DESCRIPTION OF THE CHAIRMAN'S MARK OF THE "THE ENHANCING AMERICAN RETIREMENT NOW (EARN) ACT"

Scheduled for Markup
by the
SENATE COMMITTEE ON FINANCE
on June 22, 2022

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Senate Committee on Finance has scheduled a committee markup on June 22, 2022 of the "The Enhancing American Retirement Now (EARN) Act." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's mark.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Mark of the "The Enhancing American Retirement Now (EARN) Act,"* June 17, 2022, (JCX-9-22). This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

A. Individual Retirement

1. Secure deferral arrangements

Present Law

Section 401(k) plans

A qualified defined contribution plan may include a qualified cash or deferred arrangement, under which employees may elect to have contributions made to the plan (referred to as "elective deferrals") rather than receive the same amount as current compensation (referred to as a "section 401(k) plan").[2] The maximum annual amount of elective deferrals that can be made by an employee for a year is $20,500 (for 2022) or, if less, the employee's compensation.[3] For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is increased by $6,500 (for 2022) (called "catch-up contributions").[4] The dollar limits for elective deferrals, including catch-up contributions, are indexed for inflation. An employee's elective deferrals must be fully vested (nonforfeitable to the employee).[5] A section 401(k) plan may also provide for employer matching and nonelective contributions, which may be subject to vesting conditions. A matching contribution is conditioned on the employee making elective deferrals,[6] while a nonelective contribution is not conditioned on whether an employee has elected to make contributions to the plan.

Automatic enrollment

A section 401(k) plan must provide each eligible employee with an effective opportunity to make or change an election to make elective deferrals at least once each plan year.[7] Whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including the adequacy of notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections.

Section 401(k) plans are generally designed so that an employee will receive cash compensation unless the employee affirmatively elects to make elective deferrals to the section

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[2] Except where otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended (the "Code"). Elective deferrals are generally made on a pretax basis and distributions attributable to elective deferrals are includible in income. However, a section 401(k) plan is permitted to include a "qualified Roth contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as after-tax Roth contributions. Certain distributions from a designated Roth account are excluded from income, even though they include earnings not previously taxed.

[3] Sec. 402(g).

[4] Sec. 414(v).

[5] Sec. 411(a).

[6] Matching contributions may also be conditioned on the employee making Roth contributions or after-tax contributions.

[7] Treas. Reg. sec. 1.401(k)-1(e)(2)(ii).

401(k) plan. Alternatively, a plan may provide that elective deferrals are made at a specified rate when an employee becomes eligible to participate unless the employee elects otherwise (that is, affirmatively elects not to make contributions or to make contributions at a different rate). This plan design is referred to as automatic enrollment.

Nondiscrimination testing

Actual deferral percentage test

An annual nondiscrimination test, called the actual deferral percentage test (the "ADP" test) applies to elective deferrals under a section 401(k) plan.[8] The ADP test generally compares the average rate of deferral for highly compensated employees to the average rate of deferral for non-highly compensated employees and requires that the average deferral rate for highly compensated employees not exceed the average rate for non-highly compensated employees by more than certain specified amounts.

The ADP test is deemed to be satisfied if a section 401(k) plan includes certain minimum matching or nonelective contributions under either of two plan designs ("401(k) safe harbor plan"), described below, as well as certain required rights and features and if the plan satisfies a notice requirement, if applicable.[9]

Matching contribution nondiscrimination test

Employer matching contributions are also subject to a nondiscrimination test that compares the average actual contribution percentages of matching contributions for the highly compensated employee group and the non-highly compensated employee group (the "ACP" test). Under the ACP test, the actual contribution percentage of the highly compensated employee group for the current plan year must not exceed the greater of (1) 125 percent of the actual contribution percentage of the non-highly compensated employee group for the prior plan year, or (2) 200 percent of the actual contribution percentage of the non-highly compensated employee group for the prior plan year and not more than two percentage points greater than the actual contribution percentage of the non-highly compensated employee group for the prior plan year.

The ACP test is deemed to be satisfied if a 401(k) safe harbor plan meets the contribution and notice requirements under section 401(k), and if the following limits on matching contributions are met: (1) matching contributions are not provided with respect to elective deferrals in excess of six percent of compensation, (2) the rate of matching contribution does not increase as the rate of an employee's elective deferrals increases, and (3) the rate of matching contribution with respect to any rate of elective deferral of a highly compensated employee is no

[8] Sec. 401(k)(3).

[9] Secs. 401(k)(12) and (13).

greater than the rate of matching contribution with respect to the same rate of deferral of a non-highly compensated employee.[10]

Safe harbor 401(k) plan designs

Under one type of 401(k) safe harbor plan ("basic 401(k) safe harbor plan"), the plan either (1) satisfies a matching contribution requirement, or (2) provides for a nonelective contribution to a defined contribution plan of at least three percent of an employee's compensation on behalf of each non-highly compensated employee who is eligible to participate in the plan.[11] The matching contribution requirement under the matching contribution basic 401(k) safe harbor requires a matching contribution equal to at least 100 percent of elective contributions of the employee for contributions not in excess of three percent of compensation, and 50 percent of elective contributions for contributions that exceed three percent of compensation but do not exceed five percent, for a total matching contribution of up to four percent of compensation. The required matching contributions and the three percent nonelective contribution under the basic 401(k) safe harbor must be immediately nonforfeitable (that is, 100 percent vested) when made.

Another safe harbor applies for a section 401(k) plan that includes automatic enrollment ("automatic enrollment 401(k) safe harbor plan").[12] An automatic enrollment section 401(k) safe harbor plan must provide that, unless an employee elects otherwise, the employee is treated as electing to make elective deferrals at a default rate equal to a percentage of compensation as stated in the plan that is at least (1) three percent of compensation through the end of the first plan year that begins after the first deemed election applies to the participant, (2) four percent during the second plan year, (3) five percent during the third plan year, and (4) six percent during the fourth plan year and thereafter.[13] An automatic enrollment section 401(k) safe harbor plan generally may provide for default rates higher than these minimum rates, but the default rate cannot exceed 15 percent for any year (10 percent during the first year).

The automatic enrollment section 401(k) safe harbor plan also must satisfy either (1) a matching contribution requirement, or (2) provide for a nonelective contribution. The matching contribution requirement under the matching contribution automatic enrollment 401(k) safe harbor plan is 100 percent of elective contributions of the employee for contributions not in excess of one percent of compensation, and 50 percent of elective contributions for contributions that exceed one percent of compensation but do not exceed six percent, for a total matching contribution of up to 3.5 percent of compensation. Alternatively, the plan can provide that the employer will make a nonelective contribution of three percent. For an automatic enrollment

[10] Sec. 401(m)(11); 401(m)(12).

[11] Sec. 401(k)(12).

[12] Sec. 401(k)(13).

[13] Sec. 401(k)(13)(C)(iii). These automatic increases in default contribution rates are required for plans using the safe harbor. Rev. Rul. 2009–30, 2009-39 I.R.B. 391, provides guidance for including automatic increases in other plans using automatic enrollment, including under a plan that includes an eligible automatic contribution arrangement.

401(k) safe harbor plan, the matching and nonelective contributions are required to become 100 percent vested only after two years of service (rather than being required to be immediately vested when made).

Safe harbor notice

Both the matching contribution basic section 401(k) safe harbor plan and the matching contribution automatic enrollment section 401(k) safe harbor plan are subject to a notice requirement.[14] A written notice must be provided to each employee eligible to participate, within a reasonable period before each plan year and must describe the employee's rights and obligations under the arrangement. Such notice must be (1) sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and (2) written in a manner calculated to be understood by the average employee to whom the arrangement applies.

In the case of a matching contribution automatic enrollment section 401(k) safe harbor plan, the notice must also (1) explain the employee's right under the arrangement to elect not to have elective contributions made on the employee's behalf (or to elect to have such contributions made at a different percentage), (2) in the case of an arrangement under which the employee may elect among 2 or more investment options, explain how contributions made under the arrangement will be invested in the absence of any investment election by the employee. Additionally, the employee must have a reasonable period of time after receipt of the notice and before the first elective contribution is made to make either such election.

Description of Proposal

The proposal establishes a new automatic enrollment safe harbor ("secure deferral arrangement") in addition to the existing automatic enrollment 401(k) safe harbor plan. The secure deferral arrangement is required to satisfy certain requirements, including providing for certain minimum qualified percentages of elective deferrals and certain minimum matching contributions. There is also an employee notice requirement. However, secure deferral arrangements (like other safe harbor 401(k) plans) generally are not subject to nondiscrimination testing.

Under the new secure deferral arrangement, the minimum qualified percentages of employee elective deferrals are at least six percent but not greater than 10 percent during the period ending on the last day of the first plan year (instead of the current three percent in the existing automatic enrollment 401(k) safe harbor) which begins after the date on which the first elective contribution is made with respect to such employee, at least seven percent in the second year, at least eight percent in the third year, at least nine percent in the fourth year, and at least 10 percent in all subsequent years. The 10 percent cap on the default level of employee elective deferrals applies in the first year, but no cap applies to any of the following years.

The employer is required to make matching contributions on behalf of all eligible non-highly compensated employees equal to (a) 100 percent of the employee's elective deferrals up to two percent of the employee's compensation, (b) 50 percent of such employee's elective

[14] Secs. 401(k)(12)(A); 401(k)(13)(B).

deferrals that exceed two percent but do not exceed six percent of the employee's compensation, and (c) 20 percent of such employee's elective deferrals that exceed six percent but do not exceed 10 percent of the employee's compensation for a total matching contribution of up to 4.8 percent of compensation.

Effective Date

The proposal is effective for plan years beginning after December 31, 2023.

2. Matching payments for elective deferral and IRA contributions by certain individuals

Present Law

Eligible taxpayers may claim a nonrefundable income tax credit for qualified retirement savings contributions to certain retirement accounts.[15] Subject to adjusted gross income ("AGI") limits, the credit is available to individuals who are age 18 or older, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return. The maximum amount of the contribution that may be taken into account is $2,000 with a maximum credit of $1,000 per eligible individual.[16]

The amount of the credit is based on the taxpayer's AGI and filing status. The credit is a percentage of the taxpayer's qualified retirement savings contributions with a percentage of 10 percent, 20 percent, or 50 percent, as shown in the table below. The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets alternative minimum tax liability as well as regular tax liability.

Table 1.–Credit Rates for Saver's Credit (for 2022)

Joint Filers (AGI)	Heads of Households (AGI)	All Other Filers[1] (AGI)	Credit Rate
$0 – $41,000	$0 – $30,750	$0 – $20,500	50 percent
$41,001 – $44,000	$30,751 – $33,000	$20,501 – $22,000	20 percent
$44,001 – $68,000	$33,001 – $51,000	$22,001 – $34,000	10 percent
more than $68,000	more than $51,000	more than $34,000	0 percent

Note: AGI amounts are indexed for inflation.
[1] Includes single, married filing separately, and qualifying widow or widower.

Eligible contributions for purposes of the credit include (1) contributions to traditional and Roth IRAs; (2) elective deferrals to a section 401(k) plan, a section 403(b) plan, a governmental section 457(b) plan, a SIMPLE IRA, or a SEP; (3) voluntary after-tax employee contributions to a qualified retirement plan or annuity or a section 403(b) plan; and (4) contributions to a section 501(c)(18)(D) plan. Under changes enacted by Public Law 115-97,

[15] Sec. 25B; Pub. L. No. 109-290.

[16] See IRS Form 8880, *Credit for Qualified Retirement Savings Contributions*.

eligible contributions for purposes of the credit also include contributions to Achieving a Better Life Experience ("ABLE") accounts for which the taxpayer is a designated beneficiary.[17] ABLE accounts are savings accounts utilized by individuals with disabilities. A credit for such contributions is available for contributions made in calendar years 2018 through 2025.

The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer files a joint return with the spouse) from any retirement plan or IRA to which eligible contributions can be made during the taxable year for which the credit is claimed, during the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date for filing the taxpayer's return for the year. Distributions that are rolled over to another retirement plan do not affect the credit.

Description of Proposal

Under the proposal, an eligible individual is allowed a refundable income tax credit, up to $1,000, equal to a percentage of qualified retirement savings contributions made by the individual to a retirement account.[18] The refund must be paid by the Secretary of Treasury ("Secretary") as a contribution to the eligible individual's applicable retirement savings vehicle and must be made as soon as practicable after the eligible individual files a tax return making a claim for the credit. This credit generally replaces the present-law credit for qualified retirement savings contributions to retirement accounts.[19]

Qualified retirement savings contributions

The maximum percentage of qualified retirement savings contributions eligible for the credit remains 50 percent, and the maximum amount of qualified retirement savings contributions that may be taken into account remains $2,000. This amount is not indexed for inflation. The credit percentage is reduced from 50 percent to 0 percent beginning at the applicable dollar amount of modified AGI and extending over a phaseout range.[20] For eligible married individuals who file a joint tax return and for surviving spouses,[21] the applicable dollar amount is $41,000 of modified AGI, indexed for inflation, and the phaseout range is $30,000 of modified AGI. For eligible individuals who file as head of household, the applicable dollar

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[17] Pub. L. No. 115-97, sec. 11024, December 22, 2017.

[18] Sec. 6433, as added by this proposal.

[19] Sec. 25B. The credit under the proposal does not apply with respect to contributions made to an ABLE account (within the meaning of section 529A) of which such individual is the designated beneficiary. Such contributions would continue to be eligible for the credit as it exists under present law. See sec. 25B(d)(1)(D).

[20] The percentage is reduced by the number of percentage points which bears the same ratio to 50 percentage points as the excess of the taxpayer's modified AGI for the taxable year, over the applicable dollar amount, bears to the phaseout range. Modified AGI is determined as AGI without regard to sections 911, 931, and 933, and without regard to any exclusion or deduction allowed for any qualified retirement savings contribution made during the taxable year.

[21] See sec. 2(a) (definition of surviving spouse).

amount and phaseout range are 75 percent of those in effect for joint return filers. For all other taxpayers, the applicable dollar amount and phaseout range are 50 percent of the amounts in effect for joint return filers. Taxpayers who are eligible for a credit less than $100 but more than $0 receive the amount as a cash refund (rather than as a contribution to a retirement account).

The proposal retains the criteria that only individuals who have attained age 18 as of the close of the taxable year are eligible for the credit. An eligible individual does not include any individual who would be claimed as a dependent on another individual's return,[22] or any individual who is a student.[23]

The qualified retirement savings contribution is the sum of the amounts of: (1) the qualified retirement contributions made by the eligible individual,[24] (2) any elective deferrals plus elective deferral of compensation by such individuals under a governmental section 457(b) plan,[25] and (3) voluntary employee contributions by such individual to a qualified retirement plan.[26]

The amount of qualified retirement savings contributions is reduced (but not below zero) by the aggregate distributions received by the individual during the testing period from any entity of a type to which the foregoing contributions may be made. For purposes of determining distributions received by an individual, any distribution received by a spouse of such individual is treated as received by such individual if they file a joint return for such taxable year and for the taxable year during which the spouse receives the distribution.

The testing period is the period that includes the taxable year plus the two preceding taxable years and the period after such taxable year and before the due date (including extensions) for filing the tax return for such taxable year. Certain distributions made during the testing period are not taken into account for purposes of the reduction.[27] Finally, any portion of a distribution transferred or paid in a rollover contribution[28] to an account or plan to which qualified retirement contributions can be made will not be applied to any reduction in qualified retirement savings contributions for purposes of this proposal.

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[22] As provided in section 151.

[23] As defined in sec. 152(f)(2).

[24] Sec. 219(e).

[25] Secs. 402(g)(3), 457(b), 457(e)(1)(A).

[26] Sec. 4974(c).

[27] Distributions made during the testing period are not taken into account for purposes of the reduction if made under sections 72(p), 401(k)(8), 401(m)(6), 402(g)(2), 404(k), or 408(d)(4). In addition, distributions to which sections 408(d)(3) or 408A(d)(3) applies are not taken into account for purposes of the reduction.

[28] As defined in sections 402(c), 403(a)(4), 403(b)(8), 408A(e), or 457(e)(16).

Payment of credits

As previously noted, the credit will be paid in the form of a contribution to the individual's applicable retirement savings vehicle that is an account or plan elected by the individual. The contribution is treated as a pre-tax contribution to the plan. Thus, the amount will be taxable to the distributee when it is distributed from the retirement plan.

In order to receive the credit, an eligible individual must elect to have the contribution made to an account or plan which (1) is an eligible retirement plan;[29] (2) is for the benefit of the eligible individual; (3) accepts contributions made under this proposal, and (4) is designated by such individual, in such form and manner as the Secretary may provide, on the tax return for the taxable year.

A payment of a credit that is a contribution is treated as an elective deferral made by the individual or as an IRA contribution (as applicable), except as provided by the Secretary under regulations. The contribution is not taken into account with respect to any qualified plan limitations.[30]

Any contribution that was erroneously paid, including a payment that is not made to an applicable retirement saving vehicle, is treated as an underpayment of tax[31] for the taxable year in which the Secretary determines that the payment was erroneous. In the case of an erroneous credit, the distribution of such contribution is excluded from income,[32] and the 10 percent additional tax does not apply to the distribution of such contribution or income attributable to such contribution, if the distribution of such amounts is received no later than the due date (including extensions) for filing the individual's tax return. Any plan or arrangement to which a contribution is made under this proposal, or from which a distribution is made, is not be treated as violating the requirements applicable to such plan solely by reason of such contribution or distribution.[33]

Information related to payment of credits

If an eligible individual elects to have the credit contributed to an account or plan, the Secretary must provide guidance to the custodian of the account or the plan sponsor, as the case may be, detailing the treatment of such contribution and reporting requirements with respect to such contribution.

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[29] Sec. 402(c)(8)(B).

[30] As imposed by sections 402(g)(1), 403(b), 408(a)(1), 408(b)(2)(B), 414(v)(2), 415(c), or 457(b)(2). Also, such contributions are disregarded for purposes of sections 401(a)(4), 401(k)(3), 401(k)(11)(B)(i), and 416.

[31] Such a payment shall not be treated as an underpayment of tax for purposes of Part II of subchapter A of Chapter 68.

[32] Sections 402(a), 403(a)(1), 403(b)(1), 408(d)(1), and 457(a)(1) do not apply to the distribution of the contribution.

[33] The plan is not treated as violating secs. 401, 403, or 457.

The Secretary is required to amend the reporting requirements for retirement plans and IRAs to require separate reporting of the aggregate amount of contributions received by the plan during the year from the Secretary pursuant to the proposal.

ABLE Accounts

The credit under the proposal does not apply with respect to contributions made to an ABLE account[34] of which such individual is the designated beneficiary. Such contributions would continue to be eligible for the credit as it exists under present law.[35]

Treatment of the U.S. territories

The Secretary must pay to each territory of the United States that has a mirror Code tax system—the U.S. Virgin Islands, Commonwealth of the Northern Mariana Islands, and Guam—amounts equal to the loss (if any) to that territory by reason of amendments made by this proposal. Such amounts will be determined by the Secretary based on information provided by the government of the territory. With respect to any United States territory, a mirror Code tax system means the income tax system of such territory if the income tax liability of the residents of such territory is determined by reference to the income tax laws of the United States as if that territory were the United States.

For territories that do not have a mirror Code—Puerto Rico and American Samoa--the Secretary will pay amounts estimated by the Secretary as being equal to the aggregate benefits (if any) that would have been provided to residents of that territory by reason of the amendments made by this proposal if the territory had a mirror Code. The respective territory must have a plan, which has been approved by the Secretary, under which such territory will promptly distribute such payments to its residents in order for the territory to receive amounts estimated to equal aggregate benefits.

A credit under the proposal will not be allowed against Federal income taxes to any person to whom a credit is allowed against taxes imposed by the territory due to this proposal, or who is eligible for a payment resulting from a determination of aggregate benefits in a non-mirror Code territory.

Effective Date

The amendments made by this proposal apply to taxable years beginning after December 31, 2026.

[34] Sec. 529A.

[35] Sec. 25B(d)(1)(D).

3. Modification of participation requirements for long-term, part-time workers

Present Law

Background on section 401(k) plans may be found in section A.1 of this document.

General participation requirements

A qualified retirement plan generally can delay participation in the plan based on attainment of age or completion of years of service but not beyond the later of completion of one year of service (that is, a 12-month period with at least 1,000 hours of service) or attainment of age 21.[36] A plan also cannot exclude an employee from participation (on the basis of age) when that employee has attained a specified age.[37] Employees can be excluded from plan participation on other bases, such as job classification, as long as the other basis is not an indirect age or service requirement. A plan can provide that an employee is not entitled to an allocation of employer nonelective or matching contributions for a plan year unless the employee completes either 1,000 hours of service during the plan year or is employed on the last day of the year even if the employee previously completed 1,000 hours of service in a prior year.

Long-term part-time workers

Effective generally for plan years beginning in 2021, section 401(k) plans generally must permit an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least three consecutive years and has met the minimum age requirement (age 21) by the end of the three-consecutive-year period (a "long-term part-time employee").[38] Thus, a long-term part-time employee may not be excluded from the plan merely because the employee has not completed a year of service. Once a long-term part-time employee meets the age and service requirements, such employee must be able to commence participation no later than the earlier of (1) the first day of the first plan year beginning after the date on which the employee satisfied the age and service requirements or (2) six months after the date on which the individual satisfied those requirements.

The plan is not required to provide that a long-term part-time employee is otherwise eligible to participate in the plan. Thus, the plan can continue to treat a long-term part-time employee as ineligible under the plan for employer nonelective and matching contributions based on not having completed a year of service. However, for a plan that does provide employer contributions for long-term part-time employees, the plan must credit, for each year in which such an employee worked at least 500 hours, a year of service for purposes of vesting in any

[36] Secs. 401(a)(3) and 410(a)(1). Parallel requirements generally apply to plans of private employers under section 202 of ERISA. Governmental plans under section 414(d) and church plans under section 414(e) are generally exempt from these Code requirements and from ERISA.

[37] Sec. 410(a)(2).

[38] Sec. 401(k)(2)(D). This rule was enacted as part of the Setting Every Community Up for Retirement Enhancement Act of 2019, Pub. L. No. 116-94, Division O, December 20, 2019 ("SECURE Act"), sec. 112. The rule does not apply to collectively bargained plans.

employer contributions. If a long-term part-time employee under such a plan becomes a full-time employee, the plan must continue to credit the employee with any years of service earned under the special rule for long-term part-time employees.

Employers are permitted to exclude long-term part-time employees from nondiscrimination testing,[39] including top-heavy vesting and top-heavy benefit requirements. However, the relief from the nondiscrimination rules ceases to apply to any employee who becomes a full-time employee (as of the first plan year beginning after the plan year in which the employee completes a 12-month period with at least 1,000 hours of service).

The long-term part-time employee rules are effective for plan years beginning after December 31, 2020, except that in determining whether the three-consecutive-year period has been met, 12-month periods beginning before January 1, 2021 are not taken into account.

Description of Proposal

The proposal modifies the rules that apply to long-time part-time employees under a section 401(k) plan to reduce the service requirement for such employees from three years to two years. Thus, under the proposal, a section 401(k) plan generally must permit an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least two consecutive years and has met the minimum age requirement (age 21) by the end of the two-consecutive-year period.

In addition, the proposal clarifies the effective date of the long-term part-time employee rules. Under the proposal, 12-month periods beginning before January 1, 2021 are not taken into account in determining a year of service for purposes of the rules applicable to the vesting of employer contributions. Thus, in addition to being disregarded for purposes of determining whether the employee has completed three consecutive years of service (as under present law), 12-month periods beginning before January 1, 2021 are disregarded for vesting purposes.

Effective Date

The reduction in service requirement from three years to two years is effective for plan years beginning after December 31, 2022. The clarification of the vesting rule is effective as if included in the enactment of section 112 of the SECURE Act.

4. Treatment of student loan payments as elective deferrals for purposes of matching contributions

Present Law

Section 401(k) plans

A section 401(k) plan is a type of profit-sharing or stock bonus plan that contains a qualified cash or deferred arrangement. Such arrangements are subject to the rules generally

[39] Nondiscrimination testing relief applies to sections 401(a)(4), 401(k)(3), 401(k)(12), 401(k)(13), 401(m)(2), and 410(b).

applicable to qualified defined contribution plans. In addition, special rules apply to such arrangements. Employees who participate in a section 401(k) plan may elect to have contributions made to the plan (referred to as "elective deferrals") rather than receive the same amount as current compensation.[40] The maximum annual amount of elective deferrals that can be made by an employee for a year is the lesser of $20,500 (for 2022) or the employee's compensation.[41] For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is increased by $6,500 (for 2022) (called "catch-up contributions").[42] An employee's elective deferrals must be fully vested. A section 401(k) plan may also provide for employer matching and nonelective contributions.

In order to constitute a qualified cash or deferred arrangement, no benefit under the arrangement may be conditioned, directly or indirectly, on the employee electing to have the employer make or not make contributions in lieu of receiving cash.[43] However, matching contributions are exempt from this rule.

Nondiscrimination test

Actual deferral percentage test

An annual nondiscrimination test, called the actual deferral percentage test (the "ADP" test) applies to elective deferrals under a section 401(k) plan.[44] The ADP test generally compares the average rate of deferral for highly compensated employees to the average rate of deferral for non-highly compensated employees. The average deferral rate for highly compensated employees must not exceed the average rate for non-highly compensated employees by more than certain specified amounts. If a plan fails to satisfy the ADP test for a plan year based on the deferral elections of highly compensated employees, the plan is permitted to distribute deferrals to highly compensated employees ("excess deferrals") in a sufficient amount to correct the failure. The distribution of the excess deferrals must be made by the close of the following plan year.[45]

The ADP test is deemed to be satisfied if a section 401(k) plan includes certain minimum matching or nonelective contributions under either of two plan designs ("401(k) safe harbor

[40] Elective deferrals generally are made on a pre-tax basis and distributions attributable to elective deferrals are includible in income. However, a section 401(k) plan is permitted to include a "qualified Roth contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as after-tax Roth contributions. Certain distributions from a designated Roth account are excluded from income, even though they include earnings not previously taxed.

[41] Sec. 402(g).

[42] Sec. 414(v).

[43] Sec. 401(k)(4)(A).

[44] Sec. 401(k)(3). Long-term part-time workers may be excluded from this and other nondiscrimination tests. Sec. 401(k)(2)(D).

[45] Sec. 401(k)(8).

plans"), described below, as well as certain required rights and features and the plan satisfies a notice requirement.[46]

Section 401(k) safe harbor contributions

Under one type of section 401(k) safe harbor plan ("basic 401(k) safe harbor plan"), the plan either (1) satisfies a matching contribution requirement ("matching contribution basic 401(k) safe harbor plan") or (2) provides for the employer to make a nonelective contribution to a defined contribution plan of at least three percent of an employee's compensation on behalf of each non-highly compensated employee who is eligible to participate in the plan ("nonelective basic 401(k) safe harbor plan"). The matching contribution basic 401(k) safe harbor requires a matching contribution equal to at least 100 percent of elective contributions of the employee for contributions not in excess of three percent of compensation, and 50 percent of elective contributions for contributions that exceed three percent of compensation but do not exceed five percent, for a total matching contribution of up to four percent of compensation. The required matching contributions and the three percent nonelective contribution under the basic 401(k) safe harbor must be immediately nonforfeitable (that is, 100 percent vested) when made.

