EMPLOYEE CONTRIBUTIONS TO IRA'S AND OTHER PENSION PLANS

HEARING

BEFORE THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

S. 75, S. 94, S. 209, S. 557

APRIL 3, 1979

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CONTENTS

ADMINISTRATION WITNESS

PUBLIC WITNESSES

COMMUNICATIONS

ADDITIONAL INFORMATION

EMPLOYEE CONTRIBUTIONS TO IRA'S AND OTHER PENSION PLANS

TUESDAY, APRIL 3, 1979

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the subcommittee) presiding.

Present: Senators Bentsen, Matsunaga, and Dole.

[The press release announcing this hearing and the bills S. 75, S. 94, S. 209, and S. 557 follow:]

<u>P R E S S   R E L E A S E</u>

FOR IMMEDIATE RELEASE
March 13, 1979

COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittee on Private Pension Plans and Employee Fringe Benefits
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS SETS HEARINGS ON EMPLOYEE TAX DEDUCTIBLE CONTRIBUTIONS TO QUALIFIED RETIREMENT PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS AND ON <u>RETIREMENT SAVINGS BY HUSBANDS AND WIVES</u>

Senator Lloyd Bentsen (D.-Tex.), Chairman of the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance, announced today that the Subcommittee will hold hearings on April 3, 1979 on several bills to encourage Americans to save for retirement.

<u>The hearing will be held in Room 2221 Dirksen Senate Office Building and will begin at 10:00 A.M.</u>

One of the bills, S. 75, introduced by Senator Robert Dole (R.-Kan.), would allow individuals to claim as much as a $1,000 tax deduction for certain contributions to a company retirement plan or an individual retirement plan.

Another bill, S. 94, introduced by Senator Bentsen, would give the same tax break to homemakers which wage earners now receive for establishing individual retirement accounts.

The third bill, S. 557, introduced by Senator Bentsen, would allow individuals to claim as much as a $1,500 tax deduction for certain contributions to a company pension plan or to an individual retirement account.

In addition, the Subcommittee will receive testimony on sections 201 through 204 of S. 209, introduced by Senator Williams (D.-N.J.), and Senator Javits (R.-N.Y.), which would provide certain tax deductions and credits for pension contributions and would amend the lump sum distribution rules of the Internal Revenue Code.

"It is clear that our laws need to provide more incentives than now exist for people to save for their retirment years," Bentsen said.

"The April 3 hearings will examine these legislative proposals for achieving that goal."

Witnesses who desire to testify at the hearings should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510 by no later than the close of business on March 23, 1979.

Legislative Reorganization Act. -- Senator Bentsen stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress, "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their fifteen-minute oral presentations to a summary of the points included in the statement.

(5) Not more than fifteen minutes will be allowed for oral presentation.

Written Testimony. -- Senator Bentsen stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by April 20, 1979, to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

P.R. #H-15

96TH CONGRESS
1ST SESSION

S. 75

To amend the Internal Revenue Code of 1954 to allow a retirement savings deduction for persons covered by certain pension plans.

IN THE SENATE OF THE UNITED STATES

JANUARY 18 (legislative day, JANUARY 15), 1979

Mr. DOLE (for himself and Mr. NELSON) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to allow a retirement savings deduction for persons covered by certain pension plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Internal Revenue Code of 1954 is amended to provide for the limited Employee Retirement Account of 1979 as follows:

(a) DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS CONTRIBUTIONS.—

(1) IN GENERAL.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 221 as 222 and by inserting after section 220 the following new section:

"SEC. 221. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS CONTRIBUTIONS.

"(a) DEDUCTION ALLOWED.—In the case of an eligible employee, described in subsection (c), there is allowed as a deduction amounts paid in cash for a taxable year by such individual for the benefit of himself—

"(1) to a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(2) to an annuity plan described in section 403(a),

"(3) to a qualified bond purchase plan described in section 405(a),

"(4) to an individual retirement account described in section 408(a), individual retirement annuity described in section 408(b), or for a retirement bond described in section 409, or

"(5) to a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessment paid to the trust by any participant are 100% nonforfeitable.

"(b) LIMITATION AND RESTRICTIONS.—

"(1) MAXIMUM DEDUCTION.—The amount allowable as a deduction under subsection (a) to an eligible employee for any taxable year may not exceed an amount equal to 10 percent of the compensation includible in his gross income for such taxable year, or $1,000, whichever is less.

"(2) ADDITIONAL LIMITATION.—No deduction is allowed for any amount paid to an account, annuity, or for a bond described in paragraph (4) of subsection (a) except to the extent of the excess of the amount determined under subsection (b) over any amount paid by the eligible employee to a plan or trust described in paragraph (1), (2), (3) or (5) of subsection (a).

"(3) ALTERNATIVE DEDUCTION.—No deduction is allowed under subsection (a) for the taxable year if the individual claims the deduction allowed by sections 219 or 220 for the taxable year.

"(4) EXCEPTION WHERE PLAN IS DISCRIMINATORY.—No deduction is allowed under subsection (a) for a highly compensated participant (as defined in subsection (c)(7)) unless the employer certifies in accordance with regulations to be prescribed by the Secretary that the plan satisfies the discrimination standards in subsection (c)(6).

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) ELIGIBLE EMPLOYEE.—For purposes of this section, the term 'eligible employee' shall mean an individual who is an employee without regard to section 401(c)(1) or is a member of a labor organization referred to in subparagraph (D) and who is an active participant for any part of the taxable year in—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a),

"(C) a qualified bond purchased plan described in section 405(a), or

"(D) a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable, but not if such plan is established or maintained by the United States, by a State or political subdivision thereof or by agency or instrumentality of any of the foregoing.

"(2) REPORTS.—The Secretary shall promulgate regulations which prescribe the time and manner reports shall be filed by an employer receiving contributions deductible under this section and by any eligible employee making any such deductible contribution.

"(3) RECONTRIBUTED AMOUNTS.—No deduction shall be allowed under this section with respect to a rollover contribution described in sections 402(a)(5), 402(a)(6), 402(a)(7), 403(a)(4), 403(a)(5), 403(b)(8), 408(d)(3), or 409(b)(3)(C).

"(4) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which are properly allocable, under regulations described by the Secretary, to the cost of life insurance.

"(5) MARRIED INDIVIDUALS.—In the case of an individual who is married (as determined under section 143(a)), the maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(6) DISCRIMINATION STANDARDS.—

"(A) A plan shall satisfy the discrimination standards if the actual deferral percentages for highly compensated participants (as defined in paragraph (7)) for a plan year bears a relationship to the actual deferral percentage for all other participants for such plan year which meets either of the following tests:

"(i) The actual deferral percentage for the group of highly compensated participants is not more than the actual deferral percentage of all other participants multiplied by 1.5.

"(ii) The excess of the actual deferral percentage for the group of highly compensated participants over that of all other participants is not more than 3 percentage points, and the actual deferral percentage for the group of highly compensated participants is not more than the actual deferral percentage of all other participants multiplied by 2.5.

"(B) For purposes of subparagraph (A), the actual deferral percentage for a specified group of participants for a plan year shall be the average of the ratios (calculated separately for each participant in such group) of—

"(i) the amount deducted on behalf of each participant for such plan year, to

"(ii) the participant's total compensation for such plan year.

For purposes of the preceding sentence, the amount deducted on behalf of a highly compensated participant shall be determined without regard to the exception in subsection (b)(4).

"(7) HIGHLY COMPENSATED PARTICIPANT.—For purposes of this section, the term 'highly compensated participant', means any participant who is more highly compensated than two-thirds of all participants but only if such participant's compensation for a plan year equals or exceeds the salary of an employee of the United States who is compensated at a rate equal to the annual rate paid for step 1 of grade GS-14. No individual who participates during a plan year only in a group retirement trust described in subsection (a)(5) shall be considered a highly compensated participant for such year."

(2) DEDUCTION ALLOWED IN ARRIVING AT ADJUSTED GROSS INCOME.—Section 62 (defining adjusted gross income) is amended by inserting after paragraph (13) the following new paragraph:

"(14) DEDUCTION FOR CERTAIN CONTRIBUTIONS.—The deduction allowed by section 221 (relating to certain employee retirement savings contributions)."

(b) TAX TREATMENT OF CERTAIN DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—Subpart A of part I of subchapter D of chapter 1 (relating to retirement plans) is amended by inserting after subsection (l) of section 414 the following new subsection:

"(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For purposes of this title other than for purposes of sections 401(a) (4) and (5), 404, 410(b), 411, and 412, any amount which an employer is required to report pursuant to regulations promulgated under subsection (c)(2) of section 221, with respect to an amount paid by an eligible employee, as defined in subsection (c)(1) of section 221, as an employee retirement savings contribution, shall be treated as an employer contribution."

(c) CONFORMING AMENDMENTS.—

(1) So much of section 72(f) as precedes paragraph (1) thereof is amended to read as follows:

"In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other consideration paid, amounts which an employer is required to report, pursuant to regulations promulgated under subsection (c)(2) of section 221, with respect to an amount paid by an eligible employee, as defined in subsection (c)(1) of section 221, as a retirement savings employee contribution shall be excluded, and amounts contributed by the employer shall be included, but only to the extent that—".

(2) Section 414(h) (tax treatment of certain contributions) is amended by inserting after "any amount contributed" the following: "other than an amount described in subsection (m)".

(3) So much of section 4973(b) as follows paragraph (1)(A) thereof is amended to read as follows:

"(B) the amount allowable as a deduction under section 219, 220, or 221 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

"(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 408(d)(1),

"(B) the distributions out of the account for the taxable year to which section 408(d)(5) applies, and

"(C) the excess (if any) of the maximum amount allowable as a deduction under section 219, 220, or 221 for the taxable year over the amount contributed (determined without regard to sections 219(c)(5) and 220(c)(6)) to the accounts or for the annuities or bonds for the taxable year.

For purposes of this subsection, any contribution which is distributed from the individual retirement account, individual retirement annuity, or bond in a distribution to which section 408(d)(4) applies shall be treated as an amount not contributed."

(d) EFFECTIVE DATE.—The amendments made by this Act shall apply to taxable years beginning after the date of the enactment of this Act.

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96TH CONGRESS
1ST SESSION

S. 94

To amend the Internal Revenue Code of 1954 to allow individuals to compute the amount of the deduction for payments into retirement savings on the basis of the compensation of their spouses, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 18 (legislative day, JANUARY 15), 1979

Mr. BENTSEN introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to allow individuals to compute the amount of the deduction for payments into retirement savings on the basis of the compensation of their spouses, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That paragraph (2) of section 219(c) of the Internal Revenue Code of 1954 (relating to retirement savings) is amended to read as follows:

"(2) MARRIED INDIVIDUALS.—

"(A) MAXIMUM DEDUCTION.—The maximum deduction under subsection (b)(1) shall be computed separately for each individual.

"(B) INDIVIDUALS WHO RECEIVE LESS COMPENSATION THAN THEIR SPOUSES.—If any individual—

"(i) has less compensation for the taxable year than the compensation of the spouse of such individual for such year; and

"(ii) is qualified under this section, or would so qualify except for the fact that such individual has no compensation for the taxable year,

then such individual shall, for purposes of this section, be treated as having compensation includible in the gross income of such individual equal to the compensation includible in the gross income of the spouse of such individual.

"(C) DETERMINATION OF MARITAL STATUS.—For purposes of this section, the determination of whether an individual is married shall be made in accordance with the provisions of section 143(a).".

SEC. 2. (a) Section 220 of the Internal Revenue Code of 1954 (relating to retirement savings for certain married individuals) is repealed.

(b)(1) Paragraph (10) of section 62 of such Code (relating to adjusted gross income defined) is amended by striking out "and the deduction allowed by section 220 (relating to retirement savings for certain married individuals)".

(2) Paragraph (6) of section 219(b) of such Code (relating to retirement savings) is repealed.

(3) Subparagraph (C) of section 219(c)(5) of such Code (relating to excess contribution treated as made in subsequent year for which there is an unused limitation) is amended by striking out "or section 220".

(4) Paragraph (2) of section 408(c) of such Code (relating to individual retirement accounts) is amended by striking out "(or spouse of an employee or member)".

(5) Paragraphs (4) and (5) of section 408(d) of such Code (relating to tax treatment of distributions) are each amended by striking out "or 220" each place it appears.

(6) Subsection (a) of section 415 of such Code (relating to limitations on benefits and contributions under qualified plans) is amended—

(A) by striking out "Except as provided in paragraph (3), in the case" in paragraph (2) and inserting in lieu thereof "In the case"; and

(B) by striking out paragraph (3).

(7) Paragraph (12) of section 3401(a) of such Code (relating to definition of wages) is amended by striking out "or 220(a)".

(8) Section 4973 of such Code (relating to excess contributions to individuals retirement accounts, etc.) is amended—

(A) by striking out "or section 220 (determined without regard to subsection (b)(1) thereof), whichever is appropriate" in the last sentence of subsection (a);

(B) by striking out "or 220" in subsections (b)(1)(B) and (b)(2)(C); and

(C) by striking out "and 220(c)(6)" in subsection (b)(2)(C).

(9) Subsection (d) of section 6047 of such Code (relating to other programs) is amended by striking out "or 220(a)".

SEC. 3. The amendments made by this Act shall apply to taxable years beginning after December 31, 1978.

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96TH CONGRESS
1ST SESSION

S. 209

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 for the purposes of simplifying, clarifying, and improving Federal law relating to the regulation of employee benefit plans, to foster the establishment and maintenance of plans, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 24 (legislative day, JANUARY 15), 1979

Mr. WILLIAMS (for himself and Mr. JAVITS) introduced the following bill; which was read twice and referred jointly to the Committees on Finance and Human Resources

---

A BILL

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 for the purposes of simplifying, clarifying, and improving Federal law relating to the regulation of employee benefit plans, to foster the establishment and maintenance of plans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

(a) This Act may be cited as the "ERISA Improvements Act of 1979".

(b) TABLE OF CONTENTS.—

TITLE I—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974—Continued

PART 5—ADMINISTRATION, ENFORCEMENT, AND ADJUSTMENTS IN APPLICABLE LAW

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

TITLE III—SPECIAL MASTER AND PROTOTYPE PLANS

TITLE IV—EMPLOYEE BENEFITS COMMISSION

SEC. 2. TECHNICAL AND CONFORMING CHANGES.

The Secretary of the Treasury and the Secretary of Labor shall, as soon as practicable but in any event not later than 90 days after the date of the enactment of this Act, submit to the Congress a draft of any technical and conforming changes in the Internal Revenue Code of 1954, and the Employee Retirement Income Security Act of 1974, respectively, which are necessary to reflect throughout such Code and Act the changes in the substantive provisions of law made by this Act.

SEC. 3. FINDINGS AND DECLARATION OF POLICY.

(a) The Congress finds that the paperwork burdens and compliance costs resulting from the implementation of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 affecting employee benefit plans and persons sponsoring such plans can be reduced in certain respects without jeopardizing the interests of employees in such plans and in the integrity of the assets of such plans; that the free flow of commerce and the implementation of such Act and Code have been restricted and hampered by assertions of applicability of Federal and State securities and other laws to certain employee benefit plans and certain collective funding vehicles for plans; and that present and future needs for retirement income can best be met by strengthening and improving private employee pension benefit plans and that it is in the national interest to do so.

(b) The Congress further finds that the free flow of commerce and the implementation of the provisions of the Employee Retirement Income Security Act of 1974 and of the Internal Revenue Code of 1954 have been restricted and hampered by administrative difficulties encountered by the Labor Department, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation; that duplications and overlapping of agency responsibility have resulted in costly delays, confusion, and excessive paperwork, and that the interests of participants in and beneficiaries under private sector employee benefit plans have been adversely affected thereby.

(c) It is hereby declared to be the policy of this Act to foster the establishment and maintenance of private employee pension benefit plans; to further improve such plans by clarifying, simplifying, and otherwise improving such Act and the provisions of such Code; to clarify prospectively the extent to which Federal and State securities and other laws may affect employee benefit plans and collective funding vehicles for plans which are subject to such Act; and to consolidate in a single agency the administration of the Employee Retirement Income Security Act of 1974 and certain provisions of the Internal Revenue Code of 1954 relating to employee benefit plans.

TITLE I—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

Subtitle A—Declaration of Policy; Definitions

SEC. 101. DECLARATION OF POLICY.

Section 2 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) It is hereby further declared to be the policy of this Act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employee organizations, or both.".

SEC. 102. DEFINITIONS.

Section 3 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) striking out subparagraphs (A), (B), (C), (D), (H) and (I) of paragraph (14) and inserting in lieu thereof, respectively, the following subparagraphs:

"(A) any fiduciary, counsel, or employee of such plan;

"(B) a person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan;

"(C) an employer any of whose employees are covered by such plan, if the employees of such employer constitute 5 percent or more of all employees covered by the plan;

"(D) an employee organization any of whose members are covered by such plan, if the members of such employee organization constitute 5 percent or more of all employees covered by the plan;

"(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) or a person described in subparagraph (B), (C), (D), (E), or (G); or

"(I) a 10 percent or more (in capital or profits) partner, or joint venturer in, a person described in subparagraph (B), (C), (D), (E), or (G).";

(2) inserting in paragraph (15) "brother, sister," immediately before "spouse," the first time it appears;

(3) striking out "The" in paragraph (20) and inserting in lieu thereof "Except as otherwise provided in sections 502(l) and 514(d) (2) and (3), the";

(4) (A) striking out clauses (i), (ii), and (iii) of subparagraph (A) of paragraph (37) and inserting in lieu thereof the following:

"(i) which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer,

"(ii) to which ten or more employers contribute, or to which more than one and fewer than ten employers contribute if the Secretary finds that treating such a plan as a multiemployer plan would be consistent with the purposes of this Act, and";

(B) redesignating clauses (iv) and (v) of paragraph (37)(A) as clauses (iii) and (iv), respectively, and

(C) striking out subparagraph (B) of paragraph (37) and inserting in lieu thereof the following new subparagraph:

"(B) For purposes of this paragraph, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) of the Internal Revenue Code of 1954, determined without regard to section 1563(e)(3)(C) of such Code) shall be deemed to be one employer.".

Subtitle B—Simplifying and Clarifying Amendments

PART 1—REPORTING AND DISCLOSURE

SEC. 111. DISCLOSURE OF STATUS UNDER PENSION PLANS.

Section 105 of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"DISCLOSURE OF STATUS UNDER PENSION PLANS

"SEC. 105. (a) (1) Each administrator of an employee pension benefit plan shall furnish to any plan participant or beneficiary who so requests in writing a statement indicating, on the basis of the latest available information—

"(A) for defined benefits plans, the total benefits accrued, or

"(B) for individual account plans, the balance in the account, and

"(C) for all plans, the proportion of accrued benefits or account balance which is nonforfeitable or the earliest date, assuming continued participation in the plan without a break in service, on which some or all benefits will become nonforfeitable.

"(2) In no case shall a participant or beneficiary be entitled under this subsection to receive more than one report described in paragraph (1) during any one 12-month period.

"(3) If the members of any class of participants or beneficiaries are annually furnished with a statement which contains the information required by this subsection, the requirements of this subsection shall be satisfied respecting the members of such class.

"(4) This subsection shall apply to a plan to which more than one unaffiliated employer is required to contribute only to the extent provided by regulations prescribed by the Secretary.

"(b)(1) Each administrator of an employee pension benefit plan shall report, in such manner and at such time as may be provided in regulations prescribed by the Secretary, to each plan participant who during a plan year—

"(A) (i) terminates his service with the employer, or

"(ii) has a 1-year break in service, and

"(B) is entitled to a deferred vested benefit under the plan as of the end of such plan year, and

"(C) with respect to whom retirement benefits are not paid under the plan during such plan year.

The report required under this subsection shall inform the participant of the nature, amount, and form of the deferred vested benefit to which he is entitled, and shall contain such other information as the Secretary may require.

"(2) Not more than one report shall be required under paragraph (A)(ii) with respect to consecutive 1-year breaks in service.

"(c)(1) Except as provided in paragraph (2) of this subsection, each employer shall, in accordance with regulations prescribed by the Secretary, maintain records with respect to each of his employees sufficient to determine the benefits due or which may become due to such employees. The employer shall furnish the plan administrator information necessary for the administrator to make the reports required by subsections (a) and (b).

"(2) If more than one employer adopts a plan, each such employer shall, in accordance with regulations prescribed by the Secretary, furnish to the plan administrator information necessary for the administrator to maintain the records and make the reports required by subsections (a) and (b). Such administrator shall maintain the records and, to the extent provided under regulations prescribed by the Secretary, make the reports, required by subsections (a) and (b).

"(3) If any person who is required under this section (other than under subsection (a)(1)) to furnish information or to maintain records fails to comply with such requirements, he shall pay to the plan a penalty of $10 for each employee with respect to whom such failure occurs, unless it is shown that such failure is due to reasonable cause.".

SEC. 112. EXEMPTIONS AND MODIFICATIONS.

(a) IN GENERAL.—Section 110 of such Act is amended to read as follows:

"EXEMPTIONS AND MODIFICATIONS

"SEC. 110. The Secretary may by regulation conditionally or unconditionally exempt any employee benefit plan or person, or any class of employee benefits plans or persons, from any requirement of this part or may modify any such requirement if he determines that such exemption or modification is—

"(1) appropriate and necessary in the public interest, and

"(2) consistent with the purposes of this title.".

(b) CONFORMING CHANGES.—(1) Section 104(a) of such Act is amended—

(A) by striking out paragraphs (2) and (3), and by redesignating paragraphs (4) and (5) as (2) and (3), respectively; and

(B) by striking out "paragraph (4)" in paragraph (3) (as redesignated) and inserting in lieu thereof "paragraph (2)".

(2) Section 107 of such Act is amended by striking out "104(a) (2) or (3)" in both places where it appears and inserting in lieu thereof "110".

(3) The last sentence of section 103(a)(3)(A) of such Act is amended by striking out "104(a)(2)" and inserting in lieu thereof "110".

(4) The second sentence of section 103 (a)(4)(A) of such Act is amended by striking out "104(a)(2)" and inserting in lieu thereof "110".

(5) Section 101(a)(2) of such Act is amended by striking out "(c)" immediately preceding the period and inserting in lieu thereof "(b)".

SEC. 113. ELIMINATION OF SUMMARY ANNUAL REPORT.

(a) IN GENERAL.—Section 104(b) of such Act is amended—

(1) by striking out paragraph (3) and redesignating paragraph (4) as (3), and

(2) by inserting before the period at the end of the last sentence of such redesignated paragraph the following: ", but the charge for furnishing a copy of the latest annual report may not exceed $10".

(b) CONFORMING CHANGE.—The third sentence of section 103(a)(3)(A) is amended by striking out "and the summary material required under section 104(b)(3)".

SEC. 114. IMPROVEMENT OF REPORTING REQUIREMENTS.

In order to avoid the reporting of unnecessary information, the Secretary and the Secretary of the Treasury shall develop reporting forms and requirements for employee benefit plans described in section 4(a) and not exempt under section 4(b) which, to the maximum extent feasible and consistent with the purposes of this Act and the Employee Retirement Income Security Act of 1974, take into account the different types and sizes of employee benefit plans. Not later than 12 months after the date of enactment of this Act, the Secretaries shall report to the Congress on the actions taken and proposed to be taken to implement this directive. Not later than 24 months after the enactment of this section, the Secretaries shall submit to the Congress their final written report on the implementation of this section.

SEC. 115. OPINIONS OF ACTUARIES AND ACCOUNTANTS.

Section 103(a) of such Act is amended—

(1) by inserting "except to the extent required by subparagraph (B)," in paragraph (3)(A) after "Such examination shall be conducted in accordance with generally accepted auditing standards,",

(2) by striking out "may" in paragraph (3)(B) and inserting in lieu thereof "shall",

(3) by striking out ", if he so states his reliance" in such paragraph,

(4) by striking out "may" in paragraph (4)(D) and inserting in lieu thereof "shall", and

(5) by striking out ", if he so states his reliance" in such paragraph.

SEC. 116. SCOPE OF ACCOUNTANT'S OPINION.

Section 103(a)(3)(C) of such Act is amended by striking out "need" and inserting in lieu thereof "shall".

SEC. 117. EFFECTIVE DATES.

The amendments made by sections 111 and 112 shall be effective on, and the amendments made by sections 113, 115, and 116 shall apply with respect to plan years beginning on and after, the date of enactment of this Act.

PART 2—MINIMUM STANDARDS

SEC. 121. RECIPROCAL AGREEMENTS.

Section 209 of the Employee Retirement Income Security Act of 1974 is amended in its entirety to read as follows:

"RECIPROCAL AGREEMENTS

"SEC. 209. Notwithstanding any other provision of this title, the contributions made with respect to the employment of an employee pursuant to a collective-bargaining agreement and payable to a pension or welfare plan maintained pursuant to that agreement (hereinafter in this section referred to as the 'away plan') may be transferred to a similar pension or welfare plan established pursuant to another collective-bargaining agreement under which the employee had previously become a participant (hereinafter referred to in this section as the 'home plan') if such transfer is pursuant to a written agreement between the administrator of the away plan and the administrator of the home plan. In any case where contributions received with respect to the employment of an employee are transferred from an away plan to a home plan in accordance with this section, such employment shall be considered as employment under the jurisdiction of the home plan for purposes of computing the accrued benefit and vesting of such employee, but the employer who contributed to the away plan on behalf of such employee shall not be deemed to be an employer maintaining the home plan solely because of such transferred contributions. The Secretary may by regulation establish additional conditions, and such variances and exemptions as are consistent with the purposes of this Act, in order to facilitate such transfer arrangements in the interest of portability and to protect the pension and welfare benefits of employees who become employed under two or more collective bargaining agreements associated with different pension or welfare plans.".

SEC. 122. TECHNICAL CORRECTION.

Section 204(b)(3)(E) of such Act is amended by striking out "a year of participation" and inserting in lieu thereof the following: "1,000 hours of employment".

SEC. 123. DETERMINING PARTICIPATION ON A PLAN YEAR BASIS.

The second sentence of section 202(a)(3)(A) of such Act is amended by inserting "(i)" after "first day of a plan year" and by inserting after "date his employment commenced" the following: "or (ii) in the case of a plan where rights and benefits under this part are determined on the basis of all of an employee's service without regard to the date on which the employee's participation in the plan commenced".

SEC. 124. SUMMATION OF DIFFERENT BENEFIT ACCRUAL RATES.

Section 210(a) of such Act is amended by adding at the end thereof the following new paragraph:

"(4) a multiemployer plan may provide that the accrued benefit to which a participant is entitled upon his separation from the service is—

"(A) (i) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates, or

"(ii) the sum of different rates of benefit accrual for different periods of participation, as defined by employment in different bargaining units, and

"(B) determined, for purposes of subparagraphs (A) and (C) of subsection 204(b)(1), by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.".

SEC. 125. SUSPENSION OF BENEFITS BECAUSE OF REEMPLOYMENT.

Section 203(a)(3)(B) of such Act is amended—

(1) by striking out "in the same trade" in clause (ii) and inserting in lieu thereof ", trade,"; and

(2) by striking out "'employed'." in the last sentence and inserting in lieu thereof the following: "which may, with respect to clause (ii), include self-employment. The permissible period of benefit suspension shall include a period determined pursuant to regulations promulgated by the Secretary in addition to the months in which the employment occurs to the extent necessary to prevent the periodic payment and suspension of pension benefits to workers who have not retired but who continue to work on an irregular basis. The imposition of a financial penalty on a pensioner who fails to report his employment as required by the

rules of a plan shall not be deemed a violation of the vesting requirements of this section. The amount of the financial penalty permitted by the preceding sentence shall be determined pursuant to regulations promulgated by the Secretary but in no event shall the penalty exceed an amount equal to one year's benefit.".

SEC. 126. REDUCTIONS IN RETIREMENT OR DISABILITY BENEFITS.

(a) Section 206(b) of such Act is amended—

(1) by inserting after "plan" in paragraph (1) the following: "or is receiving disability benefits under a welfare plan";

(2) by inserting immediately after "this Act" the following: "(or, in the case of a participant or beneficiary who is receiving disability benefits under a welfare plan, the date of enactment of the ERISA Improvements Act of 1979)"; and

(3) by adding at the end thereof the following new sentence: "A pension plan may not reduce or suspend pension benefits being received by a participant or beneficiary or pension benefits in which a participant who is separated from the service has a nonforfeitable right by reason of any payment made to the participant or beneficiary by the employer maintaining the plan as

the result of an award or settlement made under or pursuant to a workers' compensation law.".

(b) Section 201(1) of such Act is amended by inserting after "plan" the following: ", except as provided in section 206(b)".

SEC. 127. SURVIVOR PROTECTION.

(a) Section 205 of such Act is amended—

(1) by deleting subsection (a) and inserting in lieu thereof the following:

"(a) A pension plan may provide that the normal form of benefit is a form other than an annuity. If a pension plan provides for the payment of benefits in the form of an annuity (whether as the normal form or as an option), such plan shall provide for the payment of the annuity benefits in a form having the effect of a qualified joint and survivor annuity.";

(2) by deleting subsection (b) and inserting in lieu thereof the following:

"(b)(1) A plan which provides that the normal form of benefit is an annuity shall, with respect to any participant who under the plan is credited with at least 10 years of service for vesting purposes under section 203 and who dies before the annuity starting date, provide a survivor's annuity for the participant's spouse—

"(A) which begins on the annuity starting date (determined as if the participant had lived until the earliest retirement age under the plan, or the participant's actual date of death if later, and had retired on such date prior to death), if the spouse is living on such date, and

"(B) except as provided in paragraph (2), the payments under which are not less the payments which would have been made under the survivor's annuity to which such spouse would have been entitled if the participant had terminated employment on his date of death, had survived and retired on such annuity starting date, and had died on the day following such date.

"(2) If on the date of the participant's death, the actuarial equivalent of the survivor's annuity does not exceed $2,000, a plan described in paragraph (1) may distribute the survivor's benefit in the form of a lump sum, or in the form of installments commencing, not later than the annuity starting date specified in paragraph (1) (A).";

(3) by deleting subsection (c) and inserting in lieu thereof the following:

"(c) A plan which provides that the normal form of benefit is a form other than an annuity shall, with respect to any participant who under the plan has at least 10 years of service for vesting purposes under section 203 and who dies before receiving the percentage of his benefit which is nonforfeitable, provide (1) that the participant's benefit is distributed to the surviving spouse in the form of a lump sum, or in installments commencing, not later than 60 days after the end of the plan year in which the participant died, or (2) that the participant's benefit is distributed to the surviving spouse at such other time and in such manner as the plan and the surviving spouse may agree in writing.";

(4) by striking out "(whether or not an election has been made under subsection (c))" in subsection (d);

(5) by striking out subsection (e) and inserting in lieu thereof the following:

"(e)(1) Participants in plans subject to this section shall have the right to elect not to take joint and survivor annuities and the right to revoke such elections and to reelect, subject to the following terms and conditions:

"(A) A document explaining the terms and conditions of the joint and survivor annuity, and the rights and effects of, and procedures pertaining to, election, revocation, and reelection, shall be furnished to each participant a reasonable time before the date on which the participant completes 10 years of service for vesting purposes under section 203.

"(B) Any election, revocation or reelection shall be in writing. The right to elect, revoke, or reelect shall not extend beyond the date of a participant's death or retirement under the terms of the plan, whichever occurs earlier.

"(C) Respecting any participant, the document described in subparagraph (A) need not be furnished more than once if—

"(i) the plan's summary plan description includes an explanation, similar to the explanation described in subparagraph (A), which is generally applicable to all participants and which satisfies the requirements of section 102(a)(1); and

"(ii) the document described in subparagraph (A) makes prominent reference to the fact that the explanation contained therein may be of continuing importance to the participant and should be retained with the summary plan description.

"(2) The Secretary of the Treasury shall prescribe regulations to implement this subsection. Such regulations shall take cognizance of the difficulties certain multiemployer plans may have in furnishing the document described in paragraph (1)(A).";

(6) by striking out "subsection (c)" in subsection (f); and

(7) by striking out "joint and survivor annuity benefits under an election made under subsection (c)" in subsection (h) and inserting in lieu thereof "the sur-

vivors' benefits required under this section, to the extent such increased costs are attributable to the availability of such benefits prior to the normal retirement age under the plan".

(b) Not later than 1 year after the enactment of the ERISA Improvements Act of 1979, the Secretary of the Treasury shall develop versions of model language which can be adopted by various types of plans as amendments which comply with the requirements of this section. The Secretary shall facilitate to the maximum extent possible the administrative processing of determination letter applications resulting from this section.

(c) The amendments made by this section shall apply with respect to plan years beginning on or after the date which is 12 months after the date of enactment of this Act.

SEC. 128. ALIMONY AND SUPPORT PAYMENTS.

Section 206(d) of such Act is amended by adding at the end thereof the following new paragraph:

"(3) Paragraph (1) shall not apply in the case of a judgment, decree or order (including an approval of a property settlement agreement), pursuant to a State domestic relations law (whether of the common law or community property type), which—

"(A) affects the marital property rights of any person in any benefit payable under a pension plan or the legal obligation of any person to provide child support or make alimony payments, and

"(B) does not require a pension plan to alter the effective date, timing, form, duration, or amount of any benefit payments under the plan or to honor any election which is not provided for under the plan or which is made by a person other than a participant or beneficiary.".

PART 3—FUNDING

SEC. 131. FUNDING TO TAKE ACCOUNT OF FUTURE AMENDMENTS.

Section 302(c)(1) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following: "The funding method may take account, and for any plan year beginning after December 31, 1980, shall take account, of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits. In the event any such provision is not implemented at the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with regulations prescribed by the Secretary. A provision adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.".

PART 4—FIDUCIARY RESPONSIBILITY

SEC. 141. GENERAL ASSET ACCOUNT.

Section 401(b) of the Employee Retirement Income Security Act of 1974 is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) In the case of a plan which is funded in whole or in part by a contract or policy of insurance issued by an insurer, the assets of the plan shall include the contract or policy under which the benefits are insured but shall not, solely by reason of the issuance of such contract or policy, include the assets of the insurer issuing the contract or policy except to the extent that such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account. For purposes of this paragraph, the term 'insurer' means an insurance company, insurance service, or insurance organization, qualified to conduct business in a State.".

SEC. 142. REFUND OF MISTAKEN CONTRIBUTIONS.

(a) Section 403(c)(2)(A) of such Act is amended by inserting before the period at the end thereof the following: "or, in the case of a collectively bargained plan maintained by more than one employer, within 6 months after the plan administrator knows that the contribution was made by a mistake of fact or knows that holding a contribution would contravene the provisions of section 302 of the Labor-Management Relations Act, 1947.".

(b) The amendment made by subsection (a) shall be effective as of January 1, 1975, but as regards contributions received by a collectively bargained plan maintained by more than one employer before the date of enactment of the ERISA Improvements Act of 1979, if knowledge by the plan administrator that a contribution was made by mistake or in contravention of section 302 of the Labor-Management Relations Act, 1947, occurred before such date of enactment, such knowledge shall be deemed to have occurred on such date of enactment.

SEC. 143. COFIDUCIARY RESPONSIBILITY.

Section 405 of such Act is amended by adding at the end thereof the following new subsection:

"(e) In the case of a fiduciary other than an individual, the term 'knowledge' in subsection (a)(3) shall mean knowledge actually communicated, or knowledge which, in the normal course of business, should have been communicated, to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities, obligations, or duties or who in fact carries out such responsibilities, obligations, or duties, regarding the matter to which the knowledge relates.".

SEC. 144. EXEMPTION FOR RECIPROCITY ARRANGEMENTS.

Section 408(b) of such Act is amended by adding at the end thereof the following new paragraph:

"(10) Any transfer of contributions between plans pursuant to section 209, if a plan to which the contributions are tranferred pays not more than a reasonable charge for any administrative expenses reasonably incurred by a plan transferring such contributions.".

PART 5—ADMINISTRATION, ENFORCEMENT, AND ADJUSTMENTS IN APPLICABLE LAW

SEC. 151. ADVISORY COUNCIL.

Paragraph (3) of section 512(a) of the Employee Retirement Income Security Act of 1974 is amended by striking out "(at least one of whom shall be representative of employers maintaining or contributing to multiemployer plans)" and inserting in lieu thereof the following: "(one of whom shall be representative of employers maintaining or contributing to multiemployer plans and one of whom shall be representative of employers maintaining small plans)".

SEC. 152. IMPACT OF INFLATION ON RETIREMENT BENEFITS.

Section 513 of such Act is amended by adding at the end thereof the following new subsection:

"(d) The Secretary shall conduct a study of the feasibility and ramifications of requiring employee pension benefit plans to provide cost-of-living adjustments to benefits payable under such plans. The Secretary shall compile data and analyze the effect inflation is having and may be expected to have on retirement benefits provided by private pension plans. The Secretary shall submit the study required by this subsection to the Congress no later than 24 months after the date of enactment of the ERISA Improvements Act of 1979.".

SEC. 153. REMEDIES.

Section 502 of such Act is amended by—

(1) deleting "105(c)" in subsection (a)(4) and inserting in lieu thereof "105";

(2) by adding at the end of subsection (a) a new paragraph to read as follows:

"(7) by any employee, participant or beneficiary for damages due to reliance on a misrepresentation described in section 515.";

(3) redesignating subsection (b) as paragraph (1) of such subsection and adding a new paragraph (2), to read as follows:

"(2) The Secretary shall not initiate an action to enforce section 517.";

(4) deleting subsection (g) and inserting in lieu thereof the following:

"(g)(1) Except as provided in paragraph (2), in any action under this title by an employee, participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of the action to either party.

"(2) In any action under this title by a fiduciary on behalf of a plan to enforce the provisions of section 517 and in which a judgment in favor of the plan is awarded, the court shall allow a reasonable attorney's fee and costs of the action, to be paid by the defendant.";

(5) deleting "a participant" in subsection (h) and inserting in lieu thereof "an employee, participant", and inserting in subsection (k) "employee," before "participant";

(6) deleting "part 4" in subsection (h) and inserting in lieu thereof "parts 4 and 5"; and

(7) inserting immediately after subsection (k) a new subsection (l), to read as follows:

"(l) Except as provided by paragraph (3)—

"(1) no person or employee benefit plan shall be subject to liability or punishment, civil or criminal, or be required to reimburse or pay money or any other thing of value, as the direct or indirect result of a cause of action explicitly or implicitly alleging that the interest of an employee in an employee benefit plan is, or ought to be characterized as or deemed to be, a security for purposes of section 17(a) of the Securities Act of 1933 or section 10(b) of the Securities Exchange Act of 1934, or within the meaning of any State law which regulates securities;

"(2) no court of the United States shall have jurisdiction of an action or proceeding at law or in equity, to the extent such action or proceeding involves a cause of action explicitly or implicitly alleging that the interest of an employee in an employee benefit plan is, or ought to be characterized as or deemed to be, a security for purposes of section 17(a) of the Securities Act of 1933 or section 10(b) of the Securities Exchange Act of 1934, or within the meaning of any State which regulates securities; and

"(3) paragraphs (1) and (2) shall not apply respecting a cause of action based upon any act or omission which occurred before the date of enactment of the ERISA Improvements Act of 1979.".

SEC. 154. ADJUSTMENTS IN APPLICABLE LAW.

(a) Part 5 of subtitle B of title I of such Act is amended by—

(1) deleting "subparagraph (B)," in section 514(b)(2)(A) and inserting in lieu thereof "subparagraph (B) and subsections (d) (2) and (3),";

(2) deleting "Nothing" where it appears in section 514(d) and inserting in lieu thereof "(1) Except as provided in paragraphs (2) and (3), nothing"; and

(3) adding at the end of section 514(d) the following new paragraphs:

"(2) Notwithstanding any provision of law to the contrary, the interest of an employee in an employee benefit plan is not, and shall not be characterized as or deemed to be, a security for purposes of section 17(a) of the Securities Act of 1933 and section 10(b) of the Securities and Exchange Act of 1934, or within the meaning of any State law which regulates securities.

"(3) Notwithstanding any provision of law to the contrary, an interest or participation—

"(A) in a single or collective trust maintained by a bank or in a separate account maintained by an insurer, and

"(B) issued exclusively to one or more employee benefit plans

is not, and shall not be characterized as or deemed to be, a security for purposes of section 5 of the Securities Act of 1933 and section 12 of the Securities Exchange Act of 1934, or within the meaning of any State law which regulates securities, and such a trust or account holding exclusively assets of one or more such plans is not, and shall not be characterized as or deemed to be, an investment company within the meaning of the Investment Company Act of 1940 or any State law which regulates investment companies.".

(b) Such part is further amended by adding immediately after section 514 the following new subsections, to read as follows:

"MISREPRESENTATION

"SEC. 515. (a) It shall be unlawful for any person to knowingly misrepresent the terms and conditions of an employee benefit plan, the financial condition of a plan, or the status under the plan of any employee, participant or beneficiary.

"(b) No person shall be liable under subsection (a) respecting a document which is required to be disclosed to participants or beneficiaries or to be filed with the Secretary of Labor, the Pension Benefit Guaranty Corporation or the Secretary of the Treasury under this Act or the Internal Revenue Code of 1954, provided that such document satisfies the requirements of such Act or Code and duly promulgated regulations thereunder.

"(c) An employee benefit plan shall not be liable for damages resulting from a misrepresentation described in subsection (a).

"(d) Subsection (a) shall not apply as to any act or omission occurring before the date of enactment of the ERISA Improvements Act of 1979.

"CERTAIN FUNDING VEHICLES

"SEC. 516. (a) Not later than 12 months after enactment of the ERISA Improvements Act of 1979, the Secretary shall prescribe regulations to protect participants and beneficiaries of employee benefit plans which are or may be funded wholly or partially by a single or collective trust maintained by a bank or by a separate account maintained by an insurer, if such trust or account holds or is established to hold exclusively plan assets.

"(b) The regulations required by subsection (a) shall include—

"(1) standards to ensure full and fair disclosure of all material facts respecting such trust or account prior to and during the plan's participation in such trust or account,

"(2) standards for accuracy in the advertising and publicizing of such trust or account, and

"(3) such other standards as the Secretary may specify to protect plan participants and beneficiaries and to assist plan fiduciaries to make appropriate choices from among available funding vehicles.

"(c) In carrying out his responsibilities under this section, the Secretary shall consult with Federal banking authorities, the Securities and Exchange Commission, and State authorities who regulate insurance.

"(d) Duly promulgated regulations of the Secretary pursuant to subsection (a) or other provisions of this title shall be enforceable as provisions of this title under sections 502(a) (3) and (5).

"(e) For purposes of this section—

"(1) the term 'bank' shall have the same meaning as in section 3(38)(B)(ii), and

"(2) the term 'insurer' shall have the same meaning as in section 401(b)(2).

"OBLIGATION OF EMPLOYER TO PAY CONTRIBUTIONS

"SEC. 517. Every employer who is obligated under the terms of a collectively bargained plan (or under the terms of a collective bargaining agreement related to such plan) to make periodic contributions to the plan shall, to the extent not inconsistent with law, make such contributions in accordance with the terms and conditions of such plan or such agreement.".

SEC. 155. PREEMPTION.

Section 514 of such Act is amended by—

(1) adding at the end of subsection (b)(2)(B) the following: "A State insurance law which provides that a specific benefit or benefits must be provided or made available by a contract or policy of insurance issued to an employee benefit plan is a law which relates to an employee benefit plan within the meaning of subsection

(a) and is not a law which regulates insurance within the meaning of subparagraph (A). A provision of State law which requires that a contract or policy of insurance issued to an employee benefit plan must permit a participant to convert or continue protection after it ceases to be provided under the employee benefit plan is a provision of a law described in subparagraph (A) and not a provision of law described in subsection (a).";

(2) adding a new paragraph (5) as follows:

"(5) (A) Except as provided in subparagraph (B), subsection (a) shall not apply to the Hawaii Prepaid Health Care Law (Haw. Rev. Stat. 393-1 through 51), as in effect on January 1, 1979, and to any other State law which is determined by the Secretary to—

"(i) be substantially identical to such Hawaii law on such date, and

"(ii) require benefits which are substantially identical in type and amount to those required or permitted under such Hawaii law on such date.

"(B) Subparagraph (A) shall not apply to any provision of a State law which the Secretary determines to be similar to any provision of parts 1, 4 and 5 of this subtitle.";

(3) adding a new subsection (b)(6) to read as follows:

"(6) Subsection (a) shall not apply respecting any judgment, decree, or order pursuant to a State domestic relations law (whether of the common law or community property type), if such judgment, decree or order is described in section 206(d)(3)."; and

(4) adding a new subsection (e) to read as follows:

"(e) For purposes of subsections (d) (2) and (3) and sections 515, 516, and 517, the term 'employee benefit plan' shall include any employee benefit plan—

"(1) defined in section 3(3), irrespective of whether the only participants in the plan are owner-employees as defined in section 401(c)(3) of the Internal Revenue Code of 1954, and

"(2) which is described in section 4(a) and not exempt under section 4(b).".

EFFECTIVE DATES

SEC. 156. (a) Except as otherwise provided by this Act, the provisions of this Act and the amendments made by this Act to the Employee Retirement Income Security Act of 1974 and to the Internal Revenue Code of 1954 shall be effective on the date of enactment of this Act.

(b) Section 514(d)(3), as amended, shall be effective 12 months after the enactment of this Act.

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 201. LUMP SUM DISTRIBUTIONS; PLANS TREATED AS SINGLE PLAN.

(a) General Rule.—Section 402(e)(4)(C) of the Internal Revenue Code of 1954 (relating to aggregation of certain trusts and plans) is amended to read as follows:

"(C) Aggregation of certain trusts and plans.—For purposes of determining the balance to the credit of an employee under subparagraph (A)—

"(i) all trusts which are part of a plan shall be treated as a single trust,

"(ii) in the case of a multiemployer plan (as defined in section 3(37) of the Employee Retirement Income Security Act of 1974), all defined benefit plans maintained by an employer shall be treated as a single plan, and all defined contribution plans maintained by an employer shall be treated as a single plan,

"(iii) in the case of any plan not described in clause (ii), all pension plans maintained by an employer shall be treated as a single plan, all profit-sharing plans maintained by an employer shall be treated as a single plan, and all stock bonus plans maintained by an employer shall be treated as a single plan, and

"(iv) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of enactment of this Act.

SEC. 202. LUMP SUM DISTRIBUTIONS; SEPARATION FROM THE SERVICE.

(a) GENERAL RULE.—Section 402(e)(4) of the Internal Revenue Code of 1954 (relating to definitions and special rules) is amended by adding at the end thereof the following new subparagraph:

"(M) SEPARATION FROM THE SERVICE.—For purposes of subparagraph (A), in the case of any multiemployer plan (as defined in section 3(37) of the Employee Retirement Income Security Act of 1974), a separation from the service shall be deemed to have occurred in the case of any employee if such employee has not worked in service covered by the plan for a period of 6 consecutive months after severing his employment relationship with any employer maintaining the plan.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to plan years beginning after the date of enactment of this Act.

