-99, International Members No. 22-99, Operations Members No. 20-99, Tax Members No. 26-99, Transfer Agent Advisory Committee No. 51-99, and Unit Investment Trust Members No. 18-99, dated August 9, 1999. 2 These include provisions that would have increased income limits for deductible IRA contributions, established "individual development accounts," expanded medical savings accounts, required the delivery of periodic pension benefit statements to participants, modified distribution rights notices, and established a new simplified defined benefit plan program for small employers (the "SAFE" plan). [11184] August 13, 1999 TO: INVESTMENT ADVISERS COMMITTEE No. 10-99 OPERATIONS COMMITTEE No. 32-99 PENSION MEMBERS No. 31-99 TAX COMMITTEE No. 21-99 TRANSFER AGENT ADVISORY COMMITTEE No. 53-99 RE: CONGRESS PASSES THE TAXPAYER REFUND AND RELIEF ACT OF 1999 INCLUDING PENSION, IRA, AND EDUCATION SAVINGS PROVISIONS

On August 5, 1999, Congress passed H.R. 2488, the "Taxpayer Refund and Relief Act of 1999." The conference bill, which reconciled the House and Senate versions of the bill,¹ passed the House by a vote of 221 to 206 and the Senate by a vote of 50 to 49. The President has indicated that he will veto this bill. The conference bill contains substantial pension, IRA and education reforms. Significant provisions include those that would increase contribution limits to 401(k), 403(b), 457, and SIMPLE plans, permit "catch-up" contributions to IRAs and employer-sponsored plans for individuals 50 and older, permit after-tax "Plus" contributions to 401(k) and 403(b) plans, enhance portability, and modify top heavy rules. In addition, the bill would increase the contribution limit for IRAs and Roth IRAs and raise the income limits applicable to Roth IRAs. The bill also would expand Education IRAs and Qualified Tuition Programs. Note, however, that the conference bill does not include a number of

proposals that had appeared in the House or Senate versions of the bill.² Many of the proposals in the bill, including IRA expansion, portability, catch-up contributions, increases in contribution limits, and top-heavy reform, have been advocated by the Institute. For a complete list of all provisions, please review the table of contents to the bill, which is attached. Most pension-related provisions are in Title XII of the bill, which is divided into subtitles. The relevant legislative language and excerpts from the Conference Report are also attached. Effective dates are discussed below. Generally, provisions in the bill are effective after December 31, 2000. In addition, the bill contains a sunset provision under which certain sections of the bill, including those that would increase IRA contributions (Bill Section 211) and permit catch-up contributions (Bill Sections 214 and 1221), would sunset on December 31, 2008, and all other provisions of the bill would cease to apply after September 30, 2009.

I. Individual Retirement Accounts (Title II, Subtitle B)

A. Increase in Annual Contribution Limit. The bill would increase the current \$2,000 annual contribution limit to IRAs and Roth IRAs as follows: \$3,000 in 2001 through 2003; \$4,000 in 2004 and 2005; \$5,000 in 2006 and thereafter. Beginning in 2006, the limit would be indexed for inflation in \$100 increments. Bill Section 211; Report p. 36-40.

B. Increase in Income Limits on Roth IRA Contributions. Effective for taxable years beginning after December 31, 2002, the bill would increase the adjusted gross income (AGI) limit on eligibility to make Roth IRA contributions for a phase-out range of \$200,000 to \$210,000 for joint filers and for a range of \$100,000 to \$110,000 for individuals. Bill Section 212; Report p. 36-41.

C. Increase in Limits for Roth IRA Conversions. The bill would modify the income limit on conversions from traditional IRAs to Roth IRAs from \$100,000 (applicable to both individual and married taxpayers filing jointly) to \$100,000 for individuals and \$200,000 for joint filers. The proposal would be effective for taxable years beginning after December 31, 2002. Bill Section 212; Report p. 36-41.

D. Deemed IRAs in Employer Plans. The bill would enable employers to allow employees to make IRA or Roth IRA contributions to a separate account within their employer-sponsored retirement plan. The account would be treated as any IRA, and would not be subject to plan testing requirements. The account would be exempt from ERISA, except for ERISA sections 403(c), 404, and 405 (relating to exclusive benefit, fiduciary and co-fiduciary liability), which would continue to apply. This provision would apply to plan years beginning after December 31, 1999. Bill Section 213; Report p. 36-41.