Another safe harbor applies for a section 401(k) plan that includes automatic enrollment ("automatic enrollment 401(k) safe harbor"). Under an automatic enrollment 401(k) safe harbor, unless an employee elects otherwise, the employee is treated as electing to make elective deferrals equal to a percentage of compensation as stated in the plan, not in excess of 15 percent and at least (1) three percent of compensation for the first year the deemed election applies to the participant, (2) four percent during the second year, (3) five percent during the third year, and (4) six percent during the fourth year and thereafter.[47] The matching contribution requirement under this safe harbor is 100 percent of elective contributions of the employee for contributions not in excess of one percent of compensation, and 50 percent of elective contributions for contributions that exceed one percent of compensation but do not exceed six percent, for a total matching contribution of up to 3.5 percent of compensation ("matching contribution automatic enrollment 401(k) safe harbor"). Alternatively, the plan can provide that the employer will make a nonelective contribution of three percent, as under the basic 401(k) safe harbor ("nonelective contribution automatic enrollment 401(k) safe harbor"). However, under the automatic enrollment 401(k) safe harbors, the matching and nonelective contributions are allowed to become 100 percent vested after two years of service (rather than being required to be immediately vested when made).

Matching contribution nondiscrimination test

Employer matching contributions are also subject to a special nondiscrimination test, the "ACP test," which compares the average actual contribution percentages ("ACPs") of matching

[46] Sec. 401(k)(12) and (13). If certain additional requirements are met, matching contributions under 401(k) safe harbor plan may also satisfy a nondiscrimination test applicable under section 401(m).

[47] These automatic increases in default contribution rates are required for plans using the safe harbor. Rev. Rul. 2009–30, 2009-39 I.R.B. 391, provides guidance for including automatic increases in other plans using automatic enrollment, including under a plan that includes an eligible automatic contribution arrangement.

contributions for the highly compensated employee group and the non-highly compensated employee group. The plan generally satisfies the ACP test if the ACP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ACP of the non-highly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the non-highly compensated employee group for the prior plan year and not more than two percentage points greater than the ACP of the non-highly compensated employee group for the prior plan year.

A safe harbor section 401(k) plan that provides for matching contributions is deemed to satisfy the ACP test ("401(m) safe harbor") if, in addition to meeting the safe harbor contribution and notice requirements under section 401(k), (1) matching contributions are not provided with respect to elective deferrals in excess of six percent of compensation, (2) the rate of matching contribution does not increase as the rate of an employee's elective deferrals increases, and (3) the rate of matching contribution with respect to any rate of elective deferral of a highly compensated employee is no greater than the rate of matching contribution with respect to the same rate of deferral of a non-highly compensated employee.[48]

SIMPLE IRA plan

A small employer that employs no more than 100 employees who earned $5,000 or more during the prior calendar year can establish a simplified tax-favored retirement plan, which is called the SIMPLE IRA plan. A SIMPLE IRA plan is generally a plan under which contributions are made to an IRA for each employee (a "SIMPLE IRA").[49] A SIMPLE IRA plan allows employees to make elective deferrals to a SIMPLE IRA, subject to a limit of $14,000 (for 2022). An individual who has attained age 50 before the end of the taxable year may also make catch-up contributions under a SIMPLE IRA plan up to a limit of $3,000 (for 2022).

In the case of a SIMPLE IRA plan, the group of eligible employees generally must include any employee who has received at least $5,000 in compensation from the employer in any two preceding years and is reasonably expected to receive $5,000 in the current year. A SIMPLE IRA plan is not subject to the nondiscrimination rules generally applicable to qualified retirement plans.

Employer contributions to a SIMPLE IRA must satisfy one of two contribution formulas. Under the matching contribution formula, the employer is generally required to match 100 percent of employee elective contributions up to three percent of the employee's compensation. The employer can elect a lower percentage matching contribution for all employees (but not less than one percent of each employee's compensation); however, a lower percentage cannot be elected for more than two years out of any five-year period. Alternatively, for any year, an employer is permitted to elect, in lieu of making matching contributions, to make a nonelective contribution of two percent of compensation on behalf of each eligible employee with at least

[48] Sec. 401(m)(11); 401(m)(12).

[49] Sec. 408(p). Employer may also establish SIMPLE section 401(k) plans. Sec. 401(k)(11).

$5,000 in compensation for such year, whether or not the employee makes an elective contribution.

The employer must provide each employee who is eligible to make elective deferrals under a SIMPLE IRA plan (1) a 60-day election period before the beginning of the calendar year and (2) a notice at the beginning of the 60-day period explaining the employee's choices under the plan.[50]

No contributions other than employee elective contributions, required employer matching contributions, or employer nonelective contributions can be made to a SIMPLE IRA plan, and the employer may not maintain any other qualified retirement plan.

Section 403(b) and governmental 457(b) plans

Tax-deferred annuity plans ("section 403(b) plans") are generally similar to qualified defined contribution plans, but may be maintained only by (1) tax-exempt charitable organizations[51] and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities).[52] Section 403(b) plans may provide for employees to make elective deferrals (in pre-tax or designated Roth form), including catch-up contributions, or other after-tax employee contributions, and employers may make nonelective or matching contributions on behalf of employees. Contributions to a section 403(b) plan are generally subject to the same contribution limits applicable to qualified defined contribution plans, including the limits on elective deferrals.

Contributions to a section 403(b) plan must be fully vested. The minimum coverage and general nondiscrimination requirements applicable to a qualified retirement plan generally apply to a section 403(b) plan, as well as employer matching and nonelective contributions and after-tax employee contributions to the plan.[53] If a section 403(b) plan provides for elective deferrals, the plan is subject to a "universal availability" requirement under which all employees must be given the opportunity to make deferrals of more than $200.[54] In applying this requirement, nonresident aliens, students, and employees who normally work less than 20 hours per week may be excluded.[55]

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[50] Notice 98-4, 1998-1 C.B. 269.

[51] These are organizations exempt from tax under section 501(c)(3). Section 403(b) plans of private, tax-exempt employers may be subject to ERISA as well as the requirements of section 403(b).

[52] Sec. 403(b).

[53] These requirements do not apply to a governmental section 403(b) plan or a section 403(b) plan maintained by a church or a qualified church-controlled organization as defined in section 3121(w).

[54] Sec. 403(b)(12)(A)(ii).

[55] For this purpose, nonresident alien has the meaning in section 410(b)(3)(C), and student has the meaning in section 3121(b)(10). The universal availability requirement does not apply to a section 403(b) plan maintained by a church or a qualified church-controlled organization.

An eligible deferred compensation plan of a governmental employer ("governmental section 457(b) plan") is generally similar to a qualified cash or deferred arrangement under a section 401(k) plan in that it consists of elective deferrals, that is, contributions (in pre-tax or designated Roth form) made at the election of an employee, including catch-up contributions. Deferrals under a governmental section 457(b) plan are generally subject to the same limits as elective deferrals under a section 401(k) plan or a section 403(b) plan.

Description of Proposal

The proposal modifies the definition of matching contribution[56] for purposes of defined contribution plans, including section 401(k) plans, to include employer contributions made to the plan on behalf of an employee on account of a qualified student loan payment. For this purpose, a qualified student loan payment is a payment made by an employee in repayment of a qualified education loan[57] incurred by the employee to pay qualified higher education expenses. However, this definition applies only to the extent such payments in the aggregate for the year do not exceed the amount of elective deferrals that the employee would be permitted to contribute under the Code[58] (reduced by elective deferrals made by the employee for the year). Qualified higher education expenses are defined as the cost of attendance at an eligible educational institution.[59] In addition, in order for a student loan payment to qualify, the employee must certify annually to the employer making the matching contribution the amount of the loan payments that have been made during the year. The employer is permitted to rely on this certification.

In order for an employer contribution made on account of a qualified student loan payment to be treated as a matching contribution under the proposal, the plan must satisfy certain requirements. The plan must provide matching contributions on account of elective deferrals at the same rate as contributions on account of qualified student loan payments. The plan must provide matching contributions on account of qualified student loan payments only on behalf of employees otherwise eligible to receive matching contributions on account of elective deferrals (and, similarly, must provide matching contributions on account of elective deferrals only on behalf of employees eligible to receive matching contributions on account of qualified student loan payments). The plan must also provide that matching contributions on account of qualified

[56] Under section 401(m)(4)(A)(iii), as added by this proposal.

[57] As defined in section 221(d)(1), a qualified education loan is generally any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses (1) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred; (2) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred; and (3) which are attributable to education furnished during a period during which the recipient was an eligible student.

[58] The limitation applicable under section 402(g) for the year ($20,500 for 2022), or, if less, the employee's compensation as defined in section 415(c)(3) for the year.

[59] "Cost of attendance" for this purpose is defined in section 472 of the Higher Education Act of 1965, as in effect on the day before the enactment of the Taxpayer Relief Act of 1997. "Eligible educational institution" is defined in section 221(d)(2) of the Code.

student loan payments vest in the same manner as matching contributions on account of elective deferrals.

Under the proposal, for purposes of certain nondiscrimination rules and minimum coverage requirements,[60] matching contributions on account of qualified student loan payments do not fail to be treated as available to an employee solely because such employee does not have debt incurred under a qualified education loan. In addition, the proposal provides that a qualified student loan payment is generally not treated as a plan contribution. However, a plan may treat a qualified student loan payment as an elective deferral or an elective contribution (as applicable) for purposes of the matching contribution requirement under a basic safe harbor 401(k) plan, the automatic enrollment safe harbor 401(k) plan, and the secure deferral arrangement described in section A.1 of this document, as well as for purposes of the section 401(m) safe harbors.[61] A plan is also permitted to apply the ADP test separately to employees who receive matching contributions on account of qualified student loan payments.

The proposal also contains similar rules allowing matching contributions to be made on account of qualified student loan payments in the case of SIMPLE IRAs, section 403(b) plans, and section 457(b) plans. In the case of SIMPLE IRAs, the proposal provides that a SIMPLE IRA does not fail to meet the matching contribution requirement applicable to such arrangements solely because the arrangement treats qualified student loan payments as elective employer contributions to the extent such payments do not exceed the amount of elective employer contributions the employee is permitted to contribute under the Code[62] (reduced by elective employer contributions contributed by the employee for the year). As under a section 401(k) plan, in order for the student loan payment to qualify, the employee must certify annually to the employer making the matching contribution the amount of loan payments that have been made during the year. In addition, matching contributions on account of qualified student loan payments must be provided only on behalf of employees otherwise eligible to make elective employer contributions, and all employees otherwise eligible to participate in the arrangement must be eligible to receive matching contributions on account of qualified student loan payments.

In the case of a section 403(b) plan, under the proposal, the fact that the employer offers matching contributions on account of qualified student loan payments[63] is not taken into account in determining whether the plan satisfies the universal availability requirement.[64] Similarly, in the case of a governmental 457(b) plan, the proposal provides that a plan is not treated as failing

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[60] This rule applies for purposes of section 401(a)(4), section 410(b), and the rule under the proposal that all employees eligible to receive matching contributions on account of elective deferrals be eligible to receive matching contributions on account of qualified student loan payments.

[61] This rule applies for purposes of sections 401(k)(12)(B) and (13)(B), and sections 401(m)(11)(B) and (12). It also applies to SIMPLE section 401(k) plans under section 401(11)(B)(i)(II).

[62] The limitation applicable under section 408(p)(2)(E) for the year, including permitted catch-up contributions under section 414(v), or, if less, the employee's compensation as defined in section 415(c)(3) for the year.

[63] As described in section 401(m)(13), as added by this proposal.

[64] Sec. 403(b)(12)(A)(ii).

to meet the requirements applicable to such plans[65] solely because the plan, or another qualified plan[66] or section 403(b) plan maintained by the employer provides for matching contributions on account of qualified student loan payments.[67]

The proposal directs the Secretary to prescribe regulations for purposes of implementing the proposal, including regulations:

- Permitting a plan to make matching contributions for qualified student loan payments[68] at a different frequency than matching contributions are otherwise made under the plan, provided that the frequency is not less than annually;
- Permitting employers to establish reasonable procedures to claim matching contributions for such qualified student loan payments under the plan, including an annual deadline (not earlier than three months after the close of each plan year) by which a claim must be made; and
- Promulgating model amendments which plans may adopt to implement matching contributions on qualified student loan payments.[69]

Effective Date

The proposal is effective for contributions made for plan years beginning after December 31, 2023.

5. Withdrawals for certain emergency expenses

Present Law

Distributions from tax-favored retirement plans

A distribution from a tax-qualified plan described in section 401(a) (a "qualified retirement plan"), a tax-sheltered annuity plan (a "section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), or an individual retirement arrangement (an "IRA") generally is included in income for

[65] Under section 457(b).

[66] Under section 401(a).

[67] As described in section 401(m)(13), as added by this proposal.

[68] As defined in sections 401(m)(4)(D) and 408(p)(2)(F), as added by this proposal.

[69] For purposes of sections 401(m), 408(p), 403(b), and 457(b).

the year distributed.[70] These plans are referred to collectively as "eligible retirement plans."[71] In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[72]

In general, a distribution from an eligible retirement plan may be rolled over to another eligible retirement plan within 60 days, in which case the amount rolled over generally is not includible in income. The Internal Revenue Service ("IRS") has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual.[73]

The terms of a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan generally determine when distributions are permitted. However, for many types of plans, restrictions apply to distributions before an employee's termination of employment, referred to as "in-service" distributions or withdrawals. Despite such restrictions, an in-service distribution from a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a "section 401(k) plan"), or a section 403(b) plan may be permitted in the case of financial hardship. Similarly, a governmental section 457(b) plan may permit distributions in the case of an unforeseeable emergency. Under a qualified retirement plan that is a pension plan (*i.e.*, defined benefit pension plan or money purchase pension plan), distributions generally may be made only in the event of retirement, death, disability, or other separation from service, although in-service distributions may be permitted after age 59½.[74]

Description of Proposal

Under the proposal, an exception to the 10-percent early withdrawal tax applies in the case of withdrawals from applicable eligible retirement plans for emergency personal expenses. In addition, such eligible distributions may be recontributed subject to certain requirements.

Eligible distributions for emergency personal expenses

[70] Secs. 401(a), 403(a), 403(b), 457(b), and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

[71] Sec. 402(c)(8)(B). Eligible retirement plans also include annuity plans described in section 403(a).

[72] Sec. 72(t). The 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

[73] Rev. Proc. 2020-46, 2020-45 I.R.B. 995, provides for a self-certification procedure (subject to verification on audit) that may be used by a taxpayer claiming eligibility for a waiver of the 60-day requirement with respect to a rollover into a plan or IRA in certain specified circumstances.

[74] Sec. 401(a)(36); Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i). Section 401(k) plans, section 403(b) plans, and governmental section 457(b) plans also may permit in-service distributions after age 59½.

An emergency personal expense distribution is a permissible distribution from an applicable eligible retirement plan which, for this purpose, includes qualified retirement plans (other than defined benefit plans), section 403(b) plans, governmental section 457(b) plans, and IRAs.[75] Emergency personal expense distribution means any distribution from an applicable retirement plan to an individual for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses. In making such a distribution, a plan administrator may rely on the employee's certification that the distribution is an eligible emergency personal expense distribution.[76]

The maximum aggregate amount which may be treated as an emergency personal expense distribution by any individual in any calendar year cannot exceed the lesser of $1,000, or an amount equal to the excess of (1) the individual's total nonforfeitable accrued benefit under the plan (the individual's total interest in the plan in the case of an individual retirement plan), determined as of the date of each such distribution, over (2) $1,000. Not more than one emergency personal expense distribution may be made per year per individual.

An employer plan is not treated as violating any Code requirement merely because it treats a distribution to an individual as an emergency personal expense distribution (provided that such distribution would otherwise be an emergency personal expense distribution), so long as the aggregate amount or number of such distributions to that individual from plans maintained by the employer and members of the employer's controlled group[77] does not exceed the limits described above. Thus, under such circumstances an employer plan is not treated as violating any Code requirement merely because an individual might receive total emergency personal expense distributions in excess of the limits (pertaining to the aggregate amount or number of such distributions) as a result of emergency personal expense distributions from plans of other employers or IRAs.

Recontributions to applicable eligible retirement plans

Generally, an individual may recontribute any portion of an emergency personal expense distribution at any time during the 3-year period beginning on the day after the date on which such distribution was received, to an applicable eligible retirement plan to which a rollover can be made and of which the individual is a beneficiary. If an individual makes a recontribution of an emergency personal expense distribution, then the individual is treated as having received the distribution as an eligible rollover distribution (to the extent of the amount of the contribution) and as having transferred the recontribution amount in a direct trustee to trustee transfer within 60 days of the distribution meaning the recontribution amount is not includible in income.

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[75] An emergency personal expense distribution is subject to income tax withholding unless the recipient elects otherwise. Mandatory 20-percent withholding does not apply.

[76] The Secretary may provide by regulations for exceptions to this rule in cases where the plan administrator has actual knowledge to the contrary and for addressing cases of employee misrepresentation.

[77] The term "controlled group" means any group treated as a single employer under subsection (b), (c), (m), or (o) of section 414.

In the case of an eligible retirement plan that is not an IRA, an individual may not recontribute more than the aggregate amount of emergency personal expense distributions that are made from such plan to the individual. In addition, such recontributions are permitted only if the individual is eligible to make contributions to the plan.

Limitation on subsequent distributions

If a distribution is treated as an emergency personal expense distribution, then no amount may be treated as such a distribution during the immediately following three calendar years unless the previous emergency personal expense distribution is recontributed, or the aggregate of the elective deferrals and employee contributions to the plan (the total amounts contributed in the case of an IRA) subsequent to such previous emergency personal expense distribution is at least equal to the amount of such previous distribution which has not been recontributed.

Effective Date

The proposal is effective for distributions made after December 31, 2023.

6. Allow additional nonelective contributions to SIMPLE plans

Present Law

Under present law, certain small businesses can establish a simplified retirement plan called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans can be adopted by employers who employ 100 or fewer employees who received at least $5,000 in compensation during the preceding year and who do not maintain another employer-sponsored retirement plan. A SIMPLE plan can be either an individual retirement arrangement (an "IRA") for each employee or part of a qualified cash or deferred arrangement (a section "401(k) plan").[78] If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified retirement plans (including the top-heavy rules) and simplified reporting requirements apply. If established as part of a 401(k) plan, the SIMPLE does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified retirement plan rules continue to apply. Within limits, contributions to a SIMPLE plan are not taxable until withdrawn.

Contributions to a SIMPLE plan (whether a SIMPLE IRA or SIMPLE 401(k)) may include employee salary reduction contributions ("elective deferrals"). Employers are also required to make either a matching contribution or a nonelective contribution each year. The matching contribution must generally be to up to three percent of an employee's compensation, and the nonelective contribution must be of two percent of compensation (regardless of the employee's elective deferral).[79] In the case of the nonelective contribution, it is required to be provided only to employees who are eligible to participate in the plan and who have at least

[78] Sec. 408(p); 401(k)(11).

[79] Sec. 408(p)(2)(A)(iii); (B)(i).

$5,000 of compensation from the employer for the year. No other contributions are permitted. Contributions to a SIMPLE account must be fully vested.[80]

There is an annual threshold on the amount of an elective deferral that an employee may make to a SIMPLE plan (subject to cost-of-living adjustments). The elective deferrals under a SIMPLE plan count toward the overall annual limit on elective deferrals an employee may make to this and other plans permitting elective deferrals.[81] For 2022, the annual contribution limit for SIMPLE plans is $14,000.[82] If permitted by the SIMPLE plan, participants who are age 50 or above at the end of the calendar year may also make catch up contributions ($3,000 for 2022). In the case of a SIMPLE IRA, the contribution limit that otherwise applies to IRAs is increased to account for the limit on elective deferrals to a SIMPLE IRA and the required employer matching or nonelective contribution.[83]

In the case of a SIMPLE IRA plan, if a participant receives a payment or distribution from the plan during the first two years the individual participates in the plan, such payment or distribution is not treated as a rollover contribution if it is paid to an IRA or retirement plan, unless it is paid to another SIMPLE IRA plan.[84] In addition, the 10-percent tax on early distributions from retirement plans is increased to 25 percent in the case of any such distributions that are subject to the early distribution tax.[85]

Description of Proposal

The proposal expands the types of contributions that may be made to a SIMPLE IRA plan or a SIMPLE 401(k) plan by also permitting the employer to make nonelective contributions of a uniform percentage of up to 10 percent of compensation, not to exceed $5,000. The $5,000 amount is indexed for inflation.[86] As in the case of the two-percent nonelective contribution under present law, the nonelective contribution under the proposal is provided only to employees who are eligible to participate in the arrangement and who have at least $5,000 of compensation from the employer for the year. The proposal also increases the IRA contribution limit as it applies to SIMPLE IRAs to account for the additional nonelective contribution permitted under the proposal.

Effective Date

The proposal applies to taxable years beginning after December 31, 2023.

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[80] Secs. 401(k)(11)(A)(iii); 408(p)(3).

[81] Secs. 401(a)(30); 402(g).

[82] Secs. 401(k)(11)(B)(i)(I); 408(p)(2)(A)(ii).

[83] Sec. 408(p)(8).

[84] Sec. 408(d)(3)(G).

[85] Sec. 72(t)(6).

[86] Note that the $5,000 amount of compensation that applies to determine employee eligibility remains unindexed under the proposal.

7. Small immediate financial incentives for contributing to a plan

Present Law

Section 401(k) plans

A section 401(k) plan is a type of profit-sharing or stock bonus plan that contains a qualified cash or deferred arrangement. Such arrangements are subject to the rules generally applicable to qualified defined contribution plans. In addition, special rules apply to such arrangements. Employees who participate in a section 401(k) plan may elect to have contributions made to the plan (elective deferrals) rather than receive the same amount as current compensation.[87] The maximum annual amount of elective deferrals that can be made by an employee for a year is $20,500 (for 2022) or, if less, the employee's compensation.[88] For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is increased by $6,500 (for 2022) (called "catch-up contributions").[89] An employee's elective deferrals must be fully vested. A section 401(k) plan may also provide for employer matching and nonelective contributions.

In order to constitute a qualified cash or deferred arrangement, no benefit under the arrangement may be conditioned, directly or indirectly, on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash.[90] However, matching contributions are exempt from this rule.

Tax-sheltered annuities (section 403(b) plans)

Section 403(b) plans are a form of tax-favored employer-sponsored plan that provide tax benefits similar to qualified retirement plans. Section 403(b) plans may be maintained only by (1) charitable tax-exempt organizations, and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities). Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans. Employers may make nonelective or matching contributions to such plans on behalf of their employees, and the plan may provide for employees to make pre-tax elective deferrals, designated Roth contributions (held in designated Roth accounts)[91] or other after-tax contributions. Generally, section 403(b) plans provide for contributions toward the purchase of annuity contracts or provide for contributions to be held in custodial accounts for

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[87] Elective deferrals generally are made on a pre-tax basis and distributions attributable to elective deferrals are includible in income. However, a section 401(k) plan is permitted to include a "qualified Roth contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as after-tax Roth contributions. Certain distributions from a designated Roth account are excluded from income, even though they include earnings not previously taxed.

[88] Sec. 402(g).

[89] Sec. 414(v).

[90] Sec. 401(k)(4)(A).

[91] Sec. 402A.

each employee. In the case of contributions to custodial accounts under a section 403(b) plan, the amounts must be invested only in regulated investment company stock.[92]

Contributions to a section 403(b) plan must be fully vested. The minimum coverage and general nondiscrimination requirements applicable to a qualified retirement plan generally apply to a section 403(b) plan and to employer matching and nonelective contributions and after-tax employee contributions to the plan.[93] If a section 403(b) plan provides for elective deferrals, the plan is subject to a "universal availability" requirement under which all employees must be given the opportunity to make deferrals of more than $200. In applying this requirement, nonresident aliens, students, and employees who normally work less than 20 hours per week may be excluded.[94]

Prohibited transactions

In general

The Code and the Employee Retirement Income Security Act of 1974 ("ERISA")[95] prohibit certain transactions ("prohibited transaction") between a qualified retirement plan and a disqualified person (referred to as a "party in interest" under ERISA).[96] The prohibited transaction rules under the Code apply also to IRAs, Archer MSAs, HSAs, and Coverdell ESAs.[97]

Disqualified persons include a fiduciary of the plan; a person providing services to the plan; an employer with employees covered by the plan; an employee organization any of whose members are covered by the plan; certain owners, officers, directors, highly compensated employees, family members, and related entities.[98] A fiduciary includes any person who

[92] Sec. 403(b)(7).

[93] These requirements do not apply to a governmental section 403(b) plan or a section 403(b) plan maintained by a church or a qualified church-controlled organization as defined in section 3121(w).

[94] For this purpose, nonresident has the meaning in section 410(b)(3)(C), and student has the meaning in section 3121(b)(10). The universal availability requirement does not apply to a section 403(b) plan maintained by a church or a qualified church-controlled organization.

[95] Pub. L. No. 93-406, September 2, 1974.

[96] Sec. 4975; ERISA sec. 406. The prohibited transaction rules of the Code and ERISA are very similar; however, some differences exist between the two sets of rules. As mentioned above, ERISA generally does not apply to governmental plans or church plans. The prohibited transaction rules under the Code also generally do not apply to governmental plans or church plans. However, under section 503, the trust holding assets of a governmental or church plan may lose its tax-exempt status in the case of a prohibited transaction listed in section 503(b). Before the enactment of ERISA in 1974, section 503 applied to qualified retirement plans generally. In connection with the enactment of section 4975 by ERISA, section 503 was amended to apply only to governmental and church plans.

[97] These are included in the definition of "plan" under section 4975(e)(1).

[98] Sec. 4975(e)(2). Party in interest is defined similarly under ERISA section 3(14) with respect to an employee benefit plan. Under ERISA, employee benefit plans, defined in ERISA section 3(3), consist of two types:

(1) exercises any discretionary authority or discretionary control respecting management of the plan or exercises any authority or control respecting management or disposition of the plan's assets, (2) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so, or (3) has any discretionary authority or discretionary responsibility in the administration of the plan.[99]

Prohibited transactions include the following transactions, whether direct or indirect, between a plan and a disqualified person:

1. The sale or exchange or leasing of property,

2. The lending of money or other extension of credit,

3. The furnishing of goods, services, or facilities,

4. The transfer to, or use by or for the benefit of, the income or assets of the plan,

5. In the case of a fiduciary, an act dealing with the plan's income or assets in the fiduciary's own interest or for the fiduciary's own account, and

6. The receipt by a fiduciary of any consideration for the fiduciary's own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.[100]

Exemptions from prohibited transaction treatment

Certain transactions are statutorily exempt from prohibited transaction treatment, for example, certain loans to plan participants and arrangements with a disqualified person for legal, accounting or other services necessary for the establishment or operation of a plan if no more than reasonable compensation is paid for the services.[101]

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pension plans (that is, retirement plans), defined in ERISA section 3(2), and welfare plans, defined in ERISA section 3(1).

[99] Sec. 4975(d)(3); ERISA sec. 3(21)(A). Under ERISA, fiduciary also includes any person designated under ERISA section 405(c)(1)(B) by a named fiduciary (that is, a fiduciary named in the plan document) to carry out fiduciary responsibilities.