SEC. 203. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS AND CONTRIBUTIONS.

(a) IN GENERAL.—

(1) DEDUCTION ALLOWED.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to additional itemized deductions for individuals) is amended by redesignating section 221 as 222 and by inserting after section 220 the following new section:

"SEC. 221. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS CONTRIBUTIONS.

"(a) DEDUCTION ALLOWED.—In the case of an eligible employee, described in subsection (c), there is allowed as a deduction amounts paid in cash for a taxable year by such individual for the benefit of himself—

"(1) to a plan described in section 401(a) which includes a trust exempt from tax under section 501(a), "(2) to an annuity plan described in section 403(a),

"(3) to a qualified bond purchase plan described in section 405(a),

"(4) to an individual retirement account described in section 408(a), individual retirement annuity described in section 408(b), or for a retirement bond described in section 409, or

"(5) to a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable.

"(b) LIMITATION AND RESTRICTION.—

"(1) MAXIMUM DEDUCTION.—The amount allowable as a deduction under subsection (a) to an eligible employee for any taxable year may not exceed an amount equal to 10 percent of the compensation includible in his gross income for such taxable year, or $1,000, whichever is less.

"(2) ADDITIONAL LIMITATION.—No deduction is allowed for any amount paid to an account, annuity, or for a bond described in paragraph (4) of subsection (a) except to the extent of the excess of the amount determined under paragraph (1) over any amount paid by the eligible employee to a plan or trust described in paragraph (1), (2), (3) or (5) of subsection (a).

"(3) ALTERNATIVE DEDUCTION.—No deduction is allowed under subsection (a) for the taxable year if the individual claims the deduction allowed by section 219 or 220 for the taxable year.

"(4) EXCEPTION WHERE PLAN IS DISCRIMINATORY.—No deduction is allowed under subsection (a) for a highly compensated participant (as defined in subsection (c)(7)) unless the employer certifies in accordance with regulations prescribed by the Secretary that the plan satisfies the discrimination standards in subsection (c)(6).

"(5) EXCEPTION RESPECTING CERTAIN PLANS.—No deduction is allowed under subsection (a) for any amount paid by a participant to a plan described in paragraph (1), (2) or (3) of subsection (a) which was not in existence on January 1, 1978 (or to a successor to such a plan) if, under the terms of such plan (or successor plan), employee contributions are mandatory or employer contributions are not made unless contributions are made by employees.

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) ELIGIBLE EMPLOYEE.—For purposes of this section, the term 'eligible employee' shall mean an individual who is an employee without regard to section 401(c)(1) or is a member of a labor organization referred to in subparagraph (D) and who is an active participant for any part of the taxable year in—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a),

"(C) a qualified bond purchase plan described in section 405(a), or

"(D) a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable,

but not if such plan is established or maintained by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

"(2) REPORTS.—The Secretary shall promulgate regulations which prescribe the time and manner in which reports shall be filed by an employer receiving contributions deductible under this section and by any eligible employee making any such deductible contribution.

"(3) RECONTRIBUTED AMOUNTS.—No deduction shall be allowed under this section with respect to a rollover contribution described in section 402(a)(5), 402(a)(6), 402(a)(7), 403(a)(4), 403(a)(5), 403(b)(8), 408(d)(3), or 409(b)(3)(C).

"(4) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which are properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(5) MARRIED INDIVIDUALS.—In the case of an individual who is married (as determined under section 143), the maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(6) DISCRIMINATION STANDARDS.—

"(A) A plan satisfies the discrimination standards if the actual deferral percentage for highly compensated participants (as defined in paragraph (7)) for a plan year bears a relationship to the actual deferral percentage for all other participants for such plan year which meets either of the following tests:

"(i) The actual deferral percentage for the group of highly compensated participants is not more than the actual deferral percentage of all other participants multiplied by 1.5.

"(ii) The excess of the actual deferral percentage for the group of highly compensated participants over that of all other participants is not more than 3 percentage points, and the actual deferral percentage for the group of highly compensated participants is not more than the actual deferral percentage of all other participants multiplied by 2.5.

"(B) For purposes of subparagraph (A), the actual deferral percentage for a specified group of participants for a plan year shall be the average

47-321 O - 79 - 5

of the ratios (calculated separately for each participant in such group) of—

"(i) the amount deducted on behalf of each participant for such plan year, to

"(ii) the participant's total compensation for such plan year.

For purposes of the preceding sentence, the amount deducted on behalf of a highly compensated participant shall be determined without regard to the exception in subsection (b)(4).

"(7) HIGHLY COMPENSATED PARTICIPANT.—For purposes of this section, the term 'highly compensated participant' means any participant who is more highly compensated than two-thirds of all participants but only if such participant's compensation for a plan year equals or exceeds the salary of an employee of the United States who is compensated at a rate equal to the annual rate paid for step 1 of grade GS–12. No individual who participates during a plan year only in a group retirement trust described in subsection (a)(5) shall be considered a highly compensated participant for such year.".

(2) DEDUCTION ALLOWED IN ARRIVING AT ADJUSTED GROSS INCOME.—Section 62 of such Code

(defining adjusted gross income) is amended by inserting after paragraph (14) the following new paragraph:

"(15) DEDUCTION FOR CERTAIN CONTRIBUTIONS.—The deduction allowed by section 221 (relating to certain employee retirement savings contributions).".

(b) TAX TREATMENT OF CERTAIN DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—Subpart A of part I of subchapter D of chapter 1 of such Code (relating to retirement plans) is amended by inserting after subsection (l) of section 414 the following new subsection:

"(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For purposes of this title, other than for purposes of sections 401 (a) (4) and (5), 404, 410(b), 411, and 412, any amount which an employer is required to report pursuant to regulations promulgated under subsection (c)(2) of section 221, with respect to an amount paid by an eligible employee, as defined in subsection (c)(1) of section 221, as an employee retirement savings contribution, shall be treated as an employer contribution.".

(c) CONFORMING AMENDMENTS.—

(1) So much of section 72(f) of such Code as precedes paragraph (1) thereof is amended to read as follows:

"(f) SPECIAL RULES FOR COMPUTING EMPLOYEE'S CONTRIBUTIONS.—In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other consideration paid, amounts which an employer is required to report, pursuant to regulations promulgated under subsection (c)(2) of section 221, with respect to an amount paid by an eligible employee, as defined in subsection (c)(1) of section 221, as a retirement savings employee contribution shall be excluded, and amounts contributed by the employer shall be included, but only to the extent that—".

(2) Section 414(h) of such Code (Tax treatment of certain contributions) is amended by inserting after "any amount contributed" the following: "other than an amount described in subsection (m)".

(3) So much of section 4973(b) of such Code as follows paragraph (1)(A) thereof is amended to read as follows:

"(B) the amount allowable as a deduction under section 219, 220, or 221 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

"(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 408(d)(1),

"(B) the distributions out of the account for the taxable year to which section 408(d)(5) applies, and

"(C) the excess (if any) of the maximum amount allowable as a deduction under section 219, 220, or 221 for the taxable year over the amount contributed (determined without regard to sections 219(c)(5) and 220(c)(6)) to the accounts or for the annuities or bonds for the taxable year.

For purposes of this subsection, any contribution which is distributed from the individual retirement account, individual retirement annuity, or bond in a distribution to which section 408(d)(4) applies shall be treated as an amount not contributed.".

(d) Effective Date.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 204. CREDIT FOR THE ESTABLISHMENT OF QUALIFIED PLANS BY SMALL EMPLOYERS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"SEC. 44D. ESTABLISHMENT OF NEW SMALL BUSINESS EMPLOYER RETIREMENT PLANS.

"(a) GENERAL RULE.—In the case of a small business employer who maintains or makes contributions to or under a qualified employer retirement plan, there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to a percentage (determined under subsection (b)) of the amount allowable for the taxable year to such employer as a deduction under section 404.

"(b) DETERMINATION OF PERCENTAGE.—The percentage applicable under subsection (a) for a taxable year is—

"(1) 5 percent for the first taxable year for which a deduction under section 404 is allowable to the taxpayer,

"(2) 3 percent for each of the succeeding 2 taxable years, and

"(3) 1 percent for each of the 2 taxable years succeeding the 2 taxable years referred to in paragraph (2).

"(c) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

"(1) QUALIFIED EMPLOYER RETIREMENT PLAN.—The term 'qualified employer retirement plan' means—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a);

"(B) an annuity plan described in section 403(a); and

"(C) a qualified bond purchase plan described in section 405(a).

"(2) SMALL BUSINESS EMPLOYER.—The term 'small business employer' means an employer (within the meaning of section 404) which—

"(A) during the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed, had a monthly average of fewer than 100 employees, and

"(B)(i) if a corporation, had earnings and profits for the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed equal to no more than $50,000, or "(ii) if an unincorporated trade or business or a partnership, had net profits for the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed equal to no greater than $50,000.

"(3) DISREGARD FOR AMOUNTS ATTRIBUTABLE TO EMPLOYER SECURITIES.—In determining the amount of the credit allowable under subsection (a) for any taxable year, any portion of the deduction allowed for such year which is attributable to the transfer to or under the plan of employer securities (as defined in section 407(d)(1) of the Employee Retirement Income Security Act of 1974) shall be disregarded.

"(d) APPLICATION WITH OTHER SECTIONS.—The amount of the deduction allowable under section 404 for any taxable year shall not be reduced because of the allowance of a credit under this section for the taxable year.

"(e) TERMINATIONS.—No credit is allowable under subsection (a) for any taxable year to an employer (or successor to such an employer) who terminates a qualified employer retirement plan during the taxable year.".

(b) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44D. Establishment of new small business employer retirement plans.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after the date of enactment of this Act.

SEC. 205. CONFORMING AMENDMENTS FOR ERISA CHANGES IN TITLE I.

(a) CONFORMING AMENDMENTS FOR SECTION 102.—

(1) Paragraph (2) of section 4975(e) of such Code (relating to definition of disqualified person) is amended—

(A) by striking out subparagraphs (A) through (D) and inserting in lieu thereof the following:

"(A) any fiduciary, counsel, or employee of such plan;

"(B) a person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan;

"(C) an employer any of whose employees are covered by such plan, if the employees of such employer constitute 5 percent or more of all employees covered by the plan;

"(D) an employee organization any of whose members are covered by such plan, if the members of such employee organization constitute 5 percent or more of all employees covered by the plan;",

(B) by striking out subparagraph (I) and inserting in lieu thereof the following:

"(I) a 10 percent or more (in capital or profits) partner, or joint venturer in, a person described in subparagraph (C), (D), (E), or (G).";

(C) by inserting "brother, sister," immediately before "spouse," the first time it appears in paragraph (6);

(2) Subsection (f) of section 414 of such Code (relating to definition of multiemployer plan) is amended by—

(A) striking out subparagraphs (A), (B), and (C) of paragraph (1) of such subsection and inserting in lieu thereof the following:

"(A) which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer,

"(B) to which 10 or more employers contribute, or to which more than one and fewer than 10 employers contribute if the Secretary of Labor finds that treating such a plan as a multiemployer plan would be consistent with the purposes of this Act, and";

(B) redesignating subparagraphs (D) and (E) of paragraph (1) of such subsection as subparagraphs (C) and (D), respectively, and

(C) striking out paragraph (2) of such subsection and inserting in lieu thereof the following new paragraph:

"(2) For purposes of this subsection, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) determined without regard to section 1563(e)(3)(C)) shall be deemed to be one employer.".

(b) CONFORMING AMENDMENT FOR SECTION 111.—Subparagraph (C) of section 6057(a)(2) of such Code (relating to annual registration) is amended by redesignating clauses (ii) and (iii) as (iii) and (iv), and by inserting after (i) the following new clause:

"(ii) who has a 1-year break in service,".

(c) CONFORMING AMENDMENT FOR SECTION 121.—Subsection (l) of section 414 of such Code (relating to mergers and consolidations of plan or transfers of plan assets) is amended by striking out "A trust" and inserting in lieu thereof "except in the case of a reciprocal agreement described in section 209 of the Employee Retirement Income Security Act of 1974, a trust".

(d) CONFORMING AMENDMENT FOR SECTION 122.—Subparagraph (E) of section 411(b)(3) of such Code (relating to maritime industries) is amended by striking out "a year of participation" and inserting in lieu thereof "1,000 hours of employment".

(e) CONFORMING AMENDMENT FOR SECTION 123.—Subparagraph (A) of section 410(a)(3) of such Code (relating to definition of year of service) is amended by striking out "by reference to" and all that follows and inserting in lieu thereof the following: "by reference to—

"(i) in the case of an employee who does not complete 1,000 hours of service during the 12-month period beginning on the date his employment commenced, the first day of a plan year, and

"(ii) in the case of a plan where rights and benefits are determined on the basis of all of an employee's service, without regard to the date on which the employee's participation in the plan commenced.".

(f) CONFORMING AMENDMENT FOR SECTION 124.—Subsection (c) of section 413 of such Code (relating to plans maintained by more than one employer) is amended by inserting after paragraph (4) the following new paragraph:

"(4A) SUMMATION OF DIFFERENT BENEFIT ACCRUAL RATES.—The accrued benefit to which a participant is entitled upon a separation from the service is—

"(A)(i) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates, or

"(ii) the sum of different rates of benefit accrual for different periods of participation, as defined by employment and different bargaining units, and

"(B) determined, for purposes of subparagraphs (A) and (C) of section 411(b)(1), by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.".

(g) CONFORMING AMENDMENT FOR SECTION 125.—Subparagraph (B) of section 411(a)(3) of such Code (relating to certain permitted forfeitures, suspensions, etc.) is amended—

(1) by striking out "the same trade" and inserting in lieu thereof "trade,", and

(2) by striking out "'employed'" in the last sentence of subparagraph (B) and inserting in lieu thereof the following: "'employed', which may, with respect to clause (ii), include self employment. The permissible period of benefit suspension shall include a period, determined pursuant to regulations promulgated by the Secretary of Labor, in addition to the months in which the employment occurs to the extent necessary to prevent the periodic payment and suspension of pension benefits to workers who have not retired but who continue to work on an irregular basis. The imposition of a financial penalty on a pensioner who fails to report his employment as required by the rules of a plan shall not be treated as a violation of the requirements of this section. The amount of the financial penalty permitted by the preceding sentence shall be determined pursuant to regulations promulgated by the Secretary of Labor, but in no event shall the penalty exceed an amount equal to one year's benefit.".

(h) CONFORMING AMENDMENT FOR SECTION 126.—Paragraph (15) of section 401(a) of such Code (relating to prohibited decreases in benefit levels) is amended by adding at the end thereof the following: "A trust shall not constitute a qualified trust under this section unless under the plan of which such trust is a part, the plan may not refuse pension benefits being received by a participant or beneficiary, or pension benefits in which a participant who is separated from the service has a nonforfeitable right by reason of any payment made to the participant or beneficiary by the employer maintaining the plan, as a result of an award or settlement made under or pursuant to a workers' compensation law.".

(i) CONFORMING AMENDMENT FOR SECTION 127.—Paragraph (11) of section 401(a) of such Code (relating to joint and survivor annuities) is amended—

(1) by inserting "(whether as the normal form or as an option)" after "annuity" the first time it appears in subparagraph (A);

(2) by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) A plan which provides that the normal form of benefit is an annuity does not meet the requirements of subparagraph (A) unless, with respect to any participant who, under the plan, is credited with at least ten years of service (for purposes of section 411) and who dies before the annuity starting date, the plan provides a survivor's annuity for the participant's spouse—

"(i) which begins on the annuity starting date (determined as if the participant had lived until the earliest retirement age under the plan, or the participant's actual date of death if later, and had retired on such date prior to death), if the spouse is living on such date, and

"(ii) except as otherwise provided in this subparagraph, the payments under which are not less than the payments which would have been made under the survivor's annuity to which such spouse would have been entitled if the participant had terminated employment on his date of death, had survived and retired on such annuity starting date, and had died on the day following such date.

If, on the date of the participant's death, the actuarial equivalent of the survivor's annuity does not exceed $2,000, a plan described in this subparagraph will not be considered not to meet the requirements of subparagraph (A) if it distributes the survivor's benefit in the form of a lump sum, or in the form of installments commencing not later than the annuity starting date specified in clause (i).";

(3) by striking out subparagraph (C) and inserting in lieu thereof the following:

"(C) A plan which provides that the normal form of benefit is a form other than an annuity shall not be treated as satisfying the requirements of this paragraph unless, with respect to any participant who under the plan has at least 10 years of service for purposes of section 411 and who dies before receiving the percentage of his benefit which is nonforfeitable, the plan provides that the participant's benefit will be distributed to the surviving spouse in the form of a lump sum, or in installments commencing, not later than 60 days after the end of the plan year in which the participant died.";

(4) by striking out "whether or not an election described in subparagraph (C) has been made under subparagraph (C)" in subparagraph (D);

(5) by striking out subparagraph (E) and inserting in lieu thereof the following:

"(E) A plan shall not be treated as satisfying the requirements of this paragraph unless participants in the plan have the right to elect not to take joint survivor annuities, and the right to revoke such elections and to reelect, under the following circumstances:

47-321 O - 79 - 6

"(i) A document explaining the terms and conditions of the joint survivor annuity, the effect of an election, and the rights of, and procedures pertaining to, election and revocation, is furnished to each participant a reasonable time before the date on which the participant completes 10 years of service for the purposes of section 411.

"(ii) Any election, revocation, or reelection is in writing, and the right to elect, revoke, or reelect does not extend beyond the date of a participant's death or retirement under the terms of the plan, whichever first occurs.

"(iii) With respect to any participant, the document described in clause (i) need not be furnished more than once if—

"(I) the plan's summary plan description includes an explanation, similar to the explanation described in clause (i), which is generally applicable to all participants, and

"(II) the document described in clause (i) makes prominent reference to the fact that the explanation contained therein may be of continuing importance to the participant and should be retained with the summary plan description.";

(6) by striking out "(C) or" in subparagraph (F);

(7) by inserting after "joint and survivor annuity benefits" in subparagraph (G) the following: "as of the date on which a participant completes 10 years of service for purposes of section 411"; and

(8) by striking out "joint and survivor annuity benefits." in the last sentence of such paragraph and inserting in lieu thereof the following: "the survivors' benefits required under this paragraph, to the extent such increased costs are attributable to the availability of such benefits prior to the normal retirement age under the plan. Regulations of the Secretary under this paragraph shall take cognizance of the difficulty certain multiemployer plans may have in furnishing the document described in subparagraph (E)(i).".

(j) CONFORMING AMENDMENT FOR SECTION 125.—Paragraph (13) of section 401(a) of such Code (relating to assignment or alienation of benefits) is amended by adding at the end thereof the following new section: "For purposes of the first sentence of this paragraph, there shall not be taken into account any assignment or alienation of benefits under the plan required by a judgment, decree or order (including an approval of a property settlement agreement), pursuant to a State domestic relations law (whether of the common law or community property type), which—

"(A) affects the marital property rights of any person in any benefit payable under the plan or the legal obligation of any person to provide child support or make alimony payments, and

"(B) does not require the plan to alter the effective date, timing, form, duration or amount of any benefit payments under the plan or to honor any election which is not provided for under the plan or which is made by a person other than a participant or beneficiary.".

(k) CONFORMING AMENDMENT FOR SECTION 131.—Subparagraph (A) of section 412(c)(2) of such Code (relating to valuation of assets) is amended by adding at the end thereof the following new sentence: "The funding method may take account, and for any plan year beginning after December 31, 1980, shall take account, of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits. In the event any such provision is not implemented at the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with the regulations prescribed by the Secretary. A provision adopted but contingent upon a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.".

(l) CONFORMING AMENDMENT FOR SECTION 142.—Paragraph (2) of section 401(a) of such Code (relating to exclusive benefit of employees and beneficiaries) is amended by inserting before the semicolon at the end thereof the following: "(but this paragraph shall not be construed, in the case of a collectively bargained plan maintained by more than one employer, to prohibit the return of a contribution within 6 months after the plan administrator knows that the contribution was made by a mistake of fact or knows that holding the contribution would contravene the provisions of section 302 of the Labor-Management Relations Act, 1947)".

(m) CONFORMING AMENDMENT FOR SECTION 144.—Subsection (d) of section 4975 of such Code (relating to exemptions from prohibited transaction rules) is amended—

(1) by striking out "or" at the end of paragraph (12),

(2) by striking out the period at the end of paragraph (13) and inserting in lieu thereof a semicolon and "or", and

(3) by inserting after paragraph (13) the following new paragraph:

"(14) any transfer of contributions between plans under section 209 of the Employee Retirement Income Security Act of 1974, if the plan to which the contributions are transferred pays not more than a reasonable charge for any administrative expenses reasonably incurred by the plan transferring the contributions.".

TITLE III—SPECIAL MASTER AND PROTOTYPE PLANS

SEC. 301. SPECIAL MASTER AND PROTOTYPE PLANS.

(a) IN GENERAL.—Subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new part:

"PART 6—SPECIAL MASTER AND PROTOTYPE PLANS

"SPECIAL MASTER AND PROTOTYPE PLANS

"SEC. 601. (a) For purposes of this section—

"(1) 'special master plan' means a master or prototype employee pension benefit plan which has been approved by the Secretary of Labor in accordance with subsection (d), all of the assets of which are controlled by one or more master sponsors,

"(2) 'master sponsor' means any person who is the sponsor of a special master plan and who—

"(A) has the power to manage, acquire, or dispose of any asset of an adopting employer's plan, and

"(B) is (i) registered as an investment advisor under the Investment Advisor's Act of 1940; (ii) is a bank, as defined in that Act; or (iii) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State,

"(3) 'adopting employer' means an employer any of whose employees are covered under a special master plan, or an association of such employers.

"(b) Notwithstanding any other provisions of this Act or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the responsibilities, duties, and obligations of an adopting employer under parts 1, 2, 3, and 4 of this subtitle shall be limited to making such timely contributions and payments, and furnishing such timely, complete, and accurate information, as may be required under the terms of the plan; and

"(2) the requirements of the Internal Revenue Code of 1954 which are applicable to the design of the plan of the adopting employer shall be deemed to be initially satisfied as of the date the adopting employer and master sponsor execute the special master plan joinder agreement.

"(c) Notwithstanding any other provisions of this Act or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the master sponsor shall be the administrator of and a fiduciary respecting each adopting employer's plan for the purposes of this Act of such Code;

"(2) the requirements of section 102(b), if otherwise satisfied, will not be violated if—

"(A) the plan description of an adopting employer's plan includes plan provisions common to the plans of all employers adopting the special master plan, together with a description of each type of variation from such common provisions that is permitted under the terms of the approval provided for in subsection (d), and an identification, by name of adopting employer, employer identification number, name of plan, and plan identification number of the employers who have adopted, and the plans containing, each such variation, and

"(B) the summary plan description of each adopting employer's plan describes provisions common to the plans of all employers adopting the special master plan, together with a description of any provisions of such adopting employer's plan which vary from such common provisions, with appropriate cross-references;

"(3) the requirements of section 103 of this Act and of section 6058 of the Internal Revenue Code of 1954, if otherwise satisfied, will not be violated merely because data in the annual report reflect the aggregate assets of the special master plan, if the annual report also includes an identification, by name of adopting employer, employer identification number, name of plan, and plan identification number, of the percentage of total special master plan assets attributable to each adopting employer's plan;

"(4)(A) the exemption described in section 408(b)(2) of this Act and in section 4975(d)(2) of the Internal Revenue Code of 1954 shall be applied as if any master sponsor of a special master plan or a party in interest respecting such plan for a reason other than by virtue of such person's being a fiduciary, and

"(B) the term 'bank or similar financial institution' in section 408(b)(6) of this Act and in section 4975(d)(6) of the Internal Revenue Code of 1954 shall be deemed to mean any master sponsor, and the term 'sound banking and financial practice' in such sections shall, in the case of a master sponsor other than a bank, be deemed to mean 'sound fiduciary practice'; and

"(5) no master sponsor shall have a responsibility, obligation, or duty under this Act or the Internal Revenue Code of 1954—

"(A) to ascertain whether information required to be furnished to the master sponsor by an adopting employer pursuant to the terms of a special master plan is accurate or complete,

"(B) due to the failure of an adopting employer to satisfy the requirements of subsection (b)(1), or

"(C) respecting the decision of an employer to adopt the master sponsor's plan, except as regards the advertising or publicizing of and disclosures concerning trusts and accounts described in section 516 of this Act.

"(d)(1) The Secretary of Labor and the Secretary of the Treasury shall prescribe such regulations, and furnish such rulings, opinions, forms, and other types of guidance as are necessary to implement this section. To the greatest extent consistent with the purposes of this Act and the Internal Revenue Code of 1954, such regulations and other types of guidance shall be designed to facilitate the development of special master plans and their adoption by employers. Initial regulations and forms, sufficient to enable perspective master sponsors to submit special master plans for approval, shall be issued on or before the effective date specified in section 301(c) of the ERISA Improvements Act of 1979.

"(2)(A) The Secretary shall approve a special master plan only if he determines that the plan of an adopting employer, in design and in operation, will satisfy the requirements of this section, and of other applicable requirements of this Act and of the Internal Revenue Code of 1954 (to the extent that such Act and Code are not inconsistent with this section).

"(B) The Secretary shall not approve any special master plan unless he has first submitted the plan to the Secretary of the Treasury for review, together with such information as the Secretary of the Treasury may request. The review of the Secretary of the Treasury shall be limited to the applicability of, and compliance with, the provisions of the Internal Revenue Code of 1954. The Secretary of the Treasury shall either concur in the approval or refuse to concur. If the Secretary of the Treasury refuses to concur, he shall specify the changes that must be made in the plan to obtain his concurrence. In the case of a refusal, the Secretary shall not approve the plan unless the specified changes are made. If the Secretary of the Treasury fails to concur or refuses to concur within 270 days after such submittal, the failure shall be deemed to be a failure described in section 7476(a)(2)(A) of such Code, and—

"(i) the master sponsor shall be deemed to be a 'plan administrator' for the purposes of subsection (b)(1) of such section,

"(ii) subsections (b)(2) through (b)(5) of such section shall not be applicable, and

"(iii) the special master plan shall be deemed to be a 'retirement plan' within the meaning of subsection (d) of such section.

"(3) Approval of special master plans and amendments to such plans shall be accomplished by a process carried out in the national office of the Secretary, until such time as he may establish procedures for field office approval under which uniformity of treatment by field offices is assured.

"(4) Upon approval of a special master plan, or of any amendment to such a plan for which approval is required, a special master plan certificate shall be issued to the master sponsor by the Secretary. Except as provided in paragraph (5), for a period of 60 months from the date of adoption of the plan by an employer or from the effective date of an amendment for which approval is required, such certificate or duly notorized copy thereof shall be prima facie evidence in any administrative or judicial proceeding that the terms and conditions of the plan meet the applicable requirements of this

Act and of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954.

"(5) The Secretary, after notice and hearing, and after consultation with the Secretary of the Treasury respecting the applicability of or compliance with the Internal Revenue Code of 1954, shall revoke the certificate described in paragraph (4)—

"(A) respecting the plan of any adopting employer, if he finds that there has been a failure on the part of the employer to observe the terms and conditions of the plan and that such failure has been detrimental to the rights of plan participants or beneficiaries under the terms and conditions of the plan, this Act, or such Code; and

"(B) respecting the special master plan, if he finds that there has been a failure to observe the terms and conditions of the plan or the provisions of this section on the part of the master sponsor and that such failure has been detrimental to the rights of plan participants under the terms and conditions of the plan, this Act, or such Code.

"(6) The certificate issued by the Secretary upon the approval of a special master plan, or upon the approval of an amendment to such a plan for which approval is required, shall specify the types of amendments, if any, for which approval need not be obtained.

"(7) Nothing in this section shall limit the power of the Secretary of the Treasury, after audit, to determine that the plan of any adopting employer, in operation, has failed to meet the applicable requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, but no such plan shall be treated as not having met such requirements for any plan year preceding the year in which the Secretary of the Treasury makes such determination unless the determination includes a finding that the failure to meet such requirements in any such preceding year was a result of intentional failure or willful neglect on the part of the adopting employer.

"(e)(1) Any adopting employer who fails to make such timely contributions and payments or who fails to furnish such timely, complete and accurate information as may be required under the terms of a special master plan shall, in accordance with the terms of such plan, be deemed to be the administrator of the plan (only to the extent the plan covers the employees of such adopting employer), as of the time specified in such plan, and as of such specified time the master sponsor shall cease to be the administrator and a fiduciary of such adopting employer's plan.".

"(2) To the extent that an adopting employer, under the terms of a special master plan, assumes responsibility for furnishing the summary plan description or other documents required to be furnished or otherwise made available to participants, beneficiaries, or employees under the provisions of part 1 of this subtitle, section 3001 of this Act or section 6057 of the Internal Revenue Code of 1954, such adopting employer shall be deemed to be the administrator of the plan (only to the extent the plan covers the employees of such employer), and the master sponsor shall not be the administrator regarding the responsibilities undertaken by such adopting employer.".

(b) The table of contents for the Employee Retirement Income Security Act of 1974 is amended by inserting immediately after the item relating to section 517 the following:

"PART 6—SPECIAL MASTER AND PROTOTYPE PLANS

"Sec. 601. Special master and prototype plans.".

(c) The amendments made by this section shall take effect 12 months after the date of enactment of this Act.

TITLE IV—EMPLOYEE BENEFITS COMMISSION

SEC. 401. EMPLOYEE BENEFITS COMMISSION.

(a) ESTABLISHMENT.—There is established, as an independent agency within the executive branch of the Government, the Employee Benefits Commission. The Commission is composed of—

(1) a chairman, who shall be the special liaison officer for the Secretary of Labor appointed under paragraph (1) of subsection (b),

(2) a vice chairman, who shall be the special liaison officer for the Secretary of the Treasury appointed under paragraph (2) of subsection (b), and

(3) three additional members appointed by the President, by and with the advice and consent of the Senate, selected from a list of nominees submitted jointly by the Secretary of Labor and the Secretary of the Treasury.

(b) LABOR AND TREASURY DEPARTMENT LIAISON OFFICERS.—

(1) There is established within the office of the Secretary of Labor, the position of special liaison officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of Labor and shall serve for a term of years in accordance with the provisions of subsection (c). The special liaison officer shall report regularly to the Secretary of Labor on the activities of the Commission.

(2) There is established within the office of the Secretary of the Treasury the position of special liaison

officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of the Treasury and shall serve for a term of years in accordance with the provisions of subsection (c). The special liaison officer for the Treasury shall report regularly to the Secretary of the Treasury on the activities of the Commission.

(c) TERMS OF OFFICE.—

(1) NUMBER OF YEARS.—Members of the Commission shall serve for terms of 6 years, except—

(A) the special liaison officer for the Secretary of the Treasury first appointed after the date of enactment of this Act shall serve for a term of 3 years, and

(B) of the 3 members of the Commission initially appointed under paragraph (3) of subsection (a), one shall serve for a term of 2 years, one shall serve for a term of 4 years, and one shall serve for a term of 6 years.

(2) SERVICE BEYOND EXPIRATION DATE.—A member of the Commission may serve as a member of the Commission after the expiration of his term until a

successor has taken office as a member of the Commission.

(3) VACANCY APPOINTMENTS.—An individual appointed to fill a vacancy occurring other than by the expiration of a term of office shall be appointed only for the unexpired term of the member such individual succeeds.

(4) POLITICAL AFFILIATION.—Not more than 3 members of the Commission may be affiliated with the same political party.

(d) COMPENSATION.—Members of the Commission shall receive compensation equivalent to the compensation paid at level III of the Executive Schedule.

(e) FUNCTIONS.—The Commission shall—

(1) formulate policy respecting Federal laws which now or may hereafter relate to employee benefit plans,

(2) administer and enforce titles I and IV of such Act, and

(3) administer and obtain compliance with—

(A) sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954, and

(B) such other provisions of such Code as are designated under subsection (f), insofar as such sections and provisions relate to employee benefit plans defined in section 3(3) of the Employee Retirement Income Security Act of 1974 (irrespective of whether the only participants in such plans are owner-employees, as defined in section 401(c)(3) of such Code) which are described in section 4(a) of such Act and not exempt under section 4(b) of such Act, including, to the extent provided by presidential order under subsection (f), individual retirement accounts, annuities and bonds described in sections 408 and 409 of such Code.

(f) DESIGNATED SECTIONS.—Not later than 9 months after the enactment of this Act, the President shall by order designate such sections (or provisions of sections) of the Internal Revenue Code of 1954, in addition to the sections described in subsection (e)(3)(A), under which functions, duties, powers, or responsibilities presently exercised by the Secretary of the Treasury shall be exercised by the Commission. Such additional sections or provisions shall include those as may be necessary to effectuate the maximum feasible consolidation in the Commission of all functions of the Departments of Labor and of the Treasury respecting employee benefit plans and to otherwise carry out the purposes of this Act. For purposes of this subsection, the term "employee benefit plans" shall include any plan defined in section 3(3) of the

Employee Retirement Income Security Act of 1974 (whether or not the only participants in such plan are owner-employees, as defined in section 401(c)(3) of the Internal Revenue Code of 1954) which is described in section 4(a) of such Act and not exempt under section 4(b) of such Act, and shall also include an individual retirement account, annuity or bond described in section 408 or 409 of such Code.

(g) RULES, ETC.—The Commission shall prepare written rules for the conduct of its activities, shall have an official seal which shall be judicially noticed, and shall have its principal office in or near the District of Columbia (but it may meet or exercise any of its powers anywhere in the United States).

(h) ADMINISTRATIVE AUTHORITY.—

(1) STAFF DIRECTOR; GENERAL COUNSEL.—The Commission shall have a staff director and a general counsel who shall be appointed by the Chairman. The staff director and the general counsel shall be paid at a rate not in excess of the rate in effect for level IV of the Executive Schedule. With the approval of the Chairman, the staff director may—

(A) appoint and fix the compensation of such additional personnel as he considers necessary, and

(B) procure temporary and intermittent services to the same extent as authorized by section 3109(b) of title 5, United States Code.

(2) USE OF OTHER AGENCIES' RESOURCES.—In carrying out its responsibilities, the Commission may avail itself of the assistance, including personnel and facilities, of other agencies and departments of the United States Government. The heads of such other agencies and departments may make available to the Commission such personnel, facilities, and other assistance, with or without reimbursement, as the Commission may request.

SEC. 402. POWERS OF COMMISSION.

(a) IN GENERAL.—The Commission has the powers expressly granted to the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974 and, in addition, has the power—

(1) to require, by special or general orders, any person to submit in writing such reports and answers to questions as the Commission may prescribe, and such submission shall be made within such reasonable period of time and under oath or otherwise as the Commission may require;

(2) to administer oaths or affirmations;

(3) to require by subpena, signed by the chairman or the vice chairman, the attendance and testimony of witnesses and the production of all documentary evidence relating to the execution of its duties;

(4) in any proceeding or investigation, to order testimony to be taken by deposition before any person who is designated by the Commission and has the power to administer oaths and, in such instances, to compel testimony and the production of evidence in the same manner as authorized under paragraph (3);

(5) to pay witnesses the same fees and mileage as are paid in like circumstances in the courts of the United States;

(6) to initiate (through civil actions for injunctive, declaratory, or other appropriate relief), defend, or appeal from a decision in, any civil action in the name of the Commission for the purpose of enforcing the provisions of this Act, nd titles I and IV of the Employee Retirement Income Security Act of 1974, or for the purpose of obtaining compliance with the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act, through its general counsel;

(7) to develop such prescribed forms, to make, amend, and repeal such rules, pursuant to the provi-

sions of chapter 5 of title 5, United States Code, and to issue such interpretations, opinions, and other forms of guidance as are necessary to carry out the provisions of this Act and titles I and IV of the Employee Retirement Income Security Act of 1974, and as are necessary to administer the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act;

(8) to conduct investigations and hearings, to encourage voluntary compliance, and to report apparent criminal law violations to the appropriate law enforcement authorities; and

(9) to certify to the Secretary of the Treasury that an employee benefit plan described in section 401(e)(3) of this Act—

(A) satisfies or does not satisfy (or has or has not satisfied) the requirements of in any of the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act, or

(B) satisfies or does not satisfy (or has or has not satisfied) the requirements of section 44C of the Internal Revenue Code of 1954.

(b) ENFORCEMENT OF ORDERS OF THE COMMISSION.—Any United States district court within the jurisdiction of which any inquiry is carried on may, upon petition by the Commission in case of refusal to obey a subpena or order of the Commission issued under subsection (a), issue an order requiring compliance therewith. Any failure to obey the order of the court may be punished by the court as contempt.

(c) TRANSFER OF FUNCTIONS.—All functions and duties of the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974 are transferred to, and shall be carried out by, the Commission, and all functions and duties of the Secretary of the Treasury under the sections and provisions of the Internal Revenue Code of 1954, described in section 401(e)(3) of this Act, insofar as such sections relate to employee benefit plans described in such section, are transferred to, and shall be carried out by, the Commission.

(d) TRANSFER PROVISIONS.—

(1) PERSONNEL, ETC.—All personnel, liabilities, contracts, property, and records determined by the Director of the Office of Management and Budget to be employed, held, or used primarily in connection with the functions of the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974, and of the Secretary of the Treasury under the sections and provisions of the Internal Revenue Code of 1954, de-

scribed in section 401(e)(3) of this Act, insofar as such sections relate to employee benefit plans described in such section, are transferred to the Commission.

(2) TRANSFER OF PERSONNEL.—

(A) Except as provided in subparagraph (B), personnel engaged in functions transferred under paragraph (1) shall be transferred in accordance with applicable laws and regulations relating to the transfer of functions.

(B) The transfer of personnel pursuant to paragraph (1) shall be made without reduction in classification or compensation for one year after such transfer.

(3) PROCEDURAL EFFECTS OF TRANSFER.—

(A) All laws and regulations relating to the functions and duties transferred under this Act shall, insofar as such laws and regulations are applicable and not amended by this Act, remain in full force and effect. All orders, determinations, rules, and opinions made, issued, or granted under such laws by the Secretary of Labor, the Pension Benefit Guaranty Corporation, or by the Secretary of the Treasury, which are in effect at the time of the transfer provided by paragraph (1), and which are consistent with the amendments made by this Act, shall continue in effect to the same extent as if such transfer had not occurred.

(B) The provisions of this Act shall not affect any proceeding pending before the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury on the date of enactment of this Act.

(C) No suit, action, or other proceeding commenced by or against the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury shall abate merely by reason of the transfer made under paragraph (1).

SEC. 403. TERMINATION OF TREASURY DEPARTMENT'S JURISDICTION.

(a) TERMINATION OF TREASURY JURISDICTION.—Except as provided in subsection (b), the Secretary of the Treasury shall not administer, seek to obtain compliance with, or otherwise exercise responsibility or power respecting the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act, insofar as such sections relate to employee benefit plans described in such section.

(b) CERTIFICATIONS BY COMMISSION.—Certifications made by the Employee Benefits Commission to the Secretary of the Treasury pursuant to section 402(a)(9) of this Act shall be treated by the Secretary as if he had made such certifications himself.

SEC. 404. AGENCY COOPERATION.

Pursuant to procedures they shall jointly formulate and establish, the Employee Benefits Commission, the Secretary of Labor, and the Secretary of the Treasury shall make arrangements for—

(1) notification by the respective Secretaries to the Commission regarding information which concerns the Commission's functions under section 401(e), and

(2) notification by the Commission to the Secretaries regarding information which concerns their respective functions under laws relating to employee benefit plans.

SEC. 405. EFFECTIVE DATE AND REPEAL.

This title shall take effect 24 months after the date of enactment of this Act. Subtitle A of title III of the Employee Retirement Income Security Act of 1974 is repealed on such effective date.

96TH CONGRESS
1ST SESSION

S. 557

To amend the Internal Revenue Code of 1954 to permit an individual covered by a private retirement plan to establish a separate individual retirement account or deduct a separate contribution to the plan.

IN THE SENATE OF THE UNITED STATES

MARCH 7 (legislative day, FEBRUARY 22), 1979

Mr. BENTSEN introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1954 to permit an individual covered by a private retirement plan to establish a separate individual retirement account or deduct a separate contribution to the plan.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. INDIVIDUALS COVERED BY OTHER PLANS.

(a) IN GENERAL.—Subsection (a) of section 219 of the Internal Revenue Code of 1954 (relating to deduction allowed for retirement savings) is amended—

(1) by striking out "or" at the end of paragraph (2).

(2) by striking out the period at the end of paragraph (3) and inserting in lieu thereof a comma and "or"; and

(3) by inserting after paragraph (3) the following new paragraph:

"(4) to or under a qualified plan in which such individual was an active participant for any part of the taxable year.".

(b) CONFORMING CHANGES.—Section 219 of such Code is amended—

(1) by striking out parts (2)(A)(i), (2)(A)(ii), and (2)(A)(iii) of subsection (b), and

(2) by redesignating part (2)(A)(iv) as part (2)(A)(i),

(3) by adding at the end of subsection (c) the following new paragraph:

(5) QUALIFIED PLAN.—For purposes of this section, the term 'qualified plan' means—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a), "(C) a qualified bond purchase plan described in section 405(a)," or

"(D) a plan described in section 805(d)(3)."

SECTION 2. EFFECTIVE DATE.

The amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1978.

Senator BENTSEN. Good morning. This hearing will come to order.

This morning, this hearing will concentrate on encouraging people to save for their own retirement. Last month, I introduced S. 557, which would allow participants in a qualified pension plan to receive a tax deduction for contributions, either to a pension plan or to an IRA. The deduction could not exceed the lesser of $1,500 or 15 percent of compensation.

Earlier, I introduced S. 94 which would allow homemakers to establish an IRA. Greater individual savings in our economy could make an important contribution to help us overcome inflation. One of the most important things that can be done in the fight to hold down the cost of living should be to help boost productivity and productivity depends very largely on investment in equipment and machinery and that requires capital.

Individuals must save more than they presently do to make that capital available. The rate of savings in the United States is significantly lower than that in the rest of the world. The United States' rate of savings as a percentage of disposable national income in 1976 was 4.8 percent compared to a rate of 6.6 percent in the United Kingdom, 13.1 percent in France, 13.2 percent in Germany, 17.2 percent in Switzerland, and 25.3 percent in Japan.

One of the reasons that savings in Japan increased at five times the savings of the United States is that you have some very major tax incentives to encourage that savings. The same thing is happening in France. I met with the Economics Minister of France the other day and he was talking about the savings incentive they enacted to encourage capital formation and the dramatic success that they were having with it.

Proposals to encourage pension contributions will help provide greater retirement security, particularly for employees who do not remain with the company long enough to meet the minimum vesting requirements. That has been a serious problem for mobile employees, such as scientists and engineers. Very often, these individuals do not earn a pension benefit which would otherwise provide an important supplement to social security. I would like to now turn to my colleague, Senator Dole, for such comments as he might have.

Senator DOLE. I thank you, Mr. Chairman. I would ask that my statement be made a part of the record.

Senator BENTSEN. Without objection.

Senator DOLE. I appreciate the chairman Senator Bentsen holding the hearings on my legislation and other bills. I know this is a very busy time. However I know Senator Bentsen feels, as I do, that Congress should encourage American workers to accumulate adequate retirement benefits by providing tax benefits for current savings.

The Dole-Nelson proposal, S. 75, allows an active participant in a qualified plan to make a deductible contribution either to the plan or to IRA. The deduction under the bill would be the lesser of 10 percent of compensation or $1,000.

In addition, the bill contains a nondiscrimination test. While there may be some who think a nondiscrimination test is not appropriate or desirable, I believe that such a test is essential if

Congress is to enact legislation providing deductibility for pension contributions.

A nondiscrimination test will encourage highly-compensated individuals to provide the proper plan which may be used by lower-paid employees.

I might point out that approximately 95 percent of all Americans can take advantage my proposal without regard to the nondiscrimination test. I understand the concern expressed. However, the alternative is no legislation or legislation providing for an income phaseout is less preferable. Mr. Chairman, S. 75 is very similar to an initiative I sponsored as a part of the Senate-passed Revenue Act of 1978. I am pleased to say that this proposal has bipartisan support. The Dole-Nelson Limited Employee Retirement Act is cosponsored by Senators Moynihan, Gravel, Cochran, and Lugar. It is my opinion that since the enactment of ERISA in 1974 the failure to permit tax deduction from employee contributions to qualified plans has led to a drop in employee participation in private pension plans. LERA is the first step to reversing this trend.

We have had the benefit, I might add, of considerable input and expertise from the Treasury Department. While we may still disagree on some of the policy issues, I certainly want to express my appreciation for all hard work. I appreciate the opportunity to hear the witnesses this morning.

Thank you.

Senator BENTSEN. Thank you very much, Senator Dole.

I am very pleased to have Congressman Trible here this morning who has played a leading role in pension considerations in the House and is the sponsor of the Homemaker Retirement Bill in the House.

Congressman?

STATEMENT OF HON. PAUL S. TRIBLE, JR., A U.S. CONGRESSMAN FROM THE STATE OF VIRGINIA

Representative TRIBLE. Senators, it is a pleasure to be here this morning. I thank you for the opportunity to testify in support of Senate bill 94. I also appreciate your courtesy in allowing me to testify at the early stages of this hearing today, as my Armed Services Committee is marking up the supplemental defense bill on the House side and I will return there very promptly after the completion of my testimony.

Mr. Chairman, there are 30 to 50 million American homemakers who are rapidly approaching retirement age without any type of retirement plan. These hard-working men and women compose approximately one-third of our adult population. Unfortunately, they face the dismal prospect of old age without any source of outside income other than social security, but it does not have to be that way.

If Congress would ease the present restrictions on eligibility for the establishment of an individual retirement account, many of these homemakers could start saving now for the future.

Many homemakers cannot invest in an individual retirement account today because they do not earn any wages. I think that is wrong. Paycheck or not, you and I know how hard homemakers work and how valuable is there work. I believe it is time to recognize the economic value of a homemakers's contribution to society.

In the 95th Congress, I introduced a bill, H.R. 4649, cosponsored by 150 Members of the House, which sought to give homemakers an opportunity—equal to that enjoyed by other self-employed persons—to prepare for their retirement. For many homemakers—men as well as women—that bill represented a first opportunity to prepare for retirement.

In the 95th Congress, I have reintroduced the homemaker retirement bill, H.R. 1542 (S. 94) and to date 106 of my colleagues in the House have cosponsored this legislation. I am pleased that you have introduced this bill in the Senate and sincerely value your strong leadership in this matter.

In 1976, Congress established the spousal IRA which extended IRA benefits to a select group of homemakers under five very narrow conditions.

To qualify for a spousal IRA, a homemaker must: One, not be a participant in a retirement plan; two, earn no wages; three, have a spouse who could own an IRA; four, have a spouse who is willing to invest in an IRA; and five, have a spouse who is willing to reduce the maximum contribution to his or her IRA from a maximum of $1,500 to $875.

Quite frankly, there are relatively few homemakers who meet these rather rigorous tests. The tendency for many of those who do not meet the test is to take a who cares attitude since the family can only increase its total savings for retirement by $250, even if it meets all five tests.