E. Catch-Up Contributions to IRAs by Individuals Age 50 or Over. The bill would permit individuals who have attained age 50 to make additional elective contributions to IRAs. The catch-up amount would be phased in over five years in 10% increments beginning in taxable years after December 31, 2000, until 2005, when the annual permitted catch-up amount would be equal to 50% of the maximum annual IRA contribution limit. Bill Section 214; Report p. 36-40 (see also Bill Section 1221, which would permit similar catch-up contributions to employer-sponsored retirement plans).

F. IRA Distributions For Charitable Purposes. Title X, Section 1009 of the bill would exclude qualified charitable distributions from IRAs from the gross income of the distributee if the distributions are made to qualified charitable organizations. Qualifying distributions would be those from an IRA made on or after age 70½ that are made as a charitable contribution (as defined in Code section 170(c)) directly to an eligible entity.³ The amount otherwise allowable as a deduction to an individual as charitable contributions would be reduced by the amount of qualified charitable distributions for that year. Section 1009 would become effective for tax years after December 31, 2002. Bill Section 1009; Report p. 202-203.

II. Education Savings Incentives (Title IV)

A. Education IRAs (Bill Section 401; Report p. 53-58)

Increased Contribution Limit. Effective January 1, 2001, the bill would increase the annual contribution limit to an Education IRA from \$500 per designated beneficiary to \$2,000. Bill Section 401(a).

Expansion of Qualified Education Expenses. Effective January 1, 2001, the bill would expand the definition of qualified education expenses for which account distributions may

be used to include qualified elementary and secondary education expenses, as well as certain homeschooling expenses. The definition relating to qualifying higher education expenses also would be further modified in section 402(f) of the bill, effective January 1, 2000. Bill Section 401(b). Special Needs Beneficiaries. Under current law, contributions to an Education IRA are not permitted once the beneficiary reaches age 18. The bill would eliminate this age limitation for beneficiaries with "special needs," effective January 1, 2001. Bill Section 401(c). Entities Eligible to Contribute to Accounts. The bill would clarify that corporate and nonprofit entities may contribute to Education IRAs. Such entities would not be subject to the income limitations applicable to individual contributors. This provision would be effective January 1, 2001. Bill Section 401(d). Extension of Time to Contribute and to Remove Excess. Effective January 1, 2001, the bill would extend 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 would provide 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(e). Coordination with HOPE and Lifetime Learning Credits and Qualified Tuition Programs. Effective January 1, 2001, the bill would alter 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 would allow 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 would permit 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 401(f). Education IRAs Renamed "Education Savings Accounts." Effective upon the date of the bill's enactment, the bill would change the name of Education IRAs to "Education Savings Accounts." Bill Section 401(g). B. Qualified Tuition Programs (Bill Section 402; Report p. 59-63) Expansion to Private Educational Institutions. Effective January 1, 2000, the bill would expand the qualified state tuition program to enable private educational institutions to establish such programs under Code section 529. The bill would, however, require that programs established by private institutions be in the form of tuition credit or certificate programs. As under the current rule, only qualified state institutions would be permitted to establish "savings account plans." Bill Section 402(b). Exclusion from Gross Income. The bill would provide that distributions made in taxable years after December 31, 1999 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(c). Coordination with HOPE and Lifetime Learning Credits and Education IRAs. Similar to the coordination provision for Education IRAs, the bill would allow 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 would also permit 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. This provision would be effective January 1, 2000. Bill Section 402(c). Rollovers and Designated Beneficiary Changes. Effective January 1, 2000, the bill would clarify that the rollover of credits or other amounts between qualified tuition programs for the same beneficiary are permissible if limited to one in each 1-year period. Furthermore, the bill would provide 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 would also apply to Education IRAs. Bill Section 402(d), (e). Definition of

Qualified Higher Education Expenses. Effective January 1, 2000, the bill would modify the definition of qualified higher education expenses to mean (1) tuition and fees required for enrollment or attendance at an eligible educational institution, and (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance, but not in excess of the allowance for books and supplies determined by the educational institution for purposes of financial assistance programs. Certain expenses for sports, games, or hobbies also would be excluded from the definition. The bill's definition of qualified higher education expenses would also apply to Education IRAs under Code section 530. Bill Section 402(f).