[100] Sec. 4975(c)(1)(A)-(F) and ERISA sec. 406(a)(1)(A)-(D) and (b)(1) and (3). Under ERISA section 406(a)(1), a plan fiduciary is prohibited from causing the plan to engage in a transaction described in paragraphs (A)-(D). ERISA section 406(b)(2) also prohibits a plan fiduciary, in the fiduciary's individual capacity or any other capacity, from acting in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of plan participants or beneficiaries. ERISA section 406(a)(1)(E) and (a)(2) relate to limitations under ERISA section 407 on a plan's acquisition or holding of employer securities and real property.

[101] Sec. 4975(d) and ERISA sec. 408. The Code and ERISA also provide for the grant of administrative exemptions, on either an individual or class basis, subject to a finding that the exemption is administratively

Sanctions for violations

Under the Code, if a prohibited transaction occurs, the disqualified person who participated in the transaction is generally subject to a two-tiered excise tax. The first-tier tax is 15 percent of the amount involved in the transaction. The second-tier tax, imposed if the prohibited transaction is not corrected within a certain period, is 100 percent of the amount involved. In the case of an IRA, HSA, Archer MSA or Coverdell ESA, the sanction for some prohibited transactions is the loss of tax favored status, rather than an excise tax. A private right of action is not available for a Code violation.

Under ERISA, the Department of Labor ("DOL") may assess a civil penalty against a person who engages in a prohibited transaction, other than a transaction with a plan covered by the prohibited transaction rules of the Code.[102] The penalty may not exceed five percent of the amount involved in the transaction for each year or part of a year that the prohibited transaction continues. If the prohibited transaction is not corrected within 90 days after notice from DOL, the penalty can be up to 100 percent of the amount involved in the transaction. A prohibited transaction by a fiduciary may also be the basis for an action for a breach of fiduciary responsibility by DOL, a plan participant or beneficiary, or another plan fiduciary (as discussed above).

Description of Proposal

The proposal modifies the rule applicable to section 401(k) plans that prohibits the conditioning of benefits (other than matching contributions) on an employee's election to defer. As modified, the rule exempts, in addition to matching contributions, a de minimis financial incentive provided to employees who elect to make elective deferrals under the plan. Thus, a section 401(k) plan will not fail to include a qualified cash or deferred arrangement merely because it conditions a de minimis financial incentive on an employee's election to make an elective deferral. This exemption does not apply in the case of a de minimis financial incentive provided to employees who elect not to make elective deferrals under the plan.

Similarly, in the case of a section 403(b) plan, the proposal provides that a plan does not fail to satisfy the universal availability requirement[103] solely by reason of offering a de minimis financial incentive to employees who elect to have the employer make contributions pursuant to a salary reduction agreement.

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feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan.

[102] ERISA sec. 502(i).

[103] Sec. 403(b)(12)(A)(ii).

In addition, under the proposal, the provision of such de minimis financial incentives under a section 401(k) plan or a section 403(b) plan is not treated as a prohibited transaction under the Code.[104]

Effective Date

The proposal applies to plan years beginning after the date of enactment.

8. Indexing IRA catch-up limit

Present Law

There are two general types of individual retirement arrangements ("IRAs"): traditional IRAs and Roth IRAs.[105] The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($6,000 for 2022); and (2) the amount of the individual's compensation that is includible in gross income for the year.[106] In the case of an individual who has attained age 50 by the end of the taxable year, the dollar amount is increased by $1,000 (referred to as a "catch-up contribution"). In the case of a married couple, contributions can be made up to the dollar limit for each spouse if the combined compensation of the spouses that is includible in gross income is at least equal to the contributed amount. An individual may make contributions to a traditional IRA (up to the contribution limit) without regard to his or her adjusted gross income.

An individual may deduct his or her contributions to a traditional IRA if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual or the individual's spouse is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income over certain levels.[107]

Individuals with adjusted gross income below certain levels may make contributions to a Roth IRA (up to the contribution limit).[108] Contributions to a Roth IRA are not deductible.

Description of Proposal

Under the proposal, the $1,000 amount that may be contributed as a catch-up contribution by individuals who attain age 50 by the end of the taxable year is increased for cost-of-living adjustments for taxable years beginning after date of enactment.

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[104] Under section 4975. Modifications to Labor provisions are necessary to effectuate this proposal.

[105] Secs. 408 and 408A.

[106] Sec. 219(b)(2) and (5), as referenced in secs. 408(a)(1) and (b)(2)(B) and 408A(c)(2). Under section 4973, IRA contributions in excess of the applicable limit are generally subject to an excise tax of six percent per year until withdrawn.

[107] Sec. 219(g).

[108] Sec. 408A(c)(3).

Effective Date

The proposal applies to taxable years beginning after the date of enactment.

9. Higher catch-up limit to apply at age 60, 61, 62, and 63

Present Law

Under certain types of employer-sponsored retirement plans, including section 401(k) plans, section 403(b) plans, SIMPLE IRAs,[109] and governmental section 457(b) plans, an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash. The maximum annual amount of elective deferrals that can be made by an employee for a year is $20,500 for 2022 ($14,000 in the case of a SIMPLE IRA or SIMPLE section 401(k) plan[110]) or, if less, the employee's compensation.[111] For individuals who will attain age 50 by the end of the taxable year, this limit is increased to allow additional "catch-up contributions."[112]

A section 401(k) plan, section 403(b) plan, and governmental section 457(b) plan may generally permit catch-up contributions up to $6,500 in 2022 (indexed for inflation). A SIMPLE IRA or SIMPLE section 401(k) plan may permit catch-up contributions up to $3,000 in 2022. If elective deferral and catch-up contributions are made to both a section 401(k) plan and a section 403(b) plan for the same employee, a single limit applies to the elective deferrals under both plans. Special contribution limits apply to certain employees under a section 403(b) plan maintained by a church. In addition, under a special catch-up rule, an increased elective deferral limit applies under a plan maintained by an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches in the case of employees who have completed 15 years of service. In this case, the limit is increased by the least of (1) $3,000, (2) $15,000, reduced by the employee's total elective deferrals in prior years, and (3) $5,000 times the employee's years of service, reduced by the employee's total elective deferrals in prior years.

The section 457(b) plan limits apply separately from the combined limit applicable to section 401(k) and section 403(b) plan contributions, so that an employee covered by a governmental section 457(b) plan and a section 401(k) or section 403(b) plan can contribute the full amount to each plan. In addition, under a special catch-up rule, for one or more of the participant's last three years before normal retirement age, the otherwise applicable limit is increased to the lesser of (1) two times the normal annual limit ($41,000 for 2022) or (2) the sum

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[109] Sec. 408(p).

[110] Sec. 401(k)(11).

[111] Secs. 402(g); 457(c). This limit applies to total elective deferrals under all of a participant's section 401(k) plans and section 403(b) plans but applies separately to any governmental section 457(b) plan. Sec. 414(v).

[112] Sec. 414(v).

of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

Catch-up contributions are not subject to any other contribution limits and are not taken into account in applying other contribution limits. In addition, such contributions are not subject to applicable nondiscrimination rules. However, a plan fails to meet the applicable nondiscrimination requirements under section 401(a)(4) with respect to benefits, rights, and features unless the plan allows all eligible individuals participating in the plan to make the same election with respect to catch-up contributions. For purposes of this rule, all plans of related employers are treated as a single plan. In addition, the special nondiscrimination rule for mergers and acquisitions applies for this purpose.[113]

An employer is permitted to make matching contributions with respect to catch-up contributions. Any such matching contributions are subject to the normally applicable rules.

Description of Proposal

Under the proposal, the limit on catch-up contributions is increased for individuals who would attain age 60, 61, 62, or 63 (but who are not older than age 63), by the end of the taxable year. A section 401(k) plan (other than a SIMPLE section 401(k) plan), section 403(b) plan, or governmental section 457(b) plan may increase the limit on catch-up contributions for such individuals to the lesser of (1) $10,000 or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.[114] A SIMPLE section 401(k) plan or a SIMPLE IRA may increase the limit on catch-up contributions for such individuals to the lesser of (1) $5,000 or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year. Both the $10,000 amount and the $5,000 amount are indexed for inflation beginning in 2025.

Effective Date

The proposal applies to taxable years beginning after December 31, 2023.

10. Eliminate the "first day of the month" requirement for governmental section 457(b) plans

Present Law

Section 457(b) plans

Among the various types of tax-favored retirement plans under present law are eligible deferred compensation plans under section 457(b). A section 457(b) plan is a plan maintained by a State or local government or a tax-exempt organization that meets certain requirements. Generally, the maximum amount that can be deferred under a section 457(b) plan by an

[113] Secs. 410(b)(6)(C); 414(v)(4)(B).

[114] This increase also applies to catch-up contributions under a simplified employee pension under section 408(k) that includes a salary reduction arrangement.

individual during any taxable year is limited to the lesser of 100 percent of the participant's includible compensation or the applicable dollar amount for the taxable year. The applicable dollar amount for 2022 is $20,500 in 2022 and is indexed for future taxable years. For an employee who attains age 50 by the end of the year, the dollar limit on deferrals is increased by $6,500 (for 2022)[115] (called catch-up contributions).[116] A participant's includible compensation means the compensation of the participant from the eligible employer for the taxable year.

One of the requirements to be an eligible deferred compensation plan under section 457(b) is that a participant's compensation is deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month.[117]

Description of Proposal

The proposal provides that compensation is deferred under a governmental section 457(b) plan only if an agreement providing for such deferral has been entered into before the compensation is currently available to the individual, consistent with the rule for section 401(k) and 403(b) plans. In the case of a section 457(b) plan maintained by a tax-exempt organization, the proposal provides that compensation is deferred under the plan for a calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month.

Effective Date

The proposal applies to taxable years beginning after the date of enactment.

11. Tax treatment of certain non-trade or business SEP contributions

Present Law

Tax on nondeductible contributions to qualified employer plans

A 10-percent excise tax applies to nondeductible contributions made to a qualified employer plan.[118] The tax is imposed on the employer. For this purpose, nondeductible contributions generally are the sum of (1) the excess of the amount contributed for the taxable year by the employer over the amount allowable as a deduction[119] for contributions to the plan,

[115] For 2020 and 2021, this amount is $6,500.

[116] Sec. 414(v).

[117] Sec. 457(b)(4).

[118] Sec. 4972.

[119] As determined under section 404 without regard to section 404(e).

and (2) the amount determined as nondeductible[120] for the preceding year, reduced by any portion returned to the employer and by the deductible portion for that year.[121]

An exception to the application of the 10-percent excise tax applies in certain situations, including in the case of contributions to a Simple IRA[122] or to a Simple 401(k) plan[123] which are not deductible solely because the contributions are not made in connection with a trade or business (for example, the contributions are made with respect to a household employee).

The exception does not apply to contributions to a SEP IRA plan.

SEP IRA plans

A Simplified Employee Pension ("SEP") plan is a type of employer-sponsored retirement plan whereby generally only the employer makes contributions to the plan.[124] The amount of the contribution to the SEP IRA plan is up to the lesser of 25 percent of the employee's compensation or the dollar limit applicable to contributions to a qualified defined contribution plan ($61,000 for 2022). A traditional IRA is set up for each eligible employee, and all contributions must be fully vested. Any employee must be eligible to participate in the SEP if the employee has (1) attained age 21, (2) performed services for the employer during at least three of the immediately preceding five years, and (3) received at least $650 (for 2022) in compensation from the employer for the year.[125] Contributions to a SEP generally must bear a uniform relationship to compensation.

Description of Proposal

The proposal extends the exception from the 10-percent excise tax to contributions to a SEP IRA which are not deductible solely because the contributions are not made in connection with a trade or business.

Effective Date

The proposal is effective for taxable years beginning after the date of enactment.

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[120] Under section 4972(c).

[121] As determined under section 404 without regard to section 404(e).

[122] Within the meaning of section 408(p).

[123] Within the meaning of section 401(k)(11).

[124] Sec. 408(k). Certain grandfathered SEP plans may permit salary-reduction arrangements (if the SEP was in existence on December 31, 1996). Sec. 408(k)(6)(H).

[125] The annual compensation limit for SEPs is $290,000.

12. Elimination of additional tax on corrective distributions of excess contributions

Present Law

Early withdrawal tax

A distribution from a tax-qualified plan described in section 401(a), a tax-sheltered annuity plan ("section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer, or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed.[126] In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[127]

IRA rules

There are two basic types of IRAs: traditional IRAs,[128] to which both deductible and nondeductible contributions may be made,[129] and Roth IRAs, to which only nondeductible contributions may be made by certain individuals.[130] For a traditional IRA, an eligible contributor may deduct the contributions made for the year, but distributions are includible in gross income to the extent attributable to earnings on the account and the deductible contributions. For a Roth IRA, all contributions are after-tax (that is, no deduction is allowed), but distributions are not includible in gross income if certain requirements are satisfied.[131] Distributions from a Roth IRA that do not meet those requirements, however, are not qualified distributions and are includible in gross income to the extent attributable to earnings. Amounts that are includible in income that are withdrawn from a traditional IRA or a Roth IRA before

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[126] Secs. 401(a), 403(a), 403(b), 457(b), and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

[127] Sec. 72(t). The 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

[128] Sec. 408.

[129] Secs. 219 and 408. An individual may make deductible contributions to a traditional IRA up to the IRA contribution limit if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with modified adjusted gross income (AGI) for the taxable year over certain indexed levels. To the extent an individual cannot or does not make deductible contributions to a traditional IRA or contributions to a Roth IRA for the taxable year, the individual may make nondeductible contributions to a traditional IRA, subject to the same contribution limits as deductible contributions, including catch-up contributions.

[130] Sec. 408A. Individuals with modified AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with AGI for the taxable year over certain indexed levels.

[131] Sec. 408A(d).

attainment of age 59½ are subject to the 10-percent early withdrawal tax unless an exception applies.

An annual limit applies to contributions to IRAs. The contribution limit is coordinated so that the aggregate maximum amount that can be contributed to all of an individual's IRAs (both traditional and Roth) for a taxable year is the lesser of a certain dollar amount ($6,000 for 2022) or the individual's compensation. An eligible individual who has attained age 50 before the end of the taxable year may also make catch-up contributions to an IRA. For this purpose, the aggregate dollar limit is increased by $1,000.

To the extent that contributions to an IRA exceed the contribution limits, an excise tax equal to six percent of the excess amount applies.[132] Any amount contributed for a taxable year that is distributed with allocable income by the due date for the taxpayer's return for the year (including extensions) will be treated as though not contributed for the year.[133] To receive this treatment, the taxpayer must not have claimed a deduction for the amount of the distributed contribution.

Currently, these corrective distributions of excess IRA contributions are not expressly exempt from the 10-percent early withdrawal tax.

Description of Proposal

The proposal exempts from the 10-percent early withdrawal tax distribution amounts attributable to excess contributions to an IRA if those amounts are returned with income by the due date for the taxpayer's return for the year (including extensions), provided the taxpayer did not claim a deduction for the amount of the distributed contribution.

Effective Date

The proposal is effective for any determination of, or affecting, liability for taxes, interest or penalties that is made on or after the date of enactment (without regard to whether the act or failure to act upon which the determination is based occurred before the date of enactment).

13. Employer may rely on employee certifying that deemed hardship distribution conditions are met

Present Law

Section 401(k) plan and section 403(b) plan hardship distributions

A qualified defined contribution plan may include a qualified cash or deferred arrangement, under which employees may elect to have contributions made to the plan (referred to as "elective deferrals") rather than receive the same amount as current compensation (referred to as a "section 401(k) plan"). A section 403(b) plan may also include an elective deferral

[132] Secs. 4973(b) and (f).

[133] Sec. 408(d)(4).

arrangement. Amounts attributable to elective deferrals under a section 401(k) plan or a section 403(b) plan generally cannot be distributed before the occurrence of one or more specified events, including financial hardship of the employee.[134]

A hardship distribution from a section 401(k) plan may include, in addition to the employee's elective deferrals, qualified matching contributions, qualified nonelective contributions, and earnings on any of these amounts.[135] A hardship distribution from a section 403(b) plan may include elective deferrals, but not earnings on those deferrals.[136] Qualified matching contributions and qualified nonelective contributions to a section 403(b) plan that are in a custodial account are not eligible to be distributed on account of hardship.[137] A distribution under a section 401(k) plan is not treated as failing to be on account of hardship solely because the employee does not take any available plan loan. Distributions on account of hardship may be subject to an additional 10-percent early withdrawal tax.[138]

Applicable Treasury regulations provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the financial need.[139] Generally, the determination of whether an employee has an immediate and heavy financial need is based on the relevant facts and circumstances. However, a distribution is deemed to be made on account of an immediate and heavy financial need if it is for: (1) generally, deductible expenses for medical care;[140] (2) costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments); (3) payment of tuition, related educational fees, and room and board expenses, for up to the next 12 months of post-secondary education for the employee, the employee's spouse, child, or dependent,[141] or for a primary beneficiary under the plan; (4) payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence; (5) payments for burial or funeral expenses for the employee's deceased parent, spouse, child, or dependent, or for a deceased primary beneficiary under the plan; (6) expenses for the repair of damage to the employee's

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[134] Secs. 401(k)(2)(B)(i)(IV) and 403(b)(7)(A)(i)(V) and (11)(B). Other types of contributions may also be subject to this restriction.

[135] Sec. 401(k)(14). Qualified matching contributions (as defined in section 401(k)(3)(D)(ii)(I)) and qualified nonelective contributions (as defined in section 401(m)(4)(C)) may be used to enable the plan to satisfy certain nondiscrimination tests, to prevent discrimination in favor of highly compensated employees.

[136] Sec. 403(b)(11).

[137] Treas. Reg. sec. 1.403(b)-6(c).

[138] Sec. 72(t).

[139] Treas. Reg. secs. 1.401(k)-1(d)(3); 1.403(b)-6(d)(2).

[140] Expenses for (or necessary to obtain) medical care that would be deductible under section 213(d), determined without regard to the limitations in section 213(a) (relating to the applicable percentage of adjusted gross income and the recipients of the medical care) provided that, if the recipient of the medical care is not listed in section 213(a), the recipient is a primary beneficiary under the plan.

[141] As defined in section 152 without regard to section 152(b)(1), (b)(2), and (d)(1)(B).

principal residence that would qualify for the casualty deduction;[142] or (7) expenses and losses (including loss of income) incurred by the employee on account of a federally-declared disaster.[143]

A distribution is treated as necessary to satisfy the financial need under the Treasury regulations only to the extent that the amount of the distribution does not exceed the amount required. In addition, in order to be treated as necessary to satisfy the financial need, the following requirements must be met: (1) the employee has obtained all other currently available distributions under all plans of the employer; (2) the employee has provided to the plan administrator a written representation that he or she has insufficient cash or other liquid assets reasonably available to satisfy the need; and (3) the plan administrator does not have actual knowledge contrary to the representation.[144]

Governmental section 457(b) plan distributions upon unforeseeable emergency

An eligible deferred compensation plan of a governmental employer (referred to as a "governmental section 457(b) plan") is generally similar to a qualified cash or deferred arrangement under a section 401(k) plan in that it consists of elective deferrals made at the election of an employee. Such deferrals generally may not be distributed from the plan before the occurrence of one or more specified events, including when the participant is faced with an unforeseeable emergency.[145] Distributions from a governmental section 457(b) plan are not subject to the 10-percent early withdrawal tax.[146]

Under Treasury regulations, the unforeseeable emergency must be defined in the plan as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, or the participant's or beneficiary's spouse or dependent;[147] loss of the participant's or beneficiary's property due to casualty;[148] or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary.[149] The Treasury regulations provide the following as examples of

[142] Under section 165 (determined without regard to section 165(h)(5) and whether the loss exceeds 10 percent of adjusted gross income).

[143] A disaster declared by the Federal Emergency Management Agency ("FEMA") under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, Pub. L. No. 100–707, provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster.

[144] Treas. Reg. sec. 1.401(k)-1(d)(3)(iii).

[145] Sec. 457(d)(1)(A)(iii).

[146] Secs. 72(t)(1); 4974(c).

[147] As defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B).

[148] This includes the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, such as damage that is the result of a natural disaster.

[149] Treas. Reg. sec. 1.457-6(c)(2).

unforeseeable emergencies: (1) the imminent foreclosure of or eviction from the participant's or beneficiary's primary residence; (2) the need to pay for medical expenses, including non-refundable deductibles, as well as for the cost of prescription drug medication; and (3) the need to pay for the funeral expenses of a spouse or a dependent of a participant or beneficiary. The purchase of a home and the payment of college tuition are not unforeseeable emergencies, unless such expenses otherwise qualify.

In general, under the regulations, whether a participant or beneficiary is faced with an unforeseeable emergency permitting a distribution is to be determined based on the relevant facts and circumstances of each case, but, in any case, a distribution on account of an unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or by cessation of deferrals under the plan. Distributions on account of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need.

Description of Proposal

Under the proposal, in determining whether a distribution is due to an employee hardship, the plan administrator of a section 401(k) plan or a section 403(b) plan may rely on the employee's written certification that the distribution is on account of a financial need of a type that is deemed in Treasury regulations to be an immediate and heavy financial need. Thus, if the employee certifies that the financial need for the hardship distribution is one of the types of deemed immediate and heavy financial needs that are described in the Treasury regulations,[150] such as funeral expenses for the employee's deceased parent, the distribution is treated as being made on account of an immediate and heavy financial need. In addition, under the proposal, the plan administrator may rely on the employee's written certification that the distribution is not in excess of the amount required to satisfy the financial need, and that the employee has no alternative means reasonably available to satisfy such financial need.

Similarly, with respect to a governmental section 457(b) plan, in determining whether a participant's distribution is made when the participant is faced with an unforeseeable emergency, a plan administrator may rely on the participant's written certification that the distribution is on account of an unforeseeable emergency of a type that is specifically described in Treasury regulations as an unforeseeable emergency,[151] that the distribution does not exceed the amount reasonably necessary to satisfy the emergency need, and that the participant has no alternative means reasonably available to satisfy such financial need.

In the case of each of these types of plans, the proposal provides that the Secretary may by regulation provide for exceptions to the plan administrator's ability to rely on participant

[150] Treas. Reg. sec. 1.401(k)-1(d)(3)(ii)(B), or any successor regulation.

[151] Treas. Reg. sec. 1.457-6(c)(2)(i), or any successor regulation.

certification where the plan administrator has actual knowledge to the contrary. The Secretary may also by regulation adopt procedures to address misrepresentation.

Effective Date

The proposal is effective for plan years beginning after the date of enactment.

14. Penalty-free withdrawals from retirement plans for individuals in case of domestic abuse

Present Law

Distributions from tax-favored retirement plans

A distribution from a tax-qualified plan described in section 401(a) (a "qualified retirement plan"), a tax-sheltered annuity plan (a "section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed.[152] These plans are referred to collectively as "eligible retirement plans."[153] In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[154]

In general, a distribution from an eligible retirement plan may be rolled over to another eligible retirement plan within 60 days, in which case the amount rolled over generally is not includible in income. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual.[155]

The terms of a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan generally determine when distributions are permitted. However, for many types of plans, restrictions apply to distributions before an employee's termination of employment, referred to as "in-service" distributions or withdrawals. Despite such restrictions, an in-service distribution from a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a "section 401(k) plan") or a section 403(b) plan may be permitted in the

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[152] Secs. 401(a), 403(a), 403(b), 457(b), and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

[153] Sec. 402(c)(8)(B). Eligible retirement plans also include annuity plans described in section 403(a).

[154] Sec. 72(t). The 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

[155] Rev. Proc. 2020-46, 2020-45 I.R.B. 995, provides for a self-certification procedure (subject to verification on audit) that may be used by a taxpayer claiming eligibility for a waiver of the 60-day requirement with respect to a rollover into a plan or IRA in certain specified circumstances.

case of financial hardship. Similarly, a governmental section 457(b) plan may permit distributions in the case of an unforeseeable emergency. Under a qualified retirement plan that is a pension plan (*i.e.*, defined benefit pension plan or money purchase pension plan), distributions generally may be made only in the event of retirement, death, disability, or other separation from service, although in-service distributions may be permitted after age 59½.[156]

Description of Proposal

Under the proposal, an exception to the 10-percent early withdrawal tax applies in the case of an eligible distribution to a domestic abuse victim. In addition, such eligible distributions may be recontributed to applicable eligible retirement plans, subject to certain requirements.

Eligible distributions to a domestic abuse victim

The proposal provides that an eligible distribution to a domestic abuse victim is a distribution from an applicable eligible retirement plan to an individual if made during the one-year period beginning on a date on which the individual is a victim of domestic abuse by a spouse or domestic partner. Domestic abuse is defined under the proposal as physical, psychological, sexual, emotional, or economic abuse, including efforts to control, isolate, humiliate, or intimidate the victim, or to undermine the victim's ability to reason independently, including by means of abuse of the victim's child or another family member living in the household. In making such a distribution, a plan administrator may rely on the participant's certification that the distribution is an eligible distribution to a domestic abuse victim.

An applicable eligible retirement plan, for this purpose, generally includes eligible retirement plans other than defined benefit plans, including qualified retirement plans, section 403(b) plans, governmental section 457(b) plans, and IRAs. It does not include a plan that is subject to requirements relating to providing joint and survivor annuities and preretirement survivor annuities.[157] The maximum aggregate amount which may be treated as an eligible distribution to a domestic abuse victim by an individual is the lesser of $10,000 or 50 percent of the present value of the employee's account under the plan.[158] An eligible distribution to a domestic abuse victim is treated as meeting requirements relating to the timing of distributions under a section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan.[159]

Under the proposal, an employer plan is not treated as violating any Code requirement merely because it treats a distribution to an individual (that would otherwise be an eligible distribution to a domestic abuse victim) as an eligible distribution to a domestic abuse victim,

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[156] Sec. 401(a)(36); Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b)(1)(i). Section 401(k) plans, section 403(b) plans, and governmental section 457(b) plans also may permit in-service distributions after age 59 ½.

[157] Secs. 401(a)(11) and 417.

[158] 50 percent of the present value of the nonforfeitable accrued benefit of the employee under the plan.

[159] An eligible distribution to a domestic abuse victim is subject to income tax withholding unless the recipient elects otherwise. Mandatory 20-percent withholding does not apply.

provided that the aggregate amount of such distributions to that individual from plans maintained by the employer and members of the employer's controlled group[160] does not exceed the lesser of $10,000 or 50 percent of the present value of the employee's accounts under the plans of the employer's controlled group. Thus, under such circumstances an employer plan is not treated as violating any Code requirement merely because an individual might receive, for example, total distributions in excess of $10,000 as a result of distributions from plans of other employers or IRAs.

Recontributions to applicable eligible retirement plans

The proposal provides that any portion of an eligible distribution to a domestic abuse victim may, during the three-year period beginning on the day after the date the distribution was received, be recontributed to an applicable eligible retirement plan to which a rollover can be made. Such a recontribution is treated as a rollover and thus is not includible in income. In the case of a recontribution to an applicable eligible retirement plan that is not an IRA, the individual may not recontribute an amount greater than the amount of eligible distributions made from such plan to the individual. In addition, the individual in that case must be eligible to contribute to the plan (other than with respect to the recontribution of the eligible distribution).

Effective Date

The proposal is effective for distributions made after the date of enactment.

15. Amendments to increase benefit accruals under plan for previous plan year allowed until employer tax return due date

Present law

Present law provides a remedial amendment period during which, under certain circumstances, a retirement plan may be amended retroactively in order to comply with the tax qualification requirements.[161] In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs (including extensions). Discretionary amendments must be adopted by the end of the plan year.[162] The Secretary may extend the time by which plan amendments need to be made.