Simply put, H.R. 1542 and S. 94 would extend the eligibility for setting up IRA's and would increase the yearly amount those participating in spousal plans would be allowed to contribute and claim as adjustments to income.

H.R. 1542 and S. 94 would permit a homemaker to participate in an IRA regardless of whether the family's prime wage earner was eligible to set up an IRA or was an active participant in another type of retirement plan.

The homemaker would be permitted to count their spouse's income for determining allowable contributions and would be allowed to contribute a sum equal to 15 percent of that income or $1,500, whichever is less.

Let me advance a number of arguments in favor of expanding the spousal IRA provisions by approving H.R. 1542 and S. 94. First, I do not believe a homemaker's eligibility for an IRA should hinge on the eligibility of the homemaker's spouse to invest in an IRA.

If it was unfair for homemaker spouses of employees who are eligible to establish IRA's not to have tax-deferred retirement savings, I suggest it is equally unfair in the case of homemaker spouses of employees covered by other types of retirement plans. H.R. 1542 and S. 94 would permit the homemaker spouse to set up an IRA no matter what type of retirement plan the working spouse has and would thereby extend the logic underlying the creation of the spousal IRA.

Second, I see no reason why the law should distinguish between a homemaker earning wages and the homemaker who does not.

Both have the same retirement needs and they should be given an equal opportunity to provide for their future security.

As it now stands, the spousal IRA statute discourages homemakers from taking part-time, wage-earning jobs. If a homemaker who would otherwise be able to invest in an IRA decides to take a job as a school crossing guard or a weekend cashier or substitute school teacher, she or he will lose eligibility for a spousal IRA under the present law. While some of these homemakers might then be technically eligible on their own to invest in an IRA, a small sum of outside income would not warrant this course of action.

Homemakers should not be forced to accept a second-class retirement or no retirement at all because they choose to earn a small sum of money outside the home.

Third, H.R. 1542 and S. 94 eliminates the necessity of reducing the total contributions of the working spouse to an IRA in order to provide an IRA for the homemaker. Under present law, a working spouse who established a regular IRA is entitled to contribute up to $1,500 annually. When the working spouse sets up a spousal IRA, the maximum annual contribution for each spouse is limited to $875 for a total of $1,750. In other words, a family can only increase its total savings for retirement by $250 a year.

Why must a family's prime wage earner sacrifice retirement rights in order that the family's homemaker might have an IRA? Why not give homemakers equal status as citizens and allow them to save the same amount of money in an IRA as all other employed people.? H.R. 1542 and S. 94 would permit a maximum annual contribution of $1,500 by the homemaker and the working spouse for a total of $3,000.

Passage of these bills would, of course, mean a deferment of taxes and a direct shortfall in revenues to the Federal Government. However, by increasing the aggregate level of savings we can expect spillover benefits and indirect revenue gains which may far outweigh the initial revenue loss. For example, greater savings will make moneys available for capital investment, for the creation of jobs, and for the economic expansion this nation requires. Increased economic activity will mean increased revenues to the Federal Government and reduced expenditures for unemployment, welfare, and income maintenance programs.

In addition, by investing in an IRA, homemakers will be shifting the cost of their retirement years from the Government to themselves. Homemakers over the age of 65 will soon compose one-sixth of our adult population. If homemakers are not given sufficient incentives to save for their retirement, these costs will have to be borne by the Government. The demand for services will not lessen. The only issue in doubt is whether the homemaker or the Government will pay the costs of income maintenance, health care, institutionalization, and other retirement needs. If homemakers pay for at least a portion of these services through their IRA investments, the long-term savings to the Government should more than offset the revenue loss from the tax deduction and deferral features of an IRA.

Homemaker investment in IRA's will also benefit the poor. In the future, there will be a relatively fixed amount of money which Government can spend on retirement programs. Thus, a shift of homemakers from dependence on Government to self-reliance for retirement income will mean that fewer people will be dividing up the Government retirement pie. In the long run, this should mean a higher level of benefits and service for those who are unable to save for their retirement.

There are also intangible social benefits which must be weighed. How much is it worth to point people in the direction of greater self-reliance and less dependence on Government? How much is it worth to know homemakers will no longer be forced to find a job to acquire pension rights? And now much is it worth to finally recognize in the law that the homemaker's work does have economic value? These questions should be answered.

For millions of homemakers, this bill presents the first opportunity to prepare for retirement. For others, it is a way to improve their retirement savings. At the very least, the passage of this bill will insure that homemakers are treated fairly and given a chance to help themselves.

The time to act is now.

I applaud your efforts and I wish you well.

Senator BENTSEN. Thank you very much for a very succinct and a very excellent statement, Congressman. I think what we are doing in the present law is putting a penalty on marriage, are we not?

Representative TRIBLE. Exactly, Senator. America's homemakers are making a valuable social and economic contribution to our society. Unfortunately, because they have chosen to make their contributions in the home instead of the business world, they are not given equal treatment under the law in preparing for their retirement years. I think it is unfair to penalize homemakers in this manner and, if my bill was enacted, this marriage penalty would be stricken from the tax code. You have the situation of a married couple where the wife does not develop the skills of an outside job. She helps rear a family, take care of a home. For one reason or another, they divorce at 45 or 50 years of age, and that pension goes with him. He has been employed and has accrued the rights to it, and she has the problem of entering the work force, often penalized because, at that age, funding the pension benefits becomes a little more onerous and burdensome for the employer. So she is put in a very difficult position.

What we are really trying to do and what you are trying to do is to establish a remedy for this problem.

Certainly, it is a question of equity and fairness. We are only proposing to treat homemakers as we are other self-employed Americans to give them an opportunity to prepare and plan and provide for the future.

Senator BENTSEN. Senator Dole?

Senator DOLE. I have no questions. I want to commend Congressman Trible and the Chairman for their strong leadership in this area. The proposal makes a great deal of sense to this Senator. Apparently from your statement, there is interest on the House side. There are 106 cosponsors to your bill?

Representative TRIBLE. In this Congress and 150 in the last.

Senator DOLE. I assume with that much support, Treasury probably will endorse the bill this morning. In any event, even though they be slow in reaching that conclusion, your efforts have been outstanding.

Representative TRIBLE. Thank you, Senator.

Thank you, Senator Bentsen. I appreciate the opportunity to be with you.

Senator BENTSEN. We have a number of sponsors on the Senate side, but there is still time to sign up and there is still room on the bill.

Senator DOLE. I might do that. It sounds like a good idea.

Representative Trible. I urge your colleagues to join in our endeavor.

Senator BENTSEN. Thank you very much.

Mr. Secretary, we are very pleased to have you this morning. Secretary Daniel Halperin.

Mr. HALPERIN. Thank you.

STATEMENT OF DANIEL I. HALPERIN, DEPUTY ASSISTANT SECRETARY OF THE TREASURY

Mr. HALPERIN. Thank you, Mr. Chairman. With me is Mike Melton of the Office of Tax Legislative Counsel. I have a statement that comments on the several bills that are the subject of this hearing which I would like to introduce for the record.

Senator BENTSEN. We would accept those.

Mr. HALPERIN. I will concentrate here today on the the issue of deductible contributions by active participants to qualified plans.

First, let me say a word about some of the reasons why these proposals have been introduced. As with many other proposals for tax relief, part of the pressure for these bills comes from those who perceive others already having the relief that they seek.

In 1974, Congress in ERISA adopted IRA legislation which for the first time opened up pension savings to those who were not participating in employer-sponsored plans. It was felt at that time that it was not necessary to extend IRA's to those participating in employer plans, because these people already had protection for retirement. However, when one looks at the ability to make a $1,500 contribution to an IRA—which, or course, is fully vested and therefore available to an employee for retirement—and compares it to the situation of some of the people who are participating in qualified plans, the equity is not there since many of these people do not have an annual $1,500 contribution made on their behalf. Also, many are not vested, and will never vest because of the fact that they change jobs frequently.

So we have come full circle, in a sense, in that now those who are participating in qualified plans say that they do not have the same treatment, the same benefits, as those who are not. In fact, in some circumstances it is better not to be a participant in a qualified plan because that gives you the opportunity to go to an IRA. I think this is ultimately a threat to the private pension system. If wehave a large number of employees who are, in effect, saying to their employers, do not establish plans, or let me out of other plans that you have, I would rather have an IRA, that is a threat to the system. We think the long-term security of employees would be much better served by the establishment of employer plans.

Therefore, we agree with the efforts that are being made by a number of these bills to open up deductible contributions to people who are participating in qualified plans. Perhaps the most equitable way of doing that is to make up the difference: That is, allow IRA contributions to the extent of the difference between $1,500 and the employer contribution, and somehow take care of the fact that many employer contributions are not vested.

We think that as equitable as it might be, this appproach is too complex. The IRA provisions are complicated enough and we would, undoubtedly, get into a great deal of trouble if we moved in that direction. Therefore, in order to solve the problem you have to allow IRA contributions in full or in part to participants in qualified plans. Certainly the simplest solution is the one in the Chairman's bill, S. 557, which basically allows $1,500 IRA contributions, whether or not an individual is participating in a qualified plan.

Unfortunately, we are unable to support the bill for two reasons. First, it may start the IRA cycle all over again. If people can have $1,500 contributions to an IRA even if they are in qualified plans, people who are not in qualified plans may well say that they are not getting the same treatment and will push for an increase in the IRA limit above $1,500.

Second, and more importantly, we are troubled by the potential utilization of the deductible contribution benefit. I have attached at the end of my prepared statement a table indicating the utilization of IRA's by those who are potentially eligible to do so. It shows that for those with over $50,000 of income, we estimate that over half who are able to utilize IRA's do so, while if you get down to people below $20,000, you have an overall utilization level of less than 5 percent.

We think that the same thing is likely to happen if you open IRAs to participants in qualified plans and, of course, relatively more of those are in higher income levels than nonparticipants.

This illustrates the problem. If you use the tax system as an incentive, it works most effectively at high income levels where of course people not only have the money to respond to the incentive but they also have the most to save in terms of taxes if they do so.

The difficulty of using the tax system as an incentive for retirement is mitigated by the nondiscrimination requirement. With the nondiscrimination requirement, high-income individuals who are motivated by tax incentives to think about retirement plans, must in order to get the benefits for themselves provide protection for those at low or moderate income levels who may not, on their own, act to save for retirement.

Therefore we believe quite strongly that if you are going to allow deductions for contributions to a plan or IRA for those already participating in qualified plans, we need to insist on widespread participation. As Senator Dole pointed out in his opening statement, his bill, S. 75, as well as S. 209 which was introduced by Senators Williams and Javits, take this general approach, and we have been working with the staff and other interested parties to see if there is a specific provision that we can all agree on. We very much appreciate Senator Dole's willingness to work with us to try to obtain a mutually satisfactory solution.

Treasury has agreed that it is important to try to increase retirement security in this direction, but we still have some difficulties with the bills as they now stand, and I think that to the extent that there have been changes from the provisions adopted by the Senate in the 1978 act, they are moving slightly in what we, at least, would view as the wrong direction.

Let me outline briefly some of our difficulties. First, certainly there is a question of whether we are able to spend the revenue at this point on these bills. There is close to $1 billion in the next fiscal year involved in S. 75. We estimate that more than three-quarters of this is involved with tax deductions for present contributions which are being made on a nondeductible basis to qualified pension plans. So we are spending a great deal of money, three-quarters of a billion dollars, without getting any increase in retirement savings and we are spending, overall, close to $1 billion, and that is certainly a serious consideration in view of the other demands on limited revenue resources.

Second, as Senator Dole pointed out in his opening statement, his bill (S. 75) would allow approximately 95 percent of the work force to take deductions for contributions to an IRA or to a qualified plan without regard to any test of nondiscrimination. Those who presently earn less than $32,000 per year would have this opportunity under S. 75.

We are troubled by this level, because we believe it does not leave enough leverage. There are not enough people left who have to depend upon the nondiscrimination test in order to get their own contributions deductible, to give assurance that there will be, in effect, enough widespread coverage on the lower income levels. If people are left to their own devices, if we end up in a system where the high-paid say, well, we will opt out of this sytem, we will end up with primarily people under $32,000 making contributions without regard to a nondiscrimination test. I think again the table I referred to earlier would indicate that we are going to get a wide disparity in use and most of the people who will take advantage of the benefits will be earning around the $30,000 level.

It is a little difficult to talk about great tax abuse when the benefit is at that income level, but I do wish to point out that first, only about 4 or 5 percent of wage earners actually make more than $30,000 a year and second, one has to decide whether every kind of tax cut which is focused primarily on the group between $25,000 and $30,000 would be acceptable. I do not think that is true, and one has to focus on whether this one, in particular, is an exception.

Also there is a question as to the proper test for discrimination. On pages 6 and 7 of my statement, I indicate some of the difficulties we have with the test for discrimination that is presently in S. 75. Let me just discuss one of them briefly.

The question is, what is the compensation to be taken into account in determining whether there has been an equal level of contributions by employees at low and high income levels? What is the compensation that one looks to?

The bill allows a deduction of $1,000 by anybody who is earning $10,000 and above. Therefore, it appears to be focusing primarily on income replacement of the first $10,000 or thereabouts of earned income, and it is not trying to give people a means of replacing income up to $100,000 or more.

It does not really achieve the purpose of antidiscrimination and income replacement if one could have the following situation. If someone earning $100,000 a year contributes $1,000—the maximum amount—to this arrangement, this is treated as a contribution of 1 percent of pay. It would be allowed, provided that employees at low-income levels also contributed at 1 percent of pay. That would mean for someone earning $10,000 per year, the contribution would only be $100. That would not seem to us to get at the problem.

If one is trying through a limit on contributions or benefits to focus tax relief in order to assure income replacement on the earning levels up to a certain point, then in order to fulfill that purpose, one should only look at compensation up to that point.

When we first put dollar limits in pension plans with H.R. 10 in 1962, we did not limit the compensation which could be taken into account. We had a $2,500 maximum contribution. I think Congress looked at that as a 10 percent contribution on the first $25,000 of salary. But we found that people earning $100,000 per year, for example, were able treat that as a contribution of 2.5 percent of their pay and contribute only 2.5 percent for other personnel in their office. This did not fulfill the intent of the legislation.

This problem was corrected in ERISA in 1974 where a $100,000 limit on salary was imposed on H.R. 10 plans, which is still two times the salary required in order to make the maximum contribution. We think there needs to be further improvement in this area, and that this kind of salary limit ought to be imposed on qualified plans generally.

So, the main point that I am making here is that in order to test for discrimination, we feel we ought to look at contributions as a percentage of the first $10,000 of earnings and not as a percentage of total earnings.

Our other primary concern with the bill—S. 75—is the potential impact it has on the existence of contributory plans.

A problem apparently has occurred with respect to contributory plans. As I indicated earlier, there are a number of people who would prefer to have an IRA instead of being a participant in the employer's pension plan. If the employer's plan is noncontributory, many times the employee does not have this option. The employee is automatically participating, just by being on the job and fulfilling the eligibility conditions.

However, in a contributory plan, it is possible for an employee to opt out merely by refusing to make contributions and this, apparently, has been happening in increasing numbers. Some people have become concerned that their plan may no longer qualify under the code because too many low-income employees have chosen not to participate.

There have been some assertions that if this happens, the sponsor will discontinue the plan. Perhaps an alternative course of action would be to shift to a noncontributory arrangement.

In any event, it is hoped that through this bill—S. 75—,since employees will be able to deduct contributions to the employer's contributory plan, they will be motivated to do so rather than seek out the IRA alternative.

We have a problem with any proposal that would encourage continuation or proliferation of of contributory plans which we believe—for the reasons that we have set out on pages 9 and 10 of the statement—are inconsistent with some of the goals of ERISA. Also, we have difficulty with spending three-quarters of a billion dollars for encouraging contributions to these plans.

One argument that people make in favor of contributory plans is that the employer is unable to afford an adequate pension benefit of his own. Therefore, if the plan has to be noncontributory, these plans will not be established.

Of course, if we look at what really happens, not just at the surface, employees who actually contribute to these plans are taking a pay cut in terms of take-home pay or forgoing a salary increase in order to put some money into the retirement plan. It seems possible that with a little education these employees can be convinced that the same thing is happening if the plan is not contributory and the employer, in effect, does not give a raise, or gives a smaller raise, in order to be able to finance the pension benefit. Or, at least if it is impossible for the employer to establish an adequate benefit with its own contributions, why can it not say to those who refuse to contribute, "We will give you at least the inadequate benefit we are willing to pay for but if you want adequate retirement security you are going to have to be willing to put some of the money in on your own."

We have some difficulty with the real need for contributory arrangements. We are also troubled, as I said, by a number of areas where contributory plans seem to undercut protections offered by ERISA. We have set them out on pages 9 and 10 of my statement—let me just mention one.

As you would realize, if a plan provides, for example, 1 percent of pay for each year of service, then for an employee at age 30, one has to make a much smaller contribution to provide that benefit than would have to be made for an employee at age 60 because there is 30 years—instead of 5—on which to earn interest on the employer's contribution. So in that kind of plan, the employer's contribution increases as the employee gets older, assuming salary stays at the same level.

If you have a contributory plan which requires all employees to contribute a certain percentage of their salary, say 2 percent of their salary, and if that is staying level, it is obvious that the employer's contribution is increasing even more as the employee is getting older.

We find in a number of contributory plans that, in effect, the employer provides no benefit to the younger employees because the employee's contribution is adequate by itself to provide for the benefit that is being earned by the younger employee. That seems to us to undercut the intent of ERISA where the employer benefits should be earned ratably over a working career.

There are as I said, other problems with contributory plans. We think that if Congress is going to make contributory plans more viable by allowing a tax deduction for the contributions that are made by the employee to them, then we ought to be sure that contributory plans are doing a better job of providing for employees at all income levels and in providing for employees to earn benefits under the plan even where they terminate service before retirement.

Mr. Chairman, as I said, we are aware of the problem of retirement security. We are trying our best to work out an acceptable solution which will enable those who are now inadequately provided for in employer plans to be able make deductible contributions to an IRA or the plan. We will continue to work with interested parties, but we feel that the discrimination test in the present bill—S. 75—is inadequate to assure widespread coverage of low and moderate income employees. We are also troubled by any additional incentive to contributory plans without assuring that those plans are more nondiscriminatory in nature.

That concludes my remarks. I will be pleased to answer any questions you might have.

Senator BENTSEN. Mr. Secretary, it just seems like the trend is more and more toward trying to have uniformity and not giving people the individual decision as to how much they want to save for retirement and to factor in the considerations that will be facing them at the time of retirement.

In effect, you are putting down contributory plans. It sounds to me like you are doing that. I think that is a mistake.

I really believe that we ought to be encouraging the individual to do some of these things. We have had a tax system for a long time in this country that encourages consumption. That worked pretty good for awhile, but I think it is time that we redirect some of that and emphasize the supply side of the economy. That means that we have to encourage savings to be able to get the capital formation that we need in this country.

We are seeing that happen in other countries now. The Japanese have been very effective. They have done it to the point—they have overdone it, really. When you get up to a 25 percent savings factor, that is really more than necessary, more than adequate.

But the French are doing it; the Germans are doing it. I think it is time that we do some of these things, and that means some very substantive changes in some of our economic thinking in this country.

So to the contrary, I think that we ought to have those incentives carried out there to encourage people to do it. But you have stayed away from trying to take care of the working mother and the spouse. Do you want to tell me about that?

Mr. HALPERIN. Well, as we said in the written statement, we have some problems with that bill. I think again——

Senator BENTSEN. I think you are going to have a lot of problems with it if you do not go ahead and endorse it.

Mr. HALPERIN. Well, we tend to be stubborn, I suppose, even in light of——

Senator BENTSEN. I hope we prevail on this one, frankly.

Mr. HALPERIN. Let me go back a step. I think that what you said prior to this question is correct in effect, we are tending to look at the deductions for private pension systems in a way in which it can be consistent with an income tax approach and we are saying, in effect, that the tax benefit does tend to impact most on high-income people. This interferes with a progressive income tax and in order to bring it back to consistency, we must justify the system as a means of providing retirement security for those who are not likely to save on their own.

The system does, in effect, presumably operates to get people to save who would not do so if left to a voluntary choice. That may be inconsistent with the philosophy of many who believe that if people want to save for retirement, they ought to do so, and if people would rather live high now and worry about the future next year, that is their own individual decision.

If that is the approach that one wants to take, I think in fact——

Senator BENTSEN. I do not want it all on one side. I want a mixture. That is what we are trying to work toward.

Mr. HALPERIN. On the question of a consumption tax—I agree that we certainly have been moving in that direction for a number of years, and these bills would move us further in that direction. There a number of people who believe that this is the correct kind of system one ought to have, that a consumption tax is a better system than an income tax system.

There have, however, been conflicts on the question of whether a consumption tax will actually have a substantial impact on savings. Most economists, at least up until recently, have believed that the increase in savings that one would get under a consumption tax would not be significant enough to warrant that kind of switch. Perhaps that is wrong; there has been some recent evidence on the other side.

I think also, however——

Senator BENTSEN. Let me say on that that the French Economics Minister said that they had a tremendous result from an incentive in the tax system to encourage savings by investment in savings accounts and equities, and they provided, as I recall—he said if you invest $1,000 a year for 4 years, they had to keep that money in there for a substantial period of time or they lost all the tax benefits. The Frenchmen really like to save taxes and he said they really went for it, and he said they had a substantial increase of capital formation in France as a result of it.

Mr. HALPERIN. Well, we will certainly continue to look at that, and we will continue to examine the question of the impact on the economy which will occur from more incentives toward investment—in effect, what will happen by moving the income tax closer to a consumption tax system.

On the spousal question—S. 94—I think we have several difficulties with it. First, of course, is what it does—it impacts on the tax burden of one-worker families as compared to the tax burden of two-worker families. There are many people who believe that the system is essentially biased in the other direction, that the two-worker family pays too high a tax today, and spending a substantial amount of money to lower the burden on one-worker families may be inconsistent with the feeling that the disparity is in the other direction.

Second, we think that given the figures on the utilization of IRA's, the most likely participants in this program will be those nonworking spouses where the family income is in excess of $50,000. Those people will certainly utilize it. These are the people who have utilized IRA's. Our estimates indicate that over 60 percent of the benefit of S. 94. would go to families with adjusted gross incomes of in excess of $30,000. Most low-income people have not participated in IRA's when they had an opportunity to do so—we estimate that 95 percent of those are eligible for IRA's who have incomes under $20,000 a year do not do so. There is no reason to believe that you would get a different utilization factor with a spousal arrangement.

Senator BENTSEN. Would you give us the figures as to how many IRA's have been formed each year since ERISA was passed? I think that would be helpful to us.

Mr. HALPERIN. We believe—our figures show approximately 2.5 million IRA's have been established this point.

Senator BENTSEN. Would you break it down by years so that we can get a feel for any trends for the record? I would appreciate that.

[The information to be furnished follows:]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

April 26, 1979

Dear Mr. Chairman:

Thank you again for the opportunity to appear before your Subcommittee at its April 3, 1979, hearings concerning certain employee retirement security matters.

You have requested information in two areas. First, you asked for figures on the number of IRAs formed since ERISA was passed. According to records available to us, the total number of IRAs reporting in 1975 was 1,278,314; this increased to 1,948,418 in 1976 and to 2,534,448 in 1977. These figures are based on the filings of IRS Form 5329 for 1975 through 1977.

Second, you requested information regarding the preparation of regulations to implement the new Simplified Employee Pension provisions added to the Internal Revenue Code by the Revenue Act of 1978. The Internal Revenue Service estimates that, taking into account the significant backlog of other regulations which must be completed, a notice of proposed rulemaking should be published early next year. We will, of course, work closely with the Internal Revenue Service in preparing the regulations and we will endeavor to publish the notice as soon as possible. In addition, as I mentioned on April 3, if individuals who are interested in Simplified Employee Pensions have specific questions or problems, we will attempt to answer these questions if the individuals will focus on particular issues in letters addressed to me.

I will be forwarding to you in the near future a discussion of Treasury's technical comments on S. 75 and the other bills which were the subject of the April 3, 1979, hearing. We will also be glad to answer any specific questions regarding the bills or our position on them which you or other members of the Subcommittee may have.

Sincerely yours,

Daniel I. Halperin

Daniel I. Halperin
Deputy Assistant Secretary
(Tax Legislation)

The Honorable
Lloyd Bentsen
Chairman, Subcommittee on
Private Pension Plans and
Employee Fringe Benefits
Committee on Finance
United States Senate
Washington, D.C. 20510

cc: Senator Robert Dole

Senator BENTSEN. We keep running into the question of complexity on ERISA. Do you not think the discrimination test with deduction limits that Treasury proposed regarding these various bills will end up passing the same complexity into IRA's?

Mr. HALPERIN. Well, there is no question that it is simpler without it. However, to the extent that we are operating through the employer, it will not be too difficult. I think we have been able to operate a qualified pension plan without an overwhelming number of questions as to eligibility. I think that what we are really talking about here is when an employee can deduct, or exclude from income, an amount of money that the employee has the choice to take in cash. I think if that kind of information can be determined at the employer level and imparted to the employee, we would have much less difficulty than we have with IRA's

I think the main reason why we run into trouble with IRA's is that people who are relatively unsophisticated and are not accustomed to making complex tax determinations on their own are out establishing their own IRA's. That is where we run into trouble.

I think it is much less likely that we will have trouble when employers are involved.

Senator BENTSEN. You know of my continued interest in trying to simplify ERISA and one of the priorities of this administration is to reduce unnecessary regulations. I was pleased that working with you last year for an expanded IRA, a simplified pension plan, that we adopted section 152 of the 1978 Revenue Act and that it had strong Treasury support, a lot of input, and I appreciated that help. But I received numerous inquiries about the status of the regulations implementing the expanded IRA. I would appreciate it if you would check with your counterparts in the IRS to see whether implementation of this pension simplification procedure can be expedited so that the public can understand where they are going on this thing.

Could you please report back in your written comments?

Mr. HALPERIN. Fine, Mr. Chairman.[1]

Let me make one suggestion. If people are interested in simplified plans and have particular problems that they feel need an immediate answer, we will do our best to expedite the regulations. But if it is possible to answer some specific questions on an immediate basis, we would certainly be willing to try to do that, if they could focus on these issues for us, or send me directly the particular issues that are troubling them. I will check and supply for the record our target on getting out the proposed regulations in this area.

Senator BENTSEN. Mr. Secretary, we are appreciative of your comments this morning.

Thank you very much.

Mr. HALPERIN. Thank you.

[The prepared statement of Mr. Halperin follows:]

[1] See p. 122.

STATEMENT OF
DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY OF
THE TREASURY (TAX LEGISLATION)

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear before you today to present the Treasury Department's views regarding additional tax incentives for savings by individuals as well as certain other retirement plan issues. It is our understanding that the Subcommittee is interested in the Department's reaction to four areas: tax deductions for employee contributions to qualified plans or for contributions to IRAs by those participating in such plans, deductible IRA contributions by spouses, revisions to the income tax treatment of lump sum distributions from plans and tax credits for small employers who establish qualified plans.

DEDUCTIBLE CONTRIBUTIONS BY ACTIVE PARTICIPANTS

S. 75, introduced by Senators Dole and Nelson, Section 203 of S. 209, introduced by Senators Williams and Javits, and S. 557, introduced by Senator Bentsen, would allow a deduction for employee contributions by active participants in employer-sponsored plans. Both S. 75 and S. 209 allow deductible contributions to be made by any participant earning below a specific level, with contributions by those earning above the safe harbor amount deductible only if the plan is nondiscriminatory.

B-1504

S. 557 would allow deductible contributions by any participant without regard to satisfaction of a nondiscrimination test.

We would first like to examine the basic objectives of these bills and to discuss certain general tax policy issues involved in achieving these objectives.

Present law allows employees who are not active participants in qualified plans to deduct up to $1,500 annually for contributions to an Individual Retirement Account (IRA). Denial of a deduction for IRA contributions by an employee who is an active participant in a qualified plan is based on the assumption that such employees do not need an IRA to provide for retirement. This assumption may not be in accord with the facts.

Some participants in an employer-sponsored plan will receive little or no benefit from the plan at retirement. These participants are in plans which provide minimal benefits either to all participants or to those in lower wage brackets; they are also in plans which provide deferred vesting which does not generate benefits for them because of frequent job changes. These employees will tend to oppose the establishment of qualified plans or will seek to opt out of such plans in favor of individual IRAs. We believe this interferes with the long-run goal of retirement security for all workers which can be better achieved through employer-sponsored plans. Thus, we are sympathetic to one of the objectives of these bills -- to reduce the attractiveness of IRAs to those who have an option to participate in an employer plan.

We agree that any narrowly targeted solution to this dilemma will be either intolerably complex or inequitable. For example, the small benefit problem could be alleviated by allowing participants to "make up" the difference between the employer contribution on their behalf and the maximum deductible IRA contribution they could make. The difficulty here is that any attempt to determine the amount an employer contributes on behalf of an employee under many types of defined benefit plans either will be extremely complex or will involve rough approximations which may not be equitable. While it is less burdensome to determine the amounts allocated to a participant under a defined contribution plan, limiting the availability of "make up" IRAs only to participants in defined contribution plans would be an unacceptable distinction on grounds of equity and would be a further preference for defined contribution plans which we believe to be less able to provide adequately for retirement.

Further, any attempt to provide for deductible contributions while a participant has no vested interest could lead to pressure from long service employees for a slower vesting schedule, which is obviously contrary to the goals of ERISA.

Since it is not feasible to narrowly focus on those participants who will eventually receive little or no benefit from the qualified plan, we need to examine a more far-reaching approach: encouragement and broadening of retirement savings in general.

We support the objective of broadening retirement savings, but we continue to insist that there must be adequate assurance of nondiscriminatory coverage and benefits. Nondiscrimination in the enjoyment of tax benefits associated with savings for retirement is essential.

Under an income tax, income is subject to tax when earned, whether it is consumed immediately or put aside for a rainier day. Tax incentives for retirement savings work to defer tax until income is spent, presumably after retirement. This departure from the goal of a progressive income tax system can only be justified as a means of furthering nontax social policy goals. In this case, we believe the goal is the assurance that employees at all levels of compensation will be provided with retirement protection, protection which is particularly difficult to plan and save for at low income levels. As evidence of this goal, favorable tax treatment is generally allowed only if contributions or benefits provided by employer contributions do not discriminate in favor of officers, shareholders and highly compensated employees.

Without this nondiscrminiation requirement the tax system is ill-equipped to provide for those with low or moderate income. The higher a taxpayer's income, the greater the benefits of favorable tax treatment. Thus, the absence of a requirement that low-income employees receive benefits under a tax-favored program leads, quite logically, to unequal utilization of the tax benefit. This result is dramatically illustrated by the most recent figures available regarding the utilization of the current IRA deduction. Treasury estimates that of employees able to utilize an IRA in 1977, over 52 percent of those with adjusted gross income of $50,000 or more did so, while the average utilization rate was was under five percent for those with $20,000 or less of adjusted gross income. (Tables 1 and 2.)

In turning now to the specific proposals to be considered today, we will approach each bill on the assumption that it will be acceptable only if low paid workers--those who are most in need of retirement savings as well as least able to plan and save for retirement--actually participate in substantial numbers.

S. 557 - Deductions by Any Active Participant

As noted above, S. 557 allows an active participant to make a deductible contribution to a qualified plan or to an IRA. The deductible limit is the lesser of 15 percent of compensation or $1,500, the same as the current limits on contributions to IRAs. S. 557 would not apply to participants in government plans or to employees of tax-exempt organizations who participate in salary reduction tax sheltered annuity plans.

Although we acknowledge that S. 557 would probably encourage some additional retirement savings, we believe it does not pass the test set out above that it be designed to assure or encourage savings by relatively low-paid workers.

As noted above, utilization of tax benefits increases at higher income levels since the benefit of a deduction is greater as income increases. Since the tax benefit for high paid employees is not predicated on substantial savings by other employees, we believe the effect of S. 557 will be much like that of the current IRA--utilization at income levels above $50,000 will be more than 10 times ~~higher~~ than utilization at levels of $20,000 or less. Moreover, there are proportionally more active participants than nonparticipants among those at high income levels. Therefore, we oppose S. 557.

S. 75 and Section 203 of S. 209: Deductions by All Active Participants, Subject to an Antidiscrimination Test for High Paid Employees

S. 75 and Section 203 of S. 209 would allow active participants earning below a specified level to make deductible contributions of up to $1,000 to their employer's plan or to an IRA, while participants above the specified income level will be allowed a deduction for contributions only if contributions are also made, on a nondiscriminatory basis, by employees earning lesser amounts.

Under S. 75, the specified pay level is Step 1 of GS-14, which is currently $32,442; under S. 209, the level is Step 1 of GS-12, currently $23,087. In addition, each bill allows into the safe harbor those earning above the specified income level if their compensation is within the lower two-thirds of all participants.

This approach raises the following issues:

(i) Assuming a nondiscrimination test is to be applied to the allowance of deductions for high-income individuals, does it make sense to waive the test for those at lower income levels?

(ii) If so, how should the cut-off point be determined?

(iii) What criteria should be utilized in developing a staisfactory test of nondiscrimination?

Determining the Cut-off Point

As indicated above, a tax deduction for retirement savings is much more likely to impact on those at high-income levels who have both the ability to save and significant tax savings from doing so. The lower income group will be covered in qualified plans not necessarily in response to the tax savings offered to them alone but because it is essential to do so in order for the high-income group to obtain their tax savings.

The non-discrimination test is thus aimed at the behavior of high income employees and there may be no need to apply it to the lower paid. Withholding tax benefits from the top one-third, unless there is nondiscriminatory coverage, may be sufficient incentive to assure the widespread participation we seek. Setting the cut-off point based upon income level can only be acceptable if this type of incentive remains.

We estimate that over 96 percent of all employees in the United States have salaries and wages of $32,000 or less, and that over 94 percent have salaries and wages of $23,000 or less.* Based on these statistics, we believe the presently proposed safe harbors are too high. Since most of the population would be able to take advantage of the tax break without regard to participation by others there will be little encouragement of savings by workers in

* These figures include government employees.

the lowest paid group which is the goal of the favorable tax treatment. Moreover, we are concerned with the effect on tax equity if the safe harbor level is as high as $32,000. Our experience with IRA utilization levels indicates that the preponderance of use will be among those at the top of the eligible group. While people at that income level are certainly not rich they are in the top 4 percent of all earners and it is difficult to support what amounts to a tax deduction for this group and not to those earning less.

Thus, we are not willing to support a safe harbor unless it is targeted to a much smaller group; those employees who are most in need of encouragement to save for retirement. Our statistics show that over 75 percent of all workers (including government employees) would be covered by a safe harbor of $15,000. We believe a safe harbor in this general area would allow significant numbers of employees to take advantage of favorable tax treatment for retirement savings while maintaining the incentive for widespread coverage and limiting the disproportionate utilization of the tax benefit by higher paid employees.

With respect to those above this level, an antidiscrmination test is essential to permit them to deduct their contributions. If such a test is believed to be difficult to administer, we could limit the deductibility of contributions to only those earning at or below the safe harbor level. However, if we assume that allowing deductible contributions by higher paid employees when an antidiscrimination test is met will have the effect of giving these employees an incentive to encourage savings by low-paid employees, then an antidiscrimination test should be included in the bill in order to achieve a wider breadth of savings.

Testing for Discrimination

Under current law and administrative practice, an equal dollar for dollar comparison is not necessary to satisfy the antidiscrimination requirements of qualified pension plans. For example, in defined contribution plans, the rule is that employer contributions which are allocated to participants' accounts are acceptable if they are equivalent as a percentage of compensation. S. 75 and S. 209 test for discrimination by comparing the level of contributions for all highly compensated employees as a group with the contribution level of all other employees. However, even within this approach, S. 75 and S. 209 depart from the general standard of equality and allow greater percentage contributions for highly compensated employees than are made by the remaining individuals. We recognize that some exceptions are allowed from the equal percentage test of equality as, for example, under the provisions allowing a defined contribution plan to be "integrated" with the employer's Social Security contributions. We also note that the antidiscrimination tests reflected in S. 75 and S. 209 are adopted from the test for cash or deferred profit sharing plans added to the Code by the Revenue Act of 1978. However, we do not believe it is necessarily appropriate to incorporate these tests in the area of deductible employee contributions to qualified plans.

The tests adopted for cash or deferred profit-sharing plans reflect in part the historical background of such plans. Under Internal Revenue Service rulings, cash or deferred plans were deemed acceptable if one-half of the contributions to the plan come from the bottom two-thirds of employees. This allowed the top one-third of employees to contribute twice as much as the average contribution from the bottom two-thirds. In order to revise these rules, it was necessary to effect a compromise measurement of discrimination, and this compromise is reflected in the 1978 Act provision.

Furthermore, we believe it is clearly inappropriate to measure limited contributions made by an employee as a percentage of his or her total compensation. Limiting deductible employee contributions to the lesser of 10 percent of compensation or $1,000 reflects an intent to focus on replacement of the first $10,000 of earnings. A substantial limit on contributions without a limit on the salary taken into account for the computation is inconsistent with this purpose since it results in high-paid employees making the maximum deductible contribution without generating a significant contribution for low-paid employees. For example, a $100 contribution for an individual earning $10,000 would permit the maximum $1,000 contribution for an individual earning $100,000.

If an antidiscrimination test based on compensation is used, the appropriate measurement is one which limits the compensation taken into account to the level which permits the maximum dollar amount of contributions. Therefore, in S. 75 and S. 209, the deferral should be determined on the basis of an employee's compensation up to $10,000.

Contributory Plans

Once the appropriate safe harbor level and antidiscrimination test are determined, the most significant remaining issue is the treatment of employee contributions to plans under which employer contributions, or benefits derived from employer contributions, are geared to contributions by employees. We refer to these plans as "contributory."

Under Section 203 of S. 209, deductibility of employee contributions to contributory plans would be limited to plans in effect on January 1, 1978; under S. 75, all contributory plans, including those established after enactment, would be acceptable vehicles for deductible employee contributions.

We have a number of concerns relating to allowing deductible contributions to contributory plans.

First, there will be a substantial revenue loss attributable to contributory plan deductions without a corresponding increase in savings. For example, of the $1.1 billion revenue loss we estimate for S. 557 in the current calendar year, the largest portion--about $850 million--will be for employee contributions which are currently made on a nondeductible basis.

We are also concerned that allowing deductions for contributions to these plans will encourage their establishment, and that this may lead to a potential loss of retirement security for low paid workers. While we know of no detailed study, it is reasonable to believe that the level of participation in contributory plans among eligible employees increases as income rises. We do not believe that any of the arguments advanced in favor of contributory plans are forceful enough to justify them if, in fact, they deviate from the overall goal of retirement security.

In this connection, we would like to review four areas of the Internal Revenue Code applicable to contributory plans, which we believe should be considered.

First, a contributory plan may take advantage of a special safe harbor arithmetical test available for determining whether its coverage meets the minimum requirements of the Code. This test allows a plan to meet the coverage requirements if at least 70 percent of all employees who have met the plan's minimum age and service requirements are eligible to participate and 80 percent of the employees who are eligible do participate. For example, if 100 employees have met a plan's age and service requirements for eligibility, then only 70 employees actually must be eligible to participate, and only 80 percent of those employees--or 56 individuals--need to participate to satisfy this test.

If a plan does not meet the arithmetical safe harbor coverage tests, then it may still satisfy the minimum participation requirements by satisfying what is referred to as a fair cross section test. Under this test, the employer may show that the plan covers employees in all compensation ranges and that those in the middle and lower brackets are covered in more than nominal numbers. We believe that a plan which covers only the top 55 percent of employees would not satisfy the fair cross section test; thus it seems incongrous that a plan which covers only one more percent may satisfy the arithmetical test.

Second, the Code requires that a plan must provide for vesting in employer contributions at a rate or rates which satisfy certain tests based on an employee's years of service (or a combination of age and years of service.) However, service with an employer during a period in which an employee was eligible to make contributions to a contributory plan but did not contribute may be excluded in determining an employee's years of service for vesting purposes. Thus, to the extent an employee is prevented by outside economic pressures from participating in a plan, he or she will lose not only the employer derived benefits attributable to his or her contributions for that period but also vesting credit for service with the employer which may affect the employee's entitlement to employer benefits for those periods he or she is able to contribute.

Third, the rules relating to the allocation of a participant's accrued benefit between the portion derived from employee contributions and the portion derived from employer contributions in a contributory plan are often extremely unfair to younger participants. The Code generally requires that an employee's accrued benefit must grow at an equal or near equal rate for each year he or she is credited with service under a plan. However, ratable accrual focuses on the total accrued benefit of the participant under the plan. In effect, allocation of employer- and employee-derived benefits based on a participant's total benefit defeats the equal accrual rate requirement since the employer derived portion of a benefit may not be significant until a participant nears retirement age. A younger employee may be entitled merely to the return of his or her own contributions.

Fourth, a plan may provide that a participant who withdraws his or her contributions from a contributory plan will forfeit the employer benefit attributable to those contributions. Although ERISA denies this forfeiture once a participant has a 50 percent vested interest in employer contributions, the forfeiture provision may still work a substantial hardship on the withdrawing employee.

These rules lead us to two conclusions. First, it seems that contributory plans may be suspect as a means of avoiding many of the participant protections provided by ERISA. Second, since low-paid employees are most likely to be subject to significant outside economic pressures which will interfere with their ability to make contributions to a plan, we believe these employees are most likely to be adversely affected by the encouragement and continuation of contributory plans. Accordingly, we would prefer to limit the deductibility of employee contributions to those made on a voluntary basis, that is, employee contributions which do not generate employer contributions or benefits.

Mechanism for Employee Contributions

Finally, we would also like to comment on the issue of how employee contributions should be handled. Under S. 75 and Section 203 of S. 209, an employee may contribute either to an IRA or to his or her employer's qualified plan. It is not clear whether it is intended that an employee's contributions to an IRA may be taken into account in determining whether the employer's plan satisfies the nondiscrimination tests.

If an approach to the general issue of deductible contributions is adopted which does not involve an anti-discrimination test, we have no objection to allowing employees to contribute directly to IRAs without employer involvement. However, if an antidiscrimination test is adopted, then we believe that employee-established IRAs should not be counted in determining whether the anti-discrimination test is met, unless there is some way of checking on the IRAs both by the employer and by the IRS. If an acceptable mechanism can be established for certifying and verifying "outside IRAs" we would have no objection to this approach.

DEDUCTIBLE IRA CONTRIBUTIONS BY SPOUSES

S. 94 is concerned with a different aspect of retirement security than S. 75, Section 203 of S. 209 or S. 557. S. 94 is concerned with the security of a spouse who either does not work outside the home or earns less than $10,000 per year from such work. It would allow the spouse of an employee to make deductible contributions to an IRA based upon compensation equal to his or her spouse's compensation.

The bill would also repeal the current spousal IRA provisions of the Internal Revenue Code which allow up to a $1,750 deduction by an employee if equal contributions are made on behalf of the employee and his or her nonemployee spouse.

Treasury estimates the revenue loss of S. 94 would be $336 million for the current calendar year, rising to over $1 billion by 1984.

Although we recognize the goal of extending tax favored retirement savings to spouses, we believe the utilization of these IRA deductions would be similar to the utilization under current law which, as noted above, is over 52 percent for employees with more than $50,000 of adjusted gross income and less than 5 percent where adjusted gross income is below $20,000. In addition, there are many who believe that the two-worker family is overtaxed as compared to the one-worker family or unmarrieds living together. Therefore, we do not feel tax equity necessarily would be served by allowing up to a $3,000 IRA deduction for married persons in one-worker families outside the context of an overall solution to the relative tax burden of married and single persons. For these reasons, we oppose S. 94.

REVISIONS TO LUMP SUM DISTRIBUTION RULES

Section 201 of S. 209 modifies the aggregation rules contained in the Internal Revenue Code relating to the special tax treatment given lump sum payments from qualified plans. In general, the aggregation rules require that the balance to the credit of an employee must be paid from all deferred compensation plans required to be aggregated, or no lump sum treatment is possible. Generally, the present law requires the aggregation of all pension type plans and the separate aggregation of all profit sharing type plans. In the case of multiemployer plans, the bill would divide the various plan forms into defined benefit plans and defined contribtuion plans. In all other cases, the bill retains the present law, i.e., a division between pension types and profit sharing types. The significant change under the rules contained in the bill is that a defined contribution money purchase pension plan will not have to be aggregated with a defined benefit pension plan if they are both multiemployer plans.

Treasury is not opposed to this change. However, we believe that lump sum treatment should depend upon an aggregation of qualified plans of all types. Thus, we would favor the computation of tax, in the case of a lump sum distribution from one class of plan, as if the value of benefits held in all other classes had already been distributed. The effect of this would be to apply a higher rate of tax to a lump sum distribution if a benefit is being held in another type of plan for later distribution.

Section 202 of S. 209 addresses the question of the status of an employee covered by a multiemployer plan who terminates his service for one of the contributing employers. The bill provides that when the employee has not worked (for any employer) in service covered by the plan for six months after severing his employment relationship with a participating employer, he will be deemed to have separated from service, and thus be eligible for a lump sum distribution.

Treasury supports the amendment.

TAX CREDITS FOR ESTABLISHING PLANS

Section 204 of S. 209 provides a tax credit for "small business employers," both corporations and unincorporated businesses or partnerships, equal to a portion of the deductible contributions they make to newly established qualified retirement plans. The credit begins at 5 percent of the deductible plan contribution, and ends at 1 percent in the fifth year after the plan is established. No credit is allowed for contributions of employer securities to the plan, or apparently for cash contributions to the extent the cash is used to acquire employer securities.

For purposes of qualifying for the credit, a "small business employer" is an incorporated or unincorporated business with a monthly average of fewer than 100 employees in the year before the first credit year, and with earnings and profits (or in the unincorporated case, net profits) not greater than $50,000 in the year before the first credit year. Although no credit is allowable under the bill for any taxable year in which a qualified plan is terminated, there is no limitation on the credit if a qualified plan is terminated and a "new" plan is established in the next taxable year.

As we have previously testified,* we share the desire reflected in this provision of S. 209 to expand the coverage of the private pension system. Based on currently available statistics, we estimate that not much more than one-half of the nation's labor force is now covered under the private pension system, and we believe that employees working for small employers tend to be among those who are least likely to be covered. However, there is not to our knowledge sufficient information regarding both the numbers of employees who are not covered by plans and the reasons for their exclusion from the private pension system to determine if an additional tax incentive can be targeted so that it will increase coverage without providing a windfall to employers or an unreasonably large revenue cost.

We are currently working with the Internal Revenue Service in an effort to analyze the group of taxpayers who neither maintain an IRA or participate in a qualified plan. We are, in addition, soliciting the information which may be available at national accounting and consulting firms regarding

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* February 6, 1979, before the Senate Human Resources Committee.

coverage and exclusions from coverage as well as demographic information concerning the American work force. We also understand that the President's Commission on Pension Policy and the Office of Planning Policy and Research in the Department of Labor will be studying the coverage and noncoverage of employees during 1979 and 1980.

