

MEMO# 10862

April 5, 1999

SENATORS GRAHAM AND GRASSLEY INTRODUCE BIPARTISAN PENSION BILL

1 See Institute memorandum to Pension Committee No. 14-99 and Pension Operations Advisory Committee No. 14-99 dated March 16, 1999. [10862] April 5, 1999 TO: PENSION COMMITTEE No. 23-99 PENSION OPERATIONS ADVISORY COMMITTEE No. 23-99 RE: SENATORS GRAHAM AND GRASSLEY INTRODUCE BIPARTISAN PENSION BILL

Senators

Graham (D-FL) and Grassley (R-IA) have introduced S. 741, titled the "Pension Coverage and Portability Act." This bill contains significant pension reform proposals, including many items supported by the Institute, such as proposals that would enhance portability, modify top-heavy rules, raise the section 402(g) salary deferral and section 401(a)(17) compensation limitations, provide for salary-reduction-only SIMPLE plans, and grant tax credits to small employers establishing retirement plans. Although differing in detail, the bill is similar in many respects to H.R. 1102, which was recently introduced by Representatives Portman and Cardin.¹ The bill is divided into six titles each focusing on a different theme as follows: (1) expanding coverage for small business; (2) increasing pension access and fairness for women, (3) increasing portability of pension plans, (4) strengthening pension security and enforcement, (5) encouraging retirement education, and (6) reducing red tape. Key provisions are discussed below. A full copy of the bill is attached.

Title I: Expanding Coverage for Small Businesses

1. 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 take into account matching contributions for purposes of satisfying 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.

2. Salary Reduction Only SIMPLE Plans. Section 105 permits the establishment of "salary-reduction-only" SIMPLE plans. In such plans, the contribution limit would be \$4,000.

3. SIMPLE Plan Contribution Limits. The bill would raise the limitation on SIMPLE plan contributions from \$6,000 to \$8,000. See section 107 of the bill. The bill also would amend section 401(k)(11) to eliminate the application of the section 401(a)(17) compensation limit to SIMPLE 401(k) arrangements. See section 111 of the bill.

4. Payroll Deduction IRAs. Section 102 of the bill would clarify that employers may establish automatic payroll deduction plans so that their employees may contribute directly to an IRA account.

5. "SAFE" Defined Benefit Plan for Small Employers. Section 103 of the bill permits employers of 100 or less employees who do not presently maintain a qualified retirement plan to establish a simplified defined benefit plan.

6. Start Up Cost Tax Credits for Small Employers. Pursuant to section 106 of the bill, small employers would be able to obtain two

tax credits. First, a tax credit would be available in an amount up to fifty percent of the startup costs of establishing a pension plan up to \$2,000 for the first credit year and \$1,000 for each of the second and third years after the plan is established. Startup costs would include costs for retirement-related education of employees. This credit would be available for employers that have no more than 100 employees. A second tax credit would enable small employers that have no more than 50 employees to obtain a tax credit for contribution to a newly-established retirement plan. The credit would be available in an amount up to fifty percent of employer contributions made for any taxable year up to three percent of compensation for nonhighly compensated employees. This credit would be available for the first five years of the plan's existence.

7. Elimination of IRS User Fees for New Pension Plans. IRS user fees for letter rulings, opinion letters, and determination letters addressing the qualified status of a new plan would be eliminated. The fee waiver would apply only to employers who have not established or maintained a plan within the prior three years. See section 110 of the bill.

8. Section 404 Deduction Limits. Bill section 112 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.

9. "Negative Election Trust" Nondiscrimination Safe Harbor. Bill section 114 provides a new nondiscrimination safe harbor for 401(k) plans that provide for "negative election" whereby each employee is treated as having elected to make a salary deferral of at least three percent of compensation into the plan and must specifically elect not to have the contributions made. To qualify for the proposed safe harbor, automatic "elective" contributions must be made on behalf of at least seventy percent of non-highly compensated employees. The employer also must match non-highly compensated employee contributions in an amount equal to fifty percent of the contributions up to five percent of compensation, or make a contribution in the amount of two percent of compensation on behalf of each eligible employee. Such contributions would be immediately fully vested.

Title II: Increasing Pension Access and Fairness for Women

1. Elimination of "Twenty-Five-Percent" of Compensation Limitation. The Code section 415 twenty-five-percent-of-compensation limit is eliminated. See section 201 of the bill.

2. 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 6-year graded schedule. See section 202 of the bill.