Section 201 of the SECURE Act[163] provides that if an employer adopts a qualified retirement plan after the close of a taxable year but before the time prescribed by law for filing

[160] The term "controlled group" means any group treated as a single employer under subsection (b), (c), (m), or (o) of section 414.

[161] Sec. 401(b).

[162] Rev. Proc. 2016-37, .2016-29 I.R.B. 136, June 29, 2016.

[163] Sec. 201.

the return of tax of the employer for the taxable year (including extensions thereof), the employer may elect to treat the plan as having been adopted as of the last day of the taxable year.

Description of Proposal

Under the proposal, if an employer amends a stock bonus, pension, profit-sharing, or annuity plan to increase benefits accrued under the plan effective as of any date during the immediately preceding plan year (other than increasing the amount of matching contributions),[164] the amendment would not otherwise cause the plan to fail to meet any of the qualification requirements, and the amendment is adopted before the time prescribed by law for filing the return of the employer for the taxable year (including extensions) which includes the effective date described above which is a date during the immediately preceding plan year, the employer may elect to treat such amendment as having been adopted as of the last day of the plan year in which the amendment is effective.

Effective Date

The proposal applies to amendments made in plan years beginning after the date of enactment.

16. Retroactive first year elective deferrals for sole proprietors

Present Law

Present law provides a remedial amendment period during which, under certain circumstances, a retirement plan may be amended retroactively in order to comply with the tax qualification requirements.[165] In, general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs (including extensions). The Secretary may extend the time by which plan amendments need to be made.

Section 201 of the SECURE Act provides that if an employer adopts a qualified retirement plan after the close of a taxable year but before the time prescribed by law for filing the return of tax of the employer for the taxable year (including extensions thereof), the employer may elect to treat the plan as having been adopted as of the last day of the taxable year. That provision permits employers to establish and fund a qualified plan by the due date for filing the employer's return for the preceding plan year. However, that provision does not override rules requiring certain plan provisions to be in effect during a plan year, such as the provision for elective deferrals under a qualified cash or deferral arrangement (generally referred to as a "401(k) plan").[166]

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[164] As defined in subsection 401(m)(4)(A).

[165] Sec. 401(b).

[166] Treas. Reg. sec. 1.401(k)-1(e)(2)(ii).

Under section 401 of the SECURE Act, a section 401(k) plan of a sole proprietor can be funded with employer contributions as of the due date for the business's return, but the elective deferrals must be made as of December 31 of the prior year. However, an individual is deemed to have made a contribution to an individual retirement plan for a taxable year if it is contributed after the taxable year has ended but is made "on account of" that year and before the due date for filing the IRA owner's tax return, (generally) for that year without extensions, (generally, April 15).[167]

Description of Proposal

The proposal provides that in the case of an individual who owns the entire interest in an unincorporated trade or business, and who is the only employee of such trade or business, any elective deferral[168] under a qualified cash or deferred plan which is made by such individual before the time for filing the individual's return for the taxable year (determined without regard to any extensions) ending after or with the end of the plan's first plan year, shall be treated as having been made before the end of the plan's first plan year. This extension of time would only apply to the first plan year in which the 401(k) plan is established.

Effective Date

The proposal is effective for plan years beginning after the date of enactment.

17. Treasury guidance on rollovers

Present Law

In general

A distribution from an employer-sponsored retirement plan or individual retirement arrangement ("IRA") is generally includible in income except for any portion attributable to after-tax contributions, which result in basis.[169] Unless an exception applies, in the case of a distribution before age 59½, any amount included in income is generally subject to an additional 10-percent tax, referred to as the "early withdrawal" tax.[170]

Rollovers from employer-sponsored retirement plans

A distribution from a qualified retirement plan, section 403(b) plan, or a governmental section 457(b) plan that is an eligible rollover distribution may be rolled over to another such

[167] Sec. 219(f)(3). For taxpayers affected by a federally declared disaster, the IRS has the authority to postpone various tax deadlines for a period of up to one year. Sec. 7508A and ERISA sec. 518.

[168] As defined in section 402(g)(3).

[169] Secs. 402(a), 403(b)(1), 408(d)(1), and 457(a)(1). Under sections 402A(d) and 408A(d), a qualified distribution from a designated Roth account under an employer-sponsored plan and from a Roth IRA is not includible in income.

[170] Sec. 72(t). The early withdrawal tax does not apply to a section 457(b) plan.

plan or an IRA. The rollover generally can be achieved by direct rollover (direct payment from the distributing plan to the recipient plan) or by contributing the distribution to the eligible retirement plan within 60 days of receiving the distribution ("60-day rollover").[171] If the distribution from an employer-sponsored retirement plan consists of property, the rollover is accomplished by a transfer or contribution of the property to the recipient plan or IRA. Amounts that are rolled over are usually not included in gross income.[172] Generally, any distribution of the balance to the credit of a participant is an eligible rollover distribution with exceptions, for example, for certain periodic payments, required minimum distributions, and hardship distributions.[173]

Direct transfer of eligible rollover distributions

Qualified retirement plans, section 403(b) plans, and governmental section 457(b) plans are required to offer a direct rollover with respect to any eligible rollover distribution before paying the amount to the participant or beneficiary.[174] If an eligible rollover distribution is not directly rolled over into an eligible retirement plan, the taxable portion of the distribution generally is subject to mandatory 20-percent income tax withholding.[175] Participants who do not elect a direct rollover but who roll over eligible distributions within 60 days of receipt also defer tax on the rollover amounts; however, the 20 percent withheld will remain taxable unless the participant substitutes funds within the 60-day period.

Rollovers from IRAs

Distributions from IRAs are permitted to be rolled over tax-free to another IRA or any other eligible retirement plan. The general 60-day rollover rule (discussed above) applies to IRA rollovers as well as rollovers from qualified retirement plans, section 403(b) annuities, and governmental section 457(b) plans. There is no provision for direct rollovers from an IRA, but direct payment to another eligible retirement plan (via a trustee-to-trustee transfer) generally satisfies the requirements. Distributions from an inherited IRA (except in the case of an IRA acquired by the surviving spouse by reason of the IRA owner's death) and required minimum

[171] Secs. 402(c), 402A(c)(3), 403(b)(8) and 457(e)(16). An exception to the 60-day rules applies to rollovers of qualified plan loan offset amounts. Sec. 402(c)(3)(C).

[172] Distributions from qualified retirement plans, section 403(b) plans, and governmental section 457(b) plans may be rolled into a Roth IRA. Distributions from these plans that are rolled over into a Roth IRA and that are not distributions from a designated Roth account must be included in gross income.

[173] Sec. 402(c)(4). Treas. Reg. sec. 1.402(c)-1 identifies certain other payments that are not eligible for rollover, including, for example, certain corrective distributions, loans that are treated as deemed distributions under section 72(p), and dividends on employer securities as described in section 404(k). In addition, pursuant to section 402(c)(11), any distribution to a beneficiary of a deceased employee other than the participant's surviving spouse is only permitted to be rolled over to an IRA using a direct rollover; 60-day rollovers are not available to nonspouse beneficiaries.

[174] Sec. 401(a)(31).

[175] Treas. Reg. sec. 1.402(c)-2, Q&A-1(b)(3).

distributions are not permitted to be rolled over.[176] The portion of any distribution from an IRA that is not includible in gross income is only permitted to be rolled over to another IRA. Generally, distributions from a traditional IRA may only be rolled over tax-free to another IRA and distributions from a Roth IRA may only be rolled over tax-free to another Roth IRA. However, a distribution from a traditional IRA may be rolled over to a Roth IRA as a Roth conversion with the required income inclusion.[177]

Description of Proposal

The proposal requires the Secretary, no later than January 1, 2025, to develop and release sample forms for (1) direct rollovers of eligible rollover distributions from employer-sponsored retirement plans to another such plan or IRA, and (2) trustee-to-trustee transfers of amounts from an IRA to another IRA or retirement plan. The purpose of such forms is to simplify, standardize, and facilitate the completion of direct rollovers and trustee-to-trustee transfers. The sample forms must be written in a manner calculated to be understood by the average person, and must apply to both the distributing retirement plans or transferring IRAs and the receiving retirement plans or IRAs.

Effective Date

The proposal is effective on the date of enactment.

18. Exemption for automatic portability transactions

Present Law

Distributions and rollovers

A distribution from an employer-sponsored retirement plan is generally includible in income except for any portion attributable to after-tax contributions, which result in basis.[178] Unless an exception applies, in the case of a distribution before age 59½ from a qualified retirement plan or a section 403(b) plan, any amount included in income is subject to an additional 10-percent tax, referred to as the "early withdrawal" tax.[179]

Rollovers

A distribution from a qualified retirement plan, section 403(b) plan, or a governmental section 457(b) plan that is an eligible rollover distribution may be rolled over to another such

[176] A trustee-to-trustee transfer between IRAs is not treated as a distribution and rollover. Thus, nonspouse beneficiaries of IRAs can move funds to another inherited IRA established as a beneficiary of the decedent IRA owner. In contrast, a surviving spouse is permitted to roll over a distribution to his or her own IRA.

[177] Sec. 408A(d)(3).

[178] Secs. 402(a), 403(b)(1) and 457(a)(1). Under section 402A(d), a qualified distribution from a designated Roth account under an employer-sponsored plan is not includible in income.

[179] Sec. 72(t).

plan or an IRA. The rollover generally can be achieved by direct rollover (direct payment from the distributing plan to the recipient plan) or by contributing the distribution to the eligible retirement plan within 60 days of receiving the distribution ("60-day rollover").[180] If the distribution from an employer-sponsored retirement plan consists of property, the rollover is accomplished by a transfer or contribution of the property to the recipient plan or IRA. Amounts that are rolled over are usually not included in gross income.[181] Generally, any distribution of the balance to the credit of a participant is an eligible rollover distribution with exceptions, for example, for certain periodic payments, required minimum distributions, and hardship distributions.[182]

Direct transfer of eligible rollover distributions

Qualified retirement plans, section 403(b) plans, and governmental section 457(b) plans are required to offer a direct rollover with respect to any eligible rollover distribution before paying the amount to the participant or beneficiary.[183] If an eligible rollover distribution is not directly rolled over into an eligible retirement plan, the taxable portion of the distribution generally is subject to mandatory 20-percent income tax withholding.[184] Participants who do not elect a direct rollover but who roll over eligible distributions within 60 days of receipt also defer tax on the rollover amounts; however, the 20 percent withheld will remain taxable unless the participant substitutes funds within the 60-day period.

However, a mandatory distribution,[185] where the present value of the nonforfeitable accrued benefit of the participant (as determined under section 411(a)(11)) is in excess of $1,000 but does not exceed $5,000, must be directly rolled over to an IRA chosen by the plan administrator or the payor, unless a participant elects otherwise.

[180] Secs. 402(c), 402A(c)(3), 403(b)(8) and 457(e)(16). An exception to the 60-day rules applies to rollovers of qualified plan loan offset amounts. Sec. 402(c)(3)(C).

[181] Distributions from qualified retirement plans, section 403(b) plans, and governmental section 457(b) plans may be rolled into a Roth IRA. Distributions from these plans that are rolled over into a Roth IRA and that are not distributions from a designated Roth account must be included in gross income.

[182] Sec. 402(c)(4). Treas. Reg. sec. 1.402(c)-1 identifies certain other payments that are not eligible for rollover, including, for example, certain corrective distributions, loans that are treated as deemed distributions under section 72(p), and dividends on employer securities as described in section 404(k). In addition, pursuant to section 402(c)(11), any distribution to a beneficiary of a deceased employee other than the participant's surviving spouse is only permitted to be rolled over to an IRA using a direct rollover; 60-day rollovers are not available to nonspouse beneficiaries.

[183] Sec. 401(a)(31).

[184] Treas. Reg. sec. 1.402(c)-2, Q&A-1(b)(3).

[185] Under section 401(a)(3)(B)(i)

Prohibited transactions

In general

The Code and ERISA prohibit certain transactions ("prohibited transaction") between a qualified retirement plan and a disqualified person (referred to as a "party in interest" under ERISA).[186] The prohibited transaction rules under the Code apply also to IRAs, Archer MSAs, HSAs, and Coverdell ESAs.[187]

Disqualified persons include a fiduciary of the plan; a person providing services to the plan; an employer with employees covered by the plan; an employee organization any of whose members are covered by the plan; certain owners, officers, directors, highly compensated employees, family members, and related entities.[188] A fiduciary includes any person who (1) exercises any discretionary authority or discretionary control respecting management of the plan or exercises any authority or control respecting management or disposition of the plan's assets, (2) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so, or (3) has any discretionary authority or discretionary responsibility in the administration of the plan.[189]

Prohibited transactions include the following transactions, whether direct or indirect, between a plan and a disqualified person:

1. The sale or exchange or leasing of property,

2. The lending of money or other extension of credit,

3. The furnishing of goods, services, or facilities,

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[186] Sec. 4975; ERISA sec. 406. The prohibited transaction rules of the Code and ERISA are very similar; however, some differences exist between the two sets of rules. As mentioned above, ERISA generally does not apply to governmental plans or church plans. The prohibited transaction rules under the Code also generally do not apply to governmental plans or church plans. However, under section 503, the trust holding assets of a governmental or church plan may lose its tax-exempt status in the case of a prohibited transaction listed in section 503(b). Before the enactment of ERISA in 1974, section 503 applied to qualified retirement plans generally. In connection with the enactment of section 4975 by ERISA, section 503 was amended to apply only to governmental and church plans.

[187] These are included in the definition of "plan" under section 4975(e)(1).

[188] Sec. 4975(e)(2). Party in interest is defined similarly under ERISA section 3(14) with respect to an employee benefit plan. Under ERISA, employee benefit plans, defined in ERISA section 3(3), consist of two types: pension plans (that is, retirement plans), defined in ERISA section 3(2), and welfare plans, defined in ERISA section 3(1).

[189] Sec. 4975(d)(3); ERISA sec. 3(21)(A). Under ERISA, fiduciary also includes any person designated under ERISA section 405(c)(1)(B) by a named fiduciary (that is, a fiduciary named in the plan document) to carry out fiduciary responsibilities.

4. The transfer to, or use by or for the benefit of, the income or assets of the plan,

5. In the case of a fiduciary, an act dealing with the plan's income or assets in the fiduciary's own interest or for the fiduciary's own account, and

6. The receipt by a fiduciary of any consideration for the fiduciary's own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.[190]

Exemptions from prohibited transaction treatment

Certain transactions are statutorily exempt from prohibited transaction treatment, for example, certain loans to plan participants and arrangements with a disqualified person for legal, accounting, or other services necessary for the establishment or operation of a plan if no more than reasonable compensation is paid for the services.[191]

Sanctions for violations

Under the Code, if a prohibited transaction occurs, the disqualified person who participated in the transaction is generally subject to a two-tiered excise tax. The first tier tax is 15 percent of the amount involved in the transaction. The second tier tax, imposed if the prohibited transaction is not corrected within a certain period, is 100 percent of the amount involved. In the case of an IRA, HSA, Archer MSA or Coverdell ESA, the sanction for some prohibited transactions is the loss of tax favored status, rather than an excise tax. A private right of action is not available for a Code violation.

Under ERISA, DOL may assess a civil penalty against a person who engages in a prohibited transaction, other than a transaction with a plan covered by the prohibited transaction rules of the Code.[192] The penalty may not exceed five percent of the amount involved in the transaction for each year or part of a year that the prohibited transaction continues. If the prohibited transaction is not corrected within 90 days after notice from DOL, the penalty can be up to 100 percent of the amount involved in the transaction. A prohibited transaction by a

[190] Sec. 4975(c)(1)(A)-(F) and ERISA sec. 406(a)(1)(A)-(D) and (b)(1) and (3). Under ERISA section 406(a)(1), a plan fiduciary is prohibited from causing the plan to engage in a transaction described in paragraphs (A)-(D). ERISA section 406(b)(2) also prohibits a plan fiduciary, in the fiduciary's individual capacity or any other capacity, from acting in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of plan participants or beneficiaries. ERISA section 406(a)(1)(E) and (a)(2) relate to limitations under ERISA section 407 on a plan's acquisition or holding of employer securities and real property.

[191] Sec. 4975(d) and ERISA sec. 408. The Code and ERISA also provide for the grant of administrative exemptions, on either an individual or class basis, subject to a finding that the exemption is administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan.

[192] ERISA sec. 502(i).

fiduciary may also be the basis for an action for a breach of fiduciary responsibility by DOL, a plan participant or beneficiary, or another plan fiduciary.

Description of Proposal

The proposal adds a new prohibited transaction exemption for any transaction which consists of the receipt of fees and compensation by an automatic portability provider in connection with an automatic portability transaction. An automatic portability provider is a person who executes automatic portability transactions.

An automatic portability transaction is defined as a transfer of assets made from an individual retirement plan which is established on behalf of an individual and to which amounts were transferred as a result of a mandatory distribution[193] ("the individual retirement plan") to an employer-sponsored retirement plan[194](other than a defined benefit plan) in which such individual is an active participant ("the employer sponsored retirement plan"), and after such individual has been given advance notice of the transfer and has not affirmatively opted out of such transfer.

The prohibited transaction exemption does not apply to an automatic portability transaction unless the following requirements are satisfied:

- The automatic portability provider must acknowledge in writing, at such time and in such format as the Secretary specifies, that the provider is a fiduciary with respect to the individual retirement plan;
- The fees and compensation received by the automatic portability provider in connection with the automatic portability transaction (including any increases in such fees or compensation) must not exceed reasonable compensation, and must be fully disclosed and approved in writing in advance of the transaction by a plan fiduciary of the employer-sponsored retirement plan that is independent of the automatic portability provider;
- The automatic portability provider must not market or sell data relating to the individual retirement plan nor may the automatic portability provider use the data for any purpose other than the administration of the transfers, without the express consent of the independent plan fiduciary, after full disclosure by the automatic portability provider of how the data will be used;
- The automatic portability provider must offer automatic portability on the same terms to any employer sponsored retirement plan, regardless of whether the provider provides other services for such plan;

[193] Under sec. 401(a)(31)(B)(i).

[194] A sec. 401(a) plan, a sec. 403(a) or sec. 403(b) plan, or an eligible deferred compensation plan under sec. 457(b) maintained by an eligible employer defined in sec. 457(e)(1)(A), other than a defined benefit plan.

- At least 30 days in advance of an automatic portability transaction, the automatic portability provider must provide notice to the individual on whose behalf the individual retirement plan is established which includes:
    - A description of the automatic portability transaction and the fees which will be charged in connection with the transaction;
    - A description of the individual's right to affirmatively elect not to participate in the transaction, the procedures for such an election, and a telephone number at which the individual can contact the automatic portability provider; and
    - Such other disclosures as the Secretary may require by regulation;
- Not later than three business days after an automatic portability transaction, the automatic portability provider must provide notice to the individual on whose behalf the individual retirement plan was established of:
    - The actions taken by the automatic portability provider with respect to the individual's account;
    - All relevant information regarding the location and amount of any transferred assets;
    - A statement of fees charged against the account by the automatic portability provider or its affiliates in connection with the transfer;
    - A telephone number at which the individual can contact the automatic portability provider; and
    - Such other disclosures as the Secretary may require by regulation;
- The notices required under this prohibited transaction exemption must be written in a manner calculated to be understood by the average intended recipient and must not include materially misleading statements;
- After liquidating the assets of the individual retirement plan to cash, an automatic portability provider must transfer the account balance of that plan as soon as practicable to the employer sponsored retirement plan;
- For six years, an automatic portability provider must maintain the records sufficient to demonstrate that the requirements of this prohibited transaction exemption are met; and
- An automatic portability provider must conduct an annual audit of automatic portability transactions occurring during the calendar year in accordance with regulations promulgated by the Secretary to demonstrate compliance with the requirements of this prohibited transaction exemption and must submit such audit annually to the Secretary, in such form and manner as specified by the Secretary.

The proposal authorizes the Secretary to promulgate regulations that: (1) require the automatic portability provider to provide a notice to individuals on whose behalf an individual retirement plan is established in advance of the notices required under the prohibited transaction exemption; (2) restrict the receipt of third party compensation (other than a direct fee by an employer sponsoring a plan that is in lieu of a fee imposed on an individual retirement plan owner) by an automatic portability provider in connection with an automatic portability transaction; (3) prohibit exculpatory provisions in an automatic portability provider's contracts

or communications with individuals disclaiming or limiting its liability in the event that an automatic portability transaction results in an improper transfer; (4) require an automatic portability provider to take actions necessary to reasonably ensure that participant and beneficiary data is current and accurate, and that the appropriate participants and beneficiaries, in fact, receive all the required notices and disclosures until the assets are transferred to a new retirement plan account.

The Secretary must issue interim final rules no later than July 1, 2023.

Effective Date

The proposal applies to transactions occurring after December 31, 2023.

19. Application of section 415 limit for certain employees of rural electric cooperatives

Present Law

Limitations on benefits provided under a qualified defined benefit plan

Benefits that may be provided to a participant under a qualified defined benefit plan must not exceed certain specified limitations.[195] Under a defined benefit plan, the maximum annual benefit payable to a participant at retirement cannot exceed the lesser of (1) 100 percent of the participant's average compensation for the participant's high three years, or (2) a specified dollar amount, indexed for inflation ($245,000 for 2022).[196] Other restrictions apply under certain circumstances.[197] The dollar amount limit is actuarially reduced if benefits begin before age 62, and actuarially increased if benefits being after age 65.[198] These limits apply to amounts for or with respect to a limitation year, which is generally the calendar year unless the terms of the plan provide otherwise.[199]

The 100-percent defined benefit compensation limitation does not apply to governmental plans, multiemployer plans and certain collectively bargained plans.[200] In addition, the compensation limitation does not apply to a participant in a plan maintained by certain church organizations, who has never been a highly compensated employee.[201] An employee is a "highly compensated employee" for the year if the employee was: (i) a five-percent owner at any time during the plan year or the preceding plan year, or (ii) had compensation for the preceding year

[195] Sec. 415(b); Treas. Reg. sec. 1.415(b)-1.

[196] Sec. 415(b)(1).

[197] Secs. 415(b)(4); 415(b)(5); 415(b)(7).

[198] Secs. 415(b)(2)(C); 415(b)(2)(D).

[199] Treas. Reg. sec. 1.415(j)-1.

[200] Secs. 415(b)(7) and 415(b)(11).

[201] Sec. 415(b)(11).

from the employer in excess of a specified dollar amount, indexed for inflation ($135,000 for 2022).[202]

For purposes of applying these limitations, in the case of a defined benefit plan, the term annual benefit means a benefit that is payable in the form of a straight life annuity. If a benefit is payable other than as an annual straight life annuity, then the benefit must be actuarially adjusted to an equivalent straight life annuity.[203] The interest rate assumption for this adjustment is specified and cannot be less than the greater of five percent or the rate specified under the plan.[204] If the benefit is payable in the form of a single sum distribution, then the benefit is adjusted using an interest rate that is not less than the greatest of: (i) 5.5 percent, (ii) the rate that provides a benefit of not more than 105 percent of the benefit that would be provided if the applicable interest rate[205] were the interest rate assumption, or (iii) the rate specified under the plan.[206]

Description of Proposal

The proposal exempts an employee who is a participant in an eligible rural electric cooperative plan from the defined benefit plan compensation limitation, if the employee is a qualified non-highly compensated employee. An employee is a qualified non-highly compensated employee if the employee was not a highly compensated employee[207] of an employer maintaining the plan for the earlier of the plan year in which the employee terminated employment, or in which distributions commence under the plan; or for any of the five plan years immediately preceding those plans years.

For purposes of this proposal, a plan is generally treated as an eligible rural electric cooperative plan if it is maintained by more than one employer and at least 85 percent of the employers are certain rural cooperatives that are engaged primarily in providing electric service, or an organization which is a national association of those organizations.[208]

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[202] Sec. 414(q).

[203] Sec. 415(b)(2)(B); Treas. Reg. sec. 1.415(b)-1(c).

[204] Sec. 415(b)(2)(E)(i).

[205] As defined in sec. 417(e)(3).

[206] Sec. 415(b)(2)(E)(ii).

[207] Within the meaning of sec. 414(q).

[208] Section 401(k)(7)(B) defines "rural cooperative" as any organization which is (i) engaged primarily in providing electric service on a mutual or cooperative basis, or engaged primarily in providing electric service to the public in its service area and which is exempt from tax or which is a State or local government (or an agency or instrumentality thereof), other than a municipality; (ii) a certain type of civic league or business league exempt from tax, 80 percent of the members of which are described in (i); (iii) a certain type of cooperative telephone company; (iv) a certain type of mutual irrigation or ditch company, or is a district organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation, or drainage; and (v) a national association of the organizations described above. This proposal is generally limited to non-highly compensated employees of rural cooperatives that provide electric service within the meaning of sec. 401(k)(7)(B)(i) or (ii).

This proposal is a permissible change and an employer participating in an eligible rural electric cooperative plan may choose to keep the current limitation in its plan language. In addition, the Secretary is directed to prescribe rules as may be appropriate to limit this proposal to its intended effects.[209]

Effective Date

The proposal is effective for limitation years ending after the date of enactment.

20. Insurance-dedicated exchange-traded funds

Present Law

Income exclusion and deferred tax treatment for life insurance and annuity contracts

An exclusion from gross income is provided for amounts received under a life insurance contract paid by reason of the death of the insured.[210] Further, no Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract (''inside buildup''). Distributions from a life insurance contract (other than a modified endowment contract[211]) that are made prior to the death of the insured generally are includible in income only to the extent that the amounts distributed exceed the taxpayer's investment in the contract. Such distributions generally are treated first as a tax-free recovery of the investment in the contract, and then as income.[212] Present law provides a definition of life insurance designed to limit the investment orientation of the contract.[213]

No Federal income tax is generally imposed on a deferred annuity contract holder who is a natural person with respect to the earnings on the contract (inside buildup) in the absence of a distribution under the contract. Annuity distributions generally are treated as partially excludable return of basis and partially ordinary income under an ''exclusion ratio'' (the ratio of the investment in the contract to the expected return under the contract as of that date).[214] Other distributions (which for this purpose include loans) are treated as income first, then as a tax-free return of basis.[215] An additional 10-percent tax is imposed on the income portion of distributions

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[209] For example, this proposal is not intended to be used to provide large benefits to employees with low pay in order to avoid the impact of the nondiscrimination rules.

[210] Sec. 101(a).

[211] Sec. 7702A. A modified endowment contract is generally a life insurance contract funded more rapidly than in seven level annual premiums. Distributions (including loans) from a modified endowment contract are generally treated as income first, then as a tax-free return of basis. Sec. 72(e)(10).

[212] Sec. 72(e).

[213] Sec. 7702.

[214] Sec. 72(b).

[215] Sec. 72(e).

made before age 59–1/2, and in certain other circumstances.[216] An annuity contract must provide for certain required distributions if the holder dies before the entire interest in the contract has been distributed.[217] No dollar limit is imposed on the amount that may be paid into an annuity contract (that is not a pension plan contract) for Federal income tax purposes.