Without clearer information as to the gap in coverage of employees and the portions of the gap which could be affected by new incentives, we cannot evaluate the appropriateness of Section 204 of S. 209. We feel it is premature to act now on such a proposal. With the information our studies and those being conducted by other agencies and Congressional staffs will provide, perhaps an efficient system of incentives which is narrowly targeted to expand coverage under the private pension system will be possible.

Mr. Chairman, that concludes my formal testimony. I would be pleased to answer any questions the Subcommittee may have.

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Table 1

Individual Retirement Accounts, 1977:
Estimate of Utilization Rate by Income Class

Adjusted gross income class	Number of returns with salaries and wages 1/	Estimated number of taxpayers with salaries and wages 2/	Estimated number of taxpayers eligible to use IRAs 3/	Estimated number of IRAs 4/	Utilization rate
($000)	(.................. Numbers in millions			..................)	(.. percent .)
0 - 5	20.1	20.7	17.6	0.04	0.2%
5 - 10	16.5	19.0	13.3	0.18	1.4
10 - 15	13.0	17.5	10.5	0.35	3.3
15 - 20	10.7	16.3	7.4	0.40	5.4
20 - 50	15.8	24.9	6.2	1.35	21.8
50 and over	1.1	1.4	0.4	0.21	52.5
Total	77.2	99.8	55.4	2.53	4.6%

Office of the Secretary of the Treasury
Office of Tax Analysis

March 27, 1979

1/ Unpublished data from 1977 tax returns.

2/ Includes 2 spouses when both have salaries and wages.

3/ Excludes persons covered by public or private retirement systems.

4/ Allows for 2 individual retirement accounts on some returns. Based on number of Forms 5329 filed. Some of these accounts received no deductible contributions during 1977.

Table 2

Individual Retirement Accounts, 1976:
Estimate of Utilization Rate by Income Class

Adjusted gross income class	Number of returns with salaries and wages 1/	Estimated number of taxpayers with salaries and wages 2/	Estimated number of taxpayers eligible to use IRAs 3/	Estimated number of IRAs 4/	Utilization rate
($000)	(.................. Number in millions			....................)	(.. percent ..)
0 - 5	20.3	21.2	17.1	.04	0.22
5 - 10	17.3	20.6	13.5	.19	1.4
10 - 15	13.4	19.1	11.8	.30	2.5
15 - 20	10.6	15.7	6.5	.34	5.2
20 - 50	12.9	18.6	6.1	.90	14.8
50 and over	0.9	1.2	0.4	.18	45.0
Total	75.4	96.4	55.4	1.95	3.5

Office of the Secretary of the Treasury
Office of Tax Analysis

February 16, 1978

1/ Unpublished data from 1976 tax returns.

2/ Includes 2 spouses when both have salaries and wages.

3/ Excludes persons covered by public or private retirement systems.

4/ Allows for 2 individual retirement accounts on some returns. Based on number of Forms 5329 filed.

Senator BENTSEN. Our next witness is Mr. Michael Klein, Price Waterhouse & Co.

STATEMENT OF MICHAEL KLEIN, PRICE WATERHOUSE & CO.

Mr. KLEIN. Thank you, Mr. Chairman. It is a pleasure to be here this morning. I have a written statement that I would like to submit for the record.

Senator BENTSEN. We would be pleased to have it in its entirety.

Mr. KLEIN. My remarks will be concentrated on the question of whether special antidiscrimination tests of the type that we see in S. 75 and S. 209 are workable or if they are even necessary. I think, before I go into that, it is important to understand that there are really three very different arrangements whereby employees can contribute to qualified plans and these special nondiscrimination tests would impact these deferred arrangements in diverse ways.

The first arrangement is a mandatory contribution whereby the plan requires that each employee contribute 3 to 4 percent of pay, whatever it may be.

The second is the matching type of plan, the thrift or savings plan whereby an employee can select from a range of contributions from 1 percent to 6 percent of pay, for example, and the employer's contribution to the plan will be geared to the amount the employee contributes. So what the employee contributes directly affects what the employer contributes.

Third, there is the purely voluntary contribution plan whereby an employee is permitted, but not required, to contribute and whether he contributes or not has no effect whatsoever on the employer contribution. It is very common to find that in profit-sharing plans where 10 percent of pay can be contributed.

Looking at the special nondiscrimination tests in S. 75 and S. 209, the basic difficulty, at least for the matching plans and the voluntary plans, is that these are not retrospective tests and an employer really cannot say with any precision, until that plan year is over, whether an employee's contributions are deductible or not.

But, you see, what an employer wants to do is to say to an employee at the beginning of the year: "Here are the rules as to whether your contributions are tax deductible." Remember, these contributions are often made through payroll withholding. It is an important factor in an employee's decision to contribute or not, whether his contributions are going to be tax deductible.

The difficulty is, in large measure, these limitations are retrospective. You do not know until the plan year is over.

Senator BENTSEN. You do not know because you do not have the participation at the lower salaries?

Mr. KLEIN. The problem comes about with employees whose compensation hovers around the safe harbors of a GS-12 or GS-14 pay level. Yes, it is true that for an employee who will clearly make less than a GS-12 or GS-14 salary during the year, an employer can say with reasonable confidence: "Your contributions, if you make them, will be tax deductible up to $1,000 or 10 percent of pay."

A lot of plans will have a group of employees whose compensation may or may not exceed the GS-12 or GS-14 pay level. You really do not know at the beginning of the year; a lot of things can happen. You can have commissions, overtime, bonuses, pay raises during the year.

Furthermore, the GS-12, GS-14 salary levels are a moving target; they are likely to change during the plan year and the bills fail to specify whether we are talking about a GS-12 orGS-14 salary at the beginning of the plan year, end of the plan year, or some other date during the plan year.

So it is a very iffy thing for that group of employees. The employer has to say if it turns out that you earned less than the GS-12 or GS-14 pay level, your contributions are deductible. If you earn more than that level, they may still be deductible if it turns out that you are among the two-thirds lowest paid group.

We do not know that for sure until the end of the year. If it turns out that you are in the one-third highest paid group your contributions may still be tax deductible. We cannot tell that until we have made all of these deferral percentage computations. There is the difficulty.

Furthermore, it would be a mistake to think that an employee who earns more than a GS-12 or GS-14 is almost surely going to be into the one-third highest paid group. I think that is true as a general proposition, but take an example of a professional medical corporation that has five doctors and four nurses in the plan. Under those circumstances, three of those doctors are going to be in the one-third highest paid groups; two of them are going to be in the two-thirds lowest paid group. Those two can contribute and take their deductions without question. The other three will have to meet the test, and there may be very narrow compensation differences between all five of those doctors, and a wide range between the doctors and the nurses. That is the sort of thing that happens with tests of this type.

A further complicating factor is that the contribution, at an employee's option, could go to an IRA rather to the qualified plan. That could very well happen in the case of plans which permit purely voluntary employee contributions, because an employee may say I will rather have an IRA, or I will put my money into a savings account rather than put it into your plan where it will go into the stock market and I am afraid of the stock market.

You will find in purely voluntary contribution plans some employees contributing to IRA's rather than to the qualified plan and it would seem from the bills that those contributions have to be taken into account, the IRA contributions, in making all of these nondiscrimination test computations.

How is the employer supposed to know what employees have contributed to IRA's for this purpose?

Furthermore, in the case—you will find many cases of employers who maintain only a noncontributory plan. Perhaps the employer only has a noncontributory defined benefit pension plan. In that case, contributions, by necessity, would have to go to IRA's.

It would seem from S. 75 and S. 209 that the higher compensated employees would only be able to deduct those IRA contributions if the nondiscrimination tests were met, which again requires the employer to get involved in all of these mathematical computations.

There is further difficulty if a highly compensated employee makes a contribution to an IRA and it turns out after the fact that the nondiscrimination tests are not met. Then that employee would have made an excess contribution to the IRA that he would have to withdraw from the IRA within a limited period of time or suffer a penalty.

And I suggest administering that sort of situation, where the contribution can be made but you do not know until the end of the year whether it is good or not, and if it is not good, it has to be withdrawn, would be a very hard thing for IRS to administer.

Then there is the difficulty with the matter of plan year versus the employee's taxable year. It seems clear from the bills that the 10 percent, $1,000 limits on the contributions would be based on the employee's taxable year, but the deferral percentage computations, the nondiscrimination tests, are based on the plan year, and plan years and taxable years differ very often.

The bills say nothing about how to associate a particular contribution with either a particular taxable year or a particular plan year. A contribution is made in January. Does that relate to the employee's taxable year that just ended, and what plan year does it relate to?

For example, the employer's plan year is a June 30 year. If we assume the contribution when made is associated with the plan year or taxable year in which made, then contributions July through December would have to be deductible on the employee's tax return for the taxable year then ended. He has to file his return in April. The nondiscrimination computations cannot be made until after June 30 when the plan year ends, so he has to contribute before he can know whether it is deductible or not.

Mr. Chairman, those are simply some of—and there are others in the written paper—some of the implementation problems that I can see in trying to administer antidiscrimination tests of this type.

Since I know I am running out of time, I would like to say one thing about whether any special nondiscrimination tests are necessary at all in this area.

Senator BENTSEN. Why do you not summarize?

Mr. KLEIN. I think what has to be focused on with regard to nondiscrimination, is that there is a difference—a real difference—between employee contributions and employer contributions, particularly when you are dealing with matching plans or voluntary contribution plans. An employer contribution, we all understand, cannot discriminate in favor of the highly paid—that is universally accepted.

When we get to employee contributions, you are dealing with the decisions of individuals regarding what to do with their own money. To save, or not to save.

I question whether the ability of a highly-compensated employee to deduct or not to deduct his contribution should be held hostage to the mathematical average of a lot of savings decisions of the lower paid employees in a particular plan. Executive X earning $50,000 in Company A when all the tests are made can deduct his contribution. Executive Y earning $50,000 in Company B when all the tests are made there cannot deduct his contribution.

I submit that that is simply not a sensible application of the nondiscrimination rules.

Senator BENTSEN. I think that is the heart of the argument there and that is where the major policy decision rests.

Do you have any comments, Senator Dole?

Senator DOLE. I do not have any comments.

Senator BENTSEN. I have no further comments, Mr. Klein.

Mr. KLEIN. Thank you, Mr. Chairman.

Senator BENTSEN. Thank you.

[The prepared statement of Mr. Klein follows:]

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STATEMENT OF MICHAEL F. KLEIN, JR.

My name is Michael F. Klein, Jr., and I am a partner in the firm of Price Waterhouse & Co. I am pleased to have this opportunity to appear before you today to discuss the important matter of providing tax deductions for employee contributions to qualified plans.

My prepared remarks will be devoted to the question of whether special nondiscrimination rules are either necessary or practical in connection with according tax deductions to limited amounts of employee contributions.

In discussing that question, I believe it is important to distinguish between the various types of contributory features which are found in qualified plans today. Special nondiscrimination rules such as those contained in S. 75 and S. 209 can impact the different types of contributory features in significantly different ways.

We are all familiar with the concepts of mandatory and voluntary employee contributions to tax-qualified plans. But those terms "mandatory" and "voluntary" are not totally descriptive of the full range of employee contribution options which are possible under present law in structuring plans.

There are really four differing employee contribution arrangements, which I would label as: (1) mandatory contributions under mandatory plans, (2) mandatory contributions under voluntary participation plans, (3) matching plans, and (4) pure voluntary contribution plans.

Mandatory contributions under mandatory plans

These arrangements are infrequently encountered today, in my experience. A good example would be a defined benefit pension plan which required employee contributions, and every employee is required to participate in the plan as a condition of employment.

Mandatory contributions under voluntary plans

Mandatory contributions to defined benefit pension plans are also an example of this type of arrangement, but the difference is that no employee is required to join the plan as a condition of employment. Another example would be a profit sharing plan which requires an employee contribution as a prerequisite for participation, but employees are not required to participate in the plan.

Matching plan

These are the thrift or savings plans, under which participating employees can elect a contribution rate from a range stated in the plan--from 1 percent to 6 percent of pay, for example--and the employer's contribution to the plan is geared to the employee's contribution. The employer contribution might be the same amount as that contributed by the employee, or one-half the employee's contribution, or some other matching formula. The key factor is that the more an employee contributes to the plan, the more the employer will contribute on behalf of that employee.

Pure voluntary contribution plans

These are plans under which an employee is permitted but not required to contribute, and whether or not an employee makes any contribution will have no effect on the amount of the employer contribution on that employee's behalf. It is common for profit sharing plans to permit employee contributions on this basis, up to 10 percent of pay. To a lesser extent, some defined benefit pension plans sometimes permit optional employee contributions, with those contributions accumulating in a separate account for each contributing employee.

Nondiscrimination - in general

S. 75, S. 209, and S. 557 all would permit tax deductible employee contributions to either qualified plans, or to IRAs even though the employee is an active participant in a qualified plan. S. 75 and S. 209 would limit the maximum deductible employee contribution to the lesser of 10 percent of compensation or $1,000, whereas S. 557 would adopt the present IRA limits of 15 percent of compensation or $1,500, whichever is less.

S. 557 would not impose any new nondiscrimination rules. S. 75 and S. 209, however, would impose substantially identical new rules designed to allow deductions to highly-compensated employees, as defined, only if there are significant contributions by the lower-paid employee group. That is true regardless of whether the employee contributions are made to a qualified plan or to an IRA.

Failure to satisfy these new nondiscrimination rules would not disqualify the plan, nor would it preclude the lower-paid employees from deducting their contributions.

These rules were lifted in the main from the nondiscrimination rules which appear in Section 401(k) of the Code, dealing with cash or deferred plans, which were added by the Revenue Act of 1978.

As in the case of Section 401(k), the new nondiscrimination rules would require stratifying plan participants as between the highest paid one-third and the lower paid two-thirds of the plan population. However, both S. 75 and S. 209 would modify the Section 401(k) approach by providing that a participant who is in the highest paid one-third group nevertheless will not be regarded as highly compensated if his or her compensation is less than the salary of a U.S. government employee at a stipulated GS pay level.

The only difference between the nondiscrimination rules in S. 75 and S. 209 lies in the pay level selected. S. 75 uses step (1) of grade GS-14, which is a salary of about $32,500 for 1979. S. 209 uses step (1) of grade GS-12 which is a salary of about $23,000 for 1979.

Once the identity of the highly-compensated participants has been determined, it would be necessary to compute, after the end of the plan year, the "deferral percentage" for each participant. The deferral percentage is the relationship between a participant's contributions (up to the $1,000/10 percent limit) and his or her total compensation for the plan year.

These individually computed deferral percentages are then averaged out for the highly-compensated group, and for the lower-paid group. The nondiscrimination test is met only if the average deferral percentage for the higher-paid group does not exceed that of the lower-paid group by a margin greater than those permitted under two alternative tests specified in the statute.

Administrative complexities

It all sounds very complicated, and it is. Unfortunately, to actually administer these provisions would be even more troubesome than it might appear at first blush. Permit me to elaborate on that point, because I think it is crucial in determining whether nondiscrimination provisions of this type should reasonably be required.

The basic difficulty is that in matching or purely voluntary contribution plans, an employer wants to be able to tell its employees in advance whether and to what extent their contributions will be tax deductible. That will influence an employee's contribution decision. In most cases, the contributions will be made through payroll withholding over the entire year.

But what would an employer know at the beginning of the plan year? All it can do is roughly stratify its plan participants into three groups:

1. Those who clearly will earn less than the GS-12 or 14 (whichever is applicable) salary level.
2. Those who may or may not exceed the GS-12 or 14 salary level.
3. Those who almost certainly will exceed the GS-12 or 14 salary level.

Only the employees in the first group could be advised with any confidence that they could contribute the lesser of $1,000 or 10 percent of compensation on a tax deductible basis.

The second group, those who may or may not exceed the GS-12 or 14 salary level, can be a larger group in many companies than might be thought possible. There are numerous factors which can cause an employee's total compensation to fluctuate during a plan year to a degree that makes it difficult to predict whether a certain salary level might be exceeded. These include: overtime, pay raises during the year, bonuses, commissions, and similar variables. Moreover, some increase in U.S. government salary levels during a plan year is likely. The bills fail to specify whether the GS-12 or 14 salary level is that existing at the beginning of the plan year, the end of the plan year, or some other date. That of course is a technical point which could be corrected.

In any event, an employee in this group could only be told that if in fact, after the plan year is over, his total compensation is less than the appropriate GS level, he will be entitled to his deduction. If not, he will still be entitled to his deduction if it turns out that he was among the lowest two-thirds of the participants in terms of pay. That of course can't be definitely determined until the plan year is over. And even if it turns out that he is among the highest paid one-third, he may still be entitled to his deduction if it is determined that the deferral percentage test has been met.

It might be thought that a person whose compensation exceeds the GS-14 step (1) level (about $32,500 for 1979) would almost certainly be in the highest paid one-third group. While that would probably be true as a general proposition, there would likely be many exceptions.

Consider for example the plan of a medical professional corporation, which has nine participants--six doctors and three nurses. Three of those doctors will end up as the highest paid one-third and two of them will be in the lowest paid two-thirds. Those two would be able to deduct their $1,000 contributions and the other three might not be able to--although the actual compensation differences among them could be quite small. I suggest that result doesn't make a great deal of sense.

• My discussion thus far has assumed that all employee contributions intended to be tax deductible are made to the qualified plan. But employees can choose, under the bills, to contribute to IRAs instead. And that could happen under purely voluntary contribution plans, where some employees might prefer a bank certificate of deposit through an IRA to the investment fund offered under the plan.

Although each participant's deferral percentage would not normally be difficult for an employer to determine if all contributions are to the qualified plan, how would an employer know with any assurance what amounts employees may have contributed to IRAs? And yet it is clear that in order to make the certification of compliance with the nondiscrimination standards which the bills would require, an employer would somehow have to know and include in its calculations any amounts contributed to IRAs.

In cases where an employer maintains only noncontributory qualified plans, all employee contributions would have to go to IRAs. It is only reasonable to presume that, were S. 75 or S. 209 enacted, there would be strong employee pressures for employers to make the required nondiscrimination certification so that IRA contributions could be made. That would involve the employer in the same payroll stratification and deferral percentage computations as if it maintained a noncontributory plan, except that the necessary information would be harder to come by.

Unlike S. 3017 which was introduced in the last session, none of the present bills would require any plan sponsor to make its plans contributory. That is commendable, since there are many valid considerations which may cause plan sponsors--particularly those who maintain only defined benefit pension plans--not to want to open their plans to employee contributions.

But because of the IRA potential, it would be a mistake to believe that S. 75 and S. 209 would not involve employers who maintain only noncontributory plans in the computational and administrative problems I have noted.

An additional complication is that employees who contribute to IRAs and later learn, after the fact, that they are in the highly-compensated group and the nondiscrimination tests have not been met, will have made excess contributions which must be withdrawn. Failure to withdraw in timely fashion can lead to penalties. It seems to me that administering this situation would be difficult for all concerned, including the Internal Revenue Service.

Time for making contributions

It is clear under the bills that the nondiscrimination test is to be performed with regard to the plan year, and that the 10 percent of compensation/$1,000 limits are to be applied on the basis of the employee's taxable year. But the bills fail to provide any rule for identifying the time at which the employee contribution is made with the plan year or employee's taxable year to which it applies.

For example, if an employee makes a contribution in January, 1981 would it be deductible on his 1980 return or his 1981 return? And what plan year does it apply to? The bills don't address the question. If we assume, in the absence of any direction to the contrary, that contributions would apply to the taxable year and plan year in which made, then particularly difficult problems arise in the commonplace situation where the plan year and the employee's taxable year do not coincide.

For example, assume a highly-compensated employee has a December 31 taxable year and the plan is on a June 30 year. Contributions made during the July through December period would be deductible on the employee's return for his taxable year then ended, but would apply to the plan year ending the following June 30. The determination of the nondiscrimination test applicable to the July through December contributions couldn't be completed until after the due date of the tax return on which the employee would have to claim the deduction.

And finally, as a technical matter, the nondiscrimination tests in the bills would seem to apply on a plan-by-plan basis. But an employer or a group of affiliated employers within the meaning of Section 414 may have many plans--some contributory and some noncontributory, some covering collective bargaining units and others not. It is reasonable to assume that, were S. 75 or S. 209 enacted, Treasury would attempt by regulations to apply the nondiscrimination tests across the spectrum of all affiliated plans to prevent what would otherwise be a rather obvious opportunity for manipulation. The result would simply be additional complexity.

Effect on differing contribution arrangements

It seems clear that the nondiscrimination tests in S. 75 and S. 209 would be rather easy to meet in the case of mandatory contribution plans, more difficult for matching plans, and most difficult in the case of purely voluntary plans.

It is apparent, for example, that if a plan requires employee contributions of a flat 4 percent of compensation, the nondiscrimination test in the bills is met almost by default. And under matching plans, all participants are at least required to make some contribution. But in the case of purely voluntary contribution plans, there will always be some participants who don't contribute at all.

It is somewhat ironic that S. 209 (but not S. 75) provides that tax deductible employee contributions cannot be made to mandatory contribution or matching plans which come into existence after January 1, 1978. That reflects a judgment on the part of the sponsors that the formation of new mandatory contribution and matching plans should not be encouraged. I don't necessarily agree with that judgment, particularly with regard to matching plans. But it is ironic that the nondiscrimination tests which the bill contains would be easiest to meet for the mandatory plans, and most difficult for the pure voluntary contributions plans which presumably are precisely the type the sponsors wish to encourage.

Is all this really necessary?

The nondiscrimination tests in S. 75 and S. 209 are, I believe fairly described by the classic term "administrative nightmare." I think it makes sense to ask whether there is any real necessity for special new nondiscrimination tests of any kind.

A qualified plan, after all, must be nondiscriminatory by definition. IRS has long had, as part of its plan qualification guides, special rules for contributory plans. Where contributions are mandatory, the rule has been that they should not be set at a level which would be burdensome to the lower-paid and hence discourage them from participating. The guides employ a rule of thumb that mandatory contributions which do not exceed 6 percent of compensation are presumed to be nondiscriminatory.

In the case of matching plans, the fact that the level of an employee's contributions governs the amount of the employer contribution on his behalf gives rise to concern that greater contributions by the higher-paid could cause an unduly large proportion of the employer contribution to be allocated to them. Here again the qualification guides use a 6 percent rule of thumb - as long as the employee contributions which are matched cannot exceed 6 percent of compensation, there is presumed to be no problem.

Purely voluntary contributions are not viewed in the guidelines as likely to cause any discrimination problem, provided employees at all levels have an equal opportunity to contribute. But to keep the amount of employee contributions within what the guidelines refer to as reasonable bounds, a 10 percent of compensation limit is imposed.

It is true that all of these limits were devised on the basis that employee contributions are nondeductible. But one must ask how much radical surgery is really necessary with a $1,000 or $1,500 lid on the maximum deductible amount.

There are very important differences between employer and employee contributions with respect to the nondiscrimination rule. In the case of employer contributions, the easily understood and universally accepted view is that an employer should not be permitted to contribute proportionately greater amounts for the higher paid than for the lower paid. But in the case of employee contributions under matching and in particular purely voluntary plans, employees at all levels are making individual decisions about what to do with their own money.

Why should the tax deductibility of a contribution which a higher-paid individual chooses to make be held hostage to the result of amalgamating the individual contribution decisions which the lower paid choose to make? That is what S. 75 and S. 209 would do, and in my view, it makes little sense.

Consider two examples. Executive A earning $50,000 works for Company X which has a large number of low-paid employees for whom a tax deduction would not be very significant, and who either cannot afford or choose not to save for the purpose of accumulating additional retirement income. A cannot make a deductible employee contribution.

Executive B earning $50,000 works for an entirely different type of organization, Company Y, where the lower-paid employees earn more than the lower-paid employees at Company X. Tax deductions are important to most of the Company Y employees, they are for various reasons willing to make contributions for additional retirement income, and many of them in fact do so. The nondiscrimination test is met, and B can make a deductible contribution.

I submit that this result is not sensible tax policy. Either a $50,000 a year executive should be permitted to make a tax deductible contribution, or he should not be.

That suggests, of course, a return to the compensation phase-out approach, which was in S. 3017. As compared to S. 75 and S. 209, I clearly would prefer the phase-out approach if there must be some special nondiscrimination test. But it would have to be set at a realistically high level. The question should be:

above what income level does Congress believe an individual need not be given any special encouragement or help to save for his retirement? I believe if that question were evaluated realistically, the phase-out level would be set far higher than the $30,000-35,000 range which was in S. 3017. It would be essential to provide an inflation adjuster for whatever range were selected.

There is I believe, an unfortunate propensity to confuse the plan qualification concept of "highly compensated," which is purely a relative matter, with being economically well off. Many "highly compensated" individuals in the Section 401 context are merely middle income people who need help and encouragement to save toward retirement.

Furthermore, it might well be appropriate to distinguish in some way between individuals having vested interests in benefits attributable to employer contributions, and those who do not. That kind of approach could be helpful to those in highly mobile occupations who achieve little, if any, vesting in employer financed benefits.

It needs to be borne in mind that one very real problem with the income phase-out approach has to do with the preservation of existing plans and encouragement of new plan formation in the small business sector. All too often, the only individuals who would be caught by an income phase-out test would be the very individuals who make the decisions on plan preservation and formation.

Conclusion

In summary, I am not convinced that there is any need for a special nondiscrimination test with respect to employee contributions--at least not when they are set at a maximum $1,000 or $1,500 level. Therefore, I support the S. 557 approach. But if there must be a test, it should be kept simple and administratively workable. The S. 75 and S. 209 approach certainly does not meet those criteria.

One very simple approach, for example, which eliminates any relative advantage which higher-paid people could obtain from a $1,000 contribution, would be to make it a credit rather than a deduction. For example, a credit of perhaps 25 percent of the first $1,000 of employee contributions could be considered.

Senator BENTSEN. We have a panel, if they will take their places: Mildred Jeffrey, Chairwoman, National Women's Political Caucus; Dr. John J. Guarrera, Institute of Electrical and Electronic Engineers; Mr. Boris Auerbach, the ERISA Industry Committee.

We are very pleased to have you with us this morning. You have been advised as to the limitation on time. We will take your testimony in its entirety and we are very appreciative of having you with us this morning.

Is there any particular order in which you would like to proceed?

STATEMENT OF MILDRED JEFFREY, CHAIRWOMAN, NATIONAL WOMEN'S POLITICAL CAUCUS

Ms. JEFFREY. Thank you, Senator.

We are very pleased to be here this morning. My name is Mildred Jeffrey and I am chair of the National Women's Political Caucus, a nationwide organization. The Caucus is pleased that these hearings on S. 94, the Homemaker Retirement bill are taking place in the same year as the comprehensive hearings on the American Women and Human Resources Policies and Programs.

Senator BENTSEN. Can I count on your support to roll Treasury over on this one?

Ms. JEFFREY. We are pleased that you have given the leadership to S. 94. We are also glad these other hearings are going on, and we have testified on the ERISA Improvements Act, which is also of great interest to us. What emerges from these hearings is the isolation and vulnerability of the American homemaker. Her problems are especially acute in her retirement years.

Let's take a look at just what it means to be female and over 65 today. Women 65 and over are the fastest growing group of poor in America. The median income for women 65 and older is $3,008; for minority women it is only $2,313, while for men 65 and older it is $5,526. Today there are 961,000 or 10.5 percent of men 65 and older who live below the poverty line, but there are 2,216,000 women or 16.5 percent of women 65 and over living in poverty, and 457,000 or 41.2 percent of minority women 65 and older who live in poverty. This poverty is explained in part by the failure of the traditional retirement income security programs—social security and pensions—to meet the needs of women, and particularly to credit unpaid labor in the home.

Your introduction of the homemaker retirement bill, Mr. Chairman, reflects the recognition that economic security, especially in the form of an adequate retirement income, is desperately needed by American women.

We applaud you for addressing the needs of homemakers, whose toil has been undervalued by our society, and for predicating redress on the assumption that a homemaker is entitled to benefits just as a paid worker is. S. 94 provides an important opportunity for this large group of women to insure for themselves a decent standard of living in their retirement years.

The Tax Code currently permits a very limited group of nonearning spouses to establish Independent Retirement Accounts. As S. 94 acknowledges, the current eligibility criteria are so stringent that many nonearning spouses desiring IRA's are precluded from establishing them. This bill wisely removes the strictures that limit spousal IRA's to homemakers who have no earnings and to homemakers whose spouses are eligible for IRA's.

Though precise statistics are not available, there are doubtless many homemakers who pick up seasonal, part-time, or occasional work, and the extension of eligibility to these women is important.

The stipulation in current law that the wage earning spouse must have an IRA is totally arbitrary and bears no relation to the need of the nonearning spouse. The removal of this restriction by this bill extends eligibility in an important way.

Finally, S. 94 replaces the current $1,750 ceiling on both partners' contribution with a much more realistic ceiling of $1,500 per spouse, or $3,000 in total. Under the proposal before us the earning spouse will no longer have to divide his account in half in order to provide for an IRA for a dependent spouse but will be able to contribute the maximum amount to her IRA as well as his own. This, too, is an important improvement and will, we hope, substantially increase incentives to establish spousal IRA's.

In conclusion, S. 94 extends eligibility for IRA's to all homemakers and enables women who work in the home without compensation to set aside some money for their later years. It is an important new opportunity for the long-neglected homemaker.

This particular approach to retirement security has one major limitation which I will now discuss. It is an opportunity which is in fact only really available to middle and upper income couples, for they are the only ones who have enough money left over at the end of the month or year to put some away for the future.

The Treasury Department has some preliminary data on who uses IRA's and these statistics bear out our concern.

Mr. Halperin has introduced the same information that we happen to have for 1978. The fact is that what this shows is that the low- and middle-income families who are the least likely to be well off in their later years derive little or no benefit from IRA's.

We hope that by expanding eligibility to all homemakers, the use of spousal IRA's will increase.

Finally, Mr. Chairman, I would like to remind you and other members of the committee that NWPC has gone on record in favor of comprehensive pension reform. We firmly believe that all women, regardless of their earnings record and/or marital status, are entitled to live in dignity in their retirement years. While the approach under consideration today is a modest effort which benefits a portion of women who need guarantees of economic security in their retirement years, NWPC applauds this bill as an important first step in this direction. We appreciate the opportunities which S. 94 provides to homemakers, and we hope that you will join the National Women's Political Caucus in supporting comprehensive pension reform for all women.

Thank you.

Senator BENTSEN. Thank you very much, Ms. Jeffrey.

We will withhold questions until we get through all the witnesses.

Would you proceed, sir?

Mr. AUERBACH. Thank you, Senator.

STATEMENT OF BORIS AUERBACH, SECRETARY OF FEDERATED DEPARTMENT STORES, ON BEHALF OF ERISA INDUSTRY COMMITTEE (ERIC)

Mr. AUERBACH. Mr. Chairman and members of the committee, I am Boris Auerbach, secretary of Federated Department Stores. I appear today on behalf of the ERISA Industry Committee.

ERIC thanks the subcommittee for this opportunity to present its views. Its some 100 members include half of the Nation's 50 largest industrial companies and represent a cross-section of the Nation's largest retailers, utilities, banks, and insurers. ERIC members are genuinely concerned about the well-being of their employees. Participants in pensions plans sponsored by ERIC members represent about 20 percent of all participants in private pension plans.

My testimony today will focus on the various bills which would provide deductions for employees for contributions to qualified plans or deductions for IRA contributions for employees covered by qualified plans. It also deals with other provisions in S. 209 which would affect the tax treatment of private plans and suggests two additional amendments.

ERIC strongly supports proposals to foster the growth of private plans, increase employee earnings, encourage capital formation, and increase retirement income security.

We note with satisfaction that these are the stated principal purposes of S. 557, introduced by the chairman, S. 75, introduced by Senator Dole, and section 203 of S. 209, introduced by Senators Williams and Javits.

Each of these proposals would provide deductions for employee contributions to qualified plans and, if no contribution is made to a qualified plan, deductions for contributions to IRA's by employees covered by qualified plans. In concept, the proposals should encourage employee savings for retirement, foster capital formation, and encourage the growth of private plans. Accordingly, ERIC strongly supports the purposes of the proposals.

For the reasons stated, ERIC strongly prefers an approach similar to that taken in S. 557. S. 75 and section 203 of S. 209, which are similar, contain provisions, principally relating to discrimination, which are unnecessarily complex and would present severe administrative difficulties. Thus, those proposals must be rejected.

ERIC prefers the uniform limits of $1,500 or 15 percent of gross income contained in S. 557, rather than the $1,000 or 10 percent of compensation limitation in the other proposals. A $1,500 or 15 percent limitation would put employees who participate in qualified plans on a more equal footing with persons who may now contribute to IRA's. Uniform limits would be simpler for the public to comprehend and easier for the Internal Revenue Service to administer.

It would not have to question whether persons who claim a $1,500 deduction participate in qualified plans. Uniform limits would also avoid problems where persons who are not covered under qualified plans become covered at some point in the year and, thus, under existing law, lose deductions for amounts which may already have already been contributed to IRA's.

In addition to uniform limits, ERIC strongly urges that the legislation clearly meet the following criteria.

One, there should be no additional discrimination tests. ERIC strongly opposes the adoption of any new discrimination test to govern deductible employee contributions. Any additional discrimination test would be unnecessary, costly, unadministerable, and counterproductive.

Code section 401(a)(4) prohibits existing contributory plans from discriminating in favor of officers, directors, or highly compensated employees. In order to remain tax-qualified under existing law, contributory plans must have substantial participation by rank and file. Thus, any new discrimination test would be in large part duplicative.

In addition, because the maximum deduction is $1,500 under S. 557 or $1,000 under S. 75 and S. 209, the maximum possible tax benefit to any member of a prohibited group, $750 or $500 if the taxpayer is in a 50 percent bracket, simply cannot justify the overwhelming complexity and associated administrative costs which would be engendered by any new discrimination test.

I agree with the statement of Michael Klein on this subject. The plan's sponsor must be able to decide whether to accept employee contributions. ERIC members and employees have generally developed over the years one or more plans to serve their employees' retirement needs. Any requirement that all plans accept employee contributions would present serious administrative and requalification problems, particularly in the case of noncontributory defined benefits to plans.

Employers must not be required to monitor or certify employee deductions. They simply are not in a position to do so and, in addition, employers must not be required to monitor or administer IRA contributions.

With respect to voluntary contributions, employees should have the option to make contributions to IRA's rather than to an employer's plan. However, the employer must have no obligation to withhold, pay over, administer, or monitor such contributions.

In summary, we think the purpose of the legislation is excellent. We have concern with some of the qualifications.

Thank you.

Senator BENTSEN. Thank you very much.

Doctor, if you would proceed?

STATEMENT OF DR. JOHN J. GUARRERA, INSTITUTE OF ELECTRICAL & ELECTRONICS ENGINEERS, INC. (IEEE)

Mr. GUARRERA. Thank you. I am John Guarrera, past president of the Institute of Electrical & Electronics Engineers and past chairman of the Engineers and Scientists Joint Committee on Pensions, which is an intersociety committee representing the pension interests of approximately 17 engineering and scientific societies.

IEEE is the world's largest professional technical society, composed of approximately 190,000 members worldwide—155,000 U.S. members. In this capacity, we are very concerned about the many inequities replete in pension/retirement programs commonly available in the United States today. In particular, we are distressed that individual's who have chosen a highly mobile profession are penalized by the structure of most pension/retirement programs.

Mobility frequently has nothing to do with an individual's choice but is related, in many cases, to action on the part of the Government contracting agencies. For example, a very glaring definition of the Government's ability to remove the possibility of pension benefits from an employee comes under the Service Contract Act. Under the Service Contract Act, an employee may be working in a Government-owned building and facilty for 25 or 30 years but during that passage of time may have had five or six different employers who come in as new contractors. Because no employer was there for 10 years or more, he never vested in anything and never has a pension plan, but because the employer had a qualified plan, he was not able to set up his own retirement program.

Sometimes those individuals who do manage to vest, incidentally, in an employer-sponsored plan find themselves with accruals under the employer-sponsored plan which are considerably less in value than they could have had had they opened up their own IRA. And I mean so much less in value that it would have paid them to opt out, form their own IRA, and just eliminate any benefits on the part of the company.

There are two significant problems that we see: The problem of the mobile employee who changes jobs frequently and never vests and yet never qualifies for an IRA because of a qualified plan in existence; and, second, the individual who manages to vest but vests in a benefit considerably less valuable than an IRA could have been.

The 1979 annual report of the Joint Economic Committee of the U.S. Congress states that a very high rate of capital formation is needed if we are to succeed in revising the disastrous course of productivity growth in the American economy and that saving is essential to investment and growth ought to be encouraged.

The LERA concept which is before this subcommittee would dramatically encourage the attainment of the goals espoused by the Joint Economic Committee and would also provide a broader philosophical and economic incentive for the people; namely, that of providing tax deferral mechanisms for one's own retirement program.

In summation, Mr. Chairman, the IEEE, the American Society of Mechanical Engineers, the National Society of Professional Engineers, and the ESJCP fully support and endorse the concept of the limited employee retirement account. The LERA concept would provide relief for employees who seldom or never vest in a pension plan. It would provide relief for those individuals who do become vested, but vested in a very poor pension plan.

It would provide encouragement for individual investment of long-term savings. It would provide the incentive and the tax deferred mechanism for an individual to provide for his or her own retirement.

Last, Mr. Chairman, we wish to recognize that many pressures surface during the administrative and legislative process of enactment of legislative concepts. We believe that compromises are often effected to gain enactment and to stave off total defeat of an issue. In this regard, we wish to encourage this senate subcommittee, the full committee, and the Senate not to compromise on equity to the individual. We support compromise in methodology that will balance equity with simplicity but we appeal to the parties involved to retain equity as the preferred goal of legislation.

Senator BENTSEN. I appreciate your report about the excellent report of the Joint Economic Committee. There is some prejudice in that regard. But I can recall, as we were developing ERISA, the amount of work that went into it. The major concern was this question of portability, and for a long time a lot of us have had the feeling that people moving from job to job is really a major economic loss, but to some degree that is not true. The flexibility that we have in this country and the employees have and the ability to move from one to another, looking for something that they think is more gainful where they can be more productive has been very productive to our economy.

We refer to the Japanese and we are deeply concerned about the trend lines on productivity, but if we get to the percentage of productivity of our people, as opposed to their people, we are substantially ahead of them on individual productivity of American workers compared to Japanese workers.

The trendlines are alarming; they are headed in the other direction. But the people who have studied it and who have testified before the Joint Economic Committee tell me one of the reasons we are still ahead is that you do not have that portability in Japanese industry. There you are. You are with one company and you stay there. Sometimes there is very ineffective and inefficient utilization of people because of that.

So since it is in many ways to our economic interests, then we ought to meet that, and we ought to find a way that that person can most effectively use their talents. This is particularly true of engineering, and still build their retirement income.

I would like to defer to Senator Dole for any questions he might have.

Senator DOLE. I do not have any questions. I appreciate the testimony. I am particularly interested in the National Women's Political Caucus. We all have a concern about pension reform and I am pleased to see efforts in that direction. Mr. Auerbach, I particularly appreciate your comments with reference to nondiscrimination. If I had my choice, I would not want to impose a test either. There are, however, political realities. The question is, would you rather have no legislation or a program with a nondiscrimination test. Not because of my opposition, but because of Treasury and substantial opposition on the House side.

Mr. AUERBACH. I do not know whether that question can be answered in the abstract. It is possible to build a system that would be so burdensome and would create the problem of not knowing until after the fact whether you had a discrimination problem that perhaps would make it not worthwhile.

On the other hand, it may be possible to have something that would satisfy those people who have a concern, which we do not share, that would be acceptable.

Senator DOLE. This is an area that should be addressed. We will be working with you and your association.

I do not have any further questions. I think the statements were very helpful.

Senator BENTSEN. Senator Matsunaga?

Senator MATSUNAGA. Mr. Chairman, I apologize for my tardiness and for not having heard the testimony of the panel. I have no questions at this time.

Senator BENTSEN. Let me add to that. I think that the statements will be very helpful, and I know your industry and its representatives have given it a great deal of study and we are appreciative of that.

I would like to see as much flexibility as we can have on the part of the individual in deciding how much he wants to save, or she wants to save, Mrs. Jeffrey.

Ms. JEFFREY. Thank you, Senator.

Senator BENTSEN. We are very pleased to have your comments. I am sure the support of your organization will be very helpful to us. Thank you very much.

Senator MATSUNAGA. Mr. Chairman, as a cosponsor with the Chairman of S. 94, I am happy to note that the National Women's Political Caucus supports S. 94.

Senator BENTSEN. Thank you.

[The prepared statements of the preceding panel follow:]

Statement by Mildred Jeffrey, Chair
National Women's Political Caucus

Senator Bentsen and other members of the Committee, my name is Mildred Jeffrey. I am chair of the National Women's Political Caucus, a nationwide, multi-partisan organization with local chapters in 200 towns and cities across the country. The major goal of the Caucus is to obtain equal representation for women in elective and appointive office. Central to reaching that objective is the achievement of economic justice.

NWPC is pleased that these hearings on S.94 the Homemaker Retirement Bill are taking place in the same year as the comprehensive hearings on American Women and Human Resources Policies and Programs, and on the ERISA Improvements Act. The picture of women which emerges from these sessions enables us to see the isolation and vulnerability of the American homemaker. Her problems are especially acute in her retirement years.

Let's take a look at just what it means to be female and over 65 today. Women 65 and over are the fastest growing group of poor in America. The median income for women 65 and older is $3,008, for minority women it is only $2,413, while for men 65 and older it is $5,526. Today there are 961,000 or 10.5% of men 65 and older who live below the poverty line, but there are 2,216,000 women or 16.5% of women 65 over living in poverty, and 457,000 or 41.2% of minority women 65 and older who live in poverty. This poverty is explained in part by the failure of the traditional retirement income security programs - social security and pensions to meet the needs of women, and particularly to credit unpaid labor in the home.

Your introduction of the Homemaker Retirement bill, Mr. Chairman, reflects the recognition that economic security, especially in the form of an adequate retirement income, is desperately needed by American women.

We applaud you for addressing the needs of homemakers whose toil has been undervalued by our society, and for predicating redress on the assumption that a homemaker is entitled to benefits just as a paid worker is. S.94 provides an important opportunity for this large group of women to insure for themselves a decent standard of living in their retirement years.

The Tax Code currently permits a very limited group of non-earning spouses to establish Independent Retirement Accounts (IRA's). As S.94 acknowledges, the current eligibility criteria are so stringent that many non-earning spouses desiring IRA's are precluded from establishing them. This bill wisely removes the strictures that limit spousal IRA's to homemakers who have no earnings, and to homemakers whose spouses are eligible for IRA's. Though precise statistics are not available, there are doubtless many homemakers who pick up seasonal, part-time or occasional work, and the extension of eligibility to these women is important. The stipulation in current law that the wage earning spouse must have an IRA is totally arbitrary, and bears no relation to the need of the non-earning spouse. The removal of this restriction by this bill extends eligibility in an important way. Finally, S.94 replaces the current $1,750 ceiling on both partners' contribution, with a much more realistic ceiling of $1,500 per spouse, or $3,000 in total. Under the proposal before us the earning spouse will no longer have to divide his account in half in order to provide for an IRA for a dependent spouse, but will be able to contribute the maximum amount to her IRA as well as his own. This too, is an important improvement, and will we hope, substantially increase incentives to establish spousal IRA's. In conclusion, S.94 extends eligibility for IRA's to all homemakers, and enables women who work in the home without compensation to set aside some money for thei later years. It is an important new opportunity for the long neglected homemaker.

This particular approach to retirement security has one major limitation which I will now discuss. It is an opportunity which is in fact only really available to middle and upper income couples, for they are the only ones who have enough money left over at the end of the month or year to put some away for the future. The Treasury Department has some preliminary data on who uses IRA's, and these statistics bear out our concern: the low and middle income families who are least likely to be well-off in their later years derive little or no benefit from IRA's. These recent figures reflect the utilization rate by eligible participants in various income brackets:

Adjusted gross income (in thousands of $)	Rate
0-5	.2%
5-10	1.4%
10-15	2.5%
15-20	5.2%
20-50	14.8%
50 and above	45.0%

We hope that by expanding eligibility to all homemakers - the use of spousal IRA's will increase.

Finally, Mr. Chairman, I would like to remind you and other members of the Committee, that NWPC has gone on record in favor of comprehensive pension reform. We firmly believe that all women, regardless of their earnings record, and or marital status, are entitled to live in dignity in their retirement years. While the approach under consideration today is a modest effort which benefits a portion of women who need guarantees of economic security in their retirement years, NWPC applauds this bill as an important first step in this direction. We appreciate the opportunities which S.94 provides to homemakers, and we hope that you will join the National Women's Political Caucus in supporting comprehensive pension reform for all women.

Statement of

The ERISA Industry Committee (ERIC)

SUMMARY

I. ERIC supports deductions for employee contributions to qualified plans. They would encourage employee savings and capital formation and increase retirement income security.

The limits on deductions should be uniform, as in S. 557.

The legislation should

(1) Reject the proposed unnecessary, costly, unadministerable, and counterproductive additional discrimination tests.

(2) Allow employers to decide whether and to which plans employee contributions may be made.

(3) Impose no duty on employers to monitor or certify employee deductions.

(4) Not require employers to monitor or administer IRA contributions.

II. Tax credits for establishing new plans should be rejected.

III. The requirement that interested parties be notified prior to filing any request for a determination letter should be repealed.

IV. The Internal Revenue Service should be prohibited from retroactively disqualifying a plan unless the failure to meet the qualification requirement results from an intentional failure or willful neglect.

Mr. Chairman and members of the Subcommittee:

I am Boris Auerbach, Secretary of Federated Department Stores. I appear today on behalf of The ERISA Industry Committee (ERIC). I am accompanied by Jerry L. Oppenheimer of Mayer, Brown & Platt, Washington, D.C., counsel to ERIC.

ERIC thanks the Subcommittee for this opportunity to present its views. It's some one-hundred members include half of the nation's fifty largest industrial companies and represent a cross-section of the nation's largest retailers, utilities, banks and insurers. ERIC members are genuinely concerned about the well-being of their employees. Participants in pension plans sponsored by ERIC members represent about twenty percent of all participants in private pension plans.

My testimony today will focus on the various bills which would provide deductions for employees for contributions to qualified plans or deductions for IRA contributions for employees covered by qualified plans. It also deals with other provisions in S. 209 which would affect the tax treatment of private plans and suggests two additional amendments.

I. Deductible Employee Contributions (S. 75, S. 557, and Section 203 of S. 209)

ERIC strongly supports proposals to foster the growth of private plans, increase employee savings, encourage capital formation, and increase retirement income security.

We note with satisfaction that these are the stated principal purposes of S. 557, introduced by the Chairman, S. 75, introduced by Senator Dole, and section 203 of S. 209, introduced by Senators Williams and Javits.