III. Expanding Pension Coverage (Title XII, Subtitle A) 5A. Increased Contribution and Benefit Limits. The bill would increase Code section 415's limitation on annual additions to defined contribution plans from \$30,000 to \$40,000, which would be indexed for inflation in \$1,000 increments (see also Bill Section 1222, which would increase the "25% of compensation" rule to 100% of compensation). The bill would increase section 401(a)(17)'s limit on the amount of compensation that may be taken into account under a plan for determining benefits to \$200,000, indexed in \$5,000 increments. The bill would increase the elective deferral limitation under section 402(g), beginning in 2001, in annual increments of \$1,000 until the limit reaches \$15,000 in 2005. Thus, the limit would be \$11,000 in 2001, \$12,000 in 2002, etc., until it reaches \$15,000 in 2005. The contribution limit for section 457 plans would conform to the 402(g) limit; i.e., the limit would be \$11,000 in 2001, \$12,000 in 2002, etc., until it reaches \$15,000 in 2005. The limit for 457s would be twice the otherwise applicable dollar limit in the three years prior to retirement. Finally, the bill would increase the SIMPLE plan contribution limit in \$1,000 increments beginning in 2001 until it reaches \$10,000 in 2004; i.e., the SIMPLE plan contribution limit would be \$7,000 in 2001 and \$8,000 in 2002, etc. until it reaches \$10,000 in 2004. The 402(g), 457 plan and SIMPLE plan limits would be indexed in \$500 increments. The modifications in this provision would be effective for years beginning after December 31, 2000. Bill Section 1201; Report p. 244-247.

B. Plan Loans Available to Subchapter S Shareholders, Partners and Sole Proprietors. The bill would modify the prohibited transaction rules to permit plan loans to sole proprietors, partners, and Subchapter S corporation shareholders, effective after December 31, 2000. Bill Section 1202; Report p. 247-248.

C. Top-Heavy Rule Modification. The bill would provide that a plan that satisfies the design-based safe harbor under section 401(k)(12) and the matching contribution requirements under section 401(m)(11) would not be deemed top-heavy. The bill also would provide that matching or nonelective contributions provided could be taken into account for purposes of minimum contributions under the top-heavy rules. Further, distributions made during the year ending on the date the top-heavy determination is made would be taken into account for purposes of the rule. The bill would apply the current 5-year rule to in-service distributions. The bill would define "key employee" as an employee earning more than \$150,000 and would repeal the top-10 owner key employee category. In addition, the bill would repeal the 4-year look-back rule for determining key employee status and provide that an employee is deemed a key employee only if he or she is a key employee during the current plan year. Finally, the family ownership attribution rule would no longer apply in determining whether an individual is a 5% owner of the employer. These modifications would be effective beginning on January 1, 2001. Bill Section 1203; Report p. 248-252.

D. Elective Deferrals Not Taken into Account for Deduction Limit. The bill would provide that effective 2001, elective deferrals would no longer be considered employer contributions subject to Code section 404 deduction limits. Bill Section 1204; Report p. 252-253.

E. Repeal of Coordination of Requirements for 457 Plans. Effective January 1, 2001, the bill would repeal the rules requiring coordination of contributions to other types of plans with contributions to 457 plans for purposes of the 457 plan contribution limit. Bill Section 1205; Report p. 253-254.

6F. Elimination of User Fees for Determination Letter

Requests for Small Employers. Effective for letter requests made after December 31, 2000, the bill would eliminate the user fee charged by the IRS for any determination letter regarding the qualified status of a plan for small employers (employers with 100 or fewer employees) during the first 5 plan years of the plan. Bill Section 1206; Report p. 254-255.

G. Modification of Definition of Compensation for Purposes of Deduction Limits. The bill would modify Code section 404's definition of compensation to include elective deferral contributions, effective January 1, 2001. Bill Section 1207; Report p. 255-256.