Variable contracts

A variable contract is generally an annuity or life insurance contract whose death benefit, payout, or premium amounts are based on the return on and market value of underlying assets. For tax purposes, a variable contract is defined by statute.[218] Under the statutory criteria, all or part of the amounts received for the contract (premiums) must be allocated to a segregated asset account of the insurer. The contract must provide for the payment of annuities, must be a life insurance contract,[219] or must fund insurance on retired lives.[220] The contract must reflect the investment return and the market value of the segregated asset account, or in the case of a life insurance contract, the amount of the death benefit or period of coverage must be adjusted on the basis of the investment return and the market value of the segregated asset account. The segregated asset accounts for variable contracts generally are invested in a variety of investment funds.

Diversification requirements

The investment assets held in the segregated asset account for a variable contract must be adequately diversified.[221] If the assets are not adequately diversified, the variable contract is not treated as an annuity or life insurance contract.[222] As a result, otherwise tax-deferred or excluded income on the contract is treated as ordinary income received or accrued by the contract holder during the taxable year.[223]

When the diversification requirement for variable contracts was added in 1984, the Conference Report stated, "[i]n authorizing Treasury to prescribe diversification standards, the

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[216] Sec. 72(q).

[217] Sec. 72(s).

[218] Sec. 817(d).

[219] As defined for Federal tax purposes in section 7702.

[220] As described in section 807(c)(6) (governing life insurer reserve deductions).

[221] Sec. 817(h).

[222] The investor control doctrine can also apply in some fact situations. This two-pronged doctrine generally treats a contract as not a life insurance contract or not an annuity contract if the contract holder has significant incidents of ownership with respect to the investments in the insurer segregated asset account, or if segregated asset account assets are publicly available for purchase (*i.e*, not exclusively available through purchase of the variable contract). See Rev. Rul. 81-225, 1981-2 C.B. 12, as modified by Rev. Proc. 99-44 and as clarified and amplified by Rev. Rul. 2007-7; *Christofferson v. U.S.*, 749 F.2d 513 (8th Cir. 1984); *Webber v. Commissioner*, 144 T. C. 324 (2015).

[223] Secs. 72 and 7702, and Treas. Reg. sec. 1.817-5(a).

conferees intend that standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors and investments that are made, in effect, at the direction of the investor."[224]

The regulatory diversification requirements impose investment concentration limits based on percentages of the total value of the assets in the segregated asset account.[225] A safe harbor is provided for a segregated asset account holding a regulated investment company ("RIC" or mutual fund) that is at least as diversified as is required under the RIC rules of section 851(b)(4) and no more than 55 percent of the value of whose assets is in cash, cash items, government securities, and securities of other RICs.[226]

The diversification requirements provide a lookthrough rule for assets held through a RIC, real estate investment trust ("REIT"), partnership, or certain trusts such as a grantor trust. This lookthrough rule provides that the RIC, REIT, partnership or trust is not treated as a single investment of the segregated asset account, but rather, a pro rata portion of each of its assets is treated as an asset of the account.[227]

However, the lookthrough rule imposes requirements.[228] All the beneficial interests in the RIC, REIT, partnership, or trust generally must be held by a segregated asset account. Public access to the RIC, REIT, partnership, or trust must generally be available exclusively through the purchase of a variable contract. For example, if an investment fund's interests are held by a market maker or by a financial institution that, as a participant in a clearing agency, is permitted to purchase and redeem shares directly from the fund and sell them to third parties, then the fund does not satisfy this requirement of the lookthrough rule.

Description of Proposal

Diversification requirements

The proposal directs the Secretary to revise the regulations setting forth diversification requirements with respect to variable contracts under section 817(h) to facilitate the use of exchange-traded funds ("ETFs") under variable contracts. The proposal directs that the lookthrough rule requirements in the regulations be amended so that satisfaction of those

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[224] H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. (1984), page 1055. Similarly, the Blue Book for the 1984 Act states that the diversification requirements were enacted "to discourage the use of tax-preferred variable annuities and variable life insurance primarily as investment vehicles. The Congress believed that a limitation on a customer's ability to select specific investments underlying a variable contract will help ensure that a customer's primary motivation in purchasing the contract is more likely to be the traditional economic protections provided by annuities and life insurance." Joint Committee on Taxation, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, Pub. L. No. 98-369, JCS-41-84, December 31, 1984, page 607.

[225] Treas. Reg. sec. 1.817-5(b).

[226] Treas. Reg. sec. 1.817-5(b)(2).

[227] Treas. Reg. sec. 1.817(f)(1).

[228] Treas. Reg. sec. 1.817(f)(2) and (3).

requirements with respect to an ETF is not prevented by reason of beneficial interests in an investment fund being held by one or more authorized participants or market makers.

Under the proposal, an ETF means a RIC, partnership, or trust that is registered with the SEC as an open-end investment company or unit investment trust, and the shares of which can be purchased or redeemed directly from the fund only by an authorized participant, and the shares of which are traded throughout the day on a national stock exchange at market prices that may or may not be the same as the net asset value of the shares. An authorized participant means a financial institution that is a member or participant in a clearing agency registered under section 17A(b) of the Securities Exchange Act of 1934 that contracts with an ETF to permit the financial institution to purchase or redeem shares of the ETF and to sell the shares to third parties, provided that the financial institution is precluded from purchasing the shares for its own investment purposes and from selling the shares to persons that are not market makers. A market maker means a financial institution that is a registered broker or dealer under section 15(b) of the Securities Exchange Act of 1934 and that maintains liquidity for an ETF on a national stock exchange by always being ready to buy and sell shares, provided that the financial institution is precluded from buying or selling shares to or from persons who are not authorized participants or who are persons not permitted to buy or sell shares under the lookthrough rule in the regulations.

Effective Date

The proposal is effective for segregated asset account investments made on or after the date that is seven years after the date of enactment.

B. Retirees

1. Increase in age for required beginning date for mandatory distributions

Present Law

In general

Employer-provided qualified retirement plans and IRAs are subject to required minimum distribution rules.[229] Employer-sponsored retirement plans are of two general types: defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts; and defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses. A qualified retirement plan for this purpose means a tax-qualified plan described in section 401(a) (such as a defined benefit pension plan or a section 401(k) plan), an employee retirement annuity described in section 403(a), a tax-sheltered annuity described in section 403(b), and a plan described in section 457(b) that is maintained by a governmental employer.[230]

In general, under the minimum distribution rules, distribution of minimum benefits must begin to an employee (or IRA owner) no later than a required beginning date and a minimum amount must be distributed each year (sometimes referred to as "lifetime" minimum distribution requirements). These lifetime requirements do not apply to a Roth IRA.[231] Minimum distribution rules also apply to benefits payable with respect to an employee (or IRA owner) who has died (sometimes referred to as "after-death" minimum distribution requirements). The regulations provide a methodology for calculating the required minimum distribution from an individual account under a defined contribution plan or from an IRA.[232] In the case of annuity payments under a defined benefit plan or an annuity contract, the regulations provide requirements that the stream of annuity payments must satisfy.

Failure to make a required minimum distribution triggers a 50-percent excise tax, payable by the individual or the individual's beneficiary. The tax is imposed during the taxable year that

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[229] Secs. 401(a)(9) and 408(a)(6). Roth IRAs, however, are not subject to minimum distribution rules during the owner's lifetime. The IRS recently published new proposed regulations under section 401(a)(9). 87 FR 10504, Feb. 24, 2022 (corrected March 21, 2022). The amendments to Treas. Reg. §§1.401(a)(9)-1 through 1.401(a)(9)-9, are proposed to apply for purposes of determining RMDs for calendar years beginning on or after Jan. 1, 2022.

[230] The required minimum distribution rules also apply to section 457(b) plans maintained by tax-exempt employers other than governmental employers.

[231] Sec. 408A(c)(4). Roth IRAs are, however, subject to the post-death minimum distribution rules that apply to traditional IRAs. For Roth IRAs, the IRA owner is treated as having died before the individual's required beginning date.

[232] Reflecting the directive in section 823 of the Pension Protection Act of 2006 (Pub. L. No. 109-280), pursuant to Treas. Reg. sec. 1.401(a)(9)-1, A-2(d), a governmental plan within the meaning of section 414(d) or a governmental eligible deferred compensation plan is treated as having complied with the statutory minimum distribution rules if the plan complies with a reasonable and good faith interpretation of those rules.

begins with or within the calendar year during which the distribution was required.[233] The tax may be waived if the failure to distribute is reasonable error and reasonable steps are taken to remedy the violation.[234]

Required beginning date

Required minimum distributions generally must begin by April 1 of the calendar year following the calendar year in which the individual (employee or IRA owner) reaches age 72. Prior to January 1, 2020, the age after which required minimum distributions were required to begin was 70½.[235] In the case of an employer-provided qualified retirement plan, the required minimum distribution date for an individual who is not a five-percent owner of the employer maintaining the plan may be delayed to April 1 of the year following the year in which the individual retires, if the plan provides for this later distribution date. For all subsequent years, including the year in which the individual was paid the first required minimum distribution by April 1, the individual must take the required minimum distribution by December 31.

Lifetime rules

While an employee (or IRA owner) is alive, distributions of the individual's interest are required to be made (in accordance with regulations) over the life of the employee (or IRA owner) or over the joint lives of the employee (or IRA owner) and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee (or IRA owner) or the life expectancy of such employee (or IRA owner) and a designated beneficiary).[236] For IRAs and defined contribution plans, the required minimum distribution for each year generally is determined by dividing the account balance as of the end of the prior year by the number of years in the distribution period.[237] The distribution period is generally derived from the Uniform Lifetime Table.[238] This table is based on the joint life expectancies of the individual and a hypothetical beneficiary 10 years younger than the individual. For an individual with a spouse as designated beneficiary who is more than 10 years younger, the joint life expectancy of the couple is used (because the couple's remaining joint life expectancy is longer than the length provided in the Uniform Lifetime Table). The distribution period for annuity payments under a defined benefit plan or annuity contract (to the extent not limited to the life of the employee (or IRA

[233] Sec. 4974(a).

[234] Sec. 4974(d).

[235] Section 114 of the SECURE Act increased the age after which required minimum distributions must begin from 70½ to 72, effective for distributions required to be made after December 31, 2019, with respect to individuals who attain age 70½ after that date.

[236] Sec. 401(a)(9)(A).

[237] Treas. Reg. sec. 1.401(a)(9)-5.

[238] Treas. Reg. sec. 1.401(a)(9)-9.

owner) or the joint lives of the employee (or IRA owner) and a designated beneficiary) is generally subject to the same limitations as apply to individual accounts.[239]

After-death rules for defined contributions plans and IRAs

In the case of a defined contribution plan or IRA, if an individual dies before the individual's entire interest is distributed, and the individual has a designated beneficiary, unless the designated beneficiary is an eligible designated beneficiary, the individual's entire account must be distributed within 10 years after the individual's death. This rule applies regardless of whether the individual dies before or after the individual's required beginning date. A designated beneficiary is an individual designated as a beneficiary under the plan or IRA.[240]

In the case of an eligible designated beneficiary, the remaining required minimum distributions are distributed over the life of the beneficiary (or over a period not extending beyond the life expectancy of such beneficiary). Such distributions generally must begin no later than December 31 of the calendar year immediately following the calendar year in which the individual dies. An eligible designated beneficiary is a designated beneficiary who is (1) the surviving spouse of the individual; (2) a child of the individual who has not reached majority; (3) disabled; (4) chronically ill; or (5) not more than 10 years younger than the individual.[241] The required minimum distribution for each year is determined by dividing the account balance as of the end of the prior year by a distribution period, which is determined by reference to the beneficiary's life expectancy.[242] Special rules apply in the case of trusts for disabled or chronically ill beneficiaries.[243]

In the case of an individual who does not have a designated beneficiary, if an individual dies on or after the individual's required beginning date, the distribution period for the remaining required minimum distributions is equal to the remaining years of the deceased individual's single life expectancy, using the age of the deceased individual in the year of death.[244] If an individual dies before the required beginning date, the individual's entire account must be distributed no later than December 31 of the calendar year that includes the fifth anniversary of the individual's death.[245]

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[239] Treas. Reg. sec. 1.401(a)(9)-6.

[240] Sec. 401(a)(9)(E)(i); Treas. Reg. sec. 1.401(a)(9)-4, Q&A-1. The individual need not be named as long as the individual is identifiable under the terms of the plan (or IRA). However, the fact that an interest under a plan or IRA passes to a certain individual under a will or otherwise under State law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan or IRA.

[241] Sec. 401(a)(9)(E)(ii).

[242] Treas. Reg. sec. 1.401(a)(9)-5, A-5.

[243] Sec. 401(a)(9)(H)(iv).

[244] Treas. Reg. sec. 1.401(a)(9)-5, A-5(a).

[245] Treas. Reg. sec. 1.401(a)(9)-3, Q&As 1, 2.

After-death rules for defined benefit plans

In the case of a defined benefit plan, if an individual dies before the individual's entire interest is distributed, the minimum distribution rules vary depending on whether or not the individual dies before or after the required beginning date. If the individual dies after distributions have begun, the remaining interest must be distributed at least as rapidly as under the method of distribution prior to death.[246] If the individual dies before distributions have begun, the entire account must be distributed within five years after the individual's death, unless any portion is payable to a designated beneficiary.[247] If any portion is payable to a designated beneficiary, the remaining required minimum distributions are distributed over the life of the beneficiary (or over a period not extending beyond the life expectancy of such beneficiary). Such distributions generally must begin no later than December 31 of the calendar year immediately following the calendar year in which the individual dies.

Annuity distributions

The regulations provide rules for the amount of annuity distributions from a defined benefit plan, or from an annuity purchased by the plan from an insurance company, that are paid over life (or a period not extending beyond life expectancy). Annuity distributions are generally required to be nonincreasing over time with certain exceptions, which include, for example, (i) increases to the extent of certain specified cost-of-living indices, (ii) a constant percentage increase (for a qualified defined benefit plan, the constant percentage cannot exceed five percent per year), (iii) certain accelerations of payments, and (iv) increases to reflect when an annuity is converted to a single life annuity after the death of the beneficiary under a joint and survivor annuity or after termination of the survivor annuity under a qualified domestic relations order.[248] If distributions are in the form of a joint and survivor annuity and the survivor annuitant both is an individual other than the surviving spouse and is younger than the employee (or IRA owner), the survivor annuity benefit must be limited to a percentage of the life annuity benefit for the employee (or IRA owner). The survivor benefit as a percentage of the benefit of the primary annuitant is required to be smaller (but not required to be less than 52 percent) as the difference in the ages of the primary annuitant and the survivor annuitant becomes greater.

Special rules for spouses

If the designated beneficiary is the individual's spouse, commencement of distributions is permitted to be delayed until December 31 of the calendar year in which the deceased individual would have attained age 72. If the surviving spouse dies before distributions to such spouse begin, the after-death rules apply after the death of the spouse as though the spouse were the employee (or IRA owner).

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[246] Sec. 401(a)(9)(B)(i).

[247] Sec. 401(a)(9)(B)(ii), (iii).

[248] Treas. Reg. sec. 1.401(a)(9)-6, A-14.

In the case of an IRA, if the beneficiary is the surviving spouse, the spouse is permitted to choose to calculate required minimum distributions both while the surviving spouse is alive and after death as though the surviving spouse is the IRA owner.[249]

Description of Proposal

The proposal changes the age on which the required beginning date for required minimum distributions is based, from the calendar year in which the employee or IRA owner attains age 72 to the calendar year in which the employee or IRA owner attains age 75, for calendar years after 2031. If an individual has not attained the age that applies for a given calendar year, the individual is not treated as having attained the age at which required minimum distributions must begin for that year, regardless of whether the individual had attained the applicable age in a prior calendar year. Thus, for example, an individual who attains age 73 in 2032 is not required to take a required minimum distribution for that year, even though the individual might have been required to take a required minimum distribution for calendar year 2031, on account of having attained age 72 in 2031.

Effective Date

The proposal is effective for calendar years beginning after the date of enactment.

2. Qualifying longevity annuity contracts

Present Law

Required minimum distributions

Background on required minimum distributions under qualified retirement plans may be found in B.1 of this document.

Qualifying longevity annuity contracts

A "qualifying longevity annuity contract" ("QLAC") is a deferred annuity contract that is purchased from an insurance company for an employee that is generally scheduled to commence payments at an advanced age (but no later than age 85)[250] and which satisfies each of the following requirements:[251]

1. Premiums for the QLAC do not exceed the lesser of a dollar or percentage limitation. The dollar limitation is (1) $125,000 (as adjusted) ($145,000 for 2022) over (2) the sum of (a) the premiums previously paid with respect to the contract and (b) the

[249] Treas. Reg. sec. 1.408-8, Q&A 5.

[250] Because under section 401(a)(9), minimum required distributions must generally begin no later than the April 1 of the year following the year in which the individual attains age 72, without these special rules, QLACs would violate the requirements of section 401(a)(9). See the proposal described in section B.1 of this document, which proposes an increase in the age for the required beginning date for mandatory distributions.

[251] Treas. Reg. sec. 401(a)(9)-6, Q & A-17.

premiums previously paid with respect to any other QLAC that is purchased for the employee under the plan, or any other plan of the employer.[252] The percentage limitation is 25 percent of the employer's account balance under the plan (including the value of any QLAC held under the plan for the employee) over the previously paid premiums with respect to the contract or with respect to any other QLAC that is purchased for the employee under the plan, or any other plan of the employer.

2. The QLAC provides that distributions under the contract must commence not later than the first day of the month following the individual's attainment of age 85.

3. The QLAC provides that once distributions begin under the contract, the distributions satisfy the minimum required distribution rules, except for the rule that annuity payments commence on or before the required beginning date.

4. The contract does not make available any commutation benefit, cash surrender right, or other similar feature.

5. No benefits are provided under the contract after the death of the employee other than those provided for in the regulations.

6. When the contract is issued, the contract (or a rider or endorsement) states that it is intended to be a QLAC.

7. The contract is not a variable contract, an indexed contract or a similar contract, except as provided in guidance.

Recently, IRS and Treasury issued proposed regulations relating to required minimum distributions from qualified plans; section 403(b) annuity contracts, custodial accounts, and retirement income accounts; individual retirement accounts and annuities; and eligible deferred compensation plans[253] to address the required minimum distribution requirements[254] and to update the regulations to reflect the amendments made to such distributions by sections 114 and 401 of the SECURE Act. With respect to QLACs, the definition of a QLAC in the proposed regulations is the same as in the current regulations.[255]

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[252] Including any other plan, annuity, or account described in sections 401(a), 403(a), 403(b), or 408, or an eligible governmental plan under section 457(b).

[253] Under section 457.

[254] 87 FR 10504, Feb. 24, 2022 (corrected March 21, 2022). The amendments to Treas. Reg. secs. 1.401(a)(9)-1 through 1.401(a)(9)-9, are proposed to apply for purposes of determining RMDs for calendar years beginning on or after Jan. 1, 2022. For the 2021 distribution calendar year, taxpayers must apply the existing regulations, but by taking into account a reasonable, good faith interpretation of the amendments made by sections 114 and 401 of the SECURE Act. Compliance with the proposed regulations satisfy that requirement.

[255] See Treas. Prop. Reg. sec. 1.401(a)(9)-6(q).

Description of Proposal

Under the proposal, no later than 18 months after the date of enactment, the Secretary (or the Secretary's delegate) is directed to amend the minimum required distribution regulation which applies to QLACs:

- To eliminate the requirement that premiums for QLACs be limited to 25 percent (or any other percentage) of an individual's account balance;

- To increase the dollar limitation on premiums for QLACs from $125,000 to $200,000, and to provide that, in the case of calendar years beginning on or after January 1 of the second year following the year of enactment of this Act, the $200,000 dollar limitation will be adjusted at the same time and in the same manner as the limits are adjusted under section 415(d),except that the base period will be the calendar quarter beginning July 1 of the year of enactment of this Act, and any increase to such dollar limitation which is not a multiple of $10,000 will be rounded to the next lowest multiple of $10,000;

- To provide that in the case of a QLAC purchased with joint and survivor annuity benefits for the individual and his or her spouse that were permissible under the regulations at the time the contract was originally purchased, a divorce occurring after the original purchase and before the annuity payments commence under the contract, does not affect the permissibility of the joint and survivor annuity benefits or other benefits under the contract, or require any adjustment to the amount or duration of benefits payable under the contract provided that any qualified domestic relations order[256] or in the case of an arrangement not subject to the qualified domestic relations order provisions in the Code or ERISA,[257] any divorce or separation instrument (1) provides that the former spouse is entitled to the survivor benefits under the contract, (2) does not modify the treatment of the former spouse as beneficiary under the contract who is entitled to the survivor benefits, or (3) does not modify the treatment of the former spouse as the measuring life for the survivor benefits under the contract. For purposes of this proposal, the term "divorce or separation instrument" means (1) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (2) a written separation agreement, or (3) a decree (not described in (1)) requiring a spouse to make payments for the support or maintenance of the other spouse;

- To ensure that the regulation does not preclude a contract from including a provision under which an employee may rescind the purchase of the contract within a period not exceeding 90 days from the date of purchase (the "short free look period."); and

[256] Within the meaning of section 414(p).

[257] Sec.414(p) or sec.206(d) of ERISA.

Regulatory Successor Provision

Any reference to a regulation is treated as including a reference to any successor regulation.

Effective Date

The proposal is generally effective with respect to contracts purchased or received in an exchange on or after the date of enactment. The changes with respect to joint and survivor annuities and the short free look period are effective with respect to contracts purchased or received in an exchange on or after July 2, 2014.

Prior to the date the Secretary issues final regulations, the Secretary shall administer and enforce the law in accordance with the effective dates above, and taxpayers may rely upon their reasonable good faith interpretations of the law prior to this proposal becoming effective.

3. Remove required minimum distribution barriers for life annuities

Present Law

Required minimum distributions

Background on required minimum distributions under qualified retirement plans may be found in B.1 of this document.

Annuities

A plan will not fail to satisfy the minimum required distribution rules merely because distributions are made from an annuity contract which is purchased with the employee's benefit by the plan from an insurance company.[258] Prior to the date that an annuity contract under an individual account plan commences benefits under the contract, the interest of the employee or beneficiary under that contract is treated as an individual account for purposes of the required minimum distribution requirements.[259] Once distributions are required to begin (on the required beginning date), payments under the annuity contract will satisfy the required minimum distribution rules if distributions of the employee's entire interest are paid in the form of periodic annuity payments for the employee's life (or the joint lives of the employee and beneficiary) or over a period certain as defined in the regulations.[260]

[258] Treas. Reg. sec. 1.401(a)(9)-6, A-4.

[259] Treas. Reg. sec. 1.401(a)(9)-6, A-12(a).

[260] Treas. Reg. sec. 1.401(a)(9)-6, A-1, -3 and -4. If the annuity contract is purchased after the required beginning date, the first payment must begin on or before the purchase date and the payment required must be made no later than the end of that required period.

All annuity payments (whether paid over an employee's life, joint lives or a period certain) must be nonincreasing, or only increase in accordance with certain exceptions.[261]

There are additional increases permitted for annuity payments under annuity contracts purchased from insurance companies. If the total future payments expected to be made under the annuity contract ("future expected payments") exceed the "total value being annuitized," the payments under the annuity contract will not fail to satisfy the nonincreasing payment requirement merely because the payments (1) are increased by a constant percentage, applied not less frequently than annually; (2) provide for a final payment upon the death of the employee that does not exceed the excess of the total value being annuitized over the total of payments before the death of the employee; (3) are increased as a result of dividend payments or other payments that result from actuarial gains but only if actuarial gain is measured no less frequently than annually and the resulting payments are either paid no later than the year following the year for which the actuarial experience is measured or paid in the same form as the payment of the annuity over the remaining period of the annuity; and (4) are increased for certain accelerations of payment.[262] However, in operation, this actuarial test does not permit certain guarantees in life annuities such as certain guaranteed annual increases, return of premium death benefits and period certain guarantees for participating annuities.

Recently, IRS and Treasury issued proposed regulations relating to required minimum distributions from qualified plans; section 403(b) annuity contracts, custodial accounts, and retirement income accounts; individual retirement accounts and annuities; and eligible deferred compensation plans[263] to address the required minimum distribution requirements[264] and to update the regulations to reflect the amendments made to such distributions by sections 114 and 401 of the SECURE Act.

Like the existing regulations, the proposed regulations generally provide that all payments under a defined benefit plan or annuity contract must be nonincreasing, subject to a number of exceptions. The existing regulations provide a number of exceptions under which payments from annuity contracts purchased from insurance companies may increase, and certain of these exceptions apply only if the total future expected payments under the contract exceed the total value being annuitized. The proposed regulations make a minor modification to the rules to clarify the calculation of the total future expected payments and the total value being annuitized. The proposed regulations also provide three additional exceptions to the

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[261] Treas. Reg. sec. 1.401(a)(9)-6, A-14(a). The exceptions include eligible cost of living increases, increased benefits resulting from a plan amendment, and lump sum distributions made to a beneficiary upon the death of the employee.

[262] Treas. Reg. sec. 1.401(a)(9)-6, A-14(c).

[263] Under section 457.

[264] 87 FR 10504, Feb. 24, 2022 (corrected March 21, 2022). The amendments to Treas. Reg. §§1.401(a)(9)-1 through 1.401(a)(9)-9, are proposed to apply for purposes of determining RMDs for calendar years beginning on or after Jan. 1, 2022. For the 2021 distribution calendar year, taxpayers must apply the existing regulations, but by taking into account a reasonable, good faith interpretation of the amendments made by Sections 114 and 401 of the SECURE Act. Compliance with the proposed regulations satisfy that requirement.

nonincreasing payments requirement for annuities issued by insurance companies that apply without regard to a comparison of the total future expected payments and the total value being annuitized.[265] First, the proposed regulations allow an annuity contract to provide a final payment upon the death of the employee that does not exceed the excess of total value being annuitized over the total of payments before the death of the employee. Second, the proposed regulations allow an annuity contract to offer a short-term acceleration of payments, under which up to one year of annuity payments are paid in advance of when those payments were scheduled to be made. The third exception allows an annuity contract to provide an acceleration of payments that is required to comply with the special rules for certain defined contribution plans.[266]

Description of Proposal

The proposal amends the minimum required distribution rules to permit commercial annuities[267] that are issued in connection with any eligible retirement plan[268] to provide one or more of the following types of payments on or after the annuity starting date:

- Annuity payments that increase by a constant percentage, applied not less frequently than annually, at a rate that is less than five percent per year;
- A lump sum payment that results in a shortening of the payment period with respect to an annuity, or a full or partial commutation of the future annuity payments, provided that such a lump sum is determined using reasonable actuarial methods and assumptions, determined in good faith by the issuer of the contract;
- A lump sum payment that accelerates the receipt of annuity payments that are scheduled to be received within the ensuing 12 months, regardless of whether such acceleration shortens the payment period with respect to the annuity, reduces the dollar amount of benefits to be paid under the contract, or results in a suspension of annuity payments during the period being accelerated;
- Dividends or similar distributions determined in an actuarially reasonable manner; and
- Lump sum return of premium death benefits.

[265] Prop. Treas. Reg. sec. 1.401(a)(9)-6(o)(4).

[266] Under section 401(a)(9)(H).

[267] Within the meaning of section 3405(e)(6)

[268] Within the meaning of section 402(c)(8)(B), other than a defined benefit plan.

Effective Date

The proposal is effective as of the date of enactment.