Each of these proposals would provide deductions for employee contributions to qualified plans and, if no contribution is made to a qualified plan, deductions for contributions to IRAs by employees covered by qualified plans. In concept, the proposals should encourage employee savings for retirement, foster capital formation and encourage the growth of private plans. Accordingly, ERIC strongly supports the purposes of the proposals.*/

For the reasons stated below, ERIC strongly prefers an approach similar to that taken in S. 557. S. 75 and section 203 of S. 209, which are similar, contain provisions, principally relating to discrimination, which are unnecessarily complex and would present severe administrative difficulties. Thus, those proposals must be rejected.

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*/ We note that the 1979 Study of American Attitudes Toward Pensions and Retirement, commissioned by Johnson & Higgins and conducted by Louis Harris and Associates, Inc., indicates that 89% of employers favor such pending proposals and 49% of employees favor them even if employers were to cut back their contributions. Tables VII-13 and VII-12. We also note that, possibly due to the employee question (but not the employer question) being conditioned on the generally unlikely possibility of employer reductions, 23% of employees were unsure or had no opinion. Absent this condition, it can be assumed that the favorable employee response would have been much higher. For example, 68% of employees surveyed indicated a willingness to contribute to their pension plans in exchange for increased benefits. Table VIII-2.

ERIC prefers the uniform limits of $1,500 or 15% of gross income contained in S. 557 rather than the $1,000 or 10% of compensation limitation in the other proposals. A $1,500 or 15% limitation would put employees who participate in qualified plans on a more equal footing with persons who may now contribute to IRAs. Uniform limits would be simpler for the public to comprehend and easier for the Internal Revenue Service to administer. It would not have to question whether persons who claim a $1,500 deduction participate in qualified plans. Uniform limits would also avoid problems where persons who are not covered under qualified plans become covered at some point in the year and, thus, under existing law, lose deductions for amounts which may have already been contributed to IRAs.

In addition to uniform limits, ERIC strongly urges that the legislation clearly meet the following criteria.

(1) <u>There should be no additional discrimination tests</u>. ERIC strongly opposes the adoption of any new discrimination test to govern deductible employee contributions. Any additional discrimination test would be unnecessary, costly, unadministerable, and counterproductive.

Code section 401(a)(4) prohibits existing contributory plans from discriminating in favor of officers, directors or highly compensated employees. In order to remain tax-qualified under existing law, contributory plans must have substantial participation by rank and file. Thus, any new discrimination test would be in large part duplicative.

In addition, because the maximum deduction is $1,500 under S. 557 or $1,000 under S. 75 and S. 209, the maximum possible tax benefit to any member of a prohibited group ($750 or $500 if the taxpayer is in a fifty percent bracket) simply cannot justify the overwhelming complexity and associated administrative costs which would be engendered by any new discrimination test.

For example, under S. 75 and S. 209, no deduction would be allowed members of a prohibited group unless the employer certified that the plan was not discriminatory. The certification procedure would be costly and virtually impossible to administer. In order to certify, the employer would have to compute the ratio of deducted amounts to compensation for each plan participant. Recordkeeping and computer programs would have to be revised to make such computations.

The proposed prohibited group would include significant numbers of middle management personnel for most larger employers. Under recent amendments to the IRA rules, employees can deduct contributions made up to the time of filing their returns. The same rule should apply for deductible contributions. Thus, the employer would not be able to certify compliance with the discrimination standard prior to the filing of returns by all members of the prohibited group, and they would not know if their contributions were deductible until after they were made. Such a situation would be intimidating or intolerable for many and, in any event, counterproductive. In addition, how would certification be accomplished if the plan year differed from employees' taxable years or if a member of the prohibited group adopted a fiscal year?

What if the employer's certification is erroneous? How would the certification be audited by the Service? Is it part of the employer's return, the plan's return, each employee's return? The statute of limitations may well run on employees' returns before an audit of the employer or the plan is completed. Because of bonuses, raises, or changes in compensation of or participation by other employees, a middle management employee may be in the prohibited group one year and not the next. What if such an employee takes a deduction when the employer has not certified? How would the employer, the employee and the Service monitor such situations?

In short, there would be a significant administrative burden on the employer and the Service and great uncertainty for many employees. Many employers might elect not to certify, and, to the extent that employers forego certification, members of the prohibited group would not be permitted to deduct their contributions to the plan. Particularly in smaller companies, if the employer decided not to certify and, consequently, to forego deductions for management employees, the employer might also decide not to allow rank and file to contribute to its plans. Thus, substantial private savings would be foregone, rather than encouraged.

(2) The plan sponsor must be able to decide whether to accept employee contributions. ERIC members and employers generally have developed over the years one or more plans to serve their employees' retirement needs. Any requirement that all plans accept employee contributions would present serious administrative and requalification problems, particularly in the case of current noncontributory defined benefit plans.

Substantial revisions in the administration of any existing plan, whether presently contributory or noncontributory, defined benefit or defined contribution, would be necessary before the plan could receive deductible employee contributions. For example, plan documents would have to be amended to "lock in" the deductible portion of such contributions; new accounting provisions, including revision of computer programs, would be required to keep track of deductible contributions and earnings thereon for several purposes, for example, to refund employee contributions on termination of employment before vesting of employer contributions and to determine the differing tax treatment of distributions attributable to deductible employee contributions (taxable) and non-deductible employee contributions (non-taxable) on retirement or other termination; summary plan descriptions and other employee communications would have to be revised; collective bargaining agreements might have to be renegotiated, for example, to establish conditions for organized employees' participation in certain

47-321 O - 79 - 12

plans; and amended plans would probably be submitted to the Internal Revenue Service for requalification.

Furthermore, many employers maintain more than one contributory plan. If a particular employee's contributions exceed his deduction limitation, the employer must be able for administrative purposes to determine which contributions constitute the deducted portion.

Only those employers who wish to take advantage of the proposal should be required to incur the significant attendant administrative costs. Accordingly, it must be clearly provided that the sponsor may decide whether deductible employee contributions may be made and, if so, to which plan or plans.

(3) Employers must not be required to monitor or certify employee deductions. The employer must be able to determine the status and treatment of contributions for withdrawal and similar purposes without reference to whether employees actually elect to deduct particular contributions. Accordingly, the employer must be able to presume that all employee contributions (up to the maximum limitation) to a designated plan will be deducted by the employee, unless the employee notifies the employer in writing, before a contribution is made, that the contribution will not be deducted.

(4) Employers must not be required to monitor or administer IRA contributions. With respect to voluntary contributions, employees should have the option to make

contributions to IRAs, rather than to an employer's plan. However, the employer must have no obligation to withhold, pay over, administer or otherwise monitor or handle such contributions.

II. Tax Credits for Establishing Plans (Section 204 of S. 209)

ERIC opposes granting tax credits to small employers who establish new plans. The proposed credit would be available only to employers who meet certain limitations on profits. Although ERIC generally favors provisions which encourage plan growth, ERIC strongly opposes proposals which discriminate against larger employers and against small employers who have already established plans. Employers who have not established plans should not be "rewarded" through the tax system at the expense of others (including competitors) who have been more responsible, often at great expense, in providing for their employees' retirement income.

III. Lump Sum Distributions (Section 201 of S. 209)

ERIC supports the principle that "defined benefit [pension] plans shall be considered separately from defined contribution [pension] plans for purposes of determining the balance to the credit of an employee under the lump sum distribution rules". ERIC suggests that the proposal should not be limited to multiemployer plans.

Generally, defined contribution and defined benefit pension plans of a particular employer cover different groups of employees or serve different purposes. For example, one plan may be the "primary" pension plan and the other may be a money purchase pension plan in which participation might be voluntary. An employee should not be required, for example, to withdraw in a lump sum (with adverse impact on savings) his interest in the "primary" defined benefit pension plan merely to assure that a withdrawal of his interest in his savings plan is treated as a lump sum distribution. ERIC strongly urges that, in addition to preserving the existing distinctions between pension, profit-sharing, and stock bonus plans, all defined benefit pension plans of a single employer be treated as a single plan, separately from defined contribution pension plans of that employer, as would be the rule for multiemployer plans.

We suggest that the proposal be clarified by inserting the word "multiemployer" before the word "plan" in each place it appears in proposed Code section 402(e)(4)(C)(ii). Otherwise, the proposal might be read to require that an employee who has rights under both a defined benefit multiemployer pension plan and a defined benefit single employer pension plan of the same employer might have to receive distributions from both plans to qualify for lump sum treatment.

Finally, we note that no employer "maintains" a multiemployer plan. By definition, such plans are maintained pursuant to collective bargaining agreements with more than one unrelated employer. Thus, the words "contributed to" should be inserted for "maintained" in proposed Code section 402(e)(4)(C)(ii).

IV. Additional Internal Revenue Code Amendments

In order to facilitate more efficient administration of plans, ERIC strongly urges that two additional amendments be made to the Internal Revenue Code.

A. Notice to Interested Parties. ERIC strongly urges the repeal of Code section 7476(b)(2) which, in effect, requires the notification of interested parties prior to the filing of any request for a determination letter. ERIC supports the proposition that participants and beneficiaries be informed of amendments which affect them, but this notification requirement is unduly burdensome and expensive, serves no useful purpose, is generally ignored or misunderstood by participants, and duplicates other reporting requirements.

Under the regulations, the request for a determination letter must be filed within a certain period of time after notification is given. This significantly reduces flexibility in adopting plan amendments, particularly, for example, when the amendments must be approved by a board of directors. If timely notice cannot be given, amendments may be delayed from one plan year to the next. Moreover, giving notice is often expensive where many work sites or retirees are involved.

Participants and beneficiaries may object to a request for a determination letter only on grounds that the plan is not qualified. See, e.g., James E. Thompson, Jr., 71 T.C. No. 3 (Oct. 12, 1978). Plan qualification is a matter that the Service can well decide without assistance from participants and beneficiaries. A provision cannot be rejected merely because a participant or beneficiary "doesn't like" it.

Participants and beneficiaries receive notice of amendments through the annual report, the summary of the annual report (which would be eliminated by certain proposals in S. 209), and updates to the summary plan description. If the Service were ever erroneously to approve a plan or plan amendment, a participant or beneficiary could obtain corrective action by civil enforcement under ERISA section 502.

In short, little, if any, benefit is derived from these notices. Accordingly, and in furtherance of simplifying ERISA compliance and reducing unnecessary costs, the requirement of notice to interested parties prior to filing a request for a determination letter should be eliminated.

B. Retroactive Disqualification of Plans. ERIC also strongly urges that a provision be adopted prohibiting the Internal Revenue Service from retroactively disqualifying a plan unless it determines that the failure to meet the qualification requirements in preceding years was the result of an intentional failure or willful neglect on the part of the person maintaining the plan (cf. section 307 of S. 3017, the ERISA Improvements Act of 1978). A similar rule was adopted to a limited extent in Aero Rental, 61 T.C. 331 (1975), and its statutory adoption would be welcomed.

We understand that the principal objections raised last year against such a provision before this Subcommittee and the Subcommittee on Labor of the Senate Committee on Human Resources centered on perceived difficulties by the Service in proving, as a factual matter, lack of good faith. We further understand that the Service has indicated a willingness to apply a similar rule on an individual case by case basis under the authority of Code section 7805(b). Such a case by case approach, however, necessarily includes the same type of factual determination as would be necessary under last year's proposal.

The effects of retroactive disqualification of a plan are drastic and can be financially devastating, particularly to innocent participants and beneficiaries. The qualification rules are complex, and many regulations necessary to implement ERISA have not been proposed or adopted; it is not inconceivable that a well-intentioned plan sponsor might inadvertently violate them. Employers, participants and beneficiaries should be able to rely, in the absence of evidence of intentional or willful neglect or reckless disregard of the qualification rules, on a presumption of plan qualification, rather than having to prove, on an audit at some later date, that the asserted deficiency is of the type appropriate for discretionary relief under Code section 7805(b).

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ERIC would welcome the opportunity to work with the members of the Subcommittee or their staff in drafting appropriate legislation and generally to make the experience of ERIC's members and counsel available to the Subcommittee.

We welcome your questions.

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Statement of the Institute of Electrical and Electronics Engineers (IEEE) and the Engineers and Scientists Joint Committee on Pensions (ESJCP)

I am Dr. John J. Guarrera, Past President of the Institute of Electrical and Electronics Engineers (IEEE), and more recently, Vice-President for Professional Activities and Chairman of the United States Activities Board, IEEE. I am a member of the IEEE Pension Committee, was 1978 Chairman of the Engineers and Scientists Joint Committee on Pensions (ESJCP) which is an Intersociety Committee representing the pension interests of approximately 17 Engineering and Scientific Societies.

IEEE is the world's largest professional, technical society, composed of approximately 190,000 members worldwide, (155,000 U. S. members). In this capacity we are very concerned about the many inequities replete in pension/retirement programs commonly available in the United States today. In particular, we are distressed that individuals who have chosen a highly mobile profession are penalized by the structure of most pension/retirement programs. Because such mobile individuals seldom are able to remain with one employer for a decade (the most common vesting requirement), these employees receive no pension/retirement benefits for their endeavors.

Under existing law, an employee is permitted to contribute up to 15% of his income, or $1,500 (whichever is less) per year to an Individual Retirement Account (IRA) and another $250, if a husband and wife contribute and if only one of them is employed. The IRA contribution is tax deductible, and the taxation is deferred on the income and earnings on the IRA. The taxes are paid when the account is distributed at retirement.

But under Code §. 219(b), an employee who is an "active participant" in an employer-sponsored qualified pension plan is ineligible to make <u>any</u> contribution to an IRA, <u>even if</u> the employer-sponsored pension plan provides very small benefits (even less than the benefits of an IRA), and <u>even if</u> the employee has not vested in the employer-sponsored qualified pension plan and is in a job where he/she is unlikely ever to vest, i.e., unlikely ever to receive benefits under that plan.

Many engineers and other mobile employees have in recent years become acutely aware of the inequity in the disqualification provisions of the IRA. Our typical member is an employee of a corporation, and is an "active participant" in a qualified pension plan sponsored by that employer. But many of our members, because of the very nature of their work, change employers well before ten years of service, i.e., well before vesting as required by ERISA. Indeed, many of our members change employers again and again, forfeiting pension after pension, and yet never qualifying for an IRA because they are always, or almost always, "active participants" in an employer-sponsored plan. This scenario is repeated time and again within the highly mobile American workforce.

And, even those individuals who do manage to vest in an employer-sponsored plan, frequently find themselves with accruals under the employer-sponsored plan of less value than the value they could have had in an IRA had such employees been premitted to "opt out" of the qualified plan, and contribute instead to an IRA.

So there are two significant problems:

First, there is the problem of the mobi'e employee who changes jobs frequently and, therefore, never vests under a qualified plan, and yet never qualifies for an IRA. He/she gets no retirement benefit at all.

Second, there is the individual who manages to vest, but vests in a benefit considerably less valuable then the IRA could have been.

In order to address some broader economic problems, Mr. Chairman, I wish to note the 1979 Annual Report of the Joint Economic Committee of the United States Congress. In the Summary Report the Committee states that "...a very high rate of capital formation is needed if we are to succeed in revising the disastrous course of productivity growth in the American economy." In addition, in the Minority Supplimentary Views of the Summary Report, it was stated that "...Saving is essential to investment and growth and ought to be encouraged."

The LERA concept which is before this Subcommittee would dramatically encourage the attainment of the goals espoused by the Joint Economic Committee and would also provide a broader philosophical and economic incentive for the people - that of providing a tax-deferred mechanism for designing one's own retirement. The LERA concept provides the tax incentives which would encourage the American populace to individually plan for retirement years without being totally dependent upon a government or employer pension system.

In this context we fully support Recommendation Number 6 of the Joint Economic Committee 1979 Annual Report which states that "From a longer run perspective, we need improved incentives to foster savings and investments and job creation." The LERA concept provides this incentive, and provides it to the individual which then allows that person the dignity of independence in planning for retirement. Additionally, a recent nationwide study shows that both employees and business leaders would support this retirement savings concept. According to the respondents in a "1979 Study of American Attitudes Toward Pensions and Retirement" (A Nationwide Survey of Employees, Retirees and Business Leaders, commissioned by Johnson & Higgins and conducted by Louis Harris and Associates, Inc.), "Thirty-one percent of those currently covered by a private pension plan say they would be very likely to contribute to their own retirement account and another 29% would be somewhat likely to do so...Eighty-eight percent of the [business] leaders interviewed say they would approve of such a law while only 9% would disapprove."

In summation, Mr. Chairman, the IEEE and the ESJCP fully support and endorse the concept of the Limited Employee Retirement Account and the proposal of a tax deferment for monies invested into an Individual Retirement Account (IRA) or an employer-sponsored pension plan at the option of the employee. The LERA concept would provide equity and investment incentive to the retirement system by:

1. Providing relief for employees who seldom or never vest in a pension plan because of mobility of their profession.
2. Providing relief for those individuals who do become vested but vested in a very poor pension plan.
3. Encouraging individual investment of long-term savings which addresses

the anti-inflation and investment capital formation problems recognized by the Joint Economic Committee, and

4. Providing the incentive and the tax-deferred mechanism for an individual to provide for his/her own retirement. Thus, allowing the person a dignified retirement without total dependence on government or employer benevolence.

Lastly, Mr. Chairman, we wish to recognize that many pressures surface during the administrative and legislative process of enactment of legislative concepts. We realize that compromise is often effected in order to gain enactment and to stave off total defeat of an issue. In this regard, we wish to encourage this Subcommittee, the full Committee and the Senate to not compromise on equity to the individual. Should problems arise, we support compromise in methodology which will balance equity with simplicity but appeal to the parties involved to retain equity as the preferred goal of the legislation.

Senator BENTSEN. Our next panel will be made up of Mr. Richard Taylor, National Automobile Dealers Association; Mr. Chet Salkind, executive director, American Society of Pension Actuaries; Mr. Deane E. McCormick, Association of Private Pension and Welfare Plans; Mr. Ernest Griffes, U.S. Chamber of Commerce.

Gentlemen?

STATEMENT OF ERNEST GRIFFES, U.S. CHAMBER OF COMMERCE

Mr. GRIFFES. I am Ernest Griffes, Levi Strauss & Co., director of employee benefits and I am representing the U.S. Chambers of Commerce as well as the American Society for Personnel Administration.

The chamber of commerce representation this morning is 80,000 members and the representation for the American Society for Personnel Administration is 26,000 members. This dual representation in this appearance this morning is unprecedented and remarkable and it should be interpreted as an indication of the strong and unified support that exists for the concept of encouraging individuals to set aside some resources to supplement retirement income from employer provided pension plans and social security.

The written testimony has been provided to the committee and I request that it be entered into the record. My very brief remarks this morning shall summarize the essential points made in the written testimony and shall expand upon some technical issues that can be easily resolved in the legislation and will make it operate effectively in the real world of benefit plan operations.

As the record of pre-ERISA hearings of the early 1970's demonstrate, any encouragement for individuals to save for their retirement has been a long-sought objective in my testimony before several Senate and House committees in 1972 and 1973 on behalf of the American Society for Personnel Administration. We strongly urged that every American, whether covered by an employer pension plan or not, be afforded every encouragement to provide a measure of their retirement income security from their own resources. This encouragement is totally consistent with the concept of retirement income security, resting on three solid foundations: social security as a base, private pension plans as a supplement, and personal savings as the additional margin that can make a worker's retirement years financially comfortable rather than financially marginal.

Enactment of legislation such as the chairman's bill, S. 557, as quickly as possible, would signal to the American public that our legislators have heard the proposition 13 message, are aware of the willingness and desire of the people to contribute to their retirement income as evidenced by the Lou Harris poll, and very importantly would demonstrate that Congress can act responsively, positively, and quickly to logical issues that help every American to help themselves.

We also urge Congress to demonstrate by early adoption of S. 557 that it can grasp the quick, clean, solid, and simple concept which is easily understood and translate it into a good, clean, solid, and simple law which is easily understood and administered.

Adoption of such a program as proposed by S. 75, section 203 of S. 209 and S. 557, and S. 594 and similar proposals would help cool inflationary fires, help create jobs, strengthen the private pension system, help our retired population in the future, and ease some of the pressures on the social security system.

There are many technical problems with both S. 209, section 203, and with S. 75, which bills are essentially identical. It is an old game, to take a good popular idea that would help the people but is not in favor with some Government agency, in this case the Treasury Department, and make it so unmanageable in the legislative form that employers must oppose it because, in the real world, it would be chaotic to administer.

These technical problems have been, and will be, detailed by many persons and organizations. The essential technical problems are related to attempts to prevent discrimination between higher paid and lower paid employees. Everyone knows full well that a pension plan will not even be qualified by the IRS unless it satisfies very complex provisions of the Internal Revenue Code that specifically prohibit such discrimination.

It is not necessary to destroy a perfectly good concept by burdening it with bureaucratic redundancy. This appears to be little more than a bureaucratic technique for delaying and discouraging enactment of this legislation.

Senator BENTSEN. With our time limitations, we are going to have to take the rest of your statement for the record. We appreciate it.

Mr. GRIFFES. I understand.

Senator BENTSEN. Mr. Taylor?

STATEMENT OF RICHARD TAYLOR, NATIONAL AUTOMOBILE DEALERS ASSOCIATION

Mr. TAYLOR. My name is Richard B. Taylor. I am here on behalf of the National Automobile Dealers Association Retirement Trust, a trust fund of approximately $350 million. We are a little bigger than that right now. We represent 76,000 participants and 5,300 plans.

I do have a written statement that I would like to submit for the record. I am going to try and summarize some of the major points in that statement.

We, of course, as others, applaud the efforts of the Senate and the House to correct some of the problems with the small employer and private pensions.

Our experience is that the financial position of small employers such as automobile dealers often requires the employer to require contributions of the participant. It is a way to provide meaningful benefits.

In fact, 90 percent of the 5,300 plans we administer right now are contributory. That represents about 60,000 participating employees that are contributing.

We have problems with IRA's which, inequitably, as far as we are concerned, permit the use of pretax dollars for certain employees and not for others. IRA's encourage withdrawals. That is our experience. Our participants do withdraw with the idea of establishing a tax shelter, a tax deduction.

In over 400 of our plans, we have a certain death benefit available for certain participants. When a participant withdraws from a plan he now eliminates that special death benefit which in some cases for rank and file employees can mean as much as $75,000 in death benefits lost to the family.

Participants who withdraw lose vesting credit for the time that they are out of the plan. We find that most participants fail to recognize the substantial benefits lost when they withdraw from a company-sponsored plan, even when counseled individually.

An even more serious problem we are faced with is the one when people withdraw from plans and adversely affect the coverage under the plans for continued qualification.

We have found that, in comparing choices for the participant in most cases, the net tax savings for his withdrawal and the establishment of an IRA is less than what he is giving up in employer contributions.

As far as qualified plan deductibility, we have, as I said, 60,000 participants participating now. That only represents 70 percent of the eligibles that we have available for plans. There are another 25,000 potential participants; some of them have IRA's. If we can get only 50 percent of that 25,000, 13,000 more people will begin to accumulate retirement benefits who do not now and the 60,000 who are making contributions, we think we can encourage to increase those contributions and increase their balances.

As an example, an employee at age 35 who makes $10,000 contributes 2 percent, which is $200. If we could get him to double that to $400, he would accumulate another $25,000 which would probably buy him, at age 65, $250 more per month in retirement benefits. That lessens the burden on systems such as social security. It also would encourage employers to continue to maintain plans that may now be in jeopardy because of withdrawals.

We are opposed to the grandfathering of deductibility. The problem is presented in section 203 of S. 209, because our experience indicates employers have to set up plans anyway and do not shift the burden. They have to set up that type of plan. There are rules on curtailments that probably will not permit employers to shift that burden. One Revenue ruling in particular would probably tend to disallow that.

As far as discrimination standards, we favor the simplest approach, S. 557. However, if Congress feels it necessary, then we would favor S. 75 in which only the highest paid would lose deductibility if a problem is created. So 557 involves the least expense and the least administrative burden for us as an administrator of large numbers of accounts.

That concludes our remarks, Mr. Chairman, and I would be happy to answer any questions you might have.

Senator BENTSEN. Thank you very much, Mr. Taylor.

May we have your presentation?

Mr. McCORMICK. Thank you, Mr. Chairman.

STATEMENT OF DEANE E. McCORMICK, JR., ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

Mr. McCORMICK. Mr. Chairman and members of the subcommittee, my name is Deane McCormick. I am appearing on behalf of the Association of Private Pension and Welfare Plans.

First, let me express the gratitude of the association and its members for the attention that sponsors of S. 75, S. 209, and S. 557 have given to employee savings toward the retirement years. As the cost of pensions continue to escalate, it becomes clear that the employees security must depend on the employer and Government.

We want to thank Senators Bentsen, Dole, Javits, Nelson, and Williams for recognizing the problems and proposing solutions. Who decides, though, where a particular dollar of compensation will be devoted rather to pensions, immediate wages, or some other alternatives? It is important to understand that the choice of providing pensions or the amount provided is not exclusively an employer's decision. Quite often the amount devoted to pensions is left strictly to employees. Under these circumstances you will find that the desire of one employee will differ from that of a fellow employee; the younger employee will want his compensation immediately to take care of the needs of his young and growing family while the older worker will prefer to have compensation to take care of his retirement years.

The contributory pension plans can accommodate both of these different needs by permitting the employee to vary his contribution as his needs change during the course of his working life. Recognizing the importance of pension benefits does vary and there may be conflict between the employees.

The tax considerations of funding pensions should be neutral. This is not the case, however, as Mr. Taylor has pointed out so clearly. There have been quite adverse impacts on the qualified plans since the enactment of the IRA.

Perhaps even more important is the financial impact of inflation. For instance, if an employer had instituted a final pay plan, expecting a 3-percent inflationary rate, and the national economy actually experienced a 7-percent inflationary rate, the cost of the employer would actually have experienced would increase 159 percent over what he would have initially contemplated putting into the plan.

The employees also are quite concerned about the inflationary rate and its effect on retirement security. A Lou Harris survey concluded that two-thirds of the employees are willing to contribute more than they do now in exchange for larger benefits or earlier benefit eligibility.

The greatest concern seems to be the continued rise of living cost following retirement.

Employers are hard-pressed to adopt average pay plans or improve such plans because of the recent years of heavy inflation. One way to encourage adoption of this type of plan is to provide for additional benefits in these plans is to provide for a contributory qualified supplement. Such supplements would, of course, be much more practical if employee contributions could be made on a tax-deferred basis.

By providing this additional attraction, Congress would be encouraging the growth of the private pension system and alleviating some of the presssure on private pension programs, social security in particular.

Another important byproduct of increased employee contributions is the inflationary impact. If a broad segment of society chose to forego current consumption in return for increased pensions, the overall effect would be very helpful in the national fight against inflation. An important corollary of that advantage, of course, would be that funds withheld would be invested, thus increasing capital formation and helping to generally expand the size and efficiency of the national economic plan.

The major differences between these two bills, S. 75 and S. 557, is the amount that is provided as a deduction and the discrimination test. The AAPWP suggests the need for deductibility of employee contributions has been demonstrated and is needed and the maximum has to be limited by budgetary limitations.

Nondiscrimination rules are necessary for the employee contribution as the current rule for section 401 of the code are broader and more effective than the ones proposed.

The discrimination rules of S. 75 should be confined to voluntary contributions if legislatively feasible.

We thank you.

Senator BENTSEN. Thank you very much.

Mr. Salkind?

STATEMENT OF CHET SALKIND, EXECUTIVE DIRECTOR, AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. SALKIND. Thank you very much.

My name is Chet Salkind. I am executive director of American Society of Pension Actuaries, a national professional society consisting exclusively of pension plan actuaries and consultants. Our 1,800 members provide actuarial, consulting and administrative services to approximately 25 percent of the qualified retirement plans in the United States.

Our society is pleased to be able to offer comments on the several bills under consideration by the subcommittee which will allow deductions for contributions to qualified retirement plans. We applaud the efforts made by Senators Bentsen, Dole, Javits, Nelson, and Williams to introduce the concept of deductibility of employee contributions in S. 75, S. 209, and S. 557. We heartily endorse this concept and believe its enactment would significantly strengthen the private pension system.

That the system needs strengthening is attested to by PBGC statistics which show that approximately 22,000 defined benefit plans have terminated from the time of ERISA's passage through December 1978. The rate of terminations has been particularly heavy among small plans. If one considers all types of pension plans, there has been a decrease in the ratio of new plans to terminated plans from 14.4 in 1973 to 4.3 in 1978. Such data indicates there presently is serious trouble in the private pension system.

The major reason for the number of terminations and considerable reluctance of employers to initiate new plans is cost. Not only do the vesting, funding and other substantive provisions of ERISA serve to increase costs, but the new and burdensome reporting and disclosure requirements have resulted in significant increases in administrative costs. The impact is particularly severe in the small plan area. The summary of the cost of Government regulation study developed by Arthur Andersen & Co. for the Business Roundtable stated, in part, that:

> The incremental administrative costs of ERISA are disproportionately greater for small businesses than for larger businesses. For example, the 10 smallest employers incurred average incremental costs per employee in 1977 nearly seven times those of the 10 largest.

The U.S. private pension system has been behind the systems of other countries for many years because deductions of employee contributions have not been allowed. We strongly support the concept of allowing a deduction by the employee for contributions made to qualified plans. Our society believes that such deductions would provide a strong incentive to establish and maintain tax qualified retirement plans. We urge Congress to adopt the approach taken in Senator Bentsen's bill, S. 557.

We believe the maximum deductible amount in that bill, $1,500 or 15 percent of compensation, would have a more favorable impact in stimulating the growth of pensions plans than the more limited maximum deduction of $1,000 or 10 percent of compensation in S. 75 or S. 209. Further, we would suggest inclusion of a proviso that would permit an increase in the $1,500 limit to reflect the impact of inflation, perhaps to correspond with the cost-of-living increases prescribed in the Internal Revenue Code section 415 limitation.

A second reason for our favoring S. 557 is that it does not contain the restriction found in S. 209 with regard to plans which require mandatory contributions—mandatory employee contributions made under a plan adopted after December 31, 1977, will not be deductible.

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The most prevalent and certainly the most significant reason for requiring employee contributions to a qualified plan is to enable employees to accrue more adequate retirement benefits than would be possible if the employer were the sole source of funding for the plan benefits. Employers will differ widely in financial abilities to fund an adequate pension plan and in philosophies regarding the possible methods of funding the plan. It is our view that Congress should not discriminate against plans which provide for mandatory employee contributions, but should continue to allow the parties to decide which type of plan best suits their needs.

Finally, we support the approach taken in S. 557 because of the absence of a discrimination test. We must admit that this question caused us serious concern and that, in testifying on S. 209, we supported the general concept of a discrimination standard, although we reserved judgment on the details. If the question is viewed solely from the perspective of encouraging the development of broadly based pension coverage, a case can certainly be made for the existence of a discrimination test to disallow deductions in situations where most contributions are being made by the highly compensated employees. Viewed solely from that perspective, we feel the discrimination standards in the Dole-Nelson bill, S. 75, are reasonable.

Although we recognize that a case may be made for discrimination standards, we have come to the conclusion that such standards are inappropriate if the question of deductible employee contributions is looked at from another perspective—the need to encourage the development of a major source of private capital. We are all familar with the problems of inadequate capital formation.

In our written statement there is a statement by the Investment Work Group of the DOL Advisory Council about the need for additional capital.

We believe it is of critical importance to do all that is feasible to encourage the development of pension plans as a source of investment capital, and that allowing deductions for employee contributions, as provided under S. 557, would be of significant help in solving our capital formation problems. Consequently, for this reason, as well as to provide increased retirement coverage under the private pension system, we support S. 557.

We will be happy to provide any additional information that the subcommittee feels will be useful.

Senator BENTSEN. Thank you very much.

I think all the statements have been helpful to us. You come from very diversified backgrounds and that adds to the importance of it.

Senator Dole?

Senator DOLE. I do not have any questions. It seems to me that we are all in agreement that we ought to do something. I guess the bottom line is how much can we afford and what can we pass.

Senator Bentsen's bill may be a better approach. I understand why you would want $1,500 or 15 percent. There is about $300 million in revenue difference. Those are the tradeoffs. I understand the question about the discrimination test. Hopefully based on the record today we can work out some acceptable program that will pass the Congress.

I guess that is what you are really concerned about. You all want something to happen; is that correct, or do you just want what you want to happen?

Mr. TAYLOR. We will take anything we can get.

Senator BENTSEN. You have to watch that kind of statement. Mr. Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman.

Mr. Taylor, on page 2 of your statement, you say ERISA permits employees not covered under a qualified plan to use pre-tax dollars to fund retirement benefits by deducting contributions to an individual retirement account; in contrast employees who are covered under a tax-qualified plan may not establish an IRA.

Because of this limitation, you say, a number of the participants in contributory plans have elected to withdraw in order to establish their own IRA's.

What percentage of the employees have withdrawn? Do you have any figures on this?

Mr. TAYLOR. I do not have any exact figures, Senator. I can tell you in the last several years we have terminated employer-sponsored plans for about 200 dealers who gave as a reason to IRS in the process, employee disinterest. We know what that means, because we checked the facts. They had a substantial number of people who were going to drop out, or who already had, because they would rather have IRA's than a company-sponsored plan.

The average number of participants in one of our plans is about 20. There are some much larger than that, so 20 times a couple of hundred would give you a rough idea.

Senator MATSUNAGA. What is the total number of participants?

Mr. TAYLOR. We have about 76,000 participants in all of the plans. About 90 percent, 85 to 90 percent of them are making contributions on a required basis.

Senator MATSUNAGA. You also state that approximately 90 percent of the 5,300 plans maintained by the 4,300 dealers participating are contributory. Of the 10 percent who are noncontributory, are they noncontributory because of the present law or because of other reasons.

Mr. TAYLOR. The 10 percent that are noncontributory are primarily profit-sharing plans that contributions are determined on a discretionary basis by the employer, and we discourage any mandatory contributions under such a program.

Senator MATSUNAGA. I see.

So these plans were noncontributory from the beginning and not because of the provisions of ERISA?

Mr. TAYLOR. No.

Senator MATSUNAGA. I see.

What about the other witnesses here. Do you have any experiences of your own as to dropouts because of the present provisions of ERISA?

Mr. McCORMICK. I believe we do. In my own particular company I am with, Senator, the only thing that has changed in our company with our pension plan since the enactment of ERISA has been the introduction of the IRA account by ERISA.

That lost approximately 10 percent of the participants since that time.

That would be a number of about 6,000 employees who no longer participate, but presumably would have had the law not been changed.

We think they are attracted to the IRA by reason of the tax deduction that is there. We feel this attraction is to their disadvantage. They obviously would lose disability benefits, some insurance benefits, and vesting benefits, possible improvements in benefits if the company should improve the plan in the future.

Senator MATSUNAGA. Do you believe that the enactment of the pending bills will cause a reversal of the dropouts?

Mr. MCCORMICK. I believe it would. If we had tax neutrality there would be no reason for them to drop out of the plan. They would have the deduction there.

Even if we had Senator Dole's bill of only $1,000, that would take care of the great percentage of our workers. Senator Dole's bill, as Treasury testified, would benefit 94 percent of the people of the United States. That it would be negative to them, I cannot understand their reasoning to that.

Senator MATSUNAGA. Would any of the other gentlemen like to state their experience for the record?

Thank you, Mr. Chairman.

Senator BENTSEN. If there are no further questions, thank you very much, gentlemen for your testimony. It has been helpful to us.

[The prepared statements of the preceding panel follow:]

STATEMENT OF ERNEST GRIFFES

Good morning, Mr. Chairman and committee members. I am Ernest Griffes, Director of Employee Benefits for Levi Strauss and Company and am appearing this morning on behalf of the 80,000 members of the Chamber of Commerce of the United States and, by mutual agreement, also on behalf of the 26,000 professional personnel executives who are members of the American Society for Personnel Administration.

Such dual representation in this appearance is unprecedented and remarkable and should be interpreted as an indication of the unified support that exists for the concept of encouraging individuals to set aside some resources to supplement retirement income from employer provided pension plans and social security.

Written testimony has been provided to the committee and I request it be entered in the records of this hearing.

My brief remarks shall summarize the essential points made in the written testimony and shall expand upon some technical issues that can be easily resolved in the legislation and will make it operate effectively in the real-world of benefit plan operations.

As the record of pre-ERISA hearings of the early 1970's demonstrate, any encouragement for individuals to save for their retirement has been a long sought objective. In my testimony before several Senate and House Committees in 1972 and 1973 on behalf of the American Society for Personnel Administration we strongly urged that every American, whether covered by an employer pension plan or not, be afforded every encouragement to "provide a measure of their retirement income security from their own resources."

This encouragement is totally consistent with the concept of retirement income security resting on three solid foundations: social security as a base, a private pension as a supplement, and personal savings as the additional margin that can make a workers' retirement years financially comfortable rather than financially marginal.

Enactment of legislation such as the Chairman's bill, S. 557, as quickly as possible, would signal to the American public that our legislators have heard the Proposition 13 message, are aware of the willingness and desire of the people to contribute to their retirement income as evidenced by the Lou Harris Poll, and very importantly would demonstrate that Congress can act responsibly, positively, and quickly to logical issues that help every American to help themselves.

We also urge Congress to demonstrate by early adoption of S. 557 that it can grasp a good, clean, solid and simple concept which is easily understood, and translate it into a good, clean, solid and simple law, which is easily understood and administered.

Adoption of such a program as proposed by S. 75, S. 209 (Section 203), S. 557, and S. 94 or similar proposals would help cool inflationary fires, help create jobs, strengthen the private pension system, help our retired population in the future and might even ease some of the pressures on the social security system.

There are many technical problems with both S. 209 (Section 203) and S. 75, which are essentially identical. It is an old game to take a good popular idea that would help the people, but is not in favor with some government agency (in this case the Treasury Department), and make it so unmanageable in legislative form that employers must oppose it, because in the real world it would be chaotic to administer.

These technical problems have been and will be detailed by many persons and organizations. The essential technical problems are related to attempts to prevent discrimination between higher paid and lower paid employees. Yet everyone already knows full well that a pension plan will not even be qualified by the IRS unless it satifies very complex provisions of the Internal Revenue Code that specifically prohibit such discrimination. It is unnecessary to destroy a perfectly good concept by burdening it with bureaucratic redundency. This appears to be little more than a bureaucratic technique for delaying and discouraging enactment of this legislation.

We offer the following simple suggestions which can easily be incorporated into S. 557 to make it even better legislation:

(1) Make it absolutely clear that employees may either (a) take the deduction for a contribution to an employer sponsored plan, or, (b) participate in an Individual Retirement Account outside of an employer sponsored plan. This will assure that small employers with qualified pension plans will not be forced to bear the heavy administrative burdens of adding employee contributions to the plan if they are not presently provided for, but employees will still be given the incentives to save. This would especially help small employers who can least afford the expensive administrative burdens.

(2) Provide that the employers only administrative obligation is to provide employees with a statement of the total amount of the employees contribution during the year, possibly on the W-2 wage reporting form.

(3) Provide that all the presently issued rules and regulations concerning IRA's with respect to contributors to such IRA's will apply to employee contributions to employer sponsored plans. This would support the concept of portability of benefits when an employee changes jobs by permitting rollovers. The IRA rules are also becoming established and understood and this would prevent development of a whole new set of complex rules that would be unnecessary and confusing.

(4) Incorporate the concept of a homemaker retirement savings program into S. 557 as is proposed in S. 94. This is consistent with powerful social trends that demand recognition of the important role of the homemaker spouse and equality between men and women.

(5) Clarify that where both spouses are covered by an employer pension plan, both are eligible for the retirement savings deductions.

In summary, we believe that S. 557 is completely consistent with the objectives of improving productivity, increasing employment and controlling inflation as stated in the Report of the Joint Economic Committee of Congress.

We urge Congress to resist all attempts to defile the positive values of encouraging employer savings for retirement by encumbering the idea with other objectives, such as those being proposed by Representative Pepper.

Lastly, we strongly support S. 557 and urge that with some modifications as outlined it be enacted into law quickly and apply to the current tax year. We commend the Chairman on offering a clean, honest, simple and manageable proposal that reflects the will and desire of the people, rather than the will of some bureaucratic agency.

Thank you.

STATEMENT OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

by Ernest Griffes

Good morning, I am Ernest Griffes, Director of Employee Benefits for Levi Strauss and Company with home offices in San Francisco, California. I am also a member of the Employee Benefits Committee of the Chamber of Commerce of the United States, and as such, I appear today on behalf of the more than 80,000 business and organization members of the National Chamber. Accompanying me is Michael Romig, Director of the National Chamber's Economic Security, Education and Manpower Section.

Because our nation's retirement income systems are financed largely by employer contributions to social security, private pensions, profit sharing and welfare plans, the business community has a vital stake in the genuinely concerned about the adequacy of the retirement incomes of their employees, we enthusiastically support the intent of this legislation to increase retirement savings and income.

RETIREMENT: A NATIONAL CONCERN

The United States appears to be in the early stages of a social and economic change of enormous importance. Demographic, employment and retirement patterns suggest numerous problems ahead in meeting the needs of the elderly who, by 2030, may constitute over 20 percent of our population.

Concerns about the adequacy of retirement income and national policies designed to encourage sound retirement savings plans take on a sense of urgency when we consider that the number of older citizens in America is increasing and that, because of increased longevity and improvements in pension programs, the number of years spent in retirement is growing. These trends will have a dramatic impact on retirement costs and retirement incomes.

Already, 24 percent of the FY 79 budget of the federal government is allocated to the elderly. Old Age Survivors and Disability Insurance, Medicare, Supplemental Security Income and Black Lung benefits will pay out more than $94 billion to persons over 65. Another $14 billion will be paid to the elderly under Civil Service, railroad and military retirement programs. Still another $4 billion will go the the elderly under other programs providing housing subsidies, food stamps, and social and unemployment services. In addition to these outlays from the federal budget, we can readily count about $19 billion to be paid in private pension benefits this year and another $11 billion from state and local government retirement programs.

These expenditures, large as they are, pale in comparison to HEW's estimates of $635 billion per year in 2025 -- more than 40 percent of total estimated federal government outlays. Private and public pensions can be expected to escalate as well and add many more billions of retirement income for those over 65.

Whether these costs can be afforded is a serious question and one that must be answered soon if people are to make adequate preparation for their retirement security.

For these reasons, we were extremely pleased to note the establishment of the President's Commission on Pension Policy (Executive Order 12071, July 12, 1978). This Commission is to undertake a comprehensive review of retirement programs and develop national policies to ensure that the programs are effective and equitable and take into account available resources and relevant demographic changes.

We hope this Commission will render valuable assistance to the Congress, the business community and all citizens as we move to meet the challenges ahead. And, we hope that this Committee will take the necessary steps to see that the Commission is afforded sufficient opportunity to carry out its important tasks.

SOCIAL SECURITY: A NATIONAL CONCERN

The cost of social security alone is a matter of great national concern. Granted, today's workers, as taxpayers, are letting the Congress know how much they dislike the tax increase approved in 1977. Yet, the same workers, as beneficiaries, have as much concern about the costs of social security when it is their turn to retire. A recent survey by Louis Harris for Johnson & Higgins, a nationally-respected insurance brokerage and consulting firm, found that a substantial number, particularly among younger employees, have little confidence in Social Security's ability to pay their retirement benefits.

Despite the massive payroll tax increase -- over $220 billion in the next 10 years -- the social security system remains in trouble. Payroll taxes will soon cover nearly all wages paid in America. Presently, they are imposed at over a 12 percent rate (6.13% on employers and 6.13% on workers) but that figure may need to be doubled early in the 21st century to finance the payments being promised today. If today's workers are rebelling at the prospect of 12 to 14 percent payroll taxes, what certainty is there that tomorrow's workers will be willing to pay a rate double today's?

These attitudes must be viewed with alarm. They may also be seen as an opportunity to rely more and more on the retirement savings efforts of the private sector. We see the legislation before this subcommittee as just such an opportunity. It is timely and critical to the concerns of the public and complementary to existing approaches to retirement savings.

PENSION INCOME: A NATIONAL CONCERN

The National Chamber's policy goal is to assure that private sector retirement savings efforts -- by employers, employees and self-employed individuals -- play a substantial role in meeting individual retirement income needs To the extent that government policies, laws and regulations help achieve this goal, our problems with the adequacy and the affordability of public programs are diminished.

We urge this committee to create a statutory environment that is attractive for retirement savings by individuals. Everyone is free to save for retirement but only the self-employed and those not participating in a tax qualified pension plan have the assistance of our tax laws to aid them in this effort. For these fortunate individuals, the tax laws permit them to exempt these savings and the investment income it earns from current tax. Both the funds saved and the income they earn becomes taxable only when it is drawn out from the savings vehicle. For most who elect to take this approach to retirement savings, the tax occurs at a point in their lives when it will take a smaller bite of their income. As such, this can be a strong and effective incentive to save for one's retirement.

These tax favored savings programs are known as "Keough Plans" for the self-employed and "Individual Retirement Accounts" for employed persons not participating in a tax qualified pension plan. The former permits annual retirement savings up to $7,500 per year while the latter is limited to $1,500.

Every American deserves the same opportunity to save for his or her retirement. All who are not now permitted to shield retirement savings from current income tax should be able to add to their retirement programs up to $1,500 per year on a tax deductible basis. This is generally the thrust of the legislation before this subcommittee.

WHAT THE BILLS PROVIDE

S.557, introduced by Senator Bensen, would allow individuals to claim as much as a $1,500 tax deduction for certain contributions to a company pension plan or to an individual retirement account.

S.75, introduced by Senator Dole, would allow individuals to claim as much as a $1,000 tax deduction for certain contributions to a company retirement plan or an individual retirement plan.

S. 209, introduced by Senators Williams and Javits would, among other things, allow individuals to take a tax deduction for contributions up to 10 percent of income or $1,000 (whichever is less) to a company pension plan or to an individual retirement account.

All of the foregoing bills do not require employers to accept employee contributions. But if an employer does accept contributions, he also accepts the paperwork and reporting burdens.

We enthusiatically endorse S.557 because of its higher limits and its relative simplicity. Further, it imposes no additional non-discrimination rules on employer's pension plans.

S.75 and S.209, while commendable for their efforts to increase retirement savings, are seriously flawed by unnecessarily complex rules and requirements designed to protect against a revenue loss that may be occassioned by an undue amount of retirement savings by employees. In the face of the very real problems of retirement income adequacy, social security financing and a shortage of private savings for investment, the concerns of S.75 and S.209 are overstated.

Beyond this, the national interest is served by federal encouragement to individuals to save for retirement during their working years. As such individual savings mount and are converted into retirement income, relief will be given to the pressures on both our Social Security and welfare systems. Furthermore, increased individual savings add to capital formation which yields increased employment and economic growth plus a broader tax base. This would tend to offset any revenue loss and, indeed, the revenue loss is usually only a tax deferral until the retirement income is received.

For these reasons, we urge this subcommittee to approve S.557 as the best approach to encouraging and expanding individual retirement savings.