H. After-Tax Elective Deferral "Plus" Contributions to 401(k) Plans And 403(b) Annuities. The bill would permit a section 401(k) plan or section 403(b) annuity to include a "qualified plus contribution program" under which an individual could elect to have all or a portion of his or her elective deferrals under the plan treated as after-tax contributions. Qualified distributions from the Plus program would be tax free, following rules described below. The proposal would be effective for taxable years beginning after December 31, 2000. Under the program, the annual contribution limit for Plus contributions would be the Code section 402(g) limit reduced by other elective deferrals. Plus contributions to 401(k) plans would be treated the same as other elective deferrals for the purposes of nondiscrimination requirements. A plan offering a Plus program would be required to maintain separate recordkeeping for Plus contributions and related earnings. Qualified distributions from the Plus program would not be includible in income. A qualified distribution would be one (1) made after the five-taxable year period beginning with the first taxable year in which a participant made a Plus contribution and (2) made on or after the participant attains age 59 $\frac{1}{2}$, to a beneficiary or a participant's estate upon the death of the participant, or upon disability of the participant. Bill Section 1208; Report p. 256-258.

IV. Enhancing Fairness for Women (Title XII, Subtitle B)

A. Catch-Up Contributions for Individuals Age 50 or Over. The bill would permit individuals who have attained age 50 to make additional elective contributions to employer-sponsored retirement plans. The catch-up amount would be phased in over five years in 10% increments beginning in taxable years after December 31, 2000, until 2005, when the annual permitted catch-up amount would be equal to 50% of the applicable maximum annual limit. Thus, for 401(k)s, 403(b)s, SIMPLEs and 457 plans, individuals who have attained age 50 before the end of the plan year, after the phase-in, would be permitted to make elective deferrals in addition to those permitted under their plan in amounts equal to 50% of the annual maximum dollar amount permitted under the Code. The catch-up contributions would not be subject to nondiscrimination and other testing requirements. Bill Section 1221; Report p. 265-267 (see also Bill Section 214, which permits similar catch-up contributions to IRAs).

B. Equitable Treatment for Contributions of Employees to Defined Contribution Plans. Effective January 1, 2001, the section 415(c) limit on annual additions would be amended to increase the 25% of compensation limitation to 100 percent. The 33 $\frac{1}{3}$ percent of compensation limitation on deferrals under 457 plans would be changed to 7100%. The exclusion allowance applicable to contributions to section 403(b) annuities would be repealed. The bill also would direct Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance. Bill Section 1222; Report p. 267-269.

C. Faster Vesting of Matching Contributions. The bill would require 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, 2000. Bill Section 1223; Report p. 269-270.

D. Simplification and Modification of the Minimum Required Distribution Rules. The bill would modify the current minimum required distribution ("MRD") rules, effective after December 31, 2000. First, the proposal would apply the MRD rules currently applicable to distributions where the participant has died before minimum distributions have begun to all post-death