4. Eliminating a penalty on partial annuitization

Present Law

Required minimum distributions

Background on required minimum distributions under qualified retirement plans may be found in section B.1 of this document. Proposed regulations relating to required minimum distributions from qualified plans were recently issued[269] to update the regulations to reflect the amendments made to such distributions by the SECURE Act.[270]

Annuity distributions

Additional background on annuity distributions from a qualified plan may be found in section B.3 of this document.

For IRAs and defined contribution plans, the required minimum distribution for each year generally is determined by dividing the account balance as of the end of the prior year by the number of years in the distribution period.[271] A plan will not fail to satisfy the minimum required distribution rules merely because distributions are made from an annuity contract which is purchased with the employee's benefit by the plan from an insurance company.[272] Prior to the date that an annuity contract under an individual account plan commences benefits under the contract, the interest of the employee or beneficiary under that contract is treated as an individual account for purposes of the required minimum distribution requirements.[273]

Once distributions are required to begin (on the required beginning date), payments under the annuity contract will satisfy the required minimum distribution rules if distributions of the employee's entire interest are paid in the form of periodic annuity payments for the employee's life (or the joint lives of the employee and beneficiary) or over a period certain as defined in the regulations.[274] However, if a portion of the employee's account balance under a defined

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[269] 87 FR 10504, Feb. 24, 2022 (corrected March 21, 2022). The amendments to Treas. Reg. §§1.401(a)(9)-1 through 1.401(a)(9)-9, are proposed to apply for purposes of determining RMDs for calendar years beginning on or after Jan. 1, 2022.

[270] Sections 114 and 401.

[271] Treas. Reg. sec. 1.401(a)(9)-5.

[272] Treas. Reg. sec. 1.401(a)(9)-6, A-4.

[273] Treas. Reg. sec. 1.401(a)(9)-6, A-12(a).

[274] Treas. Reg. sec. 1.401(a)(9)-6, A-1,-3 and -4. If the annuity contract is purchased after the required beginning date, the first payment must begin on or before the purchase date and the payment required must be made no later the end of that required period.

contribution plan is used to purchase an annuity contract (while another portion stays in the account), the remaining account under the plan must be distributed in accordance with the required minimum distribution rules for defined contribution plans, and the annuity payments under the annuity contract must satisfy the required minimum distribution rules applicable to defined benefit plans and annuity contracts.[275] The proposed regulations generally retain this rule.[276]

Description of Proposal

The proposal directs the Secretary (or delegate) to amend the required minimum distribution rules for defined contribution plans so that partial annuity payments could be taken into account for purposes of satisfying the required distribution rules for those plans.

Under the proposal, if an employee's benefit is in the form of an individual account under a defined contribution plan, the plan may allow the employee to elect to have the required distribution amount from such account for a year be calculated as the excess of the total required amount for such year over the annuity amount for such year. The total required amount means the amount required to be distributed from a defined contribution plan under the rules applicable to such plans for a year determined by treating the account balance as of the last valuation date in the immediately preceding calendar year as including the value on that date of all annuity contracts that were purchased with a portion of the account and from which payments are made under the required distribution rules applicable to annuities. Annuity amount for the year means the total amount distributed in the year from all annuity contracts purchased from the individual account.

The proposal also directs the Secretary to issue conforming amendments for the distribution rules applicable to a tax-sheltered annuity plan ("section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), and an individual retirement arrangement (an "IRA"). Under these amendments, any IRA or section 403(b) plan that an individual holds as the owner, or which an individual holds as a beneficiary of the same, are treated as one plan for purposes of determining the required distribution.

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[275] Treas. Reg. sec. 1.401(a)(9)-8, A-2(a). If a partial annuity is purchased, then the rules require the remaining account balance in the defined contribution plan to satisfy the required minimum distribution rules applicable to defined contribution plans. The annuity payments under the annuity contract must satisfy the rules applicable to defined benefit plans and annuity contracts.

[276] Prop. Treas. Reg. sec. 1.401(a)(9)-5. The proposed regulations specify that if an annuity is purchased that the plan will satisfy the required minimum distribution rules only if, in the year of purchase, distributions from the individual account satisfy the rules applicable to defined contribution plans, and for calendar years following the year of purchase, payments under the annuity contract are made in accordance with the rules applicable to defined benefit plans and annuity contracts. Payments under the annuity contract during the year in which the annuity contract is purchased are treated as distributions from the individual account for purposes of determining whether the distributions from the individual account satisfy the required minimum distribution rules in the calendar year of purchase.

Effective Date

The modifications and amendments required by this proposal will be deemed to have been made (and laws will be applied as if the actions the Secretary is required to take had been taken) as of the date of enactment.

5. Reduction in excise tax on certain accumulations in qualified retirement plans

Present Law

Background on required minimum distributions under qualified retirement plans may be found in B.1 of this document.

The Code imposes an excise tax on an individual if the amount distributed to an individual during a taxable year is less than the required minimum distribution under the plan for that year.[277] The excise tax is equal to 50 percent of the shortfall (that is, 50 percent of the amount by which the required minimum distribution exceeds the actual distribution). However, the Secretary may waive the tax if the individual establishes that the shortfall was due to reasonable error and reasonable steps are being taken to remedy the error.

Description of Proposal

The proposal reduces the excise tax that generally applies to the failure to take required minimum distributions from 50 percent of the shortfall to 25 percent.

In addition, the proposal further reduces the excise tax to 10 percent in the case of an individual who receives a distribution during the correction window of the amount which resulted in the imposition of the excise tax, and who submits a return during the correction period reflecting the excise tax. The correction window is defined as the time period beginning on the date the excise tax is imposed with respect to the shortfall of distributions from a qualified retirement plan or eligible deferred compensation plan (as defined in section 457(b)), and ending on the earliest of (1) the date of mailing a notice of deficiency[278] with respect to the excise tax imposed under this section, (2) the date on which the excise tax imposed under this section is assessed, or (3) the last day of the second taxable year that begins after the end of the taxable year in which the excise tax is imposed.

Effective Date

The proposal applies to taxable years beginning after the date of enactment.

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[277] Sec. 4974.

[278] Pursuant to section 6212.

6. Clarification of substantially equal periodic payment rule

Present Law

Recapture of the early withdrawal tax for substantially equal periodic payments

Distributions from a Qualified Retirement Plan

Additional background on distributions from tax-favored retirement plans may be found in section A.5 of this document.

A distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income unless an exception applies.[279] One exception to the early withdrawal tax is for distributions made as a series of substantially equal periodic payments (not less frequently than annually) that are made for the life or life expectancy of the employee or the joint lives or life expectancies of the employee and their designated beneficiary.[280]

However, if the series of payments is terminated or modified before the end of the 5-year period beginning on the date of the first payment, or before the employee attains age 59 ½, then the entire series of distributions is subject to the 10-percent early withdrawal tax.[281] In that case, the 10-percent early withdrawal tax is imposed for the first taxable year in which the payments were modified and is the same amount as would have been imposed had the exception not applied (plus interest for the deferral period).[282]

Payments are considered to be substantially equal periodic payments for purposes of the exception to the 10-percent early withdrawal tax if they are made in accordance with one of three permissible calculation methods.[283] An individual who begins distributions as a series of substantially equal periodic payments using one method can, in certain circumstances, make a one-time modification to the required minimum distribution method to determine the payment for the year of the change and all subsequent years without triggering the application of the 10-percent early withdrawal tax.[284] However, because all three calculation methods for substantially equal periodic payments are calculated using an account balance as of a specified

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[279] Sec. 72(t). The 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

[280] Sec. 72(t)(2)(A)(iv).

[281] Sec. 72(t)(4) and sec. 72(t)(10). Modification due to death or disability, or by reason of distribution to a qualified public safety employee from a governmental plan is permitted without penalty.

[282] Sec. 72(t)(4)(A)(ii).

[283] Notice 2022-6, 2022-5 I.R.B. 460. The three methods are based on the methods described in Rev. Proc. 2002-62, 2002-42 I.R.B. 710, and include the required minimum distribution method, the fixed amortization method, and the fixed annuitization method.

[284] Notice 2022-6, 2022-5 I.R.B. 460. Once this one-time change in method is made, any further modification will result in application of the 10-percent early withdrawal tax.

valuation date, a modification is considered to have occurred (and the 10-percent early withdrawal tax would then apply) if, after that first valuation date, there is (1) any addition to the account balance other than gains or losses, (2) any transfer of a portion of the account balance to another retirement plan, or (3) a rollover of the amount received by the taxpayer to another account.[285]

Distributions from Annuity Contracts

Similarly, if a taxpayer receives any amount under a non-qualified annuity contract, the taxpayer's income is increased by 10-percent of the amount received which is includible in gross income.[286] There are also exceptions to this 10-percent additional tax, one of which is for a series of substantially equal periodic payments.[287] The rules applying this exception are generally parallel to the rules described above, including the recapture of the 10-percent additional tax if the series of substantially equal periodic payments is subsequently modified.[288] In addition, the same principles described with respect to distributions from a qualified retirement plan apply when determining whether a change in substantially equal periodic payments will be treated as a modification for purposes of the 10-percent additional tax.[289]

Tax-Reporting

Information reporting on distributions from qualified plans and annuity contracts is required from certain persons, such as employers, plan administrators, trustees.[290] Failure to comply with those reporting requirements can result in penalties.[291] These penalties may be waived in certain circumstances, including with respect to any failure due to reasonable cause and not willful neglect.[292]

Description of Proposal

If a series of equal periodic payments are being made from a qualified retirement plan then, under the proposal, the transfer or a rollover from such qualified retirement plan of all or a portion of the taxpayer's benefit under the plan that is made to a subsequent qualified plan is not considered a modification for purposes of the 10-percent early withdrawal tax provided that the transfer or rollover results in distributions that satisfy the series of substantially equal period payment exception. Compliance with this exception is determined based on the combined

[285] Notice 2022-6, 2022-5 I.R.B. 460.

[286] Sec. 72(q)(1).

[287] Sec. 72(q)(2)(D).

[288] Sec. 72(q)(3).

[289] Notice 2022-6, 2022-5 I.R.B. 460.

[290] Secs. 408(i); 6047(d).

[291] Secs. 6721; 6722.

[292] Sec. 6724.

distributions from both plans as if the payments had been made only from the transferor plan. Qualified retirement plan for this purpose includes section 403(b) plans and IRAs. Similar relief is available following the tax-free exchange of all or a portion of a non-qualified annuity contract for another contract.

The proposal also adds a safe harbor for annuity payments specifying that periodic payments do not fail to be treated as substantially equal for purposes of the exception to the 10-percent early withdrawal tax merely because they are amounts received as an annuity. Such payments are deemed substantially equal if they are payable over the time periods set forth in the exception to the 10-percent early withdrawal tax for substantially equal periodic payments and satisfy the required minimum distribution requirements applicable to annuity payments.

The proposal also provides relief from the penalties associated with the applicable reporting requirements for distributions by permitting reliance on a certification from the taxpayer that the transfer or rollover meets the requirements needed for purposes of the exception to the 10-percent additional tax, absent knowledge to the contrary.

Effective Date

The amendments made by this proposal will apply to transfers, rollovers, exchanges, and distributions (as applicable) occurring on or after the date of enactment.

7. Recovery of retirement plan overpayments

Present Law

Employee Plans Compliance Resolution System

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the qualification requirements under the Code.[293] Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements under the Code applicable to section 403(b) plans. Failure to satisfy all of the applicable requirements may disqualify a plan or annuity for the intended tax-favored treatment.

The IRS has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the applicable requirements under the Code.[294] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for

[293] Sec. 401(a).

[294] The requirements under sections 401(a), 403(a), or 403(b), as applicable. Rev. Proc. 2021-30, 2021-30, I.R.B. 2021-31.

compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a three-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

SCP, VCP and Audit CAP are not available to correct failures relating to the diversion or misuses of plan assets.[295] With respect to the SCP program, in the event that the plan or the plan sponsor has been a party to an abusive tax avoidance transaction, SCP is not available to correct any operational failure that is directly or indirectly related to the abusive tax avoidance transaction.[296]

SEP and SIMPLE Plans

SCP and VCP[297] under EPCRS are available to a SEP or SIMPLE plan.[298] SCP is only available to such a plan to correct insignificant operational failures,[299] and only if the SEP or SIMPLE plan is established and maintained on a document approved by the IRS.

[295] Sec. 4.11 of Rev. Proc. 2021-30.

[296] Sec. 4.12 of Rev. Proc. 2021-30.

[297] Sec. 6.11 of Rev. Proc. 2021-30.

[298] Secs. 1.01 and 1.02 of Rev. Proc. 2021-30. A SEP is a plan intended to satisfy the requirements of Code section 408(k); a SIMPLE plan is a plan intended to satisfy the requirements of Code section 408(p). Secs. 5.06 and 5.07 of Rev. Proc. 2021-30.

[299] Sec. 4.01(c) of Rev. Proc. 2021-30.

Section 457(b) plans

EPCRS does not apply to section 457(b) plans. However, the IRS will accept submissions relating to section 457(b) plans on a provisional basis outside of EPCRS through standards that are similar to those that apply to VCP filings.[300]

Recoupment of overpayments

An overpayment is defined as a qualification failure due to a payment being made to a participant or beneficiary that exceeds the amount payable to such individual under the terms of the plan or that exceeds a limitation provided in the Code or regulations.[301] Overpayments include both payments from a defined benefit plan and from a defined contribution plan (either not made from the individual's account under the plan or not permitted to be paid under the Code, the regulations, or the terms of the plan).

Overpayments from defined benefit plans

In general, subject to certain conditions, an overpayment from a defined benefit plan may be corrected by adopting a retroactive amendment to conform to the plan's operation, by the return of overpayment correction method, the adjustment of future payments correction method, the funding exception correction method, or the contribution correction method.[302] Depending on the nature of the overpayment, other appropriate correction methods may be used Any other correction method used must satisfy the EPCRS correction principles and other requirements set forth in the EPCRS guidance.[303]

Under the funding exception correction method, corrective payments are not required for certain underfunded defined benefit plans which are subject to certain benefit limitations[304], provided that the plan's certified or presumed adjusted funding target attainment percentage ("AFTAP") that is applicable to the plan at the date of correction is equal to at least 100 percent (or, in the case of a multiemployer plan, the plan's most recent annual funding certification indicates that the plan is not in critical, critical and declining, or endangered status,[305] determined at the date of correction). Future benefit payments to an overpayment recipient must be reduced to the correct benefit payment amount. No further corrective payments from an overpayment recipient or any other party are required or permitted and no further reductions to future benefit

[300] Sec. 4.09 of Rev. Proc. 2021-30.

[301] Sec. 5.01(3)(c) and 5.02(4) of Rev. Proc. 2021-30.

[302] Sec. 6.06(3) and sec. 2.05 of Appendix B of Rev. Proc. 2021-30. The funding exception correction method and the contribution credit correction method were added to EPCRS by Rev. Proc. 2021-30.

[303] Sec. 6.02 of Rev. Proc. 2021-30.

[304] Under sec. 436.

[305] As defined in sec. 432.

payments to an overpayment recipient, or any spouse or beneficiary of an overpayment recipient, are permitted.

Under the contribution credit correction method, the amount of overpayments required to be repaid to the plan is the amount of the overpayments reduced (but not below zero) by: (1) the cumulative increase in the plan's minimum funding requirements attributable to the overpayments (including the increase attributable to the overstatement of liabilities, whether funded through cash contributions or through the use of a funding standard carryover balance, prefunding balance, or funding standard account credit balance), beginning with (1) the plan year for which the overpayments are taken into account for funding purposes, through (2) the end of the plan year preceding the plan year for which the corrected benefit payment amount is taken into account for funding purposes; and (B) certain additional contributions in excess of minimum funding requirements paid to the plan after the first of the overpayments was made. This reduction is referred to as a "contribution credit." Future benefit payments to an overpayment recipient must be reduced to the correct benefit payment amount. For purposes of EPCRS, if the amount of the overpayments is reduced to zero after the contribution credit is applied, no further corrective payments from any party are required, no further reductions to future benefit payments to an overpayment recipient, or any spouse or beneficiary of an overpayment recipient, are permitted, and no further corrective payments from an overpayment recipient, or any spouse or beneficiary of an overpayment recipient, are permitted. However, if a net overpayment remains after the application of the contribution credit, the plan sponsor or another party must take further action to reimburse the plan for the remainder of the overpayment.

Overpayments from defined contribution plans

An overpayment from a defined contribution plan or section 403(b) plan is generally corrected by plan amendment to conform the plan to the plan's operation, subject to the requirements of EPCRS.[306] If the overpayment is not corrected by plan amendment, the plan sponsor may correct the overpayment in accordance with the return of overpayment correction method.[307] Depending on the nature of the overpayment, other appropriate correction methods may be used. An appropriate correction method may include using rules similar to those described in the EPCRS guidance, but having the employer or another person contribute the amount of the overpayment (with the appropriate interest) to the plan instead of seeking recoupment from an overpayment recipient. Any other correction method used must satisfy the correction principles[308] and any other applicable EPCRS rules.

[306] See secs. 6.06(4) and 2.04 of Appendix B of Rev. Proc. 2021-30.

[307] Sec. 6.06(4)(c) of Rev. Proc. 2021-30.

[308] As set forth in sec. 6.02 of Rev. Proc. 2021-30.

Description of Proposal[309]

Under the proposal, a plan will not fail to be treated as a qualified plan, section 403(a) annuity, section 403(b) tax sheltered annuity or a governmental plan[310] (and will not fail to be treated as satisfying the requirements of section 401 or 403) merely because (1) the plan fails to obtain payment from any participant, beneficiary, employer, plan sponsor, fiduciary, or other party on account of any inadvertent benefit overpayment made by the plan, or (2) the plan sponsor amends the plan to increase past or future benefit payments to affected participants and beneficiaries in order to adjust for prior inadvertent benefit overpayments. Notwithstanding the foregoing, the plan may instead reduce future benefit payments to the correct amount provided for under the terms of the plan or seek recovery from the person or persons responsible for the overpayment. If an employer decides not to recover an overpayment, nothing in this proposal relieves that employer of any obligation imposed upon it to make contributions to a plan to satisfy the minimum funding requirements[311] or to prevent or restore an impermissible forfeiture.[312] In addition, the plan must observe any salary, compensation or benefit limitations imposed upon it,[313] and may enforce such limitations using any method approved by the Secretary for recouping benefits previously paid or allocations previously made in excess of such limitations.

The Secretary may issue regulations or other guidance of general applicability specifying how benefit overpayments and their recoupment or non-recoupment from a participant or beneficiary are to be taken into account for purposes of satisfying any requirement applicable to such a plan.

Rollovers

In the case of an inadvertent benefit overpayment from a plan which is transferred to an eligible retirement plan by or on behalf of a participant or beneficiary, (1) the portion of the overpayment with respect to which recoupment is not sought on behalf of the plan will be treated as having been paid in an eligible rollover distribution if the payment would have been an eligible rollover distribution but for being an overpayment, and (2) the portion of such overpayment with respect to which recoupment is sought on behalf of the plan will be permitted to be returned to the plan, and in such case, will be treated as an eligible rollover distribution transferred to such plan by the participant or beneficiary who received the overpayment (and the plans making and receiving such transfer will be treated as permitting such transfer).

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[309] Modifications to Labor provisions are necessary to effectuate this proposal.

[310] Under section 219(g)(5)(A)(i), (ii), (iii) or (iv).

[311] Under sections 412 and 430.

[312] In accordance with section 411.

[313] Secs. 401(a)(17) and 415.

Effective Date

The proposal applies to plan years beginning after date of enactment.

Plans, fiduciaries, employers, and plan sponsors are entitled to rely on a good faith interpretation of then existing administrative guidance for inadvertent benefit overpayment recoupments and recoveries that commenced before the first day of the first plan year beginning after date of enactment.

8. Retirement Savings Lost and Found

Present Law

Pension Benefit Guaranty Corporation Missing Participants Program

When a defined benefit pension plan (maintained by a single employer and subject to the plan termination insurance program under Title IV of ERISA) terminates under a standard termination, the plan administrator generally must purchase annuity contracts from a private insurer to provide the benefits to which participants are entitled and distribute the annuity contracts to the participants.

If the plan administrator of a terminating single employer plan cannot locate a participant after a diligent search (has a "missing participant"), the plan administrator may satisfy the distribution requirement only by purchasing an annuity from an insurer or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"). The PBGC holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.[314]

Pursuant to the Pension Protection Act of 2006,[315] the PBGC prescribed rules for terminating multiemployer plans similar to the missing participant rules applicable to terminating single employer plans subject to Title IV of ERISA. In addition, plan administrators of certain types of plans not otherwise subject to the PBGC termination insurance program are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the prescribed rules extend the missing participants program (in accordance with regulations) to defined contribution plans,[316] defined benefit pension plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit pension plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

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[314] Sec. 4041(b)(3)(A); sec. 4050 of ERISA.

[315] Pub. L. No. 109-280, August 17, 2006.

[316] The Missing Participants program for Defined Contribution plans covers common types of defined contribution pension plans; specifically section 401(k) plans, profit sharing plans, money purchase plans, target benefit plans, employee stock ownership plans, stock bonus plans, and section 403(b)(7) plans subject to Title I of ERISA. Some examples of plans not covered are governmental plans, church plans, and plans that cannot pay benefits to PBGC in cash. See 29 C.F.R. sec. 4050.201.

On December 22, 2017, PBGC established the PBGC Defined Contribution Missing Participants Program ("Missing Participants Program") to hold retirement benefits for missing participants and beneficiaries in most terminated defined contribution plans and to help those participants and beneficiaries find and receive those benefits.[317]

Department of Labor

A fiduciary safe harbor[318] may apply with respect to distributions from terminated individual account plans[319] and abandoned plans[320] on behalf of participants and beneficiaries who fail to make an election regarding a form of benefit distribution, including "missing participants." The safe harbor generally requires that distributions be rolled over to an individual retirement account or annuity (IRA), although in limited circumstances fiduciaries may make distributions to certain bank accounts or to a state unclaimed property fund. If the conditions of the safe harbor are met, a fiduciary (including a Qualified Termination Administrator ("QTA") in the case of an abandoned plan) is deemed to have satisfied the requirements of section 404(a) of ERISA with respect to distributing benefits, selecting a transferee entity, and investing funds in connection with the distribution.

The DOL consulted with the PBGC during the PBGC's development of its Missing Participants Program. As noted in the preamble to the final rule adopting the Missing Participants Program, the DOL may revise its fiduciary safe harbor regulation so that transfers to the PBGC by terminating individual account plans would be eligible for relief under the safe harbor.

On January 12, 2021, the DOL issued Field Assistance Bulletin 2021-01[321] in which it announced that pending further guidance, the DOL will not pursue fiduciary violations against either responsible plan fiduciaries of terminating defined contribution plans or QTAs of abandoned plans[322] in connection with the transfer of a missing or non-responsive participant's or beneficiary's account balance to the PBGC in accordance with the PBGC's missing participant regulations (rather than to an IRA, certain bank accounts, or to a state unclaimed property fund),[323] if the plan fiduciary or QTA complies with the guidance in the Bulletin and has acted in accordance with a good faith, reasonable interpretation of the fiduciary rules under ERISA[324] with respect to matters not specifically addressed in the guidance.

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[317] 29 C.F.R. sec. 4050.201-207.1.

[318] 29 C.F.R. sec. 2550.404a–3.

[319] Sec. 3(34) of ERISA.

[320] As described in 29 C.F.R. sec. 2578.1

[321] Field Assistance Bulletin 2021-01 can be found at: https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2021-01.

[322] As described in 29 C.F.R. sec. 2578.1.

[323] As specified in 29 C.F.R. sec. 2550.404a-3.

[324] Sec. 404 of ERISA.

Mandatory rollovers

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan. Before making a distribution that is eligible for rollover, a plan administrator must provide the participant with a written explanation of the ability to have the distribution rolled over directly to an IRA or another qualified plan and the related tax consequences.

A direct rollover is the default option for involuntary distributions that exceed $1,000 and that are eligible rollover distributions from qualified retirement plans. The distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly. The written explanation provided by the plan administrator is required to explain that an automatic direct rollover will be made unless the participant elects otherwise. The plan administrator is also required to notify the participant in writing (as part of the general written explanation or separately) that the distribution may be transferred without cost to another IRA.

Under the fiduciary rules of ERISA, in the case of an automatic direct rollover, the participant is treated as exercising control over the assets in the IRA upon the earlier of: (1) the rollover of any portion of the assets to another IRA, or (2) one year after the automatic rollover.

Lost and Found

Under present law, there is not a "Lost and Found" database to collect information on benefits owed to missing, lost or non-responsive participants and beneficiaries in tax-qualified retirement plans (other than terminated plans) and to assist such plan participants and beneficiaries in locating those benefits.

Description of Proposal[325]

Establishment of the Lost and Found

Under the proposal, not later than three years after the date of enactment, the Secretary, in consultation with the Secretary of Labor, the Secretary of Commerce, and the Director of the PBGC, will establish an online searchable database to be managed by the Department of

[325] Because this proposal also impacts parallel labor provisions, references to those labor provisions would need to be revised before this proposal could take effect.

Treasury ("Treasury"),[326] to be known as the Retirement Savings Lost and Found (the "Lost and Found"), containing information on plans, subject to the vesting standards under ERISA,[327] as well as certain additional information related to the location of certain unclaimed vested benefits of missing, lost and non-responsive participants and beneficiaries in such plans.[328] The Lost and Found database will contain information: (1) provided by plan administrators that are required to periodically report to the Office of the Lost and Found each plan year; (2) provided by plan administrators that transfer certain small benefits of non-responsive participants and beneficiaries to the Lost and Found; and (3) other relevant information obtained by Treasury.

The collection of this information in the Lost and Found will allow Treasury to assist participants and beneficiaries by providing contact information[329] on record for the plan administrator of any plan in which the participant or beneficiary may have an unclaimed benefit sufficient to allow that participant or beneficiary to locate the individual's plan in order to recover any benefit owing to that individual under the plan. With respect to those plans which have transferred such benefits to Treasury, Treasury will also be able to pay those benefits to such participants and beneficiaries. Because Treasury would be provided additional and updated information from plan administrators through reporting requirements, the Treasury will also be able to make any necessary changes to the database reflecting updates to contact information on record for the plan administrator based on any changes to such plans including those arising from mergers or consolidations of the plan with any other plan, division of the plan into two or more plans, bankruptcy, termination, change in name of the plan, change in name or address of the plan administrator, transfers of such accounts to IRAs, purchase of annuities, or other causes.

Safeguarding Participant Privacy and Security

In establishing the Lost and Found, Treasury, in consultation with the Secretary of Labor, the Secretary of Commerce, and the Director of the PBGC must take all necessary and proper precautions to ensure that individuals' plan information maintained by the Lost and Found is protected and that persons other than the individual cannot fraudulently claim the benefits to which any individual is entitled, and to allow any individual to opt out of inclusion in the Lost and Found at the election of the individual.

Treasury is also provided regulatory authority to provide guidance:

- To authorize Treasury to disclose to the agencies jointly administering the database such return information as is necessary to administer the Lost and Found database but

[326] The Office of the Retirement Savings Lost and Found (the "Office of the Lost and Found") will be established within the Department of Treasury to maintain the Retirement Savings Lost and Found.

[327] Sec. 411.

[328] Tax-qualified defined benefit and defined contribution plans (as set forth in 29 C.F.R. sec. 4050.201) that are subject to the vesting standards contained in Code section 411.