STATEMENT

OF THE

NATIONAL AUTOMOBILE DEALERS AND ASSOCIATES

RETIREMENT TRUST

My name is Richard B. Taylor. I am representing the National Automobile Dealers and Associates Retirement Trust (NADART). We appreciate the opportunity to present to the Subcommittee our comments on S.75, S.557 and S. 209. These proposals provide different solutions to one of the major problems facing small employers, such as automobile dealerships, that maintain qualified retirement plans.

For the reasons set forth below, NADART applauds the efforts made by Senators Bentsen, Dole, Javits, Nelson and Williams and strongly urges passage by the Congress of a bill which will permit deductibility of employee contributions.

Because employee contributions to qualified retirement plans are not tax deductible, individuals presently are induced to drop out of such plans to establish Individual Retirement Accounts (IRA's) where their contributions are tax deductible. The aforementioned proposals will eliminate this incentive by permitting employees belonging to qualified plans to deduct their contributions to these plans.

NADART is the sponsor/plan administrator of four Master Plans approved by the Internal Revenue Service. Members of the National Automobile Dealers Association may adopt one or more of the Master Plans sponsored by NADART. Currently, NADART administers over 5,300 retirement plans covering in excess of 76,000 employee participants. The dealers who have adopted one of NADART's Master Plans are located throughout the United States.

Generally, the financial position of an average dealer does not permit him to maintain a plan without seeking to share the cost with his employees by requiring them to contribute to the plan. This is clearly demonstrated by the fact that approximately 90% of the 5,300 Plans maintained by the 4,300 dealers participating in NADART Master Plans are contributory.

In order for a dealer to establish and maintain a tax-qualified contributory plan, he must demonstrate that a fair cross-section of the employees at all income levels participate in the plan at all times. In other words, a dealer must demonstrate that high, middle and low paid employees will contribute under his plan at all times.

The Employee Retirement Income Security Act of 1974 (ERISA) permits certain employees to use pre-tax dollars to fund a retirement benefit by deducting contributions to an Individual Retirement Account (IRA). Employees who are covered under a tax-qualified plan are not, however, allowed to participate in an IRA. Because of this limitation, a number of the participants in our contributory plans have elected to withdraw in order to participate in an IRA.

Although in most situations the participant would have been better off in the dealer's plan, the deductibility of the contribution to an IRA appears to attract the individual away from the plan. In virtually every case the participant's net tax savings from the IRA deduction is less than the amount he has given up in dealer contributions. Approximately 400 of our plans also have a significant death benefit for active participants which, depending upon the age and compensation of a rank and file employee, can be as high as $75,000. When an employee is induced to leave the dealer's plan his family loses this valuable benefit should he die. In addition, a participant who withdraws no longer continues to accrue vesting in dealer contributions during his period of inactive status. A participant often fails to recognize the substantial benefits which he will lose when electing out of a dealer's plan.

The ramifications of the trend to elect-out of the contributory plan are also very serious for NADART and its Master Plans. As previously stated, a dealer must be able to demonstrate that a fair cross-section of his employees participate in the plan at all times in order to retain the tax-qualified status of the plan. Many of the participants who elect-out of the Master Plans are lower paid rank and file employees. As these employees withdraw from the plan, the dealer's ability to demonstrate that a fair cross-section of employees participate diminishes. When the dealer is unable to demonstrate that a fair cross-section of his employees participate in the plan, the tax-qualified status of the plan is lost.

Because many of the dealers in NADART's Master Plan have fewer than twenty employees, withdrawal of even one employee can have a significant impact on the dealer's ability to maintain tax-qualified status for his plan, particcularly for the dealer who must adopt a contributory plan. Failure to enroll several employees will severely restrict his ability to demonstrate that a fair cross-section of employees will participate.

Not only will deductibility of employee contributions have a salutary effect on the problem of qualification of the plan, it should also produce greater participation in the plan. At this time, there are approximately 60,000 participants making mandatory contributions to our Master Plans. This represents only about 70% of eligible employees. Therefore, another 25,000 potential plan participants who are not in the Master Plans may be induced to join by the deductibility feature. If only 50% of this additional uncovered group enroll, about 13,000 employees who at present have no retirement plan or make small contributions to an IRA, will begin to accumulate funds for their future retirement. In addition, the bulk of the 60,000 existing participants, many of whom are only making the minimum required contribution, will be induced to make additional voluntary contributions thereby increasing their potential retirement benefits dramatically. For example, one of the NADART plans provides for a two percent employee mandatory contribution. In this case an employee earning $10,000 makes a contribution of only $200. Assuming such employee is age 35, and is induced to increase his contributions to $400 per year as a result of the deductibility of his contributions, his account balance could be expected, at present interest rates, to accumulate an additional amount of approximately $25,000 by age 65 which would increase his monthly benefits by over $250 per month.

In order to permit dealers participating in the Master Plan to continue to operate qualified plans, encourage new dealers to adopt qualified plans, and protect the best interests of participants, Congress must enact a bill to permit a deduction for employee contributions to a qualified plan.

Of course, we favor the least complex approach to solving the problem of encouraging employee participation. In this regard S. 557 provides the most straight forward provision for deductibility. We understand that last year during the Congressional conference of the tax-writing committees on the Revenue Act of 1978, the Treasury proposed discrimination standards which may be reflected in part in the Dole-Nelson bill S. 75. If Congress believes that discrimination standards are necessary to achieve a bill to permit a deduction for employee contributions, we would support S.75. In this regard, S. 75 clarifies that when a plan fails to satisfy the discrimination standards it results only in the loss of a deduction for the highly compensated participant. Furthermore, the income level established in S. 75 for highly compensated participants is reasonable.

For the same reasons we support section 203 of S. 209. However, the provision of S. 209 which precludes employers from adopting new plans providing for employee contributions we strongly oppose. The stated reason for limiting the deduction to plans currently providing for mandatory contributions is the fear that employers will shift to contributory plans passing off the cost to employees. Our experience indicates that small employers will not switch from non-contributory to contributory plans. In fact, virtually all our participating dealers establish contributory plans as the only way to provide meaningful benefits to participants since the average dealer is often unable to fund the entire plan himself. Furthermore, an amendment requiring employee contributions to provide the same benefits that previously were provided exclusively by employer contributions results in a curtailment of the plan. An existing Treasury Ruling (see Rev. Rul. 69-24, 1969-1 C.B. 110) requires that all employees become 100% vested or the plan will lose its qualified status when such curtailment occurs.

In either case the consequences are harsh and sufficient to discourage employers from switching to a contributory plan from a non-contributory plan. Arbitrarily cutting-off employers from establishing such plans in the future only serves to discourage an employer from establishing any new plan. Such a result is clearly contrary to the stated purpose of S. 209. This section of the bill is grossly unfair to the small employer and we urge that any bill enacted by Congress not contain such a restrictive provision.

For the reasons stated above, NADART urges immediate enactment of a bill which will provide employees a deduction for their contributions to a qualified retirement plan.

I appreciate the opportunity to comment upon this proposed legislation on behalf of NADART and will be happy at this time to respond to any questions you may have.

Thank you.

STATEMENT OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

The Association of Private Pension and Welfare Plans is a non-profit organization founded in 1967. Membership is composed of a full spectrum of plan sponsors including corporations and associations -- both large and small -- and most of the principal consulting firms, insurance companies, investment managers and banks which service the benefits field.

The Association is dedicated to the preservation and growth of the private employee benefits field. Our primary efforts are directed to communication between our members and legislative and regulatory officials to insure that the needs of the private pension system are met.

This position paper is the result of the efforts of one of our several effective committees to inform and educate legislators, regulators and the public in an area of great importance within the industry represented by the APPWP.

Mr. Chairman and Members of the Subcommittee:

My name is Deane E. McCormick, Jr. I am a member of the Board of Directors of the Association of Private Pension and Welfare Plans and serve as the Chairman of its Legislative Committee.

I am pleased to have the opportunity to appear before you today to present the APPWP's views on S. 75 and S. 557 as well as Section 203 of S. 209.

The Association of Private Pension and Welfare Plans is a non-profit organization which was founded in 1967. The Association's approximately 600 members represent the full spectrum of employers, unions, plan sponsors and professionals involved with the maintenance and continued well-being of every type of private pension or welfare plan being maintained in America today. Our nationwide membership includes employers, unions, accounting firms, attorneys, banks, insurance companies, investment firms and counselors, and pension and welfare plan administrators and consultants. We believe the Association's broad-based membership offers your subcommittee a unique perspective on the pension proposals being considered in these hearings.

First, let me express the gratitude of the Association and its members for the attention the sponsors of S. 75, S. 209 and S. 557 have given to employee's savings for his retirement years. As the cost of pensions continue to escalate, it becomes ever clearer that the employee's retirement security must depend on a cooperative effort of the employer, the employee and the Government. We want to thank Senators Bentsen, Dole, Javits, Nelson and Williams for recognizing the problem and proposing solutions.

Before preceding to a discussion of the pending bills and the current law, it is best to comment briefly on the factors which decide whether a particular dollar of compensation will be devoted to pensions, immediate wages or some other alternative. It is important to understand that the choice of providing pensions or the amount thereof is not exclusively an employer's decision. Quite often the amount devoted to pensions is left strictly to the employees (perhaps through their union).

Under these circumstances you will discover that the desire of one employee will be different than his fellow-employee. The older employee will be concerned about his retirement security, but the younger employee will want a larger portion of the employer's compensation costs allocated to immediate cash payments which are available for the needs of his young and growing family. If the employees must collectively determine to allocate the proposed wage increase either to current compensation or the pension plan, then either the younger or older employee is going to be disadvantaged. However, the contributory pension plan can accommodate these different needs by permitting the employee to vary his contributions -- to contribute a lesser amount in his early years and more as he grows older.

In reality, the only distinctions between the contributory and non-contributory plans are the immediate tax effects and the fact that in some contributory plans employees have a degree of choice (precluded by IRS rules from being discriminatory in favor of the highly paid) as to how much of their income to allocate to their future retirement. The new COWPS guidelines reflect the impartiality of the compensatory dollar. For instance, if a company had a plan requiring employees to contribute 2% of pay and had planned to give a 7% cost of living pay increase and eliminate the contributory feature of the plan, they could only do so by cutting back the pay increase to 5%. In essence, because of the "total compensation" concept, companies have been making trade offs of this type for years, however, the COWPS rules highlight the importance of the "total compensation" concept which essentially makes the distinction between employer and employee monies somewhat academic.

Recognizing that the importance of pension benefits to a particular individual varies through his lifetime and may conflict with individual desires of his fellow employees, the tax considerations relative to funding should be neutral. This is not the case, however, because employer contributions are made on a pre-tax basis for the employee while employee contributions must be made on an after-tax basis. In fact, the recent changes in the law although good in themselves have had adverse effects on pension coverage because individuals who are not covered by employer sponsored plans are given the opportunity to adopt an individual retirement account (IRA), on a pre-tax basis. The effects of this change has been:

1) to encourage employees to cease participation in contributory qualified pension plans;
2) to attract employees to IRAs for the benefit of an immediate available tax deduction, but resulting in the employee's loss of:
   a) vesting in the employer funded portion;
   b) disability and insurance benefits provided in the pension plan;
   c) participation in the future grant of additional retirement credit for prior years of plan participation; and
3) to threaten the qualification and loss of the benefits of the qualified plan to employees participating therein, thereby accelerating their taxation and essentially defeating their retirement expectations.

The main purpose of the foregoing has been to point out the conflicts fellow employees experience in allocating the compensatory dollar, the important role employee contributions to pension plans can play, and the problem created by the current tax discrimination against them. Elimination of that discrimination would encourage further use of this valuable benefit structuring tool.

While the current tax law has produced factors negative to the further development and maintenance of qualified plans, perhaps even more important is the financial impact of inflation in escalating the costs of pensions. For instance, if an employer instituted a final pay plan expecting 3% inflation and the economy experienced 7%, the original costs the employer expected would increase 159% in a final pay plan. If he had instituted even a career average plan, his expected cost would have increased by 73%.

Can the employer bear the entire cost of a final pay plan? The answer to that question will vary with employers. Some already do. For others, it would be financially impossible. However, the number who would undertake final pay plans would increase significantly if the employees also contributed to funding of the pension benefits.

Employees are quite concerned about the inflationary rate and its effects on their retirement security. The recent Lou Harris survey on retirement attitudes concluded that more than two-thirds of the employees are willing to contribute more than they do now in exchange for larger benefits or earlier benefit eligibility. The greatest concern seemed to be the continued rise of living costs following retirement. The defined benefit final pay plan would usually provide the best assurance of adequate benefits at the time retirement commences. However, the risk of inflation and consequent costs of any type of defined benefit plan has motivated many employers to adopt defined contribution rather than defined benefit plans. In 1978, 55,956 defined contribution plans were qualified with the Internal Revenue Service but only 9,728 defined benefit plans. ERISA itself also promotes this trend by imposing greater burdens on employers adopting defined benefit plans rather than defined contribution plans. This is unfortunate since defined benefit plans are in general more beneficial to the employee.

For example, assume a 40 year-old individual initially making $15,000 works until retirement in 25 years. His salary increases follow the assumed inflation. His pension is 2% of pay for each particular year of service in the career average plan and 2% of final pay for each year of service in the final pay plan. His pension at different assumed inflation rates would be:

Inflation rate	3%	6%	7%
Career average plan	$10,938	16,459	18,975
Final pay plan	$15,703	32,189	40,706

Upon retirement the individual would be making approximately $71,000 if inflation had been 7%. The final pay plan would provide 57.3% of pre-retirement income as opposed to only 26.7% for the career average plan.

Employers, however, are hard pressed to adopt final average pay plans or improve such plans because of the recent years of heavy inflation. One way to encourage adoption of this type of plan or to provide for additional benefits in these plans would be to allow for contributory qualified (and hence non-discriminatory) supplements. Such supplements would, of course, be much more practical if employee contributions could be made on a tax-deferred basis. By providing this additional attraction, Congress would be encouraging the growth of the private pension system and thereby alleviating some of the pressure on public pension programs (Social Secuity in particular).

It should also be stressed at this point that the kind of supplementation we are referring to here does not imply that the cost of existing benefits would be shifted back to employees. In fact, the entire cost is, of course, already borne by the employees. What we mean here by supplementations are provisions to allow employees to increase their existing retirement package without foregoing other employer planned compensation increases. In many cases, such supplementation would be voluntary, thus allowing the employees most desirous of and in need of additional pension benefits to elect to purchase them.

An additional important by-product of increased employee contributions is its anti-inflationary impact. If a broad segment of society chose to forego some current consumption in return for increased future pensions, the overall effect would be very helpful in the national fight against inflation. In addition, the dollars of reduced current consumption would not be permanently lost to those who took the reduction. Their availability would be merely deferred until some time in the future when hopefully their use would have a less inflationary effect on the economy. An important corollary advantage would, of course, be that the funds withheld would be invested, thus increasing capital formation and helping to generally expand the size and efficiency of the national economic plant.

Another interesting and important feature of the employee purchased portion of a pension plan is that under ERISA rules these benefits are fully and immediately vested in the employee. If the employee accounts were made totally tax deductible, these accounts could be rolled over into an IRA or a successor employer's plan upon an employee's termination, thus providing a totally portable pension.

Thus the frequent complaints relative to vesting would be minimized. If an employee expected that he would frequently rotate jobs he could emphasize his own deductible contributions for retirement purposes and the employer could still provide adequate pensions for his long-term employees by proper structuring of the pension plan. Deductibility of employee contributions would help resolve the conflict between the short-term employees desire for immediate compensation and the long-term employees desire to maximize retirement income.

In summary, we have tried to point out a number of reasons why we support legislation to end tax discrimination against employee contributions to pension plans. We feel S. 75 and S. 557 are excellent first steps in this direction and we wholeheartedly support them. We believe S. 209 is defective in that it does not provide for the growth of the qualified contributory plan which is the basic concept from which the private pension system grew. During the last few years we have followed the development of legislative proposals addressing this problem and we believe the problems which the private sector is experiencing under the current law has already produced many undesirable plan terminations or disqualifications, as well as literally millions of cases of lost benefits, and has stagnated the development of new plans. Particularly the small employer is in great need of this legislation. Attached to my written statement is a copy of the APPWP's position paper on the problems faced by the small employer. This paper emphasizes the negatives of the existing law for the small employer and his need for such legislation as S. 75 and S. 557.

The major differences between these two bills from the APPWP's viewpoint are 1) the deduction is confined to $1000 in S. 75 rather $1500 in S. 557, and 2) S. 557 does not possess any discrimination tests other than what would be automatically applicable to a qualified plan by reason of Section 401. The APPWP suggests:

A. The need for deductibility of employee contributions has been demonstrated and the need is immediate.

B. The amount deductible should be the maximum amount permitted by budgetary considerations.

C. Additional discrimination rules are unncessary for mandatory employee contributions as the current rules of Section 401 of the Code are broader and more effective than those proposed.

D. The discrimination rules of S. 75 should be confined to voluntary contributions, if legislatively feasible.

In conclusion the APPWP applauds your efforts to address this important issue and thanks you for the opportunity to present our views.

(The position paper referred to at the beginning of the statement follows:)

INTRODUCTION

The ultimate irony would be if the Employee Retirement Income Security Act of 1974 (ERISA), enacted to strengthen the voluntary private pension system, contributed more to its disintegration. Because the APPWP is an organization dedicated to the preservation and "privatization" of retirement plans, we would view such an eventuality as calamitous. It takes no great imagination to foresee such a calamity. Thousands of small plans have already fallen by the wayside (see Appendix A). Many more tens of thousands of pension plans will follow. We have, therefore, compiled this modest list of what we see as some of the more pressing needs for legislative relief for the small plan.

The full extent to which compliance with ERISA would impact on private pension plans obviously could not have been known prior to the passage of the Act, but we know today that many aspects of the Act and the ensuing regulations are proving to be more than many employers can stand. To the extent ERISA has created such problems and costs for employers as to induce plan terminations or curtailments, it is self-defeating. While the adverse impact of certain provisions of the Act has been experienced by all employers, small employers have been most acutely affected. The problems these small employers are experiencing because of burdensome compliance too often translates into lost retirement protection which would otherwise have been afforded to their employees, as these companies terminate plans or refuse to expand existing plans or to establish new plans.

The full impact of the Act on small employers, which is difficult to gauge in terms of plans in existence, is much more difficult to determine in terms of those that will never come into being. Statistics show that most working Americans not covered by some form of private pension plan are employed by small employers. Of almost equal concern is the fact that ERISA and its progeny of regulations make the defined benefit form of private pension coverage less attractive for small employers, while encouraging utilization of other forms of coverage which all too frequently provide quite inadequate protection upon retirement. Perhaps the greatest cause of concern is that the traditional relationship between public and private retirement income protection is being changed at an alarming rate. The increasing cost to employers of Social Security is, of course, a factor; but an even larger factor is the increasing cost and complexity of providing private coverage. According to a recent survey of 748 firms conducted by the Chamber of Commerce, Social Security costs went up 173% in the 10 years between 1967 and 1977, while in the same period private pension costs mounted by 191%. These work together to decrease the likelihood that the private sector will be able to discharge its desire to provide adequate retirement.

The Association of Private Pension and Welfare Plans is uniquely qualified to speak to this problem, because it has a broad constituency among the full spectrum of companies and individuals involved with employee benefit plans. Included among its members, besides employers of all sizes, are actuaries, consultants, attorneys, accountants, administrators, and employee organizations. A special committee of the APPWP has been studying the problems small employers are experiencing because of ERISA for more than a year, and this paper is the product of that investigation. It should be noted that this study is restricted to small single employers, and does not address the problems of small employers participating in multi-employer plans. What follows does not pretend to be the definitive laundry list for legislative action even in this limited area. It is not intended to encompass all possible revisions of ERISA to relieve the small plan, but rather our top priority recommendations. For others, the priorities may be somewhat different; but we believe all will agree that our priorities are a good start.

Because our Association wants very much to see the private pension system work, we readily accept the need for regulation of pensions, but ERISA and the regulations it spawned have created unnecessary burdens in many areas which should be alleviated. The law has now been on the books for more than four years. It is, thus, not too soon to address these problems through corrective legislation.

After careful consideration, the APPWP makes the following recommendations for legislative changes to relieve some of the larger burdens which ERISA has created for smaller businesses. We believe enactment of these changes will remove many of the disincentives for establishment and maintenance of plans, and will once more encourage growth of private pension plans among small employers.

It will be observed that our recommendations begin with suggested directions to the regulatory agencies. The growing burden of regulations, which is now recognized by the Administration itself as a major cause of inflation, is nowhere more felt than under ERISA. The problem of regulatory overkill generally is well documented. A recent article in Nation's Business puts it thus:

> "It is only a matter of time before the American consumer realizes that inflation is not the only cause of higher prices. Government regulation, increasing a hundredfold every year, is also costing the consumer, and more and more business executives and economists are convinced that an awakening is at hand." (Oct. 1978 cover story.)

The article observes that the impact of government regulation on consumer goods and services alone is boosting the cost of living by $2,000 a year for a family of four! When one adds the cost of compliance with the multitude of government regulations that do not directly add to the employee's costs as a consumer, but which take a big slice out of the pie available for his wages and fringes, like ERISA, the price the employee pays for government is frightening.

It has become apparent that the Administration itself shares the public's fast growing fears concerning over-regulation. The New York Times attributes the following views to Barry P. Bosworth, Director of the Council on Wage & Price Stability:

> "As has his iconoclastic boss, Mr. Kahn, Mr. Bosworth indicated that he had less than complete confidence in Government regulation. The regulatory agencies are 'a mess,' he said, adding that too often they have failed to calculate the true cost of complying with desirable social goals, and this failure leads to higher prices and contributes significantly to inflationary pressures. He noted that the slowdown in the growth of productivity 'shows up mostly in those industries hit hardest by Federal regulation.'
>
> "To the delight of many in the audience, Mr. Bosworth said that the Administration intends to get regulatory agencies 'to measure costs as well as benefits.'" (New York Times, 12/7/78, Sec. D, p. 4, col. 2.)

In all fairness, however, it must be said that The problem is more often not so much of the regulators' making as a function of the statutory language itself. For this reason, we think that Congress must in certain instances expressly relieve the Department of Labor and the Internal Revenue Service of the necessity of requiring some elements of notification, reporting and disclosure.

RECOMMENDATIONS

These, then, are our legislative recommendations:

(1) Costly, unnecessary, and duplicative reporting and disclosure requirements must be further eliminated, though we recognize that much has already been done administratively. Additional legislative action appears to be needed to provide authority and direction to the regulatory agencies to make further strides in this area, since it is the statute itself which mandates much of the burdensome reporting, e.g., ERISA section 103 (relating to the annual report).

(2) The Summary Plan Description (SPD), under Labor Department regulations, is a cumbersome, quasi-legal overly detailed document that defeats its intended purpose and, also, has the effect of suggesting an adversary relationship between employers and employees. Legislative directions appear to be needed here, too, to reverse the present approach of the Labor Department.

(3) The procedure for plan qualification should be streamlined, e.g., by eliminating the requirement of notice to interested parties.

(4) Retroactive disqualification of plans should be

limited to cases of abuse or fraud, because disqualification causes participants to suffer adverse tax consequences for something over which they have no control.

(5) The joint and survivor annuity requirement has, because of its complexity, created an administrative nightmare for small employers and consequently reduced retirement benefits being offered to employees. The rules should be simplified so that only meaningful information must be provided to participants. Also, defined contribution plans should be removed entirely from these requirements.

(6) ERISA's imposition of liability on employers of up to 30% of their net worth in case of plan terminations has discouraged small employers from establishing and maintaining defined benefit plans. Legislation should be enacted to reduce this liability for those small employers who adequately fund their defined benefit plans.

(7) Congress should build upon the Supreme Court's recent reversal of the extension of federal securities law to noncontributing multi-employer pension plans in the Daniel case, and expand the rule of Daniel to all retirement plans that fall under the protection of ERISA.

(8) Integration of private pension plans with the Social Security system is a valid method of balancing employees' total retirement income and should be preserved under essentially the present rules.

(9) Legislation should be enacted allowing employees a tax deduction for contributions to qualified plans.

(10) The adverse effect of Individual Retirement Accounts (IRAs) on the coverage and growth of qualified plans should be eliminated by various alternative measures offsetting the counter-incentives of IRA funding. Conversely, the opportunities to utilize IRAs in instances where qualified plans are not providing retirement benefits should be liberalized.

(11) The definition of "small employer" should be broadened so as to eliminate arbitrary tests.

SUPPORTING BRIEFS

We offer the following brief support for the foregoing recommendations:

(1) Reporting and Disclosure: The area of reporting and disclosure has had an enormously adverse impact on the

47-321 O - 79 - 15

small employer. The complexity of the information required by ERISA to be filed with multiple Federal agencies and distributed to participants in full and summary form is confusing, costly, and unnecessarily burdensome. ERISA section 103, fully five pages of detailed requirements as to the contents of annual reports filed with the Labor Department, is, perhaps, the worst example of this.

Legislative history illuminates Congressional intent to protect the rights of participants and beneficiaries by requiring detailed reporting and disclosure. But participants' and beneficiaries' equity and rights have improved because of ERISA's substantive provisions, such as minimum coverage, vesting and funding standards and fiduciary standards, not because of often incomprehensible reporting and disclosure requirements. The limited use made of the enormous mounds of paper filed to date provides compelling evidence that reporting and disclosure is not as necessary as originally conceived; and we, therefore, strongly urge Congress to authorize and direct the administrative agencies to reassess and sharply reduce reporting and disclosure requirements. In many cases, availability of the information is much more important than its distribution, as, for example, the summary annual report. Current requirements produce complicated "summary" information, which does more to confuse the participant than it does to answer his real questions about the plan. Full financial information in the form of the annual report form provides more complete information; and if the participant were simply made aware of its availability, he would be afforded more valuable and meaningful disclosure.

We applaud the recent announcement by the Department of Labor of a proposed regulation to eliminate the filing of the plan description, Form EBS-1, because of being largely redundant by reason of the requirement to furnish a summary plan description. Congressional mandating of this, while no longer essential, would nevertheless guard against a later administrative reversal of position.

In urging a major trimming of the material to be filed, we do not seek an emasculation of reporting and disclosure. Rather, we hope that any legislative or regulatory attempts to correct current problems will have as their primary thrust an elimination of all but meaningful information for participants.

(2) Summary Plan Description: In the same vein, we strongly recommend that Congress mandate that the summary plan description (SPD) be drastically simplified. The very act of eliminating the EBS-1 in favor of the SPD may have the unfortunate side effect of reinforcing the Department of Labor's

present insistence on an overburdened SPD. Thus, Congressional directive is necessary to bring about the desirable simplification of the form.

Because of all the information required to be in the summary plan description, it has become an unreadable quasi-legal document. What is even worse, negative statements, such as the Pension Benefit Guaranty Corporation insurance statement and the ERISA rights statement, are confusing to participants and contribute nothing to the understanding of plans. Both of these statements, if retained, should be substantially revised to reflect a positive rather than a negative attitude. Obviously, in a defined contribution plan the PBGC insurance feature does not apply, and yet a statement to that effect must be included in the SPD. This immediately brings to mind completely inappropriate questions on the part of the participant as to how safe the defined contribution plan is if it is not covered by PBGC insurance.

The original purpose of the SPD was to provide participants and beneficiaries with information about the operation and benefits of a plan which their employer had instituted voluntarily or pursuant to a collective bargaining agreement. There is no reason why such a document should be required to contain language which appears to impugn the employer's motives.

Additionally, a degree of protection should be afforded to employers regarding the legal status of such a document. Language calculated to be understood by the average plan participant cannot be expected to provide a precise summary of a legal document; and employers should be able to tell participants that the plan document itself, not the summary, rules the provisions of the plan. A recent court decision points the way (O'Brien v. Sperry Univac, (DC D.C. 10/19/78)); but the protection of legislation is needed.

(3) Advance Qualification: We recommend that the procedures for advance determination of plan qualification be streamlined and simplified for small employers. A good place to start would be by scrapping the Notice to Interested Parties that a plan has applied for an IRS determination letter. This notice serves no useful purpose, and it is not easily understood by the average plan participant. We strongly believe that most participants ignore this notice. Almost no participants have utilized their right to participate in the administrative qualification process. Thus, the notice is a needless and expensive spinning of red tape, and merely adds to the cost of the plan.

Moreover, the entire advance qualification procedure might be eliminated entirely, or sharply curtailed. Under current procedure, employers file forms and make amendments at the request of IRS agents; yet actual operational compliance with ERISA is determined on the basis of an audit at some future time and not on the basis of the review of the plan document.

(4) Retroactive Disqualification: More important to most employers than advance qualification is protection against retroactive disqualification. We, thus, urge that Congress mandate a system for auditing plans under which retroactive disqualification of a plan would be permissible only for a willful disregard of statutory requirements, because such retroactive disqualification places an onerous burden on participants in consequence of something over which they have no control.

(5) Joint and Survivor Requirements: We would welcome a complete revision of the joint and survivor sections of ERISA. The complex administrative burdens they impose on all plans are needless and unproductive, because they do not relate to the realities of administering a plan. Additionally, defined contribution plans should not be included at all within the reach of the statutory sections in this area. Experience has shown that since all plans which offer a benefit in the form of an annuity are required by the Regulations to offer the joint and survivor option as the normal form of benfit, very many defined contribution plans have simply changed their plans so as not to offer a benefit at all in the form of an annuity. This can be detrimental to the beneficiary. We would prefer to see the joint and survivor option required merely as one of the options, rather than as the normal form of benefit unless elected otherwise.

The rules regarding notice requirements and elections in the area of the qualified joint and survivor annuity are overly complex and burdensome to the small employer. We urge their simplication. Since the notice concerning financial information must be given to participants ahead of time, it is an administrative burden to have to calculate a benefit which might not be exact. Notices are a source of delay, create ill will on the part of participants who do not understand the provisions and may be locked into unsuitable options, and pose unreasonable administrative burdens. If plan sponsors are allowed to fulfill the notice requirements through a combination of the SPD and an explanation of the available options at actual retirement, participants would receive a more meaningful explanation of their retirement benefits.

(6) Employer Liability: If the Contingent Employer Liability Insurance program of ERISA had been able to work, this area would not have posed the problem it has. The PBGC continues, at this very writing, to try to find a solution to this complex problem after four years. The 30% net worth liability imposition under Title IV of ERISA was perhaps needed at the outset to discourage companies from burdening the PBGC with their unfunded pension plans; but the 30% rule does not take into consideration the fundamental differences between large and small employers with respect to the funding of pension benefits. The funding standards imposed by ERISA largely

eliminate the need for net worth liability in the case of small employers, most of whose plans do not have large past service liabilities, and whose current liabilities must be fully funded.

Our studies indicate that small employers are put in a difficult situation regarding availability of credit, as many financial institutions take into account the 30% liability, however remote a chance of its being imposed, when they consider granting credit to the employer, and, on occasion, we are informed, deny credit on that basis. Additionally, small employers worry about financial exposure in a way large corporations seldom do; and the mere idea of the potential imposition of a liability of 30% of its net worth is not something a small employer is willing to live with, regardless of the unlikelihood of termination of the plan or of its being underfunded. Employers have, in many cases already, simply opted to terminate existing plans and install plans which avoid net worth exposure, but at the expense of reduced protection for employees, or have refused to install plans at all. Consequently, employees who might otherwise have been covered are not.

One possible alternative would be waiver of the net worth liability for small employers, but with higher premiums for employers whose plans are not fully funded. We are not, however, advocating that such plans necessarily be relieved of liability altogether, but rather that some alternative be adopted which recognizes their special circumstances.

(7) Securities Law Protections: The regulation of pension plans by ERISA clearly provides sufficient protection for employees without the additional application of federal securities laws to such plans. The operation of such laws contains substantial risks for small employers, which are entirely unncessary and clearly not intended by Congress to be added on top of the new ERISA sanctions. The Supreme Court's recent reversal of the lower courts in the Daniel case now makes obvious what should have been obvious all along, namely, that the federal securities laws are inapplicable in a situation where the employer's money is contributed to a pension plan without discretion by the employee. However, what is needed is a blanket exemption for employee plans, since distinctions among plans based on employee discretion, while pertinent in a securities context, are not particularly germane to retirement plans.

The Supreme Court's decision in Daniel, while containing some comforting dictum regarding the pre-emptive-like effects of ERISA in pension regulation, and while settling major questions respecting (i) qualified, (ii) multi-employer, (iii) involuntary, (iv) noncontributory, (v) fixed benefit, (vi) pension plans, which (vii) do not invest inemployer securities, still leaves many questions for vast numbers of qualified and unqualified plans that do not satisfy one or more of that particular combination of features.

Moreover, one cannot confine one's concerns to just the Daniel issue, which relates only to the question of the impact of the federal securities laws on the prospective pension interest of an employee derived from the mere acceptance of employment from a company with a pension plan. That case says nothing, for example, about the 1934 Securities Act liabilities relating to the underlying investments of the plan. The reach of the securities laws is swiftly expanding into this area, as witness the new decision of the Second Circuit Court of Appeals in Kirschner v. U.S.A., et al. (decided 11/30/78), where a pension plan participant was recognized as having a cause of action for securities fraud against a plan trustee pursuant to Rule 10b-5 (promulgated under the Securities Exchange Act of 1934), by reason of the purchase of New York City municipal bonds.

If Congress does not put a halt to the predictably rapid encroachment of securities law remedies in the pension field, ERISA will soon recede into the background as the guardian of employees' pension; and all the effort of Congress to enact ERISA, and of the agencies to administer it, and of the public to learn it and live under it will have been largely wasted.

(8) Social Security Integration: We believe it is self-defeating to pla·e such blocks in the way of the voluntary system of private pension protection as to discourage employers from helping to address and solve the inadequacies of the public Social Security system. That will be the consequence

of interfering with employers' right to exercise their long-enjoyed opportunity to integrate their own plans with the Social Security system on a basis that fully counts their own contributions to the public system. The cost of contributions to the Social Security system is an increasingly heavy burden, especially on the smaller employer, and we believe it is imperative to allow employers to take those contributions fully into consideration in providing a certain level of income replacement for their employees upon retirement. The present system, which has obtained for decades, accomplishes this admirably and should not be disturbed. Indeed, new ways must be found to encourage more incentives for linkage of the public and private systems as a means of achieving cost-containment of both.

(9) Individual Retirement Accounts: The IRA had originally been seen as a desirable mechanism for achieving income replacement for retirement. However, the very fact of restricting its use to those individuals whose employers do not sponsor qualified retirement plans, while serving as an incentive to personal savings for such individuals to supplement their Social Security benefits, has had a negative impact on the growth of qualified plans.

We are concerned that the IRA is coming to be misperceived as a replacement for qualified plans rather than the palliative it was intended to be where there is no qualified plan. The existence of IRAs invites small employers to discriminate by providing IRAs only for selected employees. Additionally, when employees opt to withdraw from a qualified plan, enough withdrawals can affect the qualification of the plan by putting the employer in a discriminatory posture not of its own making. This point is even more true of contributory plans, because employees are more likely to withdraw from these and not take into consideration the value of the employer's contribution.

Realizing that the IRA concept does have some place in the private pension scheme, we think the following alternatives should be considered, to better accomplish the purpose of having the IRA serve as a last-resort retirement vehicle rather than a supplemental vehicle for accumulating tax-sheltered cash:

(a) Deny IRAs to all employees, or restrict the use of IRAs to those individuals who neither work for a bona fide employer which sponsors a retirement program nor are eligible to use an HR-10 plan.

(b) Treat any individual who "elects out" of a qualified plan in order to establish an IRA as having made an irrevocable election, and deny re-entry into the qualified plan.

(c) Impose on employer-sponsored IRAs the same nondiscrimination rules which now apply to simplified pension plans.

(d) Deny IRAs to the members of the "prohibited group".

The newly enacted concept of simplified pensions (basically employer sponsored IRAs with higher contribution limits and non-discriminatory coverage requirements) is a mixed blessing. To the extent that these programs induce a contribution on behalf of employees where none would have been made before, they increase participation by a small employer's employees.

However, if these simplified pensions should contribute to a diminution of the establishment of defined benefit plans, a serious concern would arise because one could question the suitability of utilizing the simplified pension concept as the primary method of expanding retirement income. Many of the recommendations in this paper, on the other hand, will assist small employers to make free choices of defined benefit or defined contribution plans on the basis of their own particular corporate and employee circumstances, rather than in response to congressional stimuli to encourage one type of plan over another.

(10) Employee Contributions: We recommend legislation requiring every qualified plan to contain a provision permitting a participant to make contributions to the qualified plan up to the lesser of 10% of compensation or $1,000. An alternative suggestion would be, if a qualified plan does not permit such contributions, or if only minimal (or zero) contributions are made by reason of a fixed contribution formula

in the plan, to allow the participant a deduction for contributions up to the foregoing limit, to an IRA (but only if alternative (a) under item 9 is not adopted). We feel some such approach would solve the problems of employees not being able to accumulate enough retirement savings because of participating in very modest retirement plans.

(11) Definition of "Small Employer": Whether or not the foregoing recommendations or others are adopted for the relief of small employers, the definition of "small employer" must be broadened to provide the relief where it is needed. In defining "small employer", ERISA adopts the same concept used in the Welfare and Pension Plans Disclosure Act, i.e., an employer is considered "small" if its plan covers fewer than 100 participants. We believe, however, that this definition is arbitrary and unrealistic. There are many employers with significantly larger numbers of employees who, because of the nature of their businesses, cannot afford the internal staff or outside professional services required to comply with ERISA. They should not be subjected to the same requirements as larger firms. The number should be raised to 250 participants, as a minimum, and employees, rather than participants, should be the measure, so as to more accurately reflect the employer's circumstances.

CONCLUSION

We are convinced that if ERISA is reshaped to give special consideration to the nature of small employers and their special problems in maintaining employee benefit plans, the private pension system will again begin to grow and cover an increasing proportion of the national work force, without sacrificing the main goals of ERISA.

The Association of Private Pension & Welfare Plans, its Committee on Small Employer Plans, and its General Counsel would be pleased to offer assistance to members of Congress and their staff members as changes are considered in the legislation regarding small employer plans.

{APPENDICES FOLLOW}

APPENDIX A

Surveys of ERISA's Impact on Small Employee Benefit Plans

Summarized below are the findings of a number of surveys which have been undertaken to study ERISA's impact on employee benefit plans. Although the various survey results are not uniform, they are in agreement on one significant point: ERISA is an important factor in the termination of existing plans and the failure of employers to establish new plans. Further, a not too surprising statistic which is derived from these findings is that the smallest plans (under 10 participants) account for 69% of all plans, yet they account for 90% of all plan terminations.

Further, it is suggested that government studies of plan terminations be read with care, since it would appear that results obtained by these agencies are unlikely to reflect fully the true causes of plan terminations inasmuch as employers are reluctant to admit that ERISA's administrative burdens, and not pure "business purposes", dictated their decision to terminate.

(1) Retirement Administrators and Designers of America Surveys: The RADA is a nationwide organization of twenty-three pension consulting firms which service an estimated 6,000 qualified plans, principally in the small employer area.

<u>RADA CPA Survey</u>: RADA surveyed 500 CPA firms throughout the country. Members of "Big 8" firms were excluded since the objective was to reach firms which service small businesses. Twenty-seven percent of those surveyed (135 firms) responded to the questionnaire. Results of the survey indicate that many small employers are discouraged from establishing qualified pension and profit sharing plans. ERISA was not only a disincentive to the formation of new plans, but was also cited as the reason for termination by 69% of the employers which the CPA firms reported had terminated their plans.

<u>RADA Pension Consultants Survey</u>: This survey involved 40 pension consulting firms which service an estimated 8,000 plans (mostly small plans). Forty-five percent of those surveyed responded. Of the firms responding, 94% reported a decline in the number of new plans installed after ERISA compared to the number of new plans installed prior to ERISA. The typical rate of decline in new plans was 60%. Before ERISA, the average consulting firm installed six defined benefit plans for every four defined contribution plans. However, after ERISA, this ratio has changed to three defined benefit plans for every seven defined contribution plans. The presumed reason for the shift to defined contribution plans is the avoidance of

47-321 O - 79 - 16

contingent employer liability; the obvious problem with this shift is that the small employer is setting up a retirement plan that will do very little for his older employees.

(2) IRS Statistics Based on Determination Letters Issued in 1976: The figures developed by IRS provide a comparison of the number of plans approved by the Service before and after ERISA, as well as the number of plans terminating. The report shows a dramatic increase in the number of plan terminations. The number of corporate plans terminated in 1973 was only 4,120. But, in 1976, some 15,467 plans terminated. Just as we saw with the RADA Pension Consultants Survey, the ratio of new defined benefit plans to new defined contribution plans shifted in favor of defined contribution plans. In 1976, the IRS issued determination letters for 18,891 new defined contribution plans and only 2,595 new defined benefit plans. These figures reversed the pre-ERISA ratio of about 1.25 defined benefit plans for every one defined contribution plan.

(3) Subcommittee on General Small Business Problems ERISA Questionnaire: This subcommittee of the House Committee on Small Business sent 7,185 questionnaires to businesses that had notified the PBGC from June 1976 through April 1977 that they intended to terminate their pension plans. The questionnaire was designed to obtain information on the effect of ERISA on

the decision to terminate the plans. A total of 1,661 responses were received that were in a condition to be processed; however, not all of these responses answered all of the questions. Of the questionnaires processed, 1,629 answered the direct question as to the effect of ERISA on the termination of their plan. Of these, 79.1% indicated that ERISA had some part in the decision to terminate the plan. ERISA was given as the only reason for termination in 29.5% of those plans responding and 25.8% said that ERISA had a very great effect on the termination of the plan. Increased costs due to ERISA had at least some bearing in approximately 92% of 1,269 terminations. Furthermore, 83% of 1,053 responses cited increased administrative costs, as opposed to benefit cost increases and initial installation costs, as being the type of cost increase which most influenced the termination of the plan. Other factors cited with varying frequencies as contributing to plan terminations included: lack of clarifying regulations by the Department of Labor and IRS; potential penalty for not fully meeting the reporting and disclosure requirements; and overall effect of ERISA provisions without determinable costs. Of special importance is the fact that out of 1,548 responses to the question of what coverage would be provided for employees previously covered by the terminated plan, 55.9% said that they contemplated no employer-sponsored retirement plan coverage. Where such coverage would be provided, in over 90% of the cases it would be in some form other than a defined benefit pension plan.

(4) General Accounting Office Survey: A survey of defined benefit plan terminations showed that ERISA was cited as a contributing factor in the decision to terminate for 50% of the 595 plans responding.

(5) Senator Dole's Survey: Senator Dole of Kansas conducted a survey of IRS approved pension and profit sharing plans in Kansas. Of the businesses responding, almost half had qualified plans. Yet, of those which had plans, over 25% had either terminated the plan or were anticipating terminating it in the near future. The chief complaint -- the complexity of ERISA regulations.

(6) Senator Lugar's Survey: Senator Richard Lugar of Indiana conducted a survey of Indiana businesses. (He sent out 15,000 questionnaires and received 2,000 replies.) He found that firms with 50 or fewer employees were experiencing the most trouble with ERISA. Of those responding firms who had terminated their plans, ERISA was mentioned as the reason for termination by 85% of those firms which had fewer than 50 employees. Furthermore, ERISA was cited as the reason in 64% of the cases of small employers who were planning to terminate their plans. Also, of the small employers which had never had a plan and did not intend to establish one, 46% gave ERISA as the reason for not establishing a plan.

(7) PBGC Statistics: The PBGC figures for defined benefit plans terminated in 1976 indicate that 97% of the plans covered fewer than 100 participants. However, the study cited ERISA as the cause of termination in only 25% of the cases.

(8) Price Waterhouse Survey for the Department of Labor: In June of 1976, Price Waterhouse obtained a contract from the Department of Labor to perform a study of the cost impact of ERISA on small plans. The study was completed by Price Waterhouse in November 1977, but the Department of Labor delayed publishing it until May of 1978. A great deal of interest had been expressed in the benefit industry as to the results of the study and the assumption was that the failure to release it indicated, by implication, that the study showed the administrative burden of ERISA was substantial and probably a major cause of plan termination. The Department of Labor has released its own report on the study and attempted to minimize the findings by citing the poor response to the questionnaires. However, both the Labor Department's summary report on the study and a response to that report by Price Waterhouse show a staggering increase in total pension plan administrative costs from 1974 to 1976. The Department of Labor shows a median increase of 63% while Price Waterhouse shows a median increase of 72%. Private speculation is that this figure is actually much higher than either of the above.

APPENDIX B

ASSOCIATION OF PRIVATE PENSION & WELFARE PLANS

SMALL EMPLOYER PLANS COMMITTEE

Douglas D. Stegner (Chairman)
Meidinger & Associates, Inc.
Louisville, Kentucky

Vicki L. Dungan
Schanes Associates
Washington, D. C.

Michael W. Dunigan
Meidinger & Associates, Inc.
Louisville, Kentucky

Richard Fay, Esq.
Reed, Smith, Shaw & McClay
Washington, D. C.

William Harmelin, C.L.U.
Business & Estate Planning
Consultants, Inc.
New York, New York

Michael F. Klein, Jr.
Price Waterhouse & Co.
New York, New York

Harry V. Lamon, Jr.
Henkel & Lamon, P. C.
Atlanta, Georgia

Edward K. Leaton
Lambert M. Huppeler Company
New York, New York

Robert F. McIntyre, C.L.U.
Fred S. James & Co., Inc.
of Virginia
Arlington, Virginia

Edgar R. Smith
First Union National Bank
Charlotte, North Carolina

Thaddeus W. Swank
Maryland National Bank
Baltimore, Maryland

Richard B. Taylor
National Automobile Delaers
& Associates Retirement Trust
McLean, Virginia

Ron Waterfield
Watkins, Ross, Waterfield
& Baines
Grand Rapids, Michigan

John F. Woyke
Woyke & Field, P. C.
Stamford, Connecticut

EX OFFICIO:

John H. Martin
APPWP President
Litton Industries
Beverly Hills, California

William N. Bret
APPWP President-Elect
A. S. Hansen, Inc.
Dallas, Texas

Alvin D. Lurie, Esq.
APPWP General Counsel
Chadbourne, Parke, Whiteside
& Wolff
Washington, D. C. and
New York, New York

STATEMENT

OF

THE AMERICAN SOCIETY OF PENSION ACTUARIES

The American Society of Pension Actuaries is a national professional society consisting exclusively of pension plan actuaries and consultants. Our 1800 members provide actuarial, consulting and administrative services to approximately 25 percent of the qualified retirement plans in the United States.

Our Society is pleased to be able to offer comments on the several bills under consideration by this Subcommittee which will allow deductions for contributions to qualified retirement plans. We applaud the efforts made by Senators Bentsen, Dole, Javits, Nelson, and Williams to introduce the concept of deductibility of employee contributions in S.75, S.209, and S.557. We heartily endorse this concept and believe its enactment would significantly strengthen the private pension system.