distributions, i.e., if a participant dies before his or her entire interest has been distributed, the remaining interest must be distributed within 5 years of the date of death or begin within one year of the date of death and be paid over the life or life expectancy of a designated beneficiary. The bill, however, would permit surviving spouses to begin distributions when the spouse turns 70 1/2. The proposal would apply to future distributions for participants in MRD status and would permit the selection of a new beneficiary and election of a new method of calculating life expectancy. Second, the bill would reduce the excise tax on failures to satisfy the MRD rules to 10% from 50%. Third, the bill would direct the Treasury Department to update, simplify and finalize the MRD regulations. Specifically, the bill would require Treasury to revise its current regulations to reflect current life expectancies and revise the MRD methods so that under reasonable assumptions, the amount of the required distribution does not decrease over a participant's life expectancy. Finally, section 1239 of the bill would apply the MRD rules to 457 plans, thereby repealing the special MRD rules currently applicable to 457 plans. Bill Sections 1224 and 1239; Report p. 270-273. E. Clarification of Division of 457 Plan Assets in Divorce. The bill would apply the tax rules for qualified plan distributions pursuant to a qualified domestic relations order ("QDRO") (Code section 402(e)(1)(A)) to distributions made pursuant to a QDRO for a 457 plan. In addition, the bill would provide that a 457 plan would not be treated as violating the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO. This provision would apply to transfers, distributions, and payments made after December 31, 2000. Bill Section 1225; Report p. 273-274. F. Modification of 401(k) Hardship Withdrawal Safe Harbor. The bill would direct 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 would apply to years beginning after December 31, 2000. Bill Section 1226; Report p. 274-275. V. Increasing Portability for Participants (Title XII, Subtitle C) A. Rollovers of Retirement Plan and IRA Distributions. Effective January 1, 2001, eligible rollover distributions from qualified retirement plans, section 403(b) annuities and governmental section 457 plans generally could be rolled over to any of such plans or arrangements. Similarly, taxable amounts in a traditional IRA (i.e., all but account basis) could be rolled over into a qualified plan, section 403(b) annuity or governmental section 457 plan. Direct rollover and withholding rules would be extended to section 457 plans. No plan, however, would be required to accept rollovers. Distributions from a qualified plan would not be eligible for capital gains or income averaging treatment if there was a rollover to the plan that would not have been permitted prior to these amendments to the rollover rules. Amounts distributed from a section 457 plan would be 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 would be required to separately account for such amounts. The section 402(f) rollover notice, which would be required of all plans, would be required to describe the extent to which distribution rules and tax consequences may differ from plan to plan. Bill Sections 1231 and 1232; Report p. 276-280. B. Rollover of After-Tax Contributions. The bill would permit the rollover of after-tax contributions from a qualified plan to another qualified plan or a traditional IRA for distributions made after December 31, 2000. Plan-to-plan rollovers of after-tax monies would be required to be direct rollovers. Plans accepting such rollovers would be required to separately account for them. After-tax contributions rolled over to an IRA, however, would be tracked by the taxpayer (see subparagraph C, below). After-tax contributions in an IRA (including those rolled from a qualified plan and nondeductible contributions to an IRA) would not be permitted to be rolled over from the IRA to a qualified plan, 403(b) annuity or section 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). Bill Section 1233; Report p. 279-280. C. Issuance of Regulatory Guidance on Rollovers. The accompanying Conference Report states that the IRS is expected 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. Report p. 279-280. D. Hardship Exception to 60-Day Rollover Rule. The bill would give the IRS authority to waive the 60-day rollover requirement where failure to comply is due to casualty, disaster or other events beyond the control of the individual. The provision would apply to distributions after December 31, 2000. Bill Section 1234; Report p. 280. E. Anticutback Rule Relief with Respect to Forms of Distribution. The bill would permit 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 would be permitted if (1) the transfer is either the result of a merger or consolidation of plans or is in the form of a direct transfer, (2) the terms of each plan permit the transfer and the transferee plan permits distributions in the form of a single lump sum distribution, and (3) the transfer is by voluntary election of the plan participant and, to the extent required by Code section 417, the participant's spouse consents to the transfer. The bill also provides that a defined contribution plan would not be treated as violating the anticutback rule (section 411(d)(6) of the Internal Revenue Code) if the plan is amended to eliminate a form of distribution previously available as long as a lump sum distribution is available (for at least those benefit accruals that would have been protected under section 411(d)(6)) at the same time as the form of distribution being eliminated. The effective date of the proposal would be January 1, 2001. Furthermore, Treasury would be directed to issue regulations allowing the elimination of optional forms of benefit provided the rights of participants are not adversely affected in a material manner. Such regulations would be required to be issued by December 31, 2001. Bill Section 1235; Report p. 280-283. F. Repeal of Same Desk Rule. Effective for distributions after December 31, 2000, the bill would modify 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 1236; Report p. 283-284. G. Purchase of Service Credit in Governmental Defined Benefit Plans. The bill would permit 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, 2000. Bill Section 1237; Report p. 284-285. H. Disregard of Rollovers When Applying Cash-Out Rules. Effective January 1, 2001, the bill would permit 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 1238; Report p. 285-286. VI. Strengthening Pension Security and Enforcement (Title XII, Subtitle D) A. Missing Participants. The bill would extend PBGC's missing participants program to defined contribution plans and multiemployer plans, effective after final regulations have been prescribed. Bill Section 1243; Report p. 297-298. B. Investment of Employee Contributions in 401(k) Plans. The bill would modify 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. The provision would apply as if included in the Taxpayer Relief Act of 1997. Bill Section 1246; Report p. 298-299. C. Miscellaneous Defined Benefit Plan Provisions. Subtitles D and E of Title XII contain various provisions relating to defined benefit plans. These include: Repeal of the 150 percent of current liability funding limit over a phase-in period (Bill Section 1241; Report p.