[329] Such individuals will be provided only with the ability to view contact information for the plan administrator of any plan with respect to which the individual is or was a participant or beneficiary.

only to such employees whose official duties with respect to the database require such disclosure, and

- To authorize Treasury to disclose to plan participants and beneficiaries the contact information for the plan administrator of any plan with respect to which the individual is or was a participant or beneficiary.

Establishment and responsibilities of the Office of the Retirement Savings Lost and Found

Not later than two years after the date of the enactment of this Act, the Secretary must establish, within Treasury, an Office of the Retirement Savings Lost and Found ("Office of the Lost and Found").

The "Office of the Lost and Found" will (1) maintain the Lost and Found database; (2) facilitate the transfer of small benefits of non-responsive participants and beneficiaries[330] to the Office of the Lost and Found by (a) collecting information, applicable fees, and benefits related to such individuals from the applicable plan; and (b) investing such benefits; (3) searching for and paying out benefits to those participants and beneficiaries for whom benefits have been transferred to the Office of the Lost and Found; and (4) performing an annual audit of plan information contained in the Lost and Found and ensuring that such information is current and accurate.

Required transfer of small benefits of certain non-responsive participants by plans to the Office of the Lost and Found

Under the proposal, the administrator of a plan that is not terminated[331] must transfer a non-responsive participant's[332] benefit to the Office of the Lost and Found[333] if the nonforfeitable accrued benefit[334] is no greater than $1,000.

Upon making a transfer to the Office of the Lost and Found of small benefits of non-responsive participants, the plan administrator must provide such information and certifications as the Office of the Lost and Found specifies including with respect to the transferred amount of the benefit and the identification of the non-responsive participant. In the event that, after such a transfer, the relevant non-responsive participant contacts the plan administrator or the plan administrator discovers information that may assist the Office of the Lost and Found in locating

[330] In defined benefit and defined contribution plans subject to the vesting requirements of Code section 411.

[331] And to which section 401(a)(31)(B) of the Code applies.

[332] For this proposal, a non-responsive participant means a participant or beneficiary of a plan who is entitled to a benefit subject to a mandatory transfer under section 401(a)(31)(B)(iii) and for whom the plan has satisfied the conditions in section 401(a)(31)(B)(iv).

[333] Under sec. 401(a)(31)(B).

[334] Under sec. 401(a)(31)(B).

the non-responsive participant, the plan administrator must notify and provide such information to the Office of the Lost and Found as such Office specifies.

A transfer of such benefits to the Office of the Lost and Found under this proposal will be treated as a transfer to an individual retirement plan. Such benefits will be held in a fund[335] established for the payment of such benefits which fund will also be credited with earnings on investments in the fund or on assets credited to the fund. Whenever Treasury determines that the moneys of any fund are in excess of current needs, it may request the investment of such amounts as it determines advisable by the Secretary in obligations issued or guaranteed by the United States.

Following a transfer of such benefits to the Office of the Lost and Found, the Office of the Lost and Found will periodically, and upon receiving information from the plan administrator as described above, conduct a search for the non-responsive participant for whom the Office of the Lost and Found has received a transfer. Upon location of such a non-responsive participant who claims benefits, the Office of the Lost and Found will pay the non-responsive participant the amount transferred to it in a single sum (plus an amount reflecting the return on the investment attributable to such amount). Treasury has the regulatory authority to prescribe regulations as are necessary to carry out the transfer of small benefits including rules relating to the amount payable to the Office of the Lost and Found by the plan administrator and the amount to be paid to the non-responsive participant or beneficiary by the Office of the Lost and Found when that individual is located.

Annual reporting requirements

Under the proposal, within such period after the end of each plan year beginning after the second December 31 occurring after the date of enactment, as the Office of the Lost and Found may prescribe, the plan administrator of a plan to which the vesting standards of ERISA apply[336] will submit the following information, and such other information as the Office of the Lost and Found may require:[337]

- The name of the plan;
- The name and address of the plan administrator;
- Any change in the name of the plan;
- Any change in the name or address of the plan administrator;
- The name and taxpayer identifying number of each participant or former participant in the plan:

[335] For amounts transferred to the Lost and Found.

[336] Sec. 411.

[337] Because this reporting begins approximately two years after the date of enactment, unless the Office of the Lost and Found prescribes otherwise, this information will only be provided to the Office of the Lost and Found prospectively.

- Who, during the current plan year or any previous plan year, was reported to IRS[338] as a separated participant with a deferred vested benefit that had not been paid as of the end of the previous plan year, and with respect to whom such benefit was fully paid during the plan year;
- With respect to whom any amount was distributed as a mandatory distribution during the plan year; or
- With respect to whom a deferred annuity contract was distributed during the plan year;

- The termination of the plan;
- The merger or consolidation of the plan with any other plan or its division into two or more plans;
- In the case of a participant or former participant whose benefit was distributed as a mandatory distribution during the plan year, the name and address of the designated trustee or issuer and the account number of the individual retirement plan to which the amount was distributed; and
- In the case of a participant or former participant to whom a deferred annuity contract was distributed during the plan year, the name and address of the issuer of such annuity contract and the contract or certificate number.

Guidance

The Office of the Lost and Found will prescribe such regulations as are necessary to carry out the purposes of this proposal, including rules relating to the amount payable to the Office of the Lost and Found and the amount to be paid by the Office of the Lost and Found.

Mandatory Transfers of Rollover Distributions and Coordination with Distribution Requirements

Expansion of cap

The proposal increases the cap on mandatory distributions from $5,000 to $6,000.[339]

Distribution of larger amounts only to IRAs, not to the Office of the Lost and Found

Under the proposal, the Office of the Lost and Found is not treated as a trustee eligible to receive mandatory distributions[340] that are in excess of $1,000 but not in excess of $6,000. In other words, Treasury may only accept transfers of nonforfeitable accrued benefits in the amount of $1,000 or less.

[338] Under sec. 6057.

[339] Under section 401(a)(31)(B)(ii)(I).

[340] Sec. 401(a)(31)(B).

Mandatory distributions of lesser amounts for non-responsive individuals to the Office of the Lost and Found

Under the proposal, in the case of a plan that provides for mandatory distributions of amounts of $6,000 or less, the trust of such plan will not be considered a qualified trust under the Code unless the plan provides that, if a participant in the plan separates from the service covered by the plan and the participant's nonforfeitable accrued benefit is not in excess of $1,000, the plan administrator must (either separately or as part of the written notice to recipients of distributions eligible for rollover treatment) either (1) notify the participant that the participant is entitled to such benefit, or (2) attempt to pay the benefit directly to the participant.

If, after a plan administrator either notifies the participant of the entitlement to the benefit or attempts to pay the benefit directly to the participant, the participant does not:

- Within six months of the notification either make an election to have the distribution paid directly to a specified eligible retirement plan[341] or elect to receive a distribution of the benefit directly, or
- Accept any direct payment made within six months of the attempted payment (in other words, does not cash the check),
- Then the plan administrator must transfer the amount of such benefit to the Office of the Lost and Found.

A transfer of such a distribution to the Office of the Lost and Found is treated as a transfer to an individual retirement plan, and the distribution of such amounts by the Office of the Lost and Found to a non-responsive participant who is subsequently located will be treated as a distribution from an individual retirement account.

Reporting for mandatory transfers

The proposal modifies the reporting requirements by plan administrators with respect to plans that are subject to the Code vesting standards,[342] which include tax qualified defined benefit and defined contribution plans, as follows:

- By providing that plan administrators must report[343] the name and taxpayer identification number of each participant in the plan who, during the plan year immediately preceding such plan year separated from the service covered by the plan.
- By requiring that the following information must also be included:
  - The name and taxpayer identifying number of each participant or former participant in the plan:

[341] Sec. 402(c)(8)(B), except that a qualified trust is considered an eligible retirement plan only if it is a defined contribution plan that accepts rollovers.

[342] Sec.411.

[343] Pursuant to sec. 6057.

- Who, during the current plan year or any previous plan year, was reported to IRS[344] as a separated participant with a deferred vested benefit that had not been paid as of the end of the previous plan year, and with respect to whom such benefit was fully paid during the plan year;
- With respect to whom any amount was distributed as a mandatory distribution during the plan year; or
- With respect to whom a deferred annuity contract was distributed during the plan year;

- In the case of a participant or former participant whose benefit was distributed as a mandatory distribution during the plan year, the name and address of the designated trustee or issuer and the account number of the individual retirement plan to which the amount was distributed; and
- In the case of a participant or former participant to whom a deferred annuity contract was distributed during the plan year, the name and address of the issuer of such annuity contract and the contract or certificate number.

Rules relating to direct trustee-to trustee transfers

Under the proposal, additional reporting is required with respect to direct trustee-to-trustee transfers as follows:

- Notification of the Trustee: In the case of a mandatory distribution under the Code,[345] the plan administrator must notify the designated trustee of the account or issuer, or the plan administrator will be subject to a penalty equal to $100 for each such failure, up to a maximum for all such failures during any calendar year not to exceed $50,000, unless it is shown that the failure was due to reasonable cause and not to willful neglect.[346]
- The reports required to be made to the Secretary by the trustee of an IRA or the issuer of an endowment contract[347] are modified to require, in the case of an IRA account, endowment contract or IRA annuity to which a mandatory transfer[348] is made (including a transfer from the individual retirement plan to which the original transfer was made to another individual retirement plan), for the year of the transfer and any year in which the information previously reported changes that such report:

  1. Identify the transfer as a required mandatory distribution; and

[344] Under sec. 6057.

[345] Pursuant to section 401(a)(31)(B).

[346] Sec. 6652(i).

[347] Sec. 408(i).

[348] Under section 401(a)(31)(B.

2. Include the name, address, and taxpayer identifying number of the trustee or issuer of the individual retirement plan to which the amount is transferred.

There is also a similar rule for Savings Incentive Match Plan for Employees ("SIMPLE") plans where the benefit is transferred from a SIMPLE plan to another individual retirement plan. The report required for the year of the transfer and any year in which the information previously reported is changed must: (1) identify the transfer as a required mandatory distribution; and (2) include the name, address, and taxpayer identifying number of the trustee or issuer of the individual retirement plan to which the amount is transferred.

Notification of participant upon separation of service

The individual registration statement that needs to be provided to each separated participant[349] by the plan administrator must include a notice of availability of, and the contact information for, the Office of the Lost and Found.

Requirement of electronic filing

Under the proposal, reports required with respect to separated participants from retirement plans,[350] information required with respect to certain plans of deferred compensation,[351] and periodic reports of actuaries,[352] as well as certain reports with respect to IRAs, (including endowment contracts),[353] information returns at source,[354] and information reports relating to certain trust and annuity plans,[355] (to the extent each such return or report relates to the tax treatment of a distribution from a plan, account, contract, or annuity) must be filed on magnetic media, but only with respect to persons who are required to file at least 50 returns during the calendar year which includes the first day of the plan year to which such returns or reports relate.

Effective Date

The effective date of the proposal is generally on the date of enactment.

The proposals related to the transfer of small benefits to the Office of the Lost and Found for certain non-responsive participants and the submission of information by plan administrators

[349] Pursuant to section 6057(e).

[350] Sec. 6057.

[351] Sec. 6058.

[352] Sec. 6059.

[353] Pursuant to section 408(i).

[354] Sec. 6047.

[355] Sec. 6041.

to the Office of the Lost and Found are effective with respect to plan years beginning after the second December 31 occurring after the date of the enactment.

The proposals related to changes to the mandatory distribution rules are applicable to vested benefits with respect to participants who separate from service connected to the plan in plan years beginning after the second December 31 occurring after the date of enactment.

The proposals related to modified reporting requirements under the Code and to filing certain reports electronically are applicable to returns and reports relating to years beginning after the second December 31 occurring after the date of enactment.

9. Roth plan distribution rules

Present Law

Qualified Roth contribution programs

An applicable retirement plan[356] may include a qualified Roth contribution program that permits a participant to elect to have all or a portion of the participant's elective deferrals[357] under the plan treated as designated Roth contributions.[358] Designated Roth contributions are elective deferrals that the participant designates as not excludable from the participant's gross income.[359] The plan is required to establish a separate account (a designated Roth account), and maintain separate recordkeeping, for a participant's designated Roth contributions (and earnings allocable thereto).[360]

A qualified distribution from a participant's designated Roth account generally is not includible in the participant's gross income.[361]

Roth IRA distributions

[356] As defined in section 402A(e)(1).

[357] As defined in section 402A(e)(2).

[358] Sec. 402A(a).

[359] Sec. 402A(c). The amount of elective deferrals an employee may so designate is limited (sec. 402A(c)(2)).

[360] Sec. 402A(b)(2).

[361] Sec. 402A(d). Qualified distributions are defined in section 402A(d)(2). In general, qualified distributions do not include distributions made within a five-year nonexclusion period and do not include distributions of certain excess deferrals or excess contributions, or income thereon. Rules are provided for the treatment of excess designated Roth contributions (sec. 402A(d)(3)) and rollovers (secs. 402A(c)(3) and (4)).

There are two basic types of IRAs. In the case of traditional IRAs,[362] contributions in excess of the deductible amount are not permitted,[363] and distributions are includible in the gross income of the payee or distributee.[364]

In the case of Roth IRAs, only nondeductible (after-tax) contributions may be made.[365] For a Roth IRA, if certain requirements are satisfied, distributions are not includible in gross income.[366]

Exceptions to certain distribution requirements for Roth IRAs

Distributions from a participant's designated Roth account under a qualified Roth contribution program are subject to pre-death minimum distribution rules as well as incidental death benefit requirements.

However, under an exception, the pre-death minimum distribution rules that generally apply to IRAs,[367] do not apply to Roth IRAs. In addition, the incidental death benefit rules do not apply to Roth IRAs.[368]

Description of Proposal

The proposal adds an exception in the case of a designated Roth account. Under the exception, the pre-death minimum distribution rules[369] and the incidental death benefit requirements[370] do not apply to a designated Roth account under a qualified Roth contribution program.

Effective Date

The provision is effective generally for taxable years beginning after December 31, 2023.

However, under a transition rule, the provision does not apply to distributions which are required with respect to years beginning before January 1, 2024, but are permitted to be paid on or after such date.

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[362] Sec. 408.

[363] Sec. 219.

[364] Sec. 408(d).

[365] Sec. 408A.

[366] Sec. 408A(d).

[367] Secs. 408(a)(6) and (b)(3).

[368] Secs. 408A(c)(4) and 401(a).

[369] Secs. 401(a)(9)(A).

[370] Sec. 401(a).

10. One-time election for qualified charitable distribution to split-interest entity; increase in qualified charitable distribution limitation

Present Law

In general

If an amount withdrawn from a traditional individual retirement arrangement ("IRA") or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to the following entities: (1) a charity described in section 170(c)(2); (2) certain veterans' organizations, fraternal societies, and cemetery companies;[371] and (3) a Federal, State, or local governmental entity, but only if the contribution is made for exclusively public purposes.[372] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[373]

A taxpayer who takes the standard deduction (*i.e.*, who does not itemize deductions) generally may not take a separate deduction for charitable contributions.[374]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service provided) to the taxpayer in consideration for the contribution.[375] In

[371] Secs. 170(c)(3)-(5).

[372] Sec. 170(c)(1).

[373] Secs. 170(b) and (e).

[374] Sec. 170(a).

[375] Sec. 170(f)(8). For any contribution of a cash, check, or other monetary gift, no deduction is allowed unless the donor maintains as a record of such contribution a bank record or written communication from the donee

addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[376]

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations generally may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to most private nonoperating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base. For taxable years beginning after December 31, 2017, and before January 1, 2026, the 50-percent limit is increased to 60 percent for contributions of cash.[377]

Contributions by individuals in excess of the applicable limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (*e.g.*, a remainder) while also either retaining an interest in that property (*e.g.*, an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[378] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder trusts (discussed below), pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[379] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

Charitable remainder trusts and charitable gift annuities

Both charitable remainder trusts and charitable gift annuities are arrangements under which a taxpayer contributes assets to charity (directly or through a trust) but retains an interest.

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charity showing the name of the donee organization, the date of the contribution, and the amount of the contribution. Sec. 170(f)(17).

[376] Sec. 6115.

[377] Sec. 170(b)(1)(G).

[378] Secs. 170(f), 2055(e)(2), and 2522(c)(2).

[379] Sec. 170(f)(2).

As part of these arrangements, a stream of payments is guaranteed to one or more noncharitable beneficiaries (possibly including the taxpayer) over a period of time, with the remaining interest passing to charity. The taxpayer generally claims a charitable deduction for the portion of the transfer attributable to the charitable interest.

Charitable remainder trusts

A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a noncharity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a noncharity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity.[380]

A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is less than five percent or greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the present value of the remainder interest in the trust (determined at the time of the transfer to the trust under section 7520) is at least 10 percent of the value of the assets contributed to the trust.

Distributions from a charitable remainder annuity trust or charitable remainder unitrust are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income (*e.g.*, tax-exempt income) to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus.[381]

In general, distributions to the extent they are characterized as income are includible in the income of the beneficiary for the year that the annuity or unitrust amount is required to be distributed even though the annuity or unitrust amount is not distributed until after the close of the trust's taxable year.[382]

Charitable gift annuities

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[380] Sec. 664(d). Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax for a tax year unless the trust has any unrelated business taxable income for the year (including certain debt financed income). A charitable remainder trust that loses its exemption from income tax for a taxable year is taxed as a complex trust. As such, the trust is allowed a deduction in computing taxable income for amounts required to be distributed in a taxable year, not to exceed the amount of the trust's distributable net income for the year. Taxes imposed on the trust are required to be allocated to corpus. Treas. Reg. sec. 1.664-1(d)(2).

[381] Sec. 664(b).

[382] Treas. Reg. sec. 1.664-1(d)(4).

A charitable gift annuity is similar in concept to a charitable remainder annuity trust, except that, under a contract between the taxpayer and a charity, the assets are transferred to the charity (not to a separate trust) in exchange for the charity's promise to make fixed annuity payments for life to the donor or to the donor and one other person.

Charitable gift annuities are not treated as commercial-type insurance for purposes of section 501(m), under which an organization is not described in section 501(c)(3) if a substantial part of its activities consists of providing commercial-type insurance.[383]

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Certain individuals also may make nondeductible contributions to a Roth IRA (deductible contributions cannot be made to a Roth IRA). Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59½ are subject to an additional 10-percent early withdrawal tax unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 72.[384]

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and the value of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[385] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth

[383] Sec. 501(m)(3)(E) and (5).

[384] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

[385] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[386] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

Qualified charitable distributions

Otherwise-taxable IRA distributions from a traditional or Roth IRA are excluded from gross income to the extent they are qualified charitable distributions.[387] The exclusion may not exceed $100,000 per taxpayer per taxable year.

An individual who receives a deduction for a contribution to a traditional IRA for years ending on or after age 70½ is not eligible to exclude such amount from income as a qualified charitable distribution. Thus, the amount of qualified charitable distributions otherwise excludable from an individual's gross income for a taxable year is reduced (but not below zero) by the excess of (i) the aggregate amount of deductions allowed to the taxpayer for contributions to a traditional IRA for taxable years ending on or after the individual attains age 70½, over (ii) the aggregate amount of reductions for all taxable years preceding the current year.

Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. A qualified charitable distribution is taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (generally, public charities) other than a supporting organization (as described in section 509(a)(3)) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½ and only to the extent the distribution would be includible in gross income (without regard to this provision).

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the

[386] Sec. 3405.

[387] Sec. 408(d)(8). The exclusion does not apply to distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the qualified charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

Description of Proposal

First, the proposal indexes the annual $100,000 exclusion limit for inflation for taxable years beginning after 2023.

Second, the proposal allows a taxpayer to elect for a taxable year to treat certain distributions from an IRA to a split-interest entity as if the contributions were made directly to a qualifying charity for purposes of the exclusion from gross income for qualified charitable distributions. Such an election may not have been in effect for a preceding taxable year; thus, the election may be made for only one taxable year during the taxpayer's lifetime. The aggregate amount of distributions of the taxpayer with respect to the election may not exceed $50,000 (indexed for inflation for taxable years beginning after 2023).

A split-interest entity means: (1) a charitable remainder annuity trust (as defined in section 664(d)(1)); (2) a charitable remainder unitrust (as defined in section 664(d)(2)); or (3) a charitable gift annuity (as defined in section 501(m)). In each case, the trust or arrangement must be funded exclusively by qualified charitable distributions. In the case of a charitable gift annuity, fixed payments of five percent or greater must commence not later than one year from the date of funding.

In the case of a distribution from an IRA to a charitable remainder annuity trust or charitable remainder unitrust, the distribution qualifies for the one-time election only if a charitable deduction for the entire value of the charitable remainder interest would be allowable under section 170 (determined without regard to this provision or the charitable deduction percentage limits under section 170(b)). In the case of a distribution to a charitable gift annuity, the distribution qualifies for the one-time election only if a charitable deduction in an amount equal to the amount of the distribution reduced by the value of the annuity[388] would be allowable

[388] The annuity must be described in section 501(m)(5)(B), which provides that the annuity is described in section 514(c)(5), determined as if the amount paid in cash for the issuance of the annuity were property. Section

under section 170 (determined without regard to this provision or the charitable deduction percentage limits under section 170(b)).

In addition, a distribution from an IRA to a split-interest entity qualifies for the one-time election only if: (1) no person holds an income interest in the split-interest entity other than the individual for whose benefit such account is maintained, the spouse of such individual, or both; and (2) the income interest in the split-interest entity is nonassignable.

In the case of a charitable remainder annuity trust or a charitable remainder unitrust that is funded by qualified charitable distributions, distributions are treated as ordinary income in the hands of a beneficiary to whom an annuity or unitrust payment is made. A qualified charitable distribution made to fund a charitable gift annuity is not treated as an investment in the contract for purposes of section 72(c).

Effective Date

The proposal is effective for distributions made in taxable years beginning after the date of enactment.

11. Exception to penalty on early distributions from qualified plans for individuals with a terminal illness

Present Law

Distributions from tax-favored retirement plans

Background on distributions from tax-favored retirement plans may be found in section A.5 of this document.

Description of Proposal

Under the proposal, an exception to the 10-percent early withdrawal tax applies in the case of a distribution made to an employee who is a terminally ill individual on or after the date on which such employee has been certified by a physician as having a terminal illness. For purposes of this proposal, terminally ill individual means an individual who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death in 84 months or less after the date of the certification.[389] An employee will not be

514(c)(5), in turn, describes when an obligation to pay an annuity is not treated as "acquisition indebtedness" for purposes of the section 514 debt-financed income rules. Under that section, the obligation to pay the annuity: (1) generally must be the sole consideration issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90 percent of the value of the property received in exchange; (2) is payable over the life of one individual or the lives of two individuals in being at such time; and (3) does not guarantee a minimum amount of payments or specify a maximum amount of payments and does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or any other property. Sec. 514(c)(5).

[389] This definition has the same meaning given such term under sec. 101(g)(4)(A) (pertaining to the treatment of certain accelerated death benefits) except that "84 months" is substituted for "24 months."

considered terminally ill unless sufficient evidence is provided in a form and manner to be determined by the Secretary.

Effective Date

The proposal is effective for distributions made after the date of enactment.

12. Surviving spouse election to be treated as employee

Present Law

General background on the requirements related to required minimum distributions may be found in section B.1 of this document.

Description of Proposal

In the case of an employee who dies before the distribution of required minimum distributions has begun under the plan, and who has designated a spouse as sole beneficiary, the proposal permits the spouse to elect to be treated as the employee for purposes of determining the distribution period. The proposal further directs the Secretary to amend the regulations to provide that the distribution period for the spouse in such case is determined using the Uniform Life Table.[390] Thus, the proposal allows a designated beneficiary who is a spouse to receive a similar distribution period for lifetime distributions under an employer-sponsored retirement plan as is permitted under present law in an IRA.

The proposal also permits the spouse to elect whether to apply the present-law rule that treats the spouse as the employee for purposes of determining the distribution period in cases where the spouse dies before distributions have begun.

The proposal provides for the elections to be made in such time and manner as prescribed by the Secretary. The election must include a timely notice to the plan administrator, and once made it may not be revoked except with the consent of the Secretary.

Effective Date

The proposal is effective for calendar years beginning after December 31, 2023.

13. Long-term care contracts purchased with retirement plan distributions

Present Law

Background on the distribution rules that apply to retirement plans, including the 10-percent early withdrawal tax, may be found in section A.14 of this document.

[390] Treas. Reg. sec. 1.401(a)(9)-5, Q&A 5(a), or any successor regulation.

Qualified long-term care insurance contracts

Tax-favored treatment applies to premiums and benefits under a qualified long-term care insurance contract.[391] The contract is treated as an accident and health insurance contract; thus, amounts received under the contract generally are excludable from income as amounts received for personal injuries or sickness.[392]

An employer-sponsored health plan that provides employees with coverage under a qualified long-term care insurance contract generally is treated in the same manner as employer-provided health benefits. As a result, the employer's premium payments are generally excluded from income and wages,[393] and benefits payable under the contract generally are excludable from the recipient's income. Long-term care insurance expenses of a self-employed individual are deductible under the self-employed health insurance deduction.

In addition, premiums paid for a qualified long-term care insurance contract and unreimbursed expenses for qualified long-term care services are treated as medical expenses for purposes of the itemized deduction for medical care.[394]

A qualified long-term care insurance contract is defined as any insurance contract that provides only coverage for qualified long-term care services and that meets additional requirements.[395] Per diem-type and reimbursement-type contracts are permitted. Qualified long-term care services are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services that are required by a chronically ill individual and that are provided pursuant to a plan of care prescribed by a licensed health care practitioner.[396]

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[391] Sec. 7702B(a).

[392] In the case of per diem contracts, the excludable amount is subject to a per-day dollar cap. If payments under such contracts exceed the dollar cap, then the excess is excludable only to the extent of actual costs in excess of the dollar cap that are incurred for long-term care services.

[393] However, section 106(c) provides that gross income of an employee includes employer-provided coverage of qualified long-term care services to the extent such coverage is provided through a flexible spending or similar arrangement. Thus, the exclusion does not apply to qualified long-term care insurance provided under a cafeteria plan..

[394] Under section 213(d)(10), premiums paid for long-term care coverage are deductible only to the extent that the premiums do not exceed a dollar cap measured by the insured's age at the end of the taxable year.

[395] Sec. 7702B(b). For example, the contract is not permitted to provide for a cash surrender value or other money that can be paid, assigned or pledged as collateral for a loan, or borrowed (and any premium refunds must be applied as a reduction in future premiums or to increase future benefits).

[396] Sec. 7702B(c)(1). A chronically ill individual is generally one who has been certified within the previous 12 months by a licensed health care practitioner as being unable to perform (without substantial assistance) at least two activities of daily living (ADLs) for at least 90 days due to a loss of functional capacity (or meeting other definitional requirements). Sec. 7702B(c)(2).

Description of Proposal

Qualified long-term care distributions

The proposal provides that a defined contribution plan may allow qualified long-term care distributions. Qualified long-term care distributions are those distributions made during a taxable year that do not exceed the lesser of $2,500,[397] or the amount (generally, premiums) paid by the plan participant during the taxable year for certain insurance coverage. This insurance coverage is (1) a qualified long-term care insurance contract[398] covering qualified long-term care services,[399] and (2) coverage of the risk that an insured individual would become a chronically ill individual.[400] This insurance coverage must be for the participant or the participant's spouse (or other family member of the participant as provided by the Secretary by regulation). The amounts paid can include premiums paid and charges assessed during the taxable year for such coverage that is treated as a separate contract that is a qualified long-term care insurance contract[401] (or treated as a separate contract that is not a qualified long-term care insurance contract provided that certain consumer protection requirements[402] are satisfied).