That the system needs strengthening is attested to by PBGC statistics which show that approximately 22,000 defined benefit plans have terminated from the time of ERISA's passage through December, 1978. The rate of terminations has been particularly heavy among small plans. If one considers all types of pension plans, there has been a decrease in the ratio of new plans to terminated plans from 14.4 in 1973 to 4.3 in 1978. Such data indicates there presently is serious trouble in the private pension system.

The major reason for the number of terminations and considerable reluctance of employers to initiate new plans is cost. Not only do the vesting, funding and other substantive provisions of ERISA serve to increase costs, but the new and burdensome reporting and disclosure requirements have resulted in significant increases in administrative costs. The impact is particularly severe in the small plan area. The summary of the Cost of Government Regulation Study developed by Arthur Andersen & Co. for the Business Roundtable stated, in part, that "The incremental administrative costs of ERISA are disproportionately greater for small businesses than for larger businesses. For example, the ten smallest employers incurred average incremental costs per employee in 1977 nearly seven times those of the ten largest."

The United States private pension system has been behind the systems of other countries for many years because deductions of employee contributions have not been allowed. We strongly support the concept of allowing a deduction by the employee for contributions made to qualified plans. Our Society believes that such deductions would provide a strong incentive to establish and maintain tax qualified retirement plans. We urge Congress to adopt the approach taken in Senator Bentsen's bill, S.557.

We believe the maximum deductible amount in that bill, $1500 or 15 percent of compensation, would have a more favorable impact in stimulating the growth of pension plans than the more limited maximum deduction of $1000 or 10 percent of compensation in S.75 or S.209. Further, we would suggest inclusion of a proviso that would permit an increase in the $1500 limit to reflect the impact of inflation, perhaps to correspond with the cost-of-living increases prescribed in the Internal Revenue Code section 415 limitation.

A second reason for our favoring S.557 is that it does not contain the restriction found in S.209 with regard to plans which require mandatory contributions (mandatory employee contributions made under a plan adopted after December 31, 1977, will not be deductible).

The most prevalent and certainly the most significant reason for requiring employee contributions to a qualified plan is to enable employees to accrue more adequate retirement benefits than would be possible if the employer were the sole source of funding for the plan benefits. Employers will differ widely in financial abilities to fund an adequate pension plan and in philosophies regarding the possible methods of funding the plan. It is our view that Congress should not discriminate against plans which provide for mandatory employee contributions, but should continue to allow the parties to decide which type of plan best suits their needs.

Finally, we support the approach taken in S.557 because of the absence of a discrimination test. We must admit that this question caused us serious concern and that, in testifying on S.209, we supported the general concept of a discrimination standard, although we reserved judgment on the details. If the question is viewed solely from the perspective of encouraging the development of broadly based pension coverage, a case can certainly be made for the existence of a discrimination test to disallow deductions in situations where most contributions are being made by the highly compensated employees. Viewed solely from that perspective, we feel the discrimination standards in the Dole-Nelson bill, S.75, are reasonable.

Although we recognize that a case may be made for discrimination standards, we have come to the conclusion that such standards are inappropriate if the question of deductible employee contributions is looked at from another perspective - the need to encourage the development of a major source of private capital. We are all familiar with the problems of inadequate capital formation. In this regard, the position paper of the Investment Work Group of the DOL Advisory Council on Employee Welfare and Pension Benefit Plans, issued January 24, 1978, stated:

> "Some economists believe that one of the greater obstacles facing the nation's economic health over the next ten years would be a lack of available funds flowing into capital formation. Capital consumption between 1965 and 1974 totalled approximately $1.6 trillion. The supply of capital grew at a compound annual rate of 6.7 percent during the period. As the economy grows, the capital needed will continue to expand. In addition, capital requirements have grown as attempts are made to improve energy efficiency, reduce pollution, and make working conditions safer. The resulting capital requirements of the 1975-85 period have been estimated by some at over $4.0 trillion, requiring that capital supply grow at a compound 8.7 percent rate annually. Another study of the nation's capital requirements through 1980 indicates similar requirements. Further, the Bureau of Economic Analysis has estimated that business fixed investment, as a percentage of Gross National Product, must rise from the 10.4 percent level of the past decade to approximately 12 percent to meet national goals of lower unemployment, environmental protection, and improved energy efficiency."

We believe it is of critical importance to do all that is feasible to encourage the development of pension plans as a source of investment capital, and that allowing deductions for employee contributions, as provided under S.557, would be of significant help in solving our capital formation problems. Consequently, for this reason, as well as to provide increased retirement coverage under the private pension system, we support S.557.

We will be happy to provide any additional information that the Subcommittee feels will be useful.

Senator MATSUNAGA. Mr. Chairman, I would like to submit for the record an opening statement which I intended to make.

Senator BENTSEN. Without objection, it will so be done, the opening statement of Senator Matsunaga will be inserted in the record at this point.

[The opening statement of Senator Matsunaga follows:]

STATEMENT BY HON. SPARK M. MATSUNAGA

Mr. Chairman, I want to take this opportunity to express my appreciation for allowing the Subcommittee on Private Pension Plans and Employee Fringe Benefits to consider various proposals providing deductions for individual retirement savings. Clearly, some action must be taken in this area to permit a retirement savings deduction for persons covered by qualified pension plans. You have introduced S. 557 in answer to this problem and I am glad to be a co-sponsor of the measure.

The Senate Finance Committee considered this issue during its executive session on the Revenue Act of 1978. The Committee decided at that time that changes were necessary to make the operation of the individual retirement account program more uniform and to increase the incentives for employees to save for their own retirement. Consequently, the Committee adopted a proposal to allow an active participant in a private pension plan or a group retirement trust, a deduction of the lesser of 10 percent of earned income or $1,000 for any contribution made to a private qualified pension plan, an individual retirement account, or a group retirement trust.

This provision had the support of the Association of Private Pension and Welfare Plans, the American Academy of Actuaries, the American Council of Life Insurance, the American Bankers Association, the United States Chamber of Commerce, the ERISA Industry Committee, the American Society of Pension Actuaries, and a number of other private industry associations. However, budget constraints and various objections forced the House and Senate conferees to drop this provision from the final bill.

Despite this turn of events, I believe that the 96th Congress must address this issue. Presently, individual retirement accounts are limited to workers not covered under a qualified plan. Consequently, the individual retirement account provision threatens to undermine qualified retirement plans.

It is a well known fact that many employer plans require joint contributions from workers and employers. These worker contributions are not deductible under existing law. Consequently, many workers choose not to be covered by their employer's plans so that they can set up their own individual retirement account.

Because of this option to deduct individual retirement contributions, workers tend to ignore the employer contribution which is forfeited by their electing out of a corporate plan. As more workers elect out, the corporate plan begins to cover only highly paid executives and as a consequence the plan is disqualified.

This development has been a significant factor contributing to the decline of qualified plans and the decreasing number of new plans. Employees and employers alike are unable to understand the difference in tax treatment between a qualified plan and an individual retirement account.

In 1976, the House passed a measure to permit all except civil service workers to set up an individual retirement account. The Finance Committee, concerned about the cost, disagreed with the House proposal. But the Senate Committee stated in its report that the proposal if enacted should apply to all workers, even government employees. Clearly, the alternatives should be considered and I appreciate the opportunity provided by the Chairman at this time to take testimony on the various options.

The issue is further complicated by the fact that under present law, wage earners who do not participate in a retirement plan may establish their own IRA and deduct for tax purposes up to 15 percent of earned income or $1,500, whichever is less. The wage earner may also elect to set up a spousal IRA and thus have his IRA limit extended to $1,750. However, a spousal IRA can only be elected if the wage earner is himself eligible to establish an IRA for his own account. Thus, a worker who participates in a retirement plan and who thus is disqualified from setting up an IRA may not establish an IRA for his spouse.

It is estimated that between 30 to 50 million homemakers will soon reach retirement age, and many of these individuals who have devoted their lives to their families, will have little financial provision for their old age.

Mr. Chairman, sound social policy would seem to dictate that individual citizens should be encouraged to provide for their own retirement, and that homemakers should be among those given that privilege. Consequently, I have joined the Senator from Texas, Mr. Lloyd Bentsen in supporting a bill S. 94 to allow individuals to set up homemaker IRA's. The bill would allow any homemaker to set up an IRA, regardless of the type of retirement plan, if any, the working spouse has. It would permit an annual contribution of up to $1,500 by the homemaker and the working spouse for a maximum of $3,000 combined contribution. I believe that this provision would remove the unfair discrimination against the homemaker in existing law.

The Revenue estimates for the various proposals are admittedly large. However, I strongly believe that legislation must be enacted to encourage workers to provide for their own retirement, as well as to encourage needed capital formation.

Senator BENTSEN. Thank you for your attendance.

[Whereupon, at 12 noon the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman, the following communications were made a part of the hearing record:]

western union **Telegram**

IPMPOMU HSB
1-0114530092 04/02/79
TLX FURMANITE VABH
01 VABH VA APRIL 2
PMS DLY MICHAEL STEARN, STAFF DIRECTOR

FINANCE COMMITTEE
2227 DIRKSEN SENATE OFFICE BUILDING
WASHINGTON,DC 20510

FOR YOUR HEARING REF SENATE BILLS 875 894 8557 APRIL 3, 1979

PLEASE PASS FOLLOWING COMMENTS TO SENATOR BENSON:
1, OUR FIRM NOW PLANS EMPLOYEE CONTRIBUTION THRIFT PLAN.
COMPANY WILL MATCH EMPLOYEE CONTRIBUTION AT DOLLAR FOR DOLLAR.
2, PLAN WELL RECEIVED BUT 100 PERCENT OF ALL NEGATIVE
COMMENTS FROM EMPLOYEES IS LACK OF TAX DEDUCTION.
3, THIS ESPECIALLY TRUE AT LOWER PAY LEVELS.
4, IN VIEW OF WIDESPREAD DOUBTS REF SOCIAL SECURITY,
WE FEEL IT CRITICAL TO OUR EMPLOYEES FUTURE THAT YOUR BILLS
BE PASSED ENCOURAGING PRIVATE INVESTMENT IN COMPANY AND
PRIVATE PENSION PLANS.
5, LET'S GIVE TAX BREAKS TO THOSE WHO ARE WORKING HARD TOWARDS
A MEANINGFUL LIFE AT ALL AGES, INCLUDING RETIREMENT.
6, WE ESTIMATE FAVORABLE ACTION ON REF BILLS WILL INCREASE
PARTICIPATION OVERALL 25 PERCENT.

REGARDS,
JOHN D, GHEE
FUVICE PRESIDENT
FURMANITE INCORPORATED
VIRGINIA BEACH, VIRGINIA

12:26 EST

IPMPOMU HSB

Automatic
Data Processing

ADP Pension Services Inc
180 Newport Center Drive
PO Box 2090
Newport Beach California 92663
714-644-4360

ADP

March 27, 1979

The Members of the
COMMITTEE ON WAYS AND MEANS, AND
COMMITTEE ON FINANCE

Subject: Comment on the Technical Corrections Act of 1979

Re: Rollover Provisions for Tax Sheltered Annuities ("TSAs")

Dear Sir:

ADP Pension Services, Inc., a major retirement system administrator, and International Trust Corporation, are both wholly owned subsidiaries of the CPI Group, Incorporated, in turn a wholly owned Division of Automatic Data Processing, Inc. of Clifton, New Jersey.

Moreover, ADP Pension Services, Inc. and International Trust Corporation act as Retirement System Administrator and Trustee over approximately 2,000 corporate retirement plans, 8,000 Keogh retirement plans and 3,000 Individual Retirement Accounts, and expect to obtain an additional 20,000 Keogh and IRAs by the end of 1979 through our financial institution program.

It should be noted that all of our corporate and Keogh plans are those of small employers, ranging from one to fifty plan participants each.

Further, all of the above mentioned plans and trusts have been adopted incorporating the use of one or more of our master plans, as qualified under the IRS Master and Prototype Program.

In reviewing the provisions of the Revenue Act of 1978 and Technical Corrections Act of 1979 (HR2797 and S614), we find that an oversight or drafting error occurred relating to the rollover provisions of TSAs.

March 27, 1979
Page Two

Attached hereto is a complete explanation of the problem and suggested corrective language for your consideration.

If we may be of further service to you or your staff, or should you have any questions regarding the contents of this letter, please do not hesitate to contact the undersigned. Thank you for your cooperation and consideration in this matter.

Very truly yours,

ADP PENSION SERVICES, INC.

M. John Lippman
Vice President

MJL:lp

Attachment

ADP

M E M O R A N D U M

DATE: March 27, 1979

FROM: Regulation & Compliance Department,
ADP Pension Services, Inc.

SUBJECT: Comment on the Technical Corrections Act of 1979
(HR 2797 and S 614)
Tax Sheltered Annuities ("TSA")

BACKGROUND

Tax Sheltered Annuities (TSA's), like private pensions in general, preceded the Employee Retirement Income Security Act of 1974 (ERISA) by some thirty (30) years. Despite this history, however, TSA participants have not, until the Revenue Act of 1978, been given the privilege to use the IRA Rollover as a retirement vehicle.

As you know, the Revenue Act of 1978 (P.L. 95-600) brought many changes in the tax laws. In particular, there were several additions and modifications to the rules regarding the establishment and maintainance of IRAs. Section 156 of that Act added subparagraph eight (8) to paragraph (b) of Internal Revenue Code (IRC) section 403.

The inclusion of section 156 as a provision of the Act was intended to provide TSA participants with conduit privileges as well as the ability "to reinvest the proceeds in an individual retirement arrangement if such an arrangement appeared to be a better investment for retirement purposes" (Conference Committee Reports). Each investment decision would, therefore, be left in the hands of the individual plan participant.

THE TSA NUTSHELL

Historically, an employee could establish, stop, discontinue or withdraw from a TSA at his pleasure with tax consequences applying only to the funds withdrawn. The participant could always change his contract contribution amount each calendar year. He could authorize the discontinuance of contributions to one plan (company) and start another providing the amount of contribution did not change. Also, he could transfer his plan from one company to another without tax consequences.

Tax Sheltered Annuities provide very limited opportunity for surrender. However, the basic withdrawal plans are available: 1) partial surrender, 2) periodic basic withdrawal, 3) lump-sum (total) withdrawal, or 4) life annuity. Lump-sum withdrawal in the industry has no conditions such as prescribed in 402(e)(4)(A).

Individual Retirement Accounts provide better flexibility for withdrawal after the conditions of 402(e)(4)(A) are met. By transferring a TSA into an IRA the employee is trading flexibility of withdrawal for flexibility of investment. This new flexibility, of course, carries with it stringent penalties on early withdrawal.

STATEMENT OF PROBLEM

New Code section 403(b)(3) permits participants in certain Tax Sheltered Annuity Programs to take "qualifying distributions" and make rollover contributions to IRAs.

To be a "qualifying distribution", according to the Revenue Act, all the annuity contract standing to the credit of the Program participant must be distributed to him in a lump-sum. The lump-sum must meet the requirements of IRC section 402(e)(4)(A). That is it must be distributed on account of:

(1) The participant's death,

(2) The participant's attaining age 59½,

(3) The participant's termination of employment, or

(4) The participant's becoming disabled.

In reviewing the various statutes and conference agreements it appears that the intent was to allow a complete or partial rollover of the taxable portion of a TSA distribution. Additonally, section 403(a)(4)(A) provides for a rollover without reference to the stipulations in 402(e)(4)(A). Section 403(a)(4)(B) refers to conditions similar to those in 402(a)(5)(B)(E), 402(a)(6) and 402(a)(7). These sections of the Code refer to 402(a)(5)(E) which contains specific rules for a transfer. A transfer is considered a qualifying rollover contribution under 408(d)(3) which, among other things, requires completion within 60 days of distribution and transmittal directly from a 501(a) organization to another. "Plan termination," however, is not included in this discussion even though it is mentioned in various of the sections cited.

Under 403(b)(3)(C) the applicable rules cited refer to section 402(a)(5)(B),(C),and (E)(i) which reiterate that a transfer can be made to an eligible retirement plan as described in 402 (a)(5)(D)(iv). Also, 402(a)(6)(A) refers to complete discontinuance of a plan. Thus the plan termination concept is described.

THE STATUTORY INEQUITIES

The IRC, as amended by section 156 of the Act, only partially cured the inequities which had existed between Annuity holders and other private pension plan participants. TSA participants will not have true investment flexibility until further technical corrections are made to Code section 403(b)(8).

With the inclusion of section 403(b)(8) a TSA participant and his widow (her widower) have obtained limited portability rights. This portability is necessary if the goal of investment flexibility is to be achieved. The provision, however, only covers the tip of the iceberg for these employees.

Neglected during this push for equality was the area of "plan termination". Therefore, the TSA participant himself is still unable to achieve the investment flexibility that Congress intended and his pension and profit sharing compatriots enjoy.

A TSA Program, qualified under IRC section 403(b), involves a voluntary decision by the individual employee. Unlike a Pension or Profit Sharing Plan, which must meet the requirements of IRC section 401(a) (including coverage), the TSA Program is not burdened by anti-discrimination rules. While the employing entity determines whether or not to establish a TSA Program, it is the individual employee whose voluntary decision, standing alone, determines whether contracts are purchased on his behalf within this Program. This affirmative action is the basis for the establishment or termination of his Plan during a particular tax year.

The TSA Program, in practice, is quite similar to the Employer Sponsored IRA Program described in IRC section 408(c). In both instances, the employer establishes a skeleton program and the employee commences or terminates his own Plan. The difference is that termination of the employee's TSA Plan gives rise to a distributable event, where as distribution from the IRA may not commence before the participant reaches 59½, despite earlier Plan termination. A similar restraint would, of course, apply to funds rolled over from a TSA Plan to an IRA.

It would appear that the employee's voluntary decision to discontinue his Plan would constitute "termination" within the meaning of IRC section 402(a)(5)(A) even where his employeing entity continues the TSA Program for other employees. Additionally, the establishment of an IRA Rollover with funds from such a termination will place the employee in a position comparable to that of his brethren with Plans in Employer Sponsored IRA Programs.

PROPOSALS & BENEFITS

Whether the above analysis described TSA "termination" is subject to interpretation. Nevertheless, a discontinuance of the TSA Program by the Employer must be considered to meet the statutory criteria (as amplified by I.T. Regs. 1.401-6). In either case, full equality of investment choice can not be achieved until the apparent oversight of section 156 is corrected.

A correction will involve defining plan termination in the TSA area as well as clarifying the definition of "qualifying distribution" for 403(b)(8) purposes. The changes are minor but the results will be profound.

TECHNICAL CORRECTIONS

(1) Subparagraph (C) of section 403(b)(8) is amended by striking out "(B), (C), and (E)(i)" and inserting in lieu thereof "(B) thru (E)".

(2) Subparagraph (B) of section 403(b)(8) by inserting "or 402(e)(5)" following "(determined without regard to subparagraph (B) and (H) of section 402(e)(4))" and adding the following new clause:

> "(iii) Plan Termination - For purposes of this paragraph, a plan termination shall occur when either (a) the employee's written order or (b) the employer's decision results in the complete discontinuance of contributions to the Annuity Program.

International Trust Corporation

February 27, 1979

Assistant Commissioner
Employee Plans & Exempt
Organizations Division
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Attention: E: EP: T
Employee Plans Technical
Branch
Rulings Section

Subject: Expeditious Handling
General Information Request
Termination of a Tax Sheltered
Annuity Plan

Dear Sir:

The technical problem described below requires your urgent attention. The issue concerns thousands of taxpayers and their advisors as well as uncounted pension plan trustees. International Trust Corporation (ITC) has been inundated with information requests regarding this problem and can only presume that other Individual Retirement Account (IRA) trustees are in similar positions.

As you know, the Revenue Act of 1978 (P.L. 95-600) brought many changes in the tax laws. In particular, there were several additions and modifications to the rules regarding the establishment and maintainance of IRAs. The subject of this Information Request is Section 156 of the Revenue Act of 1978. That Section added subparagraph eight (8) to paragraph (b) of Internal Revenue Code (IRC) section 403. The new subparagraph permits participants in certain Tax Sheltered Annuity (TSA) Programs to take "qualifying distributions" and make rollover contributions to IRAs.

[illegible]
San Francisco San Diego Newport Beach Los Angeles Phoenix [illegible]

To be a "qualifying distribution", according to the Revenue Act all the annuity contracts standing to the credit of the Program participant must be distributed to him in a lump-sum. The lump-sum must meet the requirements of IRC section 402(e)(4)(A) or 402(a)(5)(A). That is it must be distributed on account of:

(1) The termination of the plan of which the trust is a part,

(2) The participant's death,

(3) The participant's attaining age 59½,

(4) The participant's termination of employment, or

(5) The participant's becoming disabled.

Question has arisen as to the meaning of "plan termination" with respect to participation in these TSA Programs. ADP Pension Services, Inc. (ADP) and ITC must have a clear definition of "termination" for these purposes. A TSA Program, qualified under IRC section 403(b), involves a voluntary decision by the individual employee. Unlike a Pension or Profit Sharing Plan, which must meet the requirements of IRC section 401(a) (including coverage), the TSA Program is not burdened by anti-discrimination rules. While the employing entity determines whether or not to establish a TSA Program, it is the individual employee whose voluntary decision, standing alone, determines whether contracts are purchased on his behalf within this Program. This affirmative action is the basis for the establishment of the termination of his Plan during a particular tax year.

The TSA Program, in practice, is quite similar to the Employer Sponsored IRA Program described in IRC section 408(c). In both instances, the employer establishes a skeleton program and the employee commences or terminates his own Plan. The difference is that termination of the employee's TSA Plan gives rise to a distributable event, where as distribution from the IRA may not commence before the participant reaches 59½, despite earlier Plan termination. A similar restraint would, of course, apply to funds rolled over from a TSA Plan to an IRA.

It would appear that the employee's voluntary decision to discontinue his Plan would constitute "termination" within the meaning of IRC section 402(a)(5)(A) even where his employing entity continues the TSA Program for other employees. Additionally, the establishment of an IRA Rollover with funds from such a termination will place the employee in a position comparable to that of his brethren with Plans in Employer Sponsored IRA Programs.

Therefore, ADP and ITC hereby request that you issue a General Information Letter to the effect that a TSA Plan's termination occurs upon the decision of the employee to have contributions thereunder discontinued.

Thank you for your prompt consideration and written determination of this matter.

Yours very truly,

INTERNATIONAL TRUST CORPORATION

Norman S. Milks, J.D.
Regulation & Compliance

NSM:mm

STATEMENT OF THE

AMERICAN COUNCIL OF LIFE INSURANCE

The purpose of this statement is to present the views of the American Council of Life Insurance on the various proposals before the Subcommittee relating to the individual retirement account provisions of the Internal Revenue Code; specifically, S. 75, S. 94, S. 557 and section 203 of S. 209. The Council has a membership of 481 life insurance companies which, in the aggregate, have 94 percent of the life insurance in force in the United States and hold 99 percent of the assets of insured pension plans.

Before presenting our views on the specific proposals, we would like to comment in general on the question of tax incentives to encourage the growth of the private retirement system.

Tax Incentives. Private retirement plans, individual savings, and Social Security, together, have the job of providing retirement income security for workers and their families. It is important that there be a proper balance among the three mechanisms. In this regard, Social Security should be designed to provide retired workers with a basic level of economic protection in their retirement. The provision of retirement income above this level is, and should be, the responsibility of individual workers and their employers--with appropriate encouragement being provided by the Government--through the use of various private savings media, including insurance company products. Unlike Social Security, these private arrangements provide flexibility so that the retirement programs can be designed to suit the needs of particular groups of employees in different firms, industries, unions and geographical locations. Moreover, private retirement savings, unlike Social Security, are an important source of capital so necessary if our economy is to continue to grow.

To this end, maximum encouragement should be given to the vigorous growth of private retirement plans and savings in a manner that is flexible and equitable among individuals at all income levels. The proposals before the Subcommittee generally are a step in the right direction. However, of the three bills that provide for income tax deductions to workers who participate in qualified pension plans--S. 75, S. 209 and S. 557--we believe that S. 557, which would simply allow a worker to contribute the lesser of 15 percent of his compensation or $1,500 to his qualified retirement plan or to a separate individual retirement savings arrangement, takes by far the most straightforward and efficient approach for obtaining the desired objective of increased private retirement coverage. In contrast, the conditions to a retirement savings deduction contained in S. 75 and S. 209 seem unduly complex, would result in heavy administrative burdens for sponsors of qualified plans, and could, in many cases, preclude middle-income workers from qualifying for the tax incentive. Thus, we urge adoption of S. 557.

We would now like to comment on several concepts contained in the specific proposals before you.

Maximum Allowable Deduction. We realize that limitations on the deductibility of employee contributions to retirement savings are inevitable in view of the revenue loss potential and the existing limitations on other retirement arrangements, but we urge that the limitations be set as high as possible, consistent with these restraints. Moreover, we believe the dollar and percentage limitations on employee tax deductions should be as uniform as possible as among the various options (i.e., IRA's and contributions to qualified plans). The present tax law is complicated enough in drawing distinctions between corporate plans, H.R. 10 plans, IRA's, Subchapter S corporation plans and plans of tax-exempt organizations. Further complexity should be avoided. We believe S. 557 comes closest to accomplishing these objectives since it would provide the same deduction limits regardless of whether the employee is covered by a qualified plan.

Mandatory Employee Contributions. We believe the provision in S. 209, which would deny a retirement savings deduction to participants in plans, not in existence on January 1, 1978, that require mandatory employee contributions or employee contributions as a condition for employer contributions, runs counter to one of the most desirable objectives of permitting deductions for employee contributions. More specifically, a deduction for mandatory employee contributions would make it feasible for many employers to require their employees to share in the costs of their retirement program and, in this manner, make it easier for employers to set up such plans or improve benefits in situations where the employers would, themselves, be unable to pay the full cost of the plan or the benefit improvement.

Thus, employee contributions to a qualified retirement plan should be tax deductible, regardless of whether they are mandatory or voluntary.

Nondiscrimination Requirements. As indicated, the various proposals before you, including S. 209 and S. 75, are designed to bring about an expansion of the private retirement system and increased retirement benefits for participants. S. 209 and S. 75 provide that in order for a "highly compensated" employee to claim a deduction for contributions to his qualified plan or an IRA, the employer must certify to the IRS, after a series of very complicated mathematical computations, that the plan satisfies certain nondiscrimination standards in terms of comparative contributions by non-"highly compensated" employees.

These bills define a "highly compensated" employee as one who is compensated at a rate which equals or exceeds a Government worker who is a grade GS-14, step one. In our view, this standard sweeps into the definition, not only very highly compensated executives, but also middle-management employees. In addition, many stockholder-employees of small businesses will probably fall within the definition of "highly compensated".

We strongly expect that, rather than accept the additional burdens imposed by these nondiscrimination standards, employers will just not file the necessary certifications with the IRS, since the additional burdens and complexities will outweigh any perceived benefits provided by such deductible employee contributions for the so-called "highly compensated" employees. (In this regard, the maximum tax savings under S. 209 or S. 75 to any individual is $500 per year.) As a result, many employees, including those in the middle-income salary ranges, will be disqualified from the retirement savings incentive. We believe this is a highly undesirable result. Moreover, such reverse discrimination is likely to discourage the formation of new retirement plans where employee contributions are necessary, particularly where the individuals making the decisions may be precluded from utilizing the tax incentive.

The apparent justification for the nondiscrimination rules appears to be that, without them, the benefits from the proposed tax savings from deductible employee contributions will go largely to higher paid employees. If this is true, then the problem is with the efficiency of the incentive in attracting new savings at the rank-and-file level. Conditioning the incentive for the "highly compensated" employees on participation by the rank-and-file will not, in and of itself, cause the rank-and-file to contribute; it will merely deny the tax deduction to the "highly compensated". Thus, if utilization by the rank-and-file is the problem--the answer lies in redesigning the incentive to make it more attractive; not in denying benefits to middle and upper management, who also need to provide for their retirement security.

Finally, to the extent the contributions are made to a qualified plan, there already are extensive nondiscrimination rules in place.

We appreciate having the opportunity to present the views of the Council on the various proposals before the Subcommittee. We would be happy to attempt to furnish any additional information the Subcommittee might think helpful.

Law Offices
Mittelman and Gordon
SUITE 350
2020 K STREET, N W
WASHINGTON D C 20006
(202) 223-8576
CABLE GEMMI

EUGENE MITTELMAN
MICHAEL S GORDON

March 30, 1979

The Honorable Lloyd Bentsen
Chairman
Subcommitteee on Private Pension Plans and
Employee Fringe Benefits
Committee on Finance
United States Senate
Washington, D.C. 20510

Re: Proposed Legislation On Employee Tax Deductible Contributions to Qualified Retirement Plans and Individual Retirement Accounts (S.75, S.209 and S.557)

Dear Chairman Bentsen:

This statement is submitted on behalf of the District 65 Retirement Trust for Members of NAWCAS-NAMBAC for inclusion in the record of the hearing of April 3rd of the Subcommittee relating to the above-referenced bills. District 65 is a labor organization whose full title is District 65, Distributive Workers of America, 13 Astor Place, New York, New York 10003. NAWCAS stands for the National Association of Women's and Children's Apparel Salesmen. NAMBAC stands for the National Association of Men and Boy's Apparel Clubs. NAWCAS and NAMBAC are the principal traveling salesmen's organizations in the apparel field in the United States and Canada.

In 1973, District 65 established a pension plan for those NAWCAS members (which was subsequently expanded to include

NAMBAC members) who became dues-paying members of District 65. This step was taken after previous efforts by salesmen to provide a systematic pension program for themselves had floundered, with the result that many salesmen had been compelled to work into their seventies and beyond in order to provide for themselves and their families. There are now in excess of 3,000 traveling salesmen participating in the District 65 Retirement Trust and, undoubtedly, this particular pension program has made the crucial difference with respect to providing salesmen in the apparel industry with the means to retire with dignity.

The enactment of the IRA provisions of ERISA in 1974 created a grave and continuing threat to the stability of the salesmen's pension trust. In order to appreciate fully the extent of this threat it is necessary to realize that all contributions to the salesmen's ERISA-regulated trust are paid by the salesmen; no employer contributes a penny to the trust. Furthermore, all contributions made by the participants to the trust are 100% nonforfeitable. Due to long-standing IRS rulings, because salesmen who participate in the trust have a 100% nonforfeitable right to their contributions, and because membership in the trust is not a prerequisite to holding a union job, members have never been entitled to a tax deduction for their contributions to the trust as they are with respect to dues that are paid into the general funds of the union. Cf: Rev. Ruling 54-190, 3 CCH Pension Plan Guide, Par. 18,023 with Rev. Ruling 72-463, 3 CCH Pension Plan Guide, Par. 19,180.

The unavailability of a tax deduction, however, did not become a significant factor until the commercial promotion of the immensely popular IRA accounts became widespread. Thereafter, the salesmen's pension trust came under increasing pressure from those members who wished to transfer their accumulated contributions to tax-deductible IRA's. Moreover, the trust found it increasingly difficult and awkward to recruit new salesmen into the plan because of this one-sided IRA competition.

Originally, the trustees of the plan tried to cope with the problem by seeking to qualify the salesmen's trust as a union IRA plan under I.R.C. Section 408(c). However, this effort failed because the I.R.S. interpreted the Code as not extending to plans which provide past service and disability benefits - two vital features of the salesmen's trust which could not be sacrificed or modified. The trustees then sought legislative relief in connection with the so-called L.E.R.A. provisions which were being considered as part of the Tax Reform Act of 1976. However, this effort also came to naught as the L.E.R.A. proposal was withdrawn by the House conferees on the tax reform bill.

Thus, it was tremendously encouraging to traveling salesmen that the Senate - passed Revenue Act of 1978, as part of the section giving a deduction for an employee contribution to a qualified plan, also contained a provision authorizing a deduction in connection with a union-sponsored program like the District 65 salesmen's pension trust. Naturally, we were keenly disappointed that the provisions involved were deleted in conference last year but there is optimism that the strong support behind the measure finally will enable it to be enacted in this Congress.

It cannot be emphasized too strongly that as far as traveling salesmen are concerned, the main thrust of the bills being considered before the Subcommittee on Private Pension Plans and Employee Fringe Benefits is to rectify a glaring tax inequity. Traveling salesmen do not understand why, if they put their money in an IRA account run by a bank or an insurance company, they can get a tax deduction, but if they put their money in a union pension fund - which provides superior benefits in most instances to that provided by any IRA - they cannot get a tax deduction. Moreover, their pension trust is subject to the fiduciary and reporting and disclosure provisions of ERISA, which adds to its costs of maintenance, and this intensifies the sense of unfair tax discrimination.

The slow strangulation of plans like the salesmen's pension trust as a result of this unfair tax discrimination surely was not intended by Congress when it enacted the IRA provisions in 1974. In fact, the IRA provisions themselves originated from the tax inequity that resulted because the self-employed could put tax-deductible dollars aside for their retirement but employees whose company did not maintain a pension program could not take similar steps. Thus, it is doubly ironic that opposition to the concept of a tax deduction in contributory qualified plans or plans like the salesmen's trust is based on concerns that these programs purportedly will only benefit higher-salaried employees or will unduly impact on the revenues. Presumably, the same concerns could have been pressed even more vigorously in connection with H.R. 10 and IRA legislation when they were being considered; yet, the legislative record indicates that Congress was not deterred by these arguments, and responded instead to the underlying tax inequities that were involved.

Of course, this does not mean that tax abuses should be encouraged, and a number of the bills before the Subcommittee go a long way in curbing tax deductions from being used in a manner that would benefit only highly-paid employees. As to revenue impact, the Treasury Department has conceded in previous hearings on this subject that "in principle" the proposed legislation is sound because it attempts to remove a serious inequity. Where such a concession is made, it seems to us that the burden then shifts to those concerned over revenue impact to devise a cost-effective plan that will also deal satisfactorily with the unfair tax discrimination. We do not think that the Treasury Department has systematically sought such an approach nor do we think it is up to the victims of unfair tax discrimination to condition their own attempts to obtain legislative relief on externally-imposed perceptions as to the degree of revenue loss and its significance. The District 65 salesmen's pension trust did not specifically endorse IRA legislation in 1974 nor did it oppose it. But it assumed - as it had every right to do - that it would not be "blind-sided" by well-intentioned efforts of Congress to help employees who lacked private pension coverage. It is hard to believe that if Congress knew in 1974 what it knows now that the IRA provisions would not have included some form of tax deductions for contributory qualified plans and union-sponsored programs financed exclusively by membership contributions.

In addition, whatever the dimensions of the revenue impact, it must be considered in conjunction with the highly desirable objective of expanding coverage of private pensions. In some quarters concern has been expressed as to whether it is socially desirable to encourage expansion of contributory plans, but this criticism must be dismissed because it offers no constructive alternative. It may well be true that non-contributory plans are to be preferred over the contributory variety or plans like the salesmen's pension trust, but it is totally unrealistic to suppose that by discouraging the spread of contributory plans, non-contributory plan growth is automatically stimulated. The plain facts are that, generally, the installation of the type of pension plan involved derives from the economic strength of the plan sponsor. Those who have the economic strength to sponsor non-contributory plans will do so and the others will have to scale down their objectives. In terms of expanding private pensions, the real choice for the bulk of the private sector not covered by an employer or union sponsored pension plan, may be between having a contributory pension plan or not having any pension plan whatsoever, and certainly, employer or union sponsored group contributory plans are better than most IRA plans because they can provide a wider range of benefits. In short, any meaningful evaluation of the revenue impact of these bills cannot be made without realistically considering their potentially salutory effect on needed expansion of the private pension system.

We commend the Chairman, Senator Bentsen, for holding this important hearing as well as for introducing S. 557, and we commend Senators Dole, Nelson, Williams and Javits for their previous and current legislative efforts and for their sustained interest in seeking correction of the tax inequities that have been described. We are particularly appreciative to Senator Dole for his leadership and sensitivity to the problems of salesmen. We urge early and favorable action by the Finance Committee on a consensus bill that will combine the best features of all the bills presently pending before the Committee on this subject.

In this connection we wish to draw attention to the fact that, as drafted, S.557, unlike S.75 and S.209, does not technically cover plans like the District 65 salesmen's pension trust. To correct this apparent oversight, we suggest that the word "or" be removed from line 2, page 3 of the bill, that a comma be inserted in lieu of the period on line 3 of page 3 of the bill, that the word "or" be inserted following the quotation marks on line 3 of page 3 of the bill, and that a new subparagraph "(E)" be added after line 3 on page 3 of the bill to read as follows:

> "(E) a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100% nonforfeitable."

Sincerely,

Michael S. Gordon

Michael S. Gordon
Mittelman and Gordon

Attorneys for the District 65
Retirement Trust for Members
of NAWCAS-NAMBAC

MSG/kak

cc: Honorable Robert J. Dole

STATEMENT OF GEORGE B. BUCK CONSULTING ACTUARIES, INC.

Introduction

Every American should retire with an adequate retirement income. To find that adequacy many look to the three-legged stool of social security, employee pension plans, and individual savings.

Social security provides a valuable floor of protection. Projections by the Social Security Administration indicate that the median worker retiring at age 65 will receive a primary insurance amount from social security equal to 42% of his earnings rate before retirement. If the worker has a spouse at least age 62 (not entitled to benefits based on the spouse's own work record), this 42% may be increased to a total benefit of 58% or more of pre-retirement pay. Benefits are smaller for those retiring before age 65. For employees with above average earnings, benefits are a smaller percentage of pay. For example, for workers retiring at age 65 after 1979 whose pay always exactly equaled the social security taxable wage base (now $22,900), the primary insurance amount under social security is 23% to 29% of pre-retirement earnings, rather than 42%. While this floor of protection is very valuable, it does not by itself provide retired Americans with an adequate retirement income. This is why the other two legs of the stool, the employee pension plan and individual savings, are so important.

Employee pension plans provide a vital supplement of retirement income for many Americans. About half of all workers are now covered under a pension plan. We estimate that in 1979 almost 10 million Americans will receive pensions totalling $22 billion. While private pensions, together with social security benefits, provide adequate retirement security for many, they fall short for many others. One major factor contributing to the shortfall is that half of all workers are not covered under any private pension plan.

Congress needs to encourage employers to establish and maintain pension plans. But it also needs to encourage individual savings to fill this gap in the adequacy of retirement income.

Individual Retirement Savings

The Employee Retirement Income Security Act of 1974 (ERISA) encourages individual retirement savings by employees not covered under a qualified pension or profit-sharing plan. It allows these individuals to deduct contributions of up to 15% of pay, not to exceed $1,500, to an individual retirement account, individual retirement annuity or retirement bond (IRA). Approximately 3 million of these accounts now exist.

However, employees covered under qualified pension or profit sharing plans are not eligible to contribute to an IRA. This is true even if the employee terminates employment before becoming vested and never receives any benefit at all under the qualified plan. It is clearly inequitable that one employee not covered under a qualified plan may have the benefit of an IRA, while another employee who may be technically covered but who will not receive any benefit may not have an IRA. All employees should be allowed to establish tax-deductible IRAs in order to eliminate this inequity.

But in addition to the argument for equity, all employees should be allowed to establish tax-deductible IRAs to help reach the objective of providing each American with an adequate retirement income. Employees should be encouraged to save to help meet their own retirement needs.

Effects of IRAs on Qualified Plans

Unfortunately IRAs have had a negative effect on qualified pension plans. Employees often view the qualified plan as an obstacle preventing them from establishing an IRA. This is particularly true for employees who do not expect to continue employment long enough to become vested in any benefit from the qualified plan, and for employees in contributory plans which require employees to make non-deductible contributions to the plan instead of deductible contributions to an IRA. For these reasons, employees not already covered by a plan may object to having a plan established. Thus the present law actually discourages the establishment of qualified plans where they do not already exist. This undermines the objective of providing adequate retirement income.

Employees who are covered by a qualified plan often request to be excluded from the plan, so that they can establish an IRA. Often these requests come from short-service employees who do not expect to continue employment long enough to be vested. But some plans receive these requests even from vested participants, perhaps because they fail to understand the value of the qualified plan.

Some plans accede to employees' requests to withdraw, while others do not. In plans which allow the withdrawal, the withdrawing employee often foregoes benefits under the qualified plan far more valuable than any possible tax benefit under the IRA. Inevitably, some of the employees who did not expect to continue employment long enough to qualify for a pension do continue, only to regret their earlier decision to elect out of the plan.

In addition, if too many employees elect out of the plan, the plan itself may fail to meet the coverage requirements of section 410 of the Internal Revenue Code. This could result in the disqualification of the entire plan.

Both to protect employees against their own folly and to prevent disqualification of the plan, many employers refuse to allow employees to elect out. These employers, although they may be acting in the best interests of most employees, often incur hostility from employees who wish to elect out.

Employees covered under a qualified plan should be allowed to make deductible contributions to an IRA. This would remove the desire to elect out of qualified plans and eliminate the problems described above, at least for non-contributory qualified plans. The effect on retirement security would thus be two-fold. It would increase participation in qualified plans and encourage employees to save for themselves.

<u>Employee Contributions to Qualified Plans</u>

A large number of qualified plans require employee contributions from all participants, including virtually all thrift and savings plans.

It would be inequitable to allow plan participants to deduct contributions to an IRA, but not allow them to deduct their own contributions to a qualified plan. Many of these employees cannot afford to contribute to an IRA in addition to the qualified plan. To allow plan participants to deduct IRA contributions without equal provision for deduction of contributions to qualified plans would exacerbate the problems previously described as they relate to contributory plans.

The provisions of S.75 and S.209 which would set different requirements for deduction of employee contributions than for contributions to an IRA are inequitable. S.557 properly provides equal treatment to both types of employee contributions.

<u>Maximum Limits on Deductions</u>

To be fully effective in discouraging withdrawal from qualified plans, the deductible limits on contributions by plan participants should equal, or nearly equal, the present limits for IRA deductions for non-participants. We support the limits of 15% of pay, not to exceed $1,500, included in S.557.

Lower limits, such as those in S.75 and S.209, would help in ameliorating the problems, but would not be as effective as the limits of S.557, which would place employee plans and IRAs on equal footing.

Simplicity

Any approach needs to be kept simple in order to be understandable by employees and to avoid unnecessary administrative burdens on employers. The approach of S.75 and S.209 would substantially increase the length and complexity of the Internal Revenue Code. It would increase administrative burdens for plan administrators, thereby discouraging employers from establishing and maintaining qualified plans. Complicated non-discrimination rules in S.75 and S.209 could seriously limit these proposals. In contrast, S.557 would actually simplify the Code and result in a net increase of only 39 words in the Code - a remarkable feat for any tax bill.

Inflation

The proposals would increase saving by employees and thus reduce current demand for consumer goods in our presently overheated economy. Hence, the proposals would help fight inflation.

Conclusion

We support S.557.

TESTIMONY OF HARRY V. LAMON, JR., GENERAL COUNSEL OF THE NATIONAL ASSOCIATION OF PENSION CONSULTANTS AND ADMINISTRATORS, INC.

Summary of Principal Points

1. Legislative action should be taken to correct the long-term bias against savings and in favor of current consumption.

2. Legislative action should be taken to encourage small business employers to establish qualified retirement plans.

3. Legislative action should be taken to encourage individual savings for retirement through contributions to qualified retirement plans.

Mr. Chairman:

I am Harry V. Lamon, Jr. of the law firm of Henkel & Lamon, of Atlanta, Georgia and Washington, D.C., and am here today in my capacity as General Counsel to the National Association of Pension Consultants and Administrators, Inc. (NAPCA).

NAPCA is an organization of consultants and administrators to employee benefit plans of all types. The clients of NAPCA's members are primarily small businesses which maintain small employee retirement and welfare benefit plans. Representatives of NAPCA have testified before this Subcommittee and before other Congressional Committees concerned with employee benefit plans. The thrust of NAPCA's efforts, since its founding in 1974, has been to identify problems in the small employer plan area and to seek solutions either through the regulatory agencies or the Congress. Our constant theme has been to urge the creation of incentives and the elimination of disincentives for the establishment and maintenance of small private employee benefit plans. To this end, we have devoted substantial effort to the elimination of unnecessary red tape, paperwork and administrative burdens

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and to the creation of tax incentives for the establishment, maintenance and improvement of plans. All of the bills under consideration here today, S.75, S.94, S.557, and sections 203 and 204 of S.209 are consistent with our longstanding position and we support the concept of each of these bills.

Before addressing the specific provisions of the various proposals, I would like to offer a few general comments in support of the concept of encouraging saving through encouraging the creation of employee retirement plans and the making of employee contributions to such plans.

I am not an economist, but you do not have to be an economist to realize that much of our Country's economic problems can be traced to the long-term bias against savings in our economy and in favor of current consumption. The bias clearly exists. With our progressive income tax rate structure which taxes earnings - and then taxes the earnings on the earnings - the incentive is clearly to spend, not save. With interest deductible, borrowing for current consumption is further encouraged. Ceilings on interest rates paid to small savers, and the ever-increasing proliferation of transfer payments - which create a perception that savings for a "rainy day" or retirement are unnecessary - act as further disincentives to savings. As a result of the bias against savings, there is a capital shortfall in our economy, which reduces our productive capacity and inevitably contributes to inflationary pressures, a weak dollar, and slower real growth.

Obviously an economy needs both savings and investment and consumption to function, and I would not advocate drastic moves to "jump" total savings overnight. However, I do believe that the existing bias against savings must be corrected. Initiatives such as those under consideration here today will tend to correct the bias in a graduated and constructive manner and they have NAPCA's support.

If these initiatives would do nothing more than encourage saving, they would be desirable. However, they will do far more. Specifically, they will encourage the private sector to provide for adequate retirement and will strengthen the partnership between employers and employees in accomplishing that objective. Furthermore, to the extent the private sector is encouraged to act, future demands on the Federal Government - Social Security in particular - will tend to be stabilized.

We do not believe it is feasible to increase Social Security benefits any further. Increased benefits have to be paid for, and I sincerely question whether the American people are willing to pay any more for Social Security than they do now. Aside from that, it is not economically healthy or politically wise for the federal government to control such an enormous magnitude of our Nation's wealth. Assuming, as I must, that Social Security can only provide the first building block of retirement benefits, where will the remaining building blocks of retirement security come from?

We see three fundamental building blocks: Social Security as a base, private employer-sponsored plans as the second block, and employee contributions and individual retirement accounts as the third. Thus, NAPCA strongly supports incentives, such as the proposals before you today, to encourage the adoption and expansion of private retirement plans and to encourage employee and individual savings for retirement.

With specific reference to individual retirement accounts, they clearly have an important role in the overall retirement picture since many workers do not have employer-sponsored retirement plans. IRAs should be available when needed, and should be available to those without direct earned income, such as non-working spouses. However, they should not be viewed, utilized or encouraged as a replacement for employer-sponsored plans. Under existing law - with the exception of "Simplified Pension Plans" - participation in a qualified plan and contributions to an IRA are mutually exclusive. For obvious tax reasons, many individuals find it to their benefit to drop out of qualified plans in order to establish IRAs. This can have adverse implications for the qualification of the plan and precludes the employee from receiving ultimate benefits under the plan. NAPCA's view of the better policy would be to maintain IRAs as a "last resort", but not to have a legislative scheme which in many cases forces employees to make a choice between contributions to an IRA over participation in the employer's plan.