3. Treatment Of 457 Plan Benefits Upon Divorce. Bill section 204 would make section 414(p) QDRO rules applicable to 457 plans.

4. Spouse's Right to Know Proposal. Bill section 205 would require that retirement plans provide a copy of the written explanation of distribution rules required under Code section 417(a)(3) be provided to a participant's spouse. If the spouse is at the same address as the participant, a copy of the notice may be sent in a single mailing addressed to both the participant and spouse.

5. Simplify Minimum Distribution Rules. Bill section 206 would change the age at which distributions from retirement plans must begin from 70 ½ to 75. Second, 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). Third, 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.

Fourth, 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. And fifth, Code section 4974 excise tax would be reduced from fifty percent to ten percent.

6.

Safe Harbor Relief for Hardship Withdrawals from Cash or Deferred Arrangements. Bill section 207 directs Treasury to revise rules relating to hardship distributions from 401(k) plans to provide that the period an employee is prohibited from participating in the plan is reduced from one year to 6 months.

Title III: Increasing Portability of Pension Plans

1. Rollovers Among Various Plan Types. Bill section 301 would amend "eligible rollover distribution" rules 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. Bill section 302 permits the rollover of IRA assets into employer-sponsored plans.
3. Rollovers of After-Tax Contributions. Pursuant to bill section 303, individuals would be permitted to roll after-tax contributions to IRAs or to plans.
4. 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."
5. Modification of Same Desk Rule; Repeal of Business Sales Requirement. Bill section 304 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.
6. Treatment of Forms of Distribution for Certain Plan Transfers. Bill section 305 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.
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.

Title IV: Strengthening Pension Security and Enforcement

1. Restoration of Limits. With respect to defined contribution plans the bill would: (a) Raise the section 401(a)(17) contribution limit from \$160,000 to \$200,000; (b) Raise the section 402(g) limit on elective deferrals from \$10,000 to \$12,000; (c) Raise the limitation on section 457 contributions from \$8,000 to \$10,000. (d) Repeal the 150 percent of current liability funding limit applied to defined benefit plans and increase the section 415(b) defined benefit plan dollar limit to \$160,000.
2. Elimination of ERISA Double Jeopardy. The bill would amend ERISA section 502(h) to bar the Labor and Treasury Departments from instituting litigation in cases where a private action had been brought and settled and the Departments had been served a copy of the proposed settlement 90 days before the court approved the settlement.

Title V: Encouraging Retirement Education

1. Periodic Benefit Statements. Bill section 501 would require the furnishing of benefit statements to participants at least once each year in the case of individual account plans. Beneficiaries would be furnished such statements upon written request. Employers sponsoring defined benefit plans would be required to furnish benefit statements at least once every 3 years to each participant currently employed by the sponsoring employer. Alternatively, defined benefit plan sponsors would be able to provide participants with notice annually of their ability to request and obtain such a statement. Additionally, such statements would be required to be provided to all participants and beneficiaries upon request. Statements may be delivered electronically or by telephone.
2. Small Business Administration Advice to Small Businesses. The Small Business Administration is directed to prepare a plan to increase the awareness of retirement plan benefits, the types of plans and other options available to provide retirement plan benefits and to periodically update small business owners with respect to changing laws and regulations governing retirement benefits. See section 502 of the bill.
3. 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 503 of the bill. Title VI: Reducing Red Tape 1. Modification of 403(b) Exclusion Allowance To Conform to 415 Modification. The Secretary of the Treasury is directed to modify exclusion allowance regulations to eliminate the requirement that contributions to defined benefit plans be treated as previously excluded amounts. 2. Safety Valve From Mechanical Rules. 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. See section 605 of the bill. 3. Coverage Test Flexibility. Bill section 606 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. 4. Section 457 Inapplicable to Certain Mirror Plans. For tax-exempt organizations and state and local governments, the current rules would be amended to provide that section 415 and 401(a)(17) mirror plans would be disregarded for purposes of section 457. See section 607 of the bill. 5. Notice and Consent Period For Distributions. Section 608 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. 6. Annual Report Dissemination. The bill would eliminate the requirement that annual reports be furnished and substitute a requirement that such reports be made available and furnished only upon request. See section 612 of the bill. 7. Employees Of Tax-Exempt Entities. Section 613 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 percent 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. Repeal of Multiple Use Test. Code section 401(m)(9) is amended to repeal the multiple use test. See section 614 of the bill. Russell G. Galer Senior Counsel Attachment