Qualified long-term care distributions are generally includible in income. However, the proposal provides an exemption for such distributions from the 10-percent early withdrawal tax provided that applicable requirements are met. If the individual covered by the long-term care coverage to which the distribution relates is the spouse of the participant in the plan, this exclusion from the early withdrawal tax applies only if the participant and the participant's spouse file a joint return. A qualified long-term care distribution is not subject to mandatory withholding.[403]

In addition, only a policy that provides for high quality coverage is eligible for early distribution and waiver of the 10-percent additional tax. High quality in this context describes a policy that provides meaningful financial assistance in the event that an insured needs home-based assistance or nursing home care. High quality coverage includes key consumer protections, such as indexing benefits for inflation and protections in the event that coverage is terminated.

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[397] The $2,500 amount is indexed by the cost-of-living adjustment in section 1(f)(3) for taxable years beginning after December 31, 2024.

[398] Defined in section 7702B(b).

[399] Defined in section 7702B(c).

[400] This is a chronically ill individual within the meaning of section 101(g)(4)(B)), under a rider or other provision of a life insurance contract which satisfies the requirements of section 101(g)(3) (determined without regard to subparagraph (D) thereof).

[401] See section 7702B(e)(1), and the definition of a qualified long-term care insurance contract in section 7702B(b).

[402] Requirements under section 7702B(g).

[403] Sec. 3405.

Reporting requirements

For a distribution to be a qualified long-term care distribution, the participant must file a long-term care premium statement provided by the issuer of long-term care coverage with the plan. This statement must provide specified information, including the name and TIN of the issuer, identification of the plan participant purchasing the insurance coverage, the amount of premiums owed, certain other statutorily-specified information, and such other information as is required in guidance.

Reporting rules apply to the issuer of a qualified long-term care insurance contract (including a rider or other provision that is treated as a long-term care insurance contract) or of coverage of the risk that an insured individual would become a chronically ill individual, if the issuer is required to provide a long-term care premium statement to any purchaser in connection with a qualified long-term care distribution. The issuer is required to report specified information to the IRS, including the name and TIN of the issuer, the name of the purchaser of the insurance coverage, the amount of premiums paid for the coverage during the calendar year, certain other statutorily specified information, and such other information as is required in guidance. In addition, the issuer must furnish a statement to persons with respect to whom information is required to be reported.

Before an issuer may provide a long-term care premium statement, the issuer must have filed a disclosure application with Treasury, containing information with respect to the long-term care insurance product as required by statute and in guidance.

Information for consumers

The proposal also directs Treasury to maintain a website that lists information about long-term care insurance products for which a disclosure application has been filed pursuant to this proposal. The website must also disclose information regarding consumer protections applicable to the listed products, and information about each specific product that would assist consumers in choosing a product.

Effective Date

The proposal is effective for distributions after three years after the date of enactment.

C. Public Safety Officers and Military

1. Military spouse retirement plan eligibility credit for small employers

Present Law

Present law does not currently provide a credit specifically with respect to a military spouse who is eligible to participate during the taxable year in a defined contribution plan of a small employer.

Description of Proposal

The proposal allows an eligible small employer to take a new nonrefundable income tax credit with respect to each individual who is married to a member of the uniformed services and self-certifies as such (referred to as a military spouse), who is an employee of the employer, who is eligible to participate in an eligible defined contribution plan of the employer during the taxable year, and who is a non-highly compensated employee.[404] The credit is determined to be the sum of $200 for each such employee plus the amount of the contributions made to all eligible defined contribution plans by the employer with respect to the employee up to a maximum of $300 for the taxable year for each such employee. The credit applies for up to three consecutive years beginning with the first taxable year in which the individual begins participating in the plan.

An eligible small employer is an employer that, for the preceding year, had no more than 100 employees, each with compensation of $5,000 or more. Members of controlled groups and affiliated service groups are treated as a single employer for purposes of these requirements.[405]

An eligible defined contribution plan is a plan in which military spouses are eligible to participate within two months of beginning employment, and in which military spouses who are eligible to participate (1) are immediately eligible to receive employer contributions in amounts not less than that received by similarly situated nonmilitary spouses with two years of service, and (2) have an immediate, nonforfeitable right to the accrued benefits derived from employer contributions under the plan.

Effective Date

The proposal applies to taxable years beginning after the date of enactment.

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[404] A non-highly compensated employee is an employee who is not a highly compensated employee as defined under section 414(q).

[405] Sec. 52(a) or (b) and 414(m) or (o).

2. Distributions to firefighters

Present Law

Distributions from tax-favored retirement plans

A distribution from a qualified retirement plan,[406] a tax-sheltered annuity plan (a "section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), or an IRA generally is included in income for the year distributed.[407] These plans are referred to collectively as "eligible retirement plans." In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[408]

Qualified public safety employees in governmental plans

An exception to the early withdrawal tax applies if a distribution is made to an employee after separation from service after attainment of age 55.[409] Under a special rule for distributions to qualified public safety employees in a governmental plan,[410] this exception applies to distributions made after separation from service after attainment of age 50 ("age 50 exception").[411] For this purpose, a qualified public safety employee means (1) any employee of a State or a political subdivision of a State who provides police protection, firefighting services, or emergency medical services for any area within the State or political subdivision's jurisdiction; or (2) any Federal law enforcement officer,[412] any Federal customs and border protection officer,[413] any Federal firefighter,[414] any Federal employee who is an air traffic controller[415] or nuclear materials courier,[416] any member of the United States Capitol Police, any

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[406] Qualified under section 401(a).

[407] Secs. 401(a), 403(a), 403(b), 457(b), and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

[408] Sec. 72(t). Under present law, the 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

[409] Sec. 72(t)(2)(A)(v).

[410] As defined in section 414(d).

[411] Sec. 72(t)(10).

[412] As defined in 5 U.S.C. secs. 8331(20) or 8401(17).

[413] As defined in 5 U.S.C. secs. 8331(31) or 8401(36).

[414] As defined in 5 U.S.C. secs. 8331(21) or 8401(14).

[415] As defined in 5 U.S.C. secs. 8331(30) or 8401(35).

[416] As defined in 5 U.S.C. secs. 8331(27) or 8401(33).

member of the Supreme Court Police, or any diplomatic security special agent of the Department of State.

Description of Proposal

The proposal amends the age 50 exception for qualified public safety employees in governmental plans so that the exception also apples to distributions from a qualified retirement plan or section 403(b) plan[417] to an employee who provides firefighting services. Thus, the proposal expands the age 50 exception to also apply to private-sector firefighters receiving distributions from a qualified retirement plan or section 403(b) plan.

Effective Date

The proposal is effective for distributions made after the date of enactment.

3. Exclusion of certain disability-related first responder retirement payments

Present Law

Qualified retirement plans (and other tax-favored employer-sponsored retirement plans) are accorded special tax treatment and fall into two categories: defined benefit plans and defined contribution plans. A defined contribution plan is a type of qualified retirement plan whereby contributions, earnings, and losses are allocated to a separate account for each participant. Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pre-tax (that is, contributions are either excluded from income or deductible) or after-tax contributions by employees.

Disability-related payments

Amounts received under worker's compensation acts as compensation for personal injuries or sickness ("disability payments") generally are excluded from the gross income of the recipients.[418] The exclusion from gross income includes compensation for personal injuries or sickness received under a statute in the nature of a worker's compensation act, and also extends such exclusion to survivors of the affected worker. However, these exclusions generally do not apply to amounts received as a retirement pension or annuity (including retirement disability payments) to the extent that the amounts are determined by reference to the employee's age, length of service, or prior contributions. Such retirement payments, which may be distributed from a section 401(a) qualified retirement plan, a section 403(a) or (b) tax-sheltered annuity plan, or an eligible deferred compensation plan of a State or local government employer under section 457(b) ("retirement distributions"), generally are included in income for the year distributed.

[417] The proposal applies to a distribution from a qualified retirement plan, an annuity plan described in section 403(a), or an annuity contract described in section 403(b). Sec. 402(c)(8)(B)(iii), (iv), and (vi).

[418] Sec. 104(a)(1).

Description of Proposal

The proposal provides an exclusion from gross income for certain disability-related retirement distributions paid to qualified first responders. An individual's gross income does not include qualified first responder retirement payments for any taxable year to the extent such payments do not exceed an annualized excludable disability amount. A qualified first responder retirement payment that is excluded from gross income is an amount received as a retirement pension or annuity that would otherwise be includible in gross income, is received in connection with the individual's qualified first responder service, and is paid from a qualified trust, annuity plan, governmental deferred compensation plan under section 457(b), or a section 403(b) plan.[419] Also, for this purpose, qualified first responder service means services performed as a law enforcement officer, firefighter, paramedic, or emergency medical technician. The proposal does not limit the exclusion from gross income to individuals who provide such services in a public capacity or to individuals who address only emergency situations.

The portion of the retirement distributions which is exempted from gross income is the "annualized excludable disability amount." This is based on the determination of the excludable amount of disability payments ("service-connected excludable disability amount") that the individual received during the 12-month period before the individual attained retirement age. A service-connected excludable disability amount means periodic payments which are not includible in the individual's gross income because they are amounts received under workmen's compensation acts as compensation for personal injuries or sickness,[420] are received in connection with the individual's qualified first responder service, and terminate when the individual attains retirement age.

The proposal also provides that for an individual who only receives service-connected excludable disability amounts for a portion of the year, the annualized excludable disability amount is determined by multiplying the service-connected excludable disability amounts by the ratio of 365 to the number of days in such period to which amounts were properly attributable.

Unlike worker's compensation payments, the exclusion under the provision that is applicable to eligible first responders does not extend to surviving spouses or other survivors once the eligible individual is deceased.

Effective Date

The proposal is effective for amounts received with respect to taxable years beginning after December 31, 2027.

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[419] These plans are described in clauses (iii), (iv), (v), and (vi) of section 402(c)(8)(B), respectively.

[420] Sec. 104(a)(1).

4. Repeal of direct payment requirement on exclusion from gross income of distributions from governmental plans for health and long-term care insurance

Present Law

Under present law, a distribution from a qualified retirement plan is generally includible in income.[421] Under an exception to this general rule, certain pension distributions from an eligible retirement plan used to pay for qualified health insurance premiums are excludible from income, up to a maximum exclusion of $3,000 annually. An eligible retirement plan includes a governmental qualified retirement or annuity plan, 403(b) annuity, or 457 plan. The exclusion applies with respect to eligible retired public safety officers who make an election to have qualified health insurance premiums deducted from amounts distributed from an eligible retirement plan and paid directly to the insurer. An eligible retired public safety officer is an individual who, by reason of disability or attainment of normal retirement age, is separated from service as a public safety officer[422] with the employer who maintains the eligible retirement plan from which pension distributions are made.

Qualified health insurance premiums include premiums for accident or health insurance or qualified long-term care insurance contracts covering the taxpayer, the taxpayer's spouse, and the taxpayer's dependents. The qualified health insurance premiums do not have to be for a plan sponsored by the employer; however, the exclusion does not apply to premiums paid by the employee and reimbursed with pension distributions. Amounts excluded from income under the provision are not taken into account in determining the itemized deduction for medical expenses under section 213 or the deduction for health insurance of self-employed individuals under section 162.

The exclusion applies to a distribution only if payment of the premiums is made directly to the provider of the accident or health plan or qualified long-term care insurance contract by deduction from a distribution from the eligible retirement plan. For this purpose, all eligible retirement plans of an employer are treated as a single plan.[423]

Description of Proposal

The proposal provides that the exclusion for distributions used to pay for qualified health insurance premiums applies to a distribution without regard to whether payment of the premiums is made directly to the provider of the accident or health plan or qualified long-term care insurance contract by deduction from a distribution from the eligible retirement plan, or is made to the employee.

The proposal requires reporting in the case of a payment made to the employee. The employee is required to include with the tax return of tax for the taxable year of the distribution

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[421] Secs. 402(a), 403(a), 403(b), 408(d), and 457(a).

[422] The term "public safety officer" has the same meaning as under section 1204(9)(A) of the Omnibus Crime Control and Safe Streets Act of 1986.

[423] Sec. 402(l)(5).

an attestation that the distribution does not exceed the amount paid by the employee for qualified health insurance premiums for that taxable year.

Effective Date

The proposal applies to distributions made after the date of enactment.

5. Modification of eligible age for exemption from early withdrawal penalty

Present Law

Background on the early withdrawal tax and the rules that apply to qualified public safety employees may be found in section C.2 of this document.

Description of Proposal

The proposal modifies the exception for distributions made to a qualified public safety employee after separation from service after age 50 to also apply if the employee separates after 25 years of service under the plan. Thus, a distribution from a governmental plan that is made to a qualified public safety employee after separation from service after attainment of age 50 or 25 years of service under the plan (whichever is earlier) is exempt from the early withdrawal tax.

Effective Date

The proposal is effective for distributions made after the date of enactment.

6. Exemption from early withdrawal penalty for certain State and local government corrections employees

Present Law

Background on the early withdrawal tax and the rules that apply to qualified public safety employees may be found in section C.2 of this document.

For purposes of an exception to the early withdrawal tax, a qualified public safety employee means (1) any employee of a State or a political subdivision of a State who provides police protection, firefighting services, or emergency medical services for any area within the State or political subdivision's jurisdiction; or (2) any Federal law enforcement officer,[424] any Federal customs and border protection officer,[425] any Federal firefighter,[426] any Federal

[424] As defined in 5 U.S.C. secs. 8331(20) or 8401(17).

[425] As defined in 5 U.S.C. secs. 8331(31) or 8401(36).

[426] As defined in 5 U.S.C. secs. 8331(21) or 8401(14).

employee who is an air traffic controller[427] or nuclear materials courier,[428] any member of the United States Capitol Police, any member of the Supreme Court Police, or any diplomatic security special agent of the Department of State.

A Federal law enforcement officer means an employee, the duties of whose position are primarily the investigation, apprehension, or detention of individuals suspected or convicted of offenses against the criminal laws of the United States, including an employee engaged in this activity who is transferred to a supervisory or administrative position. "Detention" for this purpose includes the duties of (1) employees of the Bureau of Prisons and Federal Prison Industries, Incorporated; (2) employees of the Public Health Service assigned to the field service of the Bureau of Prisons or of the Federal Prison Industries, Incorporated; (3) employees in the field service at Army or Navy disciplinary barracks or at confinement and rehabilitation facilities operated by any of the armed forces; and (4) employees of the Department of Corrections of the District of Columbia, its industries and utilities; whose duties in connection with individuals in detention suspected or convicted of offenses against the criminal laws of the United States or of the District of Columbia or offenses against the punitive articles of the Uniformed Code of Military Justice require frequent direct contact with these individuals in their detention, direction, supervision, inspection, training, employment, care, transportation, or rehabilitation.

Description of Proposal

The proposal modifies the definition of qualified public safety employee to also include any employee of a State or political subdivision of a State who provides services as a corrections officer or as a forensic security employee providing for the care, custody, and control of forensic patients. Thus, a distribution from a governmental plan that is made to such a corrections officer or forensic security employee after separation from service after attainment of age 50 is exempt from the early withdrawal tax.

Effective Date

The proposal is effective for distributions made after the date of enactment.

[427] As defined in 5 U.S.C. secs. 8331(30) or 8401(35).

[428] As defined in 5 U.S.C. secs. 8331(27) or 8401(33).

D. Nonprofits and Educators

1. Enhancement of 403(b) plans

Present Law

Tax-sheltered annuities ("section 403(b) plans")

Section 403(b) plans are a form of tax-favored employer-sponsored plan that provides tax benefits similar to qualified retirement plans. Section 403(b) plans may be maintained only by (1) charitable tax-exempt organizations, and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities). Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans.

Contributions to 403(b) plans

Employers may make nonelective or matching contributions to such plans on behalf of their employees, and the plan may provide for employees to make pre-tax elective deferrals, designated Roth contributions (held in designated Roth accounts)[429] or other after-tax contributions.

Annuity contracts

Generally, section 403(b) plans provide for contributions toward the purchase of annuity contracts. The employee's rights under the annuity contract are nonforfeitable, except for a failure to pay future premiums.[430] Amounts contributed by an employer for an annuity contract are excluded from the gross income of the employee for the taxable year if certain requirements are satisfied.

Section 403(b) Custodial Accounts

Alternatively, such contributions may be held in custodial accounts established for each employee if those accounts satisfy certain requirements.

Contributions to a section 403(b) plan that are held in a custodial account are treated as contributions to an annuity contract[431] if the assets are (1) held by a bank[432] or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which the assets will be

[429] Sec. 402A.

[430] Sec. 403(b)(1)(C).

[431] Sec. 403(b)(7).

[432] A "bank" is defined as any bank as defined in section 581, an insured credit union within the meaning of section 101, paragraph (6) or (7) of the Federal Credit Union Act, and a corporation which, under the laws of the State of its incorporation, is subject to supervision and examination by the Commissioner of Banking or other officer of such State in charge of the administration of the banking laws of such State. Sec. 408(n).

held is consistent with the requirements for a qualified retirement plan[433] and (2) invested only in regulated investment company stock.[434]

In addition, assets of a section 403(b) custodial account cannot be commingled in a group trust with any assets other than those of a regulated investment company.[435] Contributions to a custodial account are not permitted to be distributed before the employee dies, attains age 59½, has a severance from employment, becomes disabled,[436] or, in the case of elective deferrals, encounters financial hardship; or, with respect to lifetime income options, the date that is 90 days prior to the date such lifetime income investment no longer is held as an investment option and is distributed in the form of a qualified distribution.[437] Finally, a custodial account must contain a written statement that the assets held in a custodial account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants and their beneficiaries.[438]

Group trust

Under the Code, a trust created or organized in the United States and forming a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of its employees or their beneficiaries constitutes a qualified trust if it provides that:

- Contributions made to the trust by the applicable employer or employers, or both, are used for the purpose of distributing the corpus and income of the trust, in accordance with the terms of the plan, to such employees or their beneficiaries;[439]
- A trust described in section 401(a) is exempt from income tax;[440] and
- Under each trust instrument, it must be impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the plan and trust, for any part of the corpus or income of the trust to be used for or diverted to purposes other than for the exclusive benefit of the employees or their beneficiaries.

[433] Sec. 401(f)(2) and Treas. Reg. sec. 1.401(f)-1. A custodial account that satisfies the requirements of section 401(f)(2) is treated as an organization described in section 401(a) solely for purposes of subchapter F of chapter 1 of Subtitle A (secs. 501-530) and subtitle F (pertaining to procedure and administration) with respect to amounts received by the account and with respect to any income from the investment of those amounts.

[434] Sec. 403(b)(7) and Treas. Reg. sec. 1.403(b)-8(d)(2)(i).

[435] Treas. Reg. sec. 1.403(b)-8(d)(2)(ii).

[436] Within the meaning of section 72(m)(7).

[437] In accordance with section 401(a)(38).

[438] Treas. Reg. sec. 1.403(b)-8(d)(2)(iii).

[439] Sec. 401(a)(1).

[440] Sec. 501(a).

A group trust is an arrangement under which individual retirement plan trusts pool their assets in a group trust (usually created for the purpose of providing diversification of investments), where the trust is declared to be part of each participating retirement plan and the trust instruments creating both the participating and group trusts provide that amounts are transferred from one trust to the other at the direction of the trustee of the participating trust.[441]

The tax status of the group trust is derived from the tax status of the entities participating in the group trust to the extent of the entities' equitable interests in such trust if the following requirements are satisfied:

- The group trust is itself adopted as a part of each adopting group trust retiree benefit plan;
- The group trust instrument expressly limits participation to pension, profit-sharing, and stock bonus trusts or custodial accounts qualifying under section 401(a) that are exempt under section 501(a); individual retirement accounts that are exempt under section 408(e); eligible governmental plan trusts or custodial accounts under section 457(b) that are exempt under section 457(g); custodial accounts under section 403(b)(7); retirement income accounts under section 403(b)(9); and section 401(a)(24) governmental plans;
- The group trust instrument expressly prohibits any part of its corpus or income that equitably belongs to any adopting group trust retiree benefit plan from being used for, or diverted to, any purpose other than for the exclusive benefit of the participants and beneficiaries of the group trust retiree benefit plan;
- Each group trust retiree benefit plan that adopts the group trust is itself a trust, a custodial account, or a similar entity that is tax-exempt under section 408(e) or section 501(a) (or is treated as exempt under section 501(a));
- Each group trust retiree benefit plan that adopts the group trust expressly provides in its governing document that it is impossible for any part of the corpus or income of the group trust retiree benefit plan to be used for, or diverted to, purposes other than for the exclusive benefit of the plan participants and their beneficiaries;
- The group trust instrument expressly limits the assets that may be held by the group trust to assets that are contributed by, or transferred from, a group trust retiree benefit plan to the group trust (and the earnings thereon), and the group trust instrument expressly provides for separate accounting to reflect the interest that each adopting group trust retiree benefit plan has in the group trust, including separate accounting for contributions to the group trust from the adopting plan, disbursements made from the adopting plan's account in the group trust, and investment experience of the group trust allocable to that account;

[441] See Rev. Rul. 81-100, 1981-1 C.B. 326, as modified by Rev. Rul. 2004-67, 2004-2 C.B. 28; Rev. Rul. 2008-40, 2008-2 C.B. 166; Rev. Rul. 2011-1, 2011-2 I.R.B. 251 which was modified by Notice 2012-6, 2012-3 I.R.B. 293, January 17, 2012; and Rev. Rul. 2014-24, 2014-37 I.R.B. 529.

- The group trust instrument expressly prohibits an assignment by an adopting group trust retiree benefit plan of any part of its equity or interest in the group trust; and
- The group trust is created or organized in the United States and is maintained at all times as a domestic trust in the United States.

With respect to section 403(b)(7) custodial accounts, under IRS guidance, such an account fails to satisfy the requirements for a group trust if the assets of the account are invested other than in the stock of a regulated investment company, and any group trust in which the assets of a section 403(b)(7) custodial account is invested must comply with this restriction.[442] As a result of this investment restriction, the assets of a custodial account under section 403(b)(7) generally will be commingled in a group trust that solely contains the assets of other section 403(b)(7) custodial accounts.

Description of Proposal[443]

The proposal provides that contributions to a section 403(b) plan that are held in a custodial account are treated as contributions to an annuity contract if the assets are to be held in that custodial account and invested in regulated investment company stock or a group trust intended to satisfy the requirements of current or future IRS guidance.[444]

Effective Date

The proposal is applicable to amounts invested after the date of enactment.

2. Hardship withdrawal rules for 403(b) plans

Present Law

Background on rules related to hardship distributions under a section 403(b) plan may be found in section A.13 of this document.

Description of Proposal

The proposal conforms the hardship distribution rules for section 403(b) plans to those of section 401(k) plans. Thus, the proposal provides that in addition to elective deferrals, a section 403(b) plan may distribute, on account of an employee's hardship, qualified nonelective contributions,[445] qualified matching contributions,[446] and earnings on any of these contributions (including on elective deferrals). In addition, the proposal provides that a distribution does not

[442] Rev. Rul. 2011-1, 2011-2 I.R.B. 251.

[443] In order to permit 403(b) plans to participate in a group trust, certain revisions to the securities laws will be required.

[444] See footnote 13 and the description of the guidance in the Present Law section of this proposal.

[445] As defined in section 401(m)(4)(C).

[446] As defined in section 401(k)(3)(D)(ii)(I).

fail to qualify as a hardship distribution solely because the employee does not take any available loan under the plan.

Effective Date

The proposal is effective for plan years beginning after the date of enactment.

3. Multiple employer 403(b) plans

Present Law

Retirement savings under the Code and ERISA

The Code provides tax-favored treatment for various types of retirement plans, including employer-sponsored plans and IRAs. Code provisions are generally within the jurisdiction of the Secretary, through his or her delegate, the IRS.

The most common type of tax-favored employer-sponsored retirement plan is a qualified retirement plan,[447] which may be a defined contribution plan or a defined benefit plan. Under a defined contribution plan, separate individual accounts are maintained for participants, to which accumulated contributions, earnings, and losses are allocated, and participants' benefits are based on the value of their accounts.[448] Defined contribution plans commonly allow participants to direct the investment of their accounts, usually by choosing among investment options offered under the plan. Under a defined benefit plan, benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts.[449] Besides qualified retirement plans, certain tax-exempt employers and public schools may maintain tax-deferred annuity plans.[450]

An IRA is generally established by the individual for whom the IRA is maintained.[451] However, in some cases, an employer may establish IRAs on behalf of employees and provide

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[447] Sec. 401(a). A qualified annuity plan under section 403(a) is similar to and subject to requirements similar to those applicable to qualified retirement plans.

[448] Sec. 414(i). Defined contribution plans generally provide for contributions by employers and may include a qualified cash or deferred arrangement under a section 401(k) plan, under which employees may elect to contribute to the plan.

[449] Sec. 414(j).

[450] Sec. 403(b). Private and governmental employers that are exempt from tax under section 501(c)(3), including tax-exempt private schools, may maintain tax-deferred annuity plans (discussed further below). State and local governmental employers may maintain another type of tax-favored retirement plan, an eligible deferred compensation plan under section 457(b).

[451] Sections 219, 408 and 408A provide rules for IRAs. Under section 408(a)(2) and (n), only certain entities are permitted to be the trustee of an IRA. The trustee of an IRA generally must be a bank, an insured credit union, or a corporation subject to supervision and examination by the Commissioner of Banking or other officer in charge of the administration of the banking laws of the State in which it is incorporated. Alternatively, an IRA trustee may be another person who demonstrates to the satisfaction of the Secretary that the manner in which the person will administer the IRA will be consistent with the IRA requirements.

retirement contributions to the IRAs.[452] In addition, IRA treatment may apply to accounts maintained for employees under a trust created by an employer (or an employee association) for the exclusive benefit of employees or their beneficiaries, provided that the trust complies with the relevant IRA requirements and separate accounting is maintained for the interest of each employee or beneficiary (referred to herein as an "IRA trust").[453] In that case, the assets of the trust may be held in a common fund for the account of all individuals who have an interest in the trust.

Tax-sheltered annuities ("section 403(b) plans")

Section 403(b) plans are a form of tax-favored employer-sponsored plan that provide tax benefits similar to qualified retirement plans. Section 403(b) plans may be maintained only by (1) charitable tax-exempt organizations, and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities).

Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans. Section 403(b) plans are generally subject to the minimum coverage and nondiscrimination rules that apply to qualified defined contribution plans. However, as in the case of a qualified retirement plan, a governmental section 403(b) plan is not subject to the nondiscrimination rules.

Contributions to section 403(b) plans

Employers may make nonelective or matching contributions to such plans on behalf of their employees, and the plan may provide for employees to make pre-tax elective deferrals, designated Roth contributions (held in designated Roth accounts)[454] or other after-tax contributions.

Annuity contracts

Generally, section 403(b) plans provide for contributions toward the purchase of annuity contracts for providing retirement benefits for their employees. The employee's rights under the annuity contract are nonforfeitable, except for a failure to pay future premiums.[455] Section 403