With these general comments in mind, I would like to turn to the specific proposals under consideration here today.

S.75 and Section 203 of S.209.

With one major difference these bills are essentially the same. Each would permit a deduction for an employee contribution to a qualified plan of 10% of compensation or $1000, whichever is less. Availability of the deduction would be limited by a "discrimination" standard similar to that now applicable to "cash or deferred plans". The major difference in the two bills is that Section 203 of S.209 would preclude mandatory employee contributions, whereas S.75 would not.

In the first place, I question the need for any "discrimination" standard. It appears to me that if everyone is entitled to participate based on relative compensation, then there is no discrimination.

Nonetheless, if the discrimination standards are to be imposed, then I would strongly urge that mandatory employee contributions be permitted. With minimum mandatory contributions, plan documents can be drawn with a "fail-safe" to insure that everyone who contributes will obtain a deduction. Without minimum mandatory contributions, the issue of deductibility would depend on the relative proclivity of lower paid employees to contribute voluntarily. Not only would it be extremely difficult to determine if a particular contribution by a high-paid employee were deductible, but we question whether it is really fair for the issue of deductibility to be determined by the level of voluntary participation of some other individual or group. Accordingly, as between Section 203 and S.75, we favor S.75. It would be much fairer and simpler to administer.

S.557.

Basically, S.557 would permit participants to voluntarily contribute and deduct up to 15% of compensation or $1500 to a qualified plan. As we understand S.557, it would impose no other limitations, and consistent with my earlier comments, NAPCA obviously would prefer it over either S.75 or Section 203. Also, S.557 is preferable for another reason. With a flat $1500 or 15% deduction limitation, S.557 would remove any incentive for individuals to withdraw from participation in a qualified plan in order to participate in an IRA and receive a higher deduction, while at the same time it would preserve the IRA alternative for those who had no other option. If $1000 is the limit on deductible contributions to plans, while $1500 is the limit on IRAs, then some individuals will still find it to their benefit to drop out of qualified plans in order to establish IRAs.

Of the three provisions dealing with employee contributions, we urge the Committee to follow the format of S.557 for the reasons stated above.

Section 204 of S.209.

Section 204 of S.209 would grant early year tax credits on a declining scale for the establishment of plans by small business employers. NAPCA strongly supports this proposal.

At the present time, most large businesses and large employee organizations have comprehensive employee benefit plans, including retirement plans. This is not the case with respect to small businesses. It has been estimated that over 60% of the some 3.4 million businesses with fewer than 50 employees do not have a qualified plan. 3.4 million businesses equates to many more millions of employees. There is no doubt in my mind where the lack of coverage exists and where the greatest opportunity for expanded coverage lies. Section 204 would provide the additional incentive to expand the coverage where it is needed. We would hope that long-term revenue projections would permit the tax credit to be increased, and the definition of "small business employer" to be expanded from the "under 100 employees and $50,000 in earnings" to a much broader figure, say, 250 employees. However, even at the moderate levels proposed, the tax credit would tend to offset the initial costs of design and installation of plans and thus would encourage their adoption.

Revenue Impact.

All of the proposals under consideration today would have some impact on the revenues, some obviously more than others. However, the revenue impact should not be viewed simply in terms of the next fiscal year and the next. It must be viewed in the long-term - ten to fifteen years at a minimum.

Specifically, the impact of these proposals on future demands on the Social Security system and other transfer programs must be considered. Further, the impact of these proposals in curtailing inflation over the long-term by increasing opportunities for productivity and decreasing current consumer demand must be considered.

Perhaps a more relevant analyses is - "What happens if we don't enact these proposals?" "What happens if we don't act now to let the private sector develop a viable private retirement system?" I believe I know what will happen - some level of benefits will have to be provided directly out of general revenues - and that is why NAPCA strongly supports what the sponsors of these bills are trying to accomplish.

We appreciate your concern, Mr. Chairman, and we hope you will not give up the fight until these bills become a reality!

Thank you.

STATEMENT OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS

The U.S. League of Savings Associations* representing approximately 4,300 federally and state chartered savings associations welcomes this opportunity to submit its comments on the various pension improvement proposals contained in S. 557, S. 75, S. 94 and S. 209. U.S. League members hold more than 99 percent of the over $500 billion in savings and loan assets, making our organization the major spokesman for American thrift institutions.

The U.S. League commends Senator Bentsen and his Finance Subcommittee on Private Pensions and Employee Fringe Benefits for providing the opportunity for public comments and discussion of these important legislative proposals to expand and improve our private retirement system. A tax deduction for employee contributions to qualified plans or for contributions to IRAs by those participating in such plans will increase retirement benefits and provide greater equity for qualified plan participants.

*The United States League of Savings Associations (formerly the United States Savings and Loan League) has a membership of 4,400 savings and loan associations representing 99-2/3% of the assets of the $510 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, insured and uninsured, stock and mutual. The principal officers are: Joseph Benedict, President, Worcester, Mass.; Ed Brooks, Vice President, Richmond, Va.; Lloyd Bowles, Legislative Chairman, Dallas, Texas; Norman Strunk, Executive Vice President, Chicago, Ill.; Arthur Edgeworth, Director-Washington Operations; and Glen Troop, Legislative Director. League headquarters are at 111 E. Wacker Drive, Chicago, Ill. 60601; and the Washington Office is located at 1709 New York Ave., N.W., Washington, D.C. 20006; Telephone: (202) 637-8900.

Currently IRA deposits at FSLIC-insured savings and loans total over $3.8 billion while Keogh balances account for an additional $1.8 billion. This substantial commitment to long-term retirement investments has made our business vitally concerned with all efforts to improve and broaden the private sector retirement system. The U.S. League supports the following legislative proposals because they broaden IRA eligibility and expand a participants potential retirement benefits:

S. 557 - Allows tax deductible contributions by pension plan participants to their plans or separate IRA's equal to IRA maximums (15% or $1500);

S. 75 and S. 209 (Section 203) - Allows tax deductible contributions by pension plan participants of up to $1000 to their plans or separate IRA's but subject to an anti-discrimination test for high income employees.

Over the last few years, the U.S. League has continually supported legislative proposals to eliminate the inequity resulting from qualified but inadequately funded retirement plans.. Members of such plans, through no choice of their own, are being prohibited from accumulating retirement benefits equal with IRAs and other adequately funded qualified plans. These plan participants are being sacrificed in order to save what in many cases are clearly inferior employer retirement plans. Why should any employee be required to bear the heavy financial burden of sustaining the employer qualified plan which would probably be rejected if an alternative were available. Instead of penalizing retirement plan members, we should provide all plans with adequate minimum benefits and thereby encourage increased participation. The

IRA alternative will provide the needed flexibility to supplement inadequate pension plans as well as providing some measure of retirement benefit for those employees who frequently change jobs and therefore never vest in any plan. Consequently, the U.S. League strongly supports the establishment of an IRA alternative with a uniform maximum for previously excluded pension plan participants.

Expanding IRA eligibility and allowing tax deductions for contributions made to existing pension plans will also respond to a growing national economic problem -- encouraging greater individual savings. The rate of savings in the United States is substantially lower than that of other industrialized countries. The U.S. rate of savings as a percent of disposable national income in 1976 was 4.8 percent compared to a rate of 6.6 percent in the United Kingdom, 13.1 percent in France, 13.2 percent in Germany, 17.2 percent in Switzerland and 25.3 percent in Japan. As savings institutions, our members are vitally concerned with this alarming savings trend because without savings this nation's capital investment, economic growth and productivity are seriously restricted. Similarly, without savings our associations will be unable to provide the mortgage financing necessary to support this country's continuing housing need. Therefore, by stimulating additional U.S. savings, particularly long-term savings, we are helping to resolve our nation's critical capital shortage problem. The U.S. League applauds the universal savings objective contained in all these bills but prefers the approach taken in S. 557 introduced by Senator Bentsen because it excludes unnecessary and cumbersome non-discrimination formulas which retard the bill's savings incentives.

The U.S. League also endorses legislation introduced by Senator Bentsen, S. 94, which extends IRA eligibility to non-working spouses, thereby encouraging long-term savings, the lifeblood of our business. Equally important to this savings stimulus, the Bentsen bill will afford millions of American homemakers the opportunity to begin accumulating the retirement money necessary to minimize the escalating financial burden of their retirement. With our social security system facing massive payroll tax increases to remain solvent due to an aging population, we will be required to rely more and more on the retirement savings of the private sector. Senator Bentsen's bill will improve our private sector retirement mechanism and allow us to somewhat offset our increasingly inadequate social security benefits.

Finally, along with encouraging adequate retirement savings in an inflationary economy, the U.S. League urges consideration of a tax incentive for all savers. Many Members of the 96th Congress believe this is such an important priority that approximately 28 bills designed to stimulate savings through a tax incentive have already been introduced, including S. 246 introduced by Chairman Bentsen. The savings and loan business will always be dependent upon the U.S. savings dollar in order to continue performing our Congressionally mandated housing finance objective. Therefore, the declining U.S. savings rate is causing great concern within our business and indeed our entire economy. To reverse the shrinking U.S. savings rate, our inflationary psychology (bolstered by a 9% inflation rate in 1978 and a continuing tax code bias against saving) must be broken. In order to accomplish this a major tax incentive is needed. Therefore, the U.S. League recommends for this Subcommittee's consideration a general savings plan which would exclude from gross income the first $1000 of interest earned at a financial institution. Because of budget considerations and the certain revenue loss generated by a tax incentive, a phase-in period might be necessary starting at $100 for 1980 and increasing by $100 per year for 10 years. But whatever the cost the elimination of our economic savings disincentives is necessary if we are to remain a productive nation.

The U.S. League would also like to suggest the following IRA improvements which were not included in the Revenue Act of 1978. These are changes which we believe will improve the administration and equity of the almost $4 billion dollars in IRA assets of the savings and loan business. They include:

1. Under the Revenue Act of 1978, a spouse of a deceased section 401(a) qualified plan participant is authorized to roll over the death benefit lump sum distribution received into an IRA of his or her own. Section 408 of the Code should be amended to extend this authority to spouses of deceased <u>IRA</u> participants as well.

2. Section 408 of the Code also should be amended to permit individuals who, after age 70 1/2, receive lump sum or plan termination distributions from qualified plans to roll over such distributions, less the amounts they would have received had they received annual distributions beginning at age 70 1/2. IRS has ruled informally that individuals over age 70 1/2 are not eligible to make rollover contributions to IRAs.

3. To provide parity with Keogh plans, an individual should be permitted to make tax deductible contributions to IRAs after 70 1/2. Keogh contributors currently are permitted to make contributions to their Keogh plans after age 70 1/2, while taking required distributions therefrom.

4. Clarification appears to be needed on the estate tax exclusion for IRA accounts provided in Section 2039(e) of the Internal Revenue Code if payout to the beneficiary is over a period of 36 months or longer. The law does not specify whether the election to take payments in the prescribed manner must be made by the IRA grantor himself or whether the exclusion also is available when the beneficiary makes the appropriate election. While there is a hint in the Conference Committee Report that the exclusion is available if the beneficiary makes the election after grantor's death (the Report states that the election may be made at any time prior to the earlier of filing or due date of the estate tax return, part of which period obviously falls after the death of grantor), there is no reflection of this intention in the Code. It is felt strongly that this should be clearly spelled out in the Code, since it represents a departure from the traditional rule that a person's estate is fixed and determined for estate tax purposes at the time of his death and is not affected by anything that happens thereafter.

   In this connection it is suggested that parity be granted between IRA and Keogh plans with respect to the estate tax exclusion. Qualified plan interests are excludible under Code section 2039(c) if they are payable to the beneficiary in a manner other than a lump sum distribution (i.e., payable over a period exceeding one taxable year); IRA interests are excludible only if they are payable over a period exceeding 36 months. It is suggested that it would be appropriate to provide parity in this matter by amending section 2039(c) to permit exclusion of IRA interests from a decedent's estate if distributions are made over a period exceeding one year, or in other words, in a manner other than a lump sum distribution.

NATIONAL ASSOCIATION OF SMALL RETIREMENT PLANS

515 National Press Building
Washington, DC 20045

202/638-4596

April 19, 1979

Mr. Michael Stern
Staff Director
Finance Committee
2227 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Stern:

The American Society of Pension Actuaries submitted testimony to the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Finance Committee in regard to Bill S.557 on April 3, 1979.

We wish to go on record in the same hearing that the National Association of Small Retirement Plans heartily endorses all the views set forth in that statement. The comments expressed in the ASPA testimony are concurrent with those of the members of NASRP.

Sincerely,

J. C. Diamond
President

JCD:rak

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association is a trade association composed of 13,254 banks, approximately 92 percent of the banks in the United States; a substantial number of our members have their own pension plans. About 4,000 of our member banks have fiduciary powers and many of these serve as trustees to employee benefit plans. Our Association thanks the Subcommittee for the opportunity to address the issues raised by S. 75, Section 203 of S. 209, S. 557, S. 94 and Section 204 of S. 209.

Three bills before the Subcommittee, S. 75, S. 209 and S. 557, would allow a limited tax deduction by an active participant in a pension plan for contributions made to a qualified plan or to an individual retirement account. We strongly support such a proposal and we believe there are some sound public policy reasons for doing so:

(1) The adoption of this concept would lead to better pension coverage of employees throughout the United States. Many employers, particularly smaller ones, cannot bear the cost of adequate pension coverage and structure plans to share the cost with employees. Allowing employees to deduct their contributions should strengthen their participation in pension programs. (We feel it would be unfair to treat in different ways mandatory and voluntary contributions to qualified plans by employees.)

(2) Improving coverage by private pension plans should lessen pressure for social security increases in the future.

(3) Increased retirement savings would increase capital formation in the United States which will strengthen the economy in the long-run.

This proposal will also solve the problem of employees electing not to participate in employer-sponsored retirement plans so that they may instead set up an individual retirement account. (Employees who feel they will not ever vest because they will not stay with the employer long enough are likely to do just that.) Such electing-out can jeopardize the tax qualification of an employer plan. The employee's ability to take a tax deduction for a contribution will be beneficial to both sponsor and participant.

Whatever proposal is adopted should not impose new burdens on existing plans. We are glad to see that the original "LERA" concept has been abandoned in these bills. The LERA idea would have allowed an individual who is a participant in a qualified plan to make a deductible contribution to an IRA account up to the difference between what the employer contributed to the plan on his behalf and the $1,500 or 15 percent IRA limit. This approach would have imposed a great administrative burden on plan administrators to make the necessary calculations and to inform the participant, and the idea is best discarded. We are also glad to see that the proposals do not force plans to accept contributions, but rather offer the choice of making contributions to the plan or using an IRA account.

The proposed discrimination provisions in two of the bills are, of course, the antithesis of simplicity in the tax law. A tax deduction such as the one

47-321 O - 79 - 20

being proposed should be written so the taxpayer knows if he does or does not qualify for the deduction. A "highly compensated" taxpayer may find himself disqualified by circumstances totally beyond his control. The discrimination provisions impose an additional bookkeeping and notification burden on plan administrators. And since this would be a year-by-year determination, some employees may not know until after they file their tax returns whether they could take the deduction, and may have to file an amended return once the company sees what the "actual deferral percentages" are for groups of employees. We question if all these restrictions are really warranted when weighed against the public benefits of increased retirement security and increased savings, no matter who may be taking the deductions. If discrimination provisions are to be included in the final legislation, there should be a one-year lag in the application of the "actual deferral percentages," i.e. if the higher/lower compensated employee ratio is acceptable for 1979, then the highly compensated employee can make deductible contributions to the plan or an IRA for 1980, and if the ratio is acceptable for 1980, then he can get a deduction for 1981 contributions, and so forth.

We realize that the Treasury Department is concerned about the revenue impact of allowing deductible contributions. It must be remembered that this proposal only allows the employee to defer the taxes due on funds set aside for retirement. In the future, the funds will be subject to tax (although perhaps at a lower rate if the person's only income is the pension). We feel the IRA program, the simplified pension plan concept enacted into law as part of the Revenue Act of 1978, and now the proposed increased coverage for active plan participants are all essential components of a viable pension plan system. It is a fact that the more one earns, the greater the possibility to set aside funds for retirement years. It is no surprise that those earning under $20,000 may very well need to use their current income to meet current expenses and just cannot set the funds aside until they retire. However, planning for retirement is a highly desirable action which public policy should encourage. In addition to the bills now being discussed, the Subcommittee should consider whether the IRA limits should be raised to $1,500 to $3,000 for those who are not active participants in a pension plan. This would represent 15 percent of a $20,000 income. It should be remembered that the $1,500 or 15 percent limit was first proposed more than eight years ago, and with the expectation of continued inflation, $1,500 savings a year does not look all that substantial when extrapolated twenty or thirty years.

We support the proposal in S. 94 that the non-working spouse or one who earns less than $10,000 a year can establish an IRA based on the income of the other spouse regardless of whether the working spouse is eligible to establish an IRA. We feel this is a means to increase retirement security of non-working spouses because the spouse would have a nonforfeitable interest in the account.

The last provision we would like to comment on is Section 204 of S. 209, "The ERISA Improvements Act of 1979." We strongly support the idea of providing incentives for additional plan formations and increased coverage of employees. We have expressed such support in our testimony before the Senate Labor and Human Resources Committee early this year. At that time we also said that these incentives, in order to be successful, must be coupled with relief from unnecessary regulatory burdens imposed by the current statute and regulations.

We thank the Subcommittee for the opportunity to submit this statement for its consideration. In the near future we hope to see the Congress enact into law many of the ideas found in these bills. The public would certainly be well served by such action.

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The National Retired Teachers Association and the American Association of Retired Persons welcome this opportunity to comment briefly on S. 75, S. 557, and Section 209 - legislation which would allow tax deductions for employee contributions to "qualified" pension plans or for contributions to individual retirement accounts (IRA's) by pension plan participants. The Associations, with a combined membership in excess of 12.2 million persons age 55 and over bring to the consideration of this legislation a perspective that is relatively unique. A significant number of our members are still active in the labor force and are participating in private pension plans. While many of these could benefit directly from the enactment of legislation of this type, most of our members could not, simply because they are already retired. Nevertheless, even retirees could benefit indirectly if this legislation turned out to have a salutary effect on the domestic economy through the promotion of savings, capital formation and productivity gains and through a lessening of current inflationary pressures. Finally, an assessment of the income situation of persons who are already retired and a consideration of the significantly increased older and retired population that is projected for the future should stimulate and guide the development of any legislation that would promote the growth and expansion of the private pension system and encourage saving for retirement.

If legislation can be enacted that will encourage employees to save for their retirement to a greater extent than they otherwise would, significant sums will be removed from consumption and be set aside and utlimately invested. Lessening consumption would tend to slow down our presently overheated economy and lessen the demand pull component of the ongoing inflationary spiral. In addition, shifting resources from consumption to savings and investment should lead to future gains in productivity - another result that would tend over the long term to reduce inflationary pressure. In view of the seriously adverse effects that inflation has on the elderly in terms of their income, assets and expenditure patterns, our Associations tend to look favorably on legislation which would dampen down those pressures which contribute to the ongoing inflationary spiral. Furthermore, we recognize that inflation discourages persons from saving for their retirement, impairs the financial viability of the private pension system and erodes the purchasing power of private pension payments.

Since the Associations deem it desirable to promote and strengthen the private pension system as a means of encouraging savings for retirement, the problem for us becomes one of determining how best to go about accomplishing this objective. Obviously, one aspect of that objectives is the equitable maximization of pension plan coverage of the active labor force. To the extent that private pension plan participation and private pension receipt can be maximized and the private pension component of the income stream of the future elderly increased the better will be the future elderly's prospects for maintaining a reasonable standard of living once retirement occurs. This in turn, will help reduce the future elderly's degree of dependence on public income transfer programs for their retirement income.

In the light of these considerations, we wish to focus on the results that legislation that would allow tax deductions to employees who are participants in qualified private pension plans for contributions they make either to those plans or to individual retirement accounts is likely to have. We shall prescind from some of the more specific issues such as anti-discrimination provisions and maximum allowable deductions. Instead we would like to offer some general assessment of the consquences for the private pension plan universe if employees were allowed tax deductions for contributions. Although it is probably impossible to assess those consequences with complete accuracy, a number of points can be made.

Passage of this type of legislation would lead to tax deductions for employee contributions to plans that are presently employee contributory. This would obviously cost the Treasury some money in terms of lost revenue. However, there is an equitable result in the deduction since the tax consequences of this transaction are not forgiven but are merely deferred until the employee retires and begins drawing retirement pension benefits. The employee would have a inducement to continue his participation in a qualified plan; IRA's would no longer be more attractive in terms of immediate tax advantages than private pension plan participation. Also, the employee would be encouraged to contribute more than a plan's minimum amount and even up to the legislative maximum with respect to which the tax deduction is available. This in turn would have the beneficial ancillary economic effects mentioned earlier.

More difficult perhaps is the assement of what effect this type of legislation would have on pension plans that do not presently require employee contributions (i.e. solely employer financed) and on employers who have no pension plan at all. Large employers might see this legislation as a means of shifting some of the burden of financing employee benefits onto the employees themselves. However, this might prove to be merely a bookkeeping move rather than an actual reallocation of the financial burden since the employees' total compensation package would not likely change as a result of the reallocation.

More significant may be the reaction of small employers to this kind of legislation. Small employers, and especially those who have no private pension plan, would probably be more willing to continue or start a plan and contribute funds to it if the employees were ready and willing to carry some of the financial burden. Certainly the employees can best be induced to do so through the making available of tax deductions with respect to those contributions.

We think it also important to make some assessment of what the employee would gain through the enactment of the type of legislation under consideration. One significant gain is that the employee is immediately vested in his contributions. The total portability of these funds would lead to a second, albeit a more speculative, gain - greater work force coverage in the private pension system. A third gain is the increased degree of flexibility the employee would have in structuring his own compensation scheme; giving the employee a tax incentive to contribute towards his retirement might cause the employee to be more thoughtful in making a choice between present and future compensation. Of course, a dampening of the inflationary spiral is needed before the future compensation choice can be made truly competitive.

Having outlined some of the possible effects of this type of legislation on pension plans that are presently employee contributory, and on those that are not, and on employees in general, we would like to reiterate our believe that the proposals before the Subcommittee do have generally positive implications. Encouraging an increased amount of savings through private pension plans would likely have a salutary effect on the inflation trend in the economy in both the short and long term. Also, this legislation would tend to promote and augment the private pension component of the income stream of the future elderly, resulting in a lessening of their degree of dependency for income on public transfer programs, and an enhancing of their ability to retire without suffering a precipitous income reduction and decline in living standard. While we recognize the difficulty involved in making a reasonable assessment of the consequences that enactment of legislation of this type would have, we would hope that the Subcommittee would endeavor to assure that any legislation that is favorably reported would have these economic and savings incentive effects and would not merely be a vehicle to facilitate a shifting of a financial burden from the employer to the employee.

National Coordinating Committee for Multiemployer Plans

SUITE 603 • 815 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20006 • (202) 347-1461

April 20, 1979

The Honorable Lloyd Bentsen
Chairman
Subcommittee on Private Pension Plans
and Employee Fringe Benefits
Senate Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In response to your press release dated March 13, 1979, soliciting testimony on several bills designed to encourage retirement savings, the following comments on sections 201 and 202 of S. 209, pertaining to lump sum distributions from qualified plans, are hereby submitted by the National Coordinating Committee for Multiemployer Plans.

<u>Summary</u>

For technical reasons, thousands of working men and women covered by multiemployer plans are unable to qualify for the favored tax treatment accorded to lump sum distributions under Code section 402(e). Section 201 of S. 209 would modify section 402(e) in order to allow

these workers to obtain the same tax benefits currently available to management and supervisory employees who are covered by both a profit sharing plan and a pension plan. The Treasury Department has testified that it is not opposed to this change although it does seek certain other changes in the treatment of lump sum distributions from qualified plans.

Section 202 of S. 209 would clarify the question of when an employee covered by a multiemployer plan has a "separation from the service" so as to be eligible for a lump sum distribution. Under this provision, a separation would be deemed to occur when the employee has not worked for any employer in service covered by the plan for six months. This amendment is supported by the Treasury.

Analysis

I. Section 201 of S. 209.

Under Code section 402(e), favored tax treatment is accorded to certain lump sum distributions from a qualified plan which are paid within one taxable year by reason of the employee's death, disability or separation from the service, or for any reason after an employee has attained age 59-1/2. In order to qualify for this favored tax treatment, the lump sum distribution must include all amounts due to the employee, and for this purpose, all profit sharing plans maintained by the employer are treated as one plan and all pension plans maintained by the employee are treated as one plan.

The above rules have been interpreted in proposed IRS regulations to mean that an employee who is covered by two plans, a defined benefit plan and a defined contribution plan, can obtain favored tax treatment for a lump sum distribution from the defined contribution plan if it is a profit sharing plan, but not if it is a money purchase plan. Although profit sharing plans are common for management and supervisory employees, when a multiemployer defined contribution plan is established under collective bargaining, the parties generally provide for a money purchase plan rather than a profit sharing plan. The result is that many workers covered by multiemployer plans are deprived of favored tax treatment for lump sum distributions from a defined contribution plan even though similarly situated management and supervisory employees can qualify for favored tax treatment. The factual circumstances which lead to this situation are described in greater detail below.

In many industries, through collective bargaining, two types of retirement plans have been established:

(a) a defined contribution plan, with immediate 100 percent vesting; and

(b) a defined benefit plan with delayed vesting.

In such industries, the fully vested defined contribution plan is responsive to the needs of younger workers who wish to have an individual account plan which will be fully distributed upon separation from service. The defined benefit plan is designed to provide pension benefits to older workers who may have less time to build up a substantial account under a defined contribution plan. However, all workers under the collective bargaining agreement generally participate in both plans.

In the event a worker leaves an industry which maintains these two types of plans, the worker is generally entitled to receive a full distribution of his account under the defined contribution plan. However, he is generally not entitled to receive a distribution of his vested account under the defined benefit plan. Typically, the defined benefit plan has no mechanism for a lump sum distribution at any time and provides benefits only in the form of an annuity beginning at early or normal retirement age.

Under pre-ERISA law, distributions to terminated employees from a defined contribution plan were entitled to favored tax treatment under Code section 402. The favored treatment of a lump sum distribution from a defined contribution plan would not be adversely affected by the fact that any vested benefit under a defined benefit plan covering the same worker could only be distributed at a later date as an annuity. However, under section 402(e) of the Code as amended by ERISA, favored lump sum tax treatment is apparently denied to workers who receive full distribution of their account balance under a defined contribution plan without also receiving a lump sum distribution under a defined benefit plan in which they participate. Prop. Reg. § 1.402(e)-2(e). We believe this result is contrary to the intent of section 402(e) and urge adoption of section 201 of S. 209 in order to insure that workers in multiemployer plans will not be deprived of the tax benefits accorded to lump sum distributions.

Under sections 3(34) and (35) of ERISA, "pension plans" are divided into two categories: "defined contribution plans" (including profit sharing plans and money purchase pension plans); and "defined benefit plans" (all other types of pension plans). ERISA recognizes that money purchase plans are more similar to profit sharing plans than to defined benefit plans, and for numerous purposes under the act, all defined contribution plans are treated alike. The above definitions are applicable not only to Title I of the Act, but are also carried over to sections 414(i) and (j) of the Internal Revenue Code and are used repeatedly under Title II.

The scheme followed by ERISA of dividing retirement plans into the categories of defined contribution plans and defined benefit plans is in accord with economic reality. In general, the only difference between a profit sharing plan and a money purchase plan is that no contributions will be made to the profit sharing plan if no profits are available. Since profits may be defined to include all accumulated earnings of profits as well as current earnings, in practice there is often no difference between a profit sharing plan and a money purchase pension plan. Except in the rare case where an employer's current and accumulated earnings and profits are entirely exhausted, the only distinction between the two types of plans lies in the name written on page one. However, for technical reasons, if the parties to a collective bargaining agreement wish to establish a multiemployer individual account plan, they must provide for a money purchase pension plan instead of a profit sharing plan. In a multiemployer framework, a profit sharing plan is not feasible because the various contributing employers will each have a different profit situation. If any employer were unable to contribute because of losses, this would cause unequal treatment of different workers covered under the same plan. This practical necessity which forces any multiemployer individual account plan to take the form of a money purchase plan should not have the effect of depriving participants and beneficiaries of the benefits provided under Code section 402(e). In order to cure this technical problem, we urge enactment of section 201 of S. 209.

II. Section 202 of S. 209.

Under section 402(e)(4)(A) of the Code, a "lump-sum distribution" includes any total distribution from a qualified plan paid within one taxable year which becomes payable on account of the employee's "separation from the service." A number of court decisions, as well as outstanding revenue rulings, indicate that a separation from the service is deemed to occur in the event of "an employee's death, retirement, resignation or discharge." E.g., Rev. Rul. 72-440, 1972-2 C.B. 225, 226; United States v. Johnson, 331 F.2d 943, 949 (5th Cir. 1964); United States v. Haggart, 410 F.2d 449, 452 (8th Cir. 1966). However, no published case or ruling applies the concept of "separation from the service" to the conditions of employment characteristic of many multiemployer plans where shifts from one employer to another occur frequently throughout the employment history of the typical plan participant.

Section 202 of S. 209 would clarify the concept of "separation from service" as applied to a multiemployer plan by specifying that any employee who has not worked in service covered by the plan for a consecutive period of six months will be deemed to have "separated from the service" and thus be eligible for a lump sum distribution. The Treasury Department has testified in support of this amendment.

For the reasons explained above, the National Coordinating Committee for Multiemployer Plan supports sections 201 and 202 of S. 209.

Respectfully submitted,

Robert A. Georgine
Chairman

Hartford, Connecticut 06152
(203) 786-5426

CONNECTICUT GENERAL

LIFE INSURANCE COMPANY

Marvin A. Levine
Senior Vice President

April 19, 1979

The Honorable Senator Lloyd Bentsen, Chairman
Subcommittee on Private Pension Plans and
Employee Fringe Benefits
Senate Finance Committee
United States Senate
Washington, D.C.

Re: Section 203 of S209, S75, S557 and S94

Dear Mr. Chairman:

The purpose of this letter is to express our views regarding employee deductions under private pension plans. Connecticut General Life Insurance Company is one of the eight major insurance companies in America. We administer over 14,000 retirement plans covering more than 500,000 participants. As a service provider of employee pensions and as an employer of over 9,000 employees, Connecticut General is genuinely concerned that private pensions provide adequate retirement income. We are pleased that the Subcommittee is considering proposals to encourage Americans to save for retirement and appreciate the opportunity to comment on these bills.

Connecticut General strongly supports legislation which provides tax incentives for private savings as a means of securing retirement income. These bills represent a positive step toward achieving this goal. We endorse the concept not only because it will increase individual retirement savings but because it will promote the establishment and maintenance of private employer-sponsored pension plans, particularly those of the small employer. This will improve capital formation, resulting in more jobs and more tax revenue. In

April 19, 1979
Page 2

addition, we feel such a program will be especially advantageous to individuals in highly mobile professions where short service with one employer often results in a loss of benefits.

In Connecticut General's Group Pension Department, among 23 of our major clients' plans which permit voluntary employee contributions, the participation rate in the "voluntary investment plan" averages over 25%. Annual participant contributions range between $1,000 and $1,500. Under Connecticut General's own pension plan, over 50% of those employees participating in the "voluntary investment plan" earn less than $15,000 a year; nearly 20% earn less than $10,000. Per participant annual contributions average $1,300. These figures indicate to us that many employees, even those in lower income brackets, are willing and able to contribute to a retirement savings program even without a tax deduction. We believe the added incentive of a tax deduction provided by the LERA concept would enable those individuals who cannot now afford it to also participate in voluntary retirement savings plans.

The following comments describe in detail the approach we believe legislation on the "LERA" concept should take. In our opinion, your bills, S557 and S94, come closest to this approach.

1. Deduction Limits. Employees covered by private plans should be permitted the same deduction amount as individuals contributing to IRA's (i.e. the lesser of 15% of compensation or $1,500, as provided under S557). We realize that while some employers are quite willing to establish retirement programs, their plans often do not provide adequate benefits, and some employees feel they would be better off if they could establish their own IRA's. If employees are given the option to participate in the employer's plan, the employer may find that his

plan is competing with the IRA. This is counterproductive to the growth of private pension plans. The IRA was intended for employees whose employer had no plan. It should not serve as a disincentive for employers to establish plans, nor should the IRA discourage employees from participating in their employer's plan. Employees who opt out of the employer's plan in favor of an IRA may be foregoing favorable death benefits and often better investment results. At the same time, the employer risks loss of plan qualification due to reduced coverage. Uniform deduction limits for private plans and IRA's would eliminate this competition. Furthermore, they would simplify plan administration for the employer as well as tax reporting for both employees and the Internal Revenue Service.

2. Deductible Contributions. Employees should be permitted to deduct their contributions whether they are mandatory or voluntary, as provided in S75 and S557. Connecticut General encourages the establishment of certain types of contributory plans. We feel such arrangements foster greater employee awareness of the need for retirement income. Thrift plans especially, where the employer contribution is based on the amount the employee contributes, are a good mechanism for generating employee savings. Therefore, we feel that prohibiting employee deductions for mandatory contributions to new plans set up after January 1, 1978, (as does section 203 of S209) would obviously discourage formation of contributory plans. Where such plans were established, employees under the matching thrift type of plan would be forced to choose between making a deductible voluntary contribution or making a non-deductible mandatory contribution which would be matched by their employer. This is a confusing and difficult choice employees should not have to make.

3. Non-discrimination Rules. Connecticut General strongly opposes the non-discrimination rules contained in S75 and Section 203 of S209.

* We feel that the non-discrimination rules for qualified plans as provided under Code section 401(a)(4) are sufficient to ensure that highly paid employees do not receive preferred treatment. Furthermore, existing non-discrimination rules applicable to employer contributions, which can be as much as $32,700 per year under defined contribution plans (as provided in Code section 415), have provided adequate protection for the low paid employee in the past and should certainly be appropriate for the LERA program where the maximum deduction is only $1,500.
* The non-discrimination rules described in these two bills are extremely complex. Assuming the employer can understand how the rules operate, their administration, requiring annual calculations on each plan participant, may be so costly as to discourage employers from performing the computations necessary to certify the plan as non-discriminatory. We estimate that administration of these rules could increase plan costs for our group pension, defined contribution clients by as much as fifty cents ($.50) per participant, per year. This represents a 5% increase.
* If the employer does not certify the plan, he is in effect prohibiting his high paid employees, and possibly many middle income employees as well, from taking the deduction under the plan or an IRA. Avoidance of the non-discrimination rules may then be perceived as discriminating in favor of the low paid employee, and this is not equitable from an overall tax policy point of view. Since the rules do apply even if participants deduct contributions made to an IRA, the employer who is willing to certify the plan would be required to make calculations based on figures which would be difficult, if not impossible, to obtain

and totally outside the accounting data maintained for the plan.

* The non-discrimination rules are set out in such a way that certification cannot be completed until after the plan year. Thus neither the employers nor their employees know until after the end of the plan year (1) whether the plan will be certified and (2) who will be classified as "high paid" and who may or may not take the deduction or for how much. While the low paid employee's deduction may be ensured, this uncertainty is bound to discourage the middle and upper income employees from making their contributions on an ongoing basis during the plan year (a common and preferred approach for contributions made via payroll deduction) for fear the plan will not be certified. Employees who contribute to IRA's would be particularly concerned since, if the plan is not certified, failure to withdraw IRA contributions could lead to substantial penalties.
* Many employers' plan years will not coincide with the employees' tax years. The discrepancy between an employee's deduction for his tax year and the deferral percentage for a plan year creates an unworkable situation.

4. Optional Employee Contributions. Connecticut General supports the approach taken in all three LERA bills permitting employee contributions at the employer's discretion. For many employers administration of deductible employee contributions will mean plan and booklet amendments, changes to computer systems and new operating procedures. Employers should be free to decide whether they can afford to offer this plan feature. Since employees could still contribute to the IRA, we do not believe that the intent of the LERA bills would suffer by giving employers this option.

5. Recordkeeping. Connecticut General believes that employers should be able to account for employee contributions without having to keep detailed records

of the actual deductions employees take (as required under Section 203 of S209 and S75). Since employees are free to deduct contributions made to the plan and/or the IRA, the employer may not know which amounts were, in fact, deducted. Keeping track of plan and IRA deductions would be a cumbersome, costly process. For purposes of reporting the taxable and non-taxable portions of distributions of employee contributions, it should be sufficient for the employer to assume that the employee will deduct the total amount (up to the maximum permissible) contributed to the plan, unless the employee indicates otherwise.

6. Effective Date. In order to give employers and service providers sufficient lead time to adopt the necessary documentation and administrative changes, the effective date of any legislation permitting employee deductions should be no earlier than the first day of the taxable year beginning after such law is passed. Therefore, we recommend the effective date of S557 be revised accordingly.

7. Format/Legislative Drafting. Connecticut General believes that S557 is preferable to the other bills in its form and its simplicity. Since the enactment of ERISA, employers have been deluged with complicated regulations from a variety of Federal agencies. Many employers cannot afford lawyers to help them interpret these rules. We applaud any effort to make legislation/regulations as simple and clear as possible. S557, which amends Code section 219, merely adds qualified plans to the types of retirement arrangement for which employees may currently deduct contributions. This approach avoids the need for a new Code section (as required under S75 and Section 203 of S209) and as a result, the need for extensive conforming amendments. We recommend that an additional provision be added to S557 to clarify the application of the second paragraph of section 219(a) to employer contributions to qualified plans on

April 19, 1979
Page 7

behalf of employees.

8. S94/The Homemaker Bill. Connecticut General also supports legislation permitting increased retirement savings by equalizing spousal deductions. We believe that each spouse whether or not they both work, earn the same income or participate in a qualified plan, should be allowed a maximum deduction for retirement savings. Furthermore, S94 if enacted in conjunction with S557, would generate more capital under private plans where one or both spouses participated in employer plans.

In conclusion, Connecticut General strongly endorses the Subcommittee's efforts to find new ways to meet individual retirement needs in our mobile economy. We feel that bills S557 and S94 provide the most effective way of achieving this very important objective. We are in agreement with the testimony of the ERISA Industry Committee and the Association of Private Pension and Welfare Plans presented to your Subcommittee on April 3, as well as the written statements made by the American Council of Life Insurance. We would be pleased to work with you or members of your Subcommittee in any way that you would find helpful. Don't hesitate to call on us.

Sincerely,

Senior Vice President

COMMENTS OF AMERICAN EXPRESS COMPANY ON S.75 - RETIREMENT SAVINGS DEDUCTION

These comments are submitted by American Express Company in support of S.75, legislation introduced by Senators Dole and Nelson, to amend the Internal Revenue Code in order to allow a retirement savings deduction for persons covered by tax-qualified pension plans. S.75 would permit an employee who is covered by a qualified plan to deduct the lesser of $1,000, or 10% of his or her salary for contributions made to such a plan or to an Individual Retirement Account. The bill also contains a provision designed to insure that this deduction does not discriminate in favor of more highly compensated employees.

American Express Company and its affiliates, engaged in travel-related, insurance and international banking business, employs approximately 23,000 individuals within the United States and provides a comprehensive system of plans aimed at insuring the retirement security of these employees. These plans include non-contributory pension plans covering all employees, as well as voluntary contributory profit-sharing plans intended to supplement benefits payable under the pension plans.

While American Express considers the retirement program sound and highly competitive, it recognizes that the issue of retirement security for older Americans is one of the most important problems presently confronting our lawmakers. As the proportion of the American population that has reached retirement age steadily increases in relation to other age groups, there is a national interest in providing adequately for the needs of older citizens. A mechanism which promotes individual savings for retirement security would supplement available income for these persons while helping to alleviate the burdens upon the Social Security system and other government programs.

A tax incentive for participation in employer-sponsored pension and profit-sharing plans is one such mechanism. American Express, therefore, supports S.75 because it will encourage employees to whom IRA's are not presently available to save for their retirement and will help to insure that employer-sponsored qualified pension and profit-sharing plans, which offer employees extensive benefits, will remain viable through widespread employee participation.

In light of these significant benefits to working Americans through the encouragement of prudent retirement savings practices, we support S.75. The Committee is to be commended for conducting hearings on this important legislation.

LAW OFFICES
GROOM AND NORDBERG
SUITE 450
1775 PENNSYLVANIA AVENUE, N. W.
WASHINGTON, D. C. 20006
(202) 857-0620

THEODORE R. GROOM
CARL A. NORDBERG, JR.
ROBERT K. PERRY, JR.
ROBERT B. HARDING
LAWRENCE J. HASS
LOUIS T. MAZAWEY
MICHAEL F. KELLEHER
DONALD J. FITZGERALD
LINDA A. SCHWARTZSTEIN

April 23, 1979

The Honorable Lloyd Bentsen
Chairman, Subcommittee on Private
Pension Plans & Employee Fringe
Benefits of the Committee on Finance
United States Senate
2227 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

On April 3, 1979, the Senate Finance Committee's Subcommittee on Private Pension Plans and Employee Fringe Benefits held hearings with respect to S. 75, S. 94, S. 209 and S. 557. Among other things, those bills would permit participants in qualified pension plans to deduct certain contributions they made to the plan or to an IRA. The Finance Committee also announced that interested persons could submit written statements for the record with regard to the proposed legislation. We are submitting this written statement in response to that announcement.

The Prudential Insurance Company of America is a leading life insurance company conducting its business throughout the United States. Prudential plays a major role in the funding and administration of a large number of private pension plans. Prudential has also entered into many thousands of contracts for individual retirement savings programs.

We fully support the purposes of the legislative proposals to permit qualified plan participants to make deductible contributions to the plan or to an IRA. The availability of deductions for such contributions would provide incentive for an increase

The Honorable Lloyd Bentsen
April 23, 1979
Page 2

in retirement savings and, consequently, would stimulate capital formation. Employees and their families would benefit individually and our economy as a whole would benefit. We urge adoption of S. 557 because we believe that it is the best proposal being considered by the Subcommittee. Our reasons for supporting S. 557 are in accord with the reasons set forth in the statement of the American Council of Life Insurance to the Subcommittee dated March 30, 1979.

While we support the goals of the proposed legislation, however, we also suggest that the legislation finally adopted should contain additional protections for current holders of fixed premium IRA endowment contracts and should again permit sales of such contracts in the IRA market. We believe that the amendments proposed are consistent with the legislation under consideration and that these amendments directly address a problem of major concern to the Committee: what types of retirement income vehicles are more likely to attract low and moderate income taxpayers to retirement savings. Additionally, the proposed amendments deal with a major oversight in the 1978 Revenue Act provisions relating to IRAs.

The Problems

Fixed premium IRA endowment contracts are excellent vehicles for individuals to provide for retirement. Such contracts were especially attractive in the past to young persons with families and with moderate incomes because such contracts combine immediate insurance protection with long-term retirement benefits. Over 300,000 contracts of this type were in existence at the time Congress passed the Revenue Act of 1978. In Prudential's experience, the average age of purchasers of IRA endowment contracts was 32 and 80% of those purchasers earned less than $20,000 per year. Prudential also offered flexible annuities in the IRA market as an alternative to endowment contracts, but purchasers of flexible annuities were about 48 years old on the average and had higher incomes than endowment purchasers. Thus, IRA endowment contracts were found to be particularly suitable for retirement savings by precisely the type of individual the proposed legislation is designed to benefit.

The Honorable Lloyd Bentsen
April 23, 1979
Page 3

The problems associated with fixed premium IRA endowment contracts arise largely as a result of the current provisions in the Internal Revenue Code that make active participants in qualified pension plans ineligible to make contributions to an IRA on a tax-favored basis. An individual holding a fixed premium IRA endowment contract who becomes an active participant in a qualified plan because of a change in jobs is faced with a difficult choice: either continue participation in the contract and suffer harsh tax consequences or terminate the contract prematurely. Premature termination in the early years of the contract is disadvantageous because the return on investment in such contracts is best in the case of long-term participation.

Congress responded to these problems by enacting section 157(d) of the Revenue Act of 1978. That section prohibited sales of fixed premium endowment contracts in the IRA market after November 6, 1978, and, as a relief measure, permitted current holders of such contracts to exchange them for flexible annuity contracts on a nontaxable basis until January 1, 1981.

The Revenue Act of 1978 made IRA endowment contracts unavailable in the future to the young persons of low or moderate income who needed and wanted such contracts the most. In addition, the relief afforded to existing contractholders under the Revenue Act of 1978 is inadequate. In most cases, an individual who exchanged his contract for a flexible annuity contract would incur loading charges on the new contract, thus reducing the return on his investment in retirement savings. (Prudential voluntarily protects its IRA endowment contractholders from this potentially harsh result, however, by not imposing loading charges on such contractholders who exchange their IRA endowment contract for a Prudential flexible annuity.) Also, in the case of an endowment contract, the person's family would lose valuable insurance protection against his premature death. Congressman J. J. Pickle, who was a leading proponent of improvements in the IRA provisions in connection with the Revenue Act of 1978, stated in the Congressional Record that the relief afforded to existing contractholders in that Revenue Act may not be enough and that alternative relief measures should be considered this year. We agree with Congressman Pickle.

The legislative proposals currently under consideration by the Finance Committee offer a good opportunity for Congress to provide more far-ranging solutions to the problems associated with fixed premium IRA endowment contracts. This is because the legislative proposals would solve the major problem in this area: the IRA endowment contractholder who becomes a participant in a qualified plan.

The Solutions

a) Existing Endowment Contracts

Holders of existing IRA endowment contracts should be allowed to continue participation in their IRA programs without tax penalty after becoming covered by a qualified plan, as they would be permitted to do by the bills currently under consideration. This same relief should be extended to existing contractholders who become participants in government plans, section 403(b) annuity plans, or H.R. 10 plans. Unless relief is extended to these individuals, too, a significant number of existing contractholders could still be faced with the harsh choices that led to the passage of section 157(d) of the Revenue Act of 1978.

b) Future Sales of IRA Endowment Contracts

Sales of fixed premium endowment contracts should be permitted in the IRA market again and the rule proposed above for existing contractholders should be applied to new purchasers of such contracts. The bills currently under consideration would allow qualified plan participants to contribute to an IRA on a tax-favored basis. This would effectively remove the major cause of problems associated with endowment contracts under current law. By reinstating such contracts in the IRA market, more individuals would be able to utilize endowment contracts to provide a valuable combination of insurance protection and retirement savings.

Last year Prudential suggested that IRA endowment contractholders who became ineligible to continue making contributions to their IRA on a tax-favored basis should be permitted to make nondeductible contributions to those contracts without penalty under the Internal Revenue Code. There were objections to this suggestion on the ground that the proposed rules would be complex. The rules under our current proposal would be simpler to understand and to administer than those earlier proposals, however.

Very truly yours,

Theodore R. Groom

Theodore R. Groom
Attorney for
The Prudential Insurance
Company of America

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