

**MEMO# 3595**

March 16, 1992

## **PENSION PROVISIONS OF SENATE TAX BILL**

March 16, 1992 TO: PENSION MEMBERS NO. 4-92 RE: PENSION PROVISIONS OF SENATE TAX BILL \_\_\_\_\_ The Senate has approved its version of H.R. 4210, the "Family Tax Fairness, Economic Growth and Health Care Access Act of 1992". The bill contains a number of pension provisions of interest to mutual funds. Bentsen-Roth Deductible IRA The provisions of the Bentsen-Roth revised IRA bill are included with no substantive differences from S. 1921, the "Tax Fairness and Savings Incentive Act of 1991", which had been introduced in November 6, 1991. For a description of these provisions, see Institute Memorandum to Members - One Per Complex No. 58-91 and Pension Members No. 37-91, dated November 8, 1991. The penalty-free withdrawal provisions which were a separate section of the House version are included in the Bentsen-Roth IRA portion of the Senate bill. The Senate version would reduce the amount which may be withdrawn for qualified higher education expenses by amounts received tax-free from U.S. education savings bonds, while the House has no such limit. Also, the House bill limits the amount which may be withdrawn penalty free for first time homebuyers to \$10,000, while the Senate bill has no limit. Finally, in floor amendments, provisions were added to the Senate version which would allow penalty-free withdrawals for the purchase of new passenger automobiles and for living expenses of unemployed persons. The amendment related to purchases of new passenger automobiles also deals with the withdrawals for first time homebuyers, but it is unclear precisely what effect the amendment is meant to have on the existing provisions of the bill. The floor amendment would allow the amount withdrawn for purchase of new passenger automobiles to be recontributed to the IRA over four years with no tax at all on the withdrawal. The IRA provisions of the bill generally would be effective for taxable years beginning after December 31, 1992. However, the provisions permitting penalty-free withdrawals would be effective for taxable years beginning after December 31, 1991, as - 1 - would be the provisions providing for the transfer from deductible to special (nondeductible) IRAs. The provision allowing penalty-free (and tax-free) withdrawals for purchases of new passenger automobiles would expire December 31, 1992. Pension Simplification The section of the bill dealing with pension simplification contains a number of provisions which either differ from the corresponding provisions of the House bill or are entirely new. See Institute Memorandum to Pension Members No. 3-92, dated February 27, 1992, for information on the House version of the pension simplification provisions common to both bills and not otherwise described here, and for a description of the provisions concerning the responsibilities of sponsors of master and prototype plans, which are identical in both the House and Senate versions of the bill. Transfers Upon Plan Distributions Under the House bill, a plan would be required to allow a participant to have his or her distribution made as a trustee to trustee transfer to another qualified plan or an

individual retirement account ("IRA"). The Senate bill, however, would require basically all distributions to be made as transfers to an "eligible transferee fund". An eligible transferee fund would include an IRA or a defined contribution plan that provides for transfers. Certain distributions would not be required to be transferred directly to another plan, such as hardship distributions, distributions after age 55, and distributions of less than \$500. The Senate bill would also repeal the requirement that distributions begin at age 70 1/2 regardless of whether the participant is still employed; instead, the required distributions would have to begin on the later of age 70 1/2 or retirement. The House bill contains no such provision. The bill would generally be effective for taxable years beginning after December 31, 1992, except the provisions expanding the allowable rollover situations, which would be effective upon enactment. The provision requiring distributions to be made as transfers to eligible transferee plans would be effective for distributions in plan years beginning after December 31, 1993.

**SARSEP Revisions** The SARSEP revisions in the House bill provide that for a SARSEP to be exempt from the nondiscrimination requirements, the employer would be required to make a mandatory 1 percent of salary contribution to all employees, allow elective contributions, and match those contributions 100 percent for the first 3 percent of salary contributed to the plan and at a 50 - 2 - percent rate for the next 2 percent of salary. The Senate - 3 - provision would require either a 3 percent of salary mandatory contribution, or a match of elective contributions similar to that in the House bill. The bill provides that these provisions would be effective for years beginning after December 31, 1992. Presumably, the effective date is for plan years beginning after that date, but the bill is not clear on that point.

**Simplification of Nondiscrimination Test on Cash or Deferred Plans** The Senate bill section concerning nondiscrimination tests under Code sections 401(k) and (m) contains provisions not in the House bill which deal with distributions of excess contributions. The Senate bill would provide that where the highly compensated group has excess contributions, the distribution of excess contributions would be made first from those persons with the highest dollar amount of deferrals, not from the persons with the highest deferral percentage, as under current law. This provision also applies to years beginning after December 31, 1992, although the precise meaning of this provision is unclear.

**Elimination of the Half-Year Requirements** The Senate bill would eliminate the half-year requirements; for example, changing age 59 1/2 to age 59 and age 70 1/2 to age 70. This provision would be effective for years beginning after December 31, 1992.

**Changes to Section 457 Plans** The Senate bill does not contain the provision in the House bill which would have indexed the deferral limits of section 457 for inflation and which would allow certain in-service distributions and new elections on the timing of the beginning of distributions without treating the deferred income as having been constructively received.

**Standardization of Penalties Upon Failure to Provide Pension Information Reports** Both the Senate and the House bills would conform the information reporting penalties applicable to pension information returns to the general information penalty reporting structure. The House bill dealt with this provision in a section on Administrative Provisions, while the Senate version is under pension simplification. The effective date would be for returns due after December 31, 1992.

**- 4 - Date for Adoption of Plan Amendments** The Senate bill would provide that any plan amendments required as a result of the bill would not have to be made before the first plan year beginning on or after January 1, 1994, provided that the plan is operated in compliance with the applicable provision and is amended retroactive to the applicable effective date.

**Prohibition on State Taxation of Pension Income of Nonresidents** A floor amendment to the Senate bill added a provision which would prohibit a state from taxing the retirement income of a nonresident. The provision is aimed at those states which attempt to tax pension income of former residents who earned the pension while working in the state, then moved to a state with no income tax upon retirement. \* \* \* \* Anyone who would like a copy of the bill language or

the Technical Explanation with respect to any provision should call the undersigned at (202) 955-3521. We will keep you informed of developments on this legislation. David J. Mangefrida Jr. Assistant Counsel -Tax

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