287-288); relief from excise tax for sound pension funding (Bill Section 1244; Report p. 288-290); imposition of an excise tax for failure to provide notice regarding significant reduction of future benefit accruals (Bill Section 1245; Report p. 290-297); exemption of multiemployer plans from the 100 percent of compensation limitation in Code section 415(b)(1) (Bill Section 1247; Report p. 316-317); modification of plan valuation timing requirements (Bill Section 1251; Report p. 303-304); modification of PBGC guaranteed benefits for substantial owners in terminated plans (Bill Section 1258; Report p. 317-318).

VII. Reducing Regulatory Burdens (Title XII, Subtitle E) A. Employees of Tax-Exempt Organizations and 401(k) Plan Formation. The bill would rectify 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 in the Small Business Job Protection Act of 1996. Previously implemented IRS rules establish 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 would direct Treasury to modify its rule to accommodate the SBJPA change as follows: employees who are eligible to make elective deferrals under 403(b) arrangement 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% of the employees who are not employees of that organization are eligible to participate in the 401(k) plan. Bill Section 1254; Report p. 308-309. B. Clarification of Treatment of Employer-Provided Retirement Advice. Effective for taxable years beginning after December 31, 2000, the bill would provide that qualified retirement planning services 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 1255; Report p. 310-311. C. Simplified Annual Filing Requirement for Owners and Their Spouses. The bill would direct Treasury to eliminate the annual filing requirements for one-participant retirement plans with \$250,000 in assets or less. Similarly, retirement plans that cover less than 25 employees would need only file a simplified form substantially similar to that presently required of one-participant plans. The provision would be effective January 1, 2001. Bill Section 1256; Report p. 313-314. D. Improvement of Employee Plans Compliance Resolution System (EPCRS). The bill would direct the Secretary to update and improve the EPCRS by (1) increasing the awareness and knowledge of small employers concerning the availability and use of the program; (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures; (3) extending the duration of the self-correction period under the Administrative Policy Regarding Self-Correction for significant compliance failures; (4) expanding the availability to correct insignificant compliance failures under the Administrative Policy Regarding Self-Correction during audit; and (5) assuring that any tax, penalty or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure. Bill Section 1257; Report p. 314-316. E. 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, 2000. Bill Section 1260; Report p. 302-303. F. Flexibility in Nondiscrimination, Coverage, and Line of Business Rules. The bill would direct Treasury to modify its regulations to permit plans to satisfy the section 401(a)(4) nondiscrimination and section 410(b) coverage requirements using "facts and circumstances" tests in cases where the current mechanical tests are not satisfied. Under the regulations, a plan would be submitted to the IRS for a determination whether the test has been met. The regulations would apply in years beginning after December 31, 2000. Similarly, the bill would direct Treasury to modify

existing line of business regulations to allow plans to meet a facts and circumstances test. Bill Section 1261; Report p. 304-305. VIII. Plan Amendments (Title XII, Subtitle F) The bill would provide that plan amendments required as a result of the bill would not be required to be made before the last day of the first plan year beginning on or after January 1, 2003. For government plans, the amendment dates would be extended to the first plan year beginning on or after January 1, 2005. Bill Section 1271; Report p. 311-312. IX. Revenue Offset Provisions (Title XV) A. Extension of IRS User Fees. Current law authorizes the IRS to charge user fees for certain requests, including requests for letter rulings, determination letters, and opinion letters, until September 30, 2003. Effective upon the date of enactment, the bill would extend the statutory authorization for such fees through September 30, 2009. Bill Section 1502; Report p. 394 (see also Bill Section 1206, which would waive fees for certain small employer plans). B. Increase in Elective Withholding Rate for Nonperiodic Distributions from Deferred Compensation Plans. The bill would increase the elective withholding rate for nonperiodic distributions from 10% to 15%, effective for distributions after December 31, 2000. Bill Section 1504; Report p. 397-398. C. Transfer of Excess Defined Benefit Plan Assets for Retiree Health Benefits. The bill would extend the availability of qualified transfers of excess pension assets of a defined benefit plan to health benefit accounts of such plans from December 31, 2000 to September 30, 2009. The bill would also replace the minimum benefit requirement, which requires the provision of a minimum level of health benefits for 5 taxable years beginning with the taxable year of transfer, with a minimum cost requirement, which would require the provision of a minimum dollar level of retiree health expenditures for the same period. The modification to the minimum benefit requirement would apply to qualified transfers after the date of enactment. Bill Section 1507; Report p. 405-407. 12 Thomas T. Kim Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11184. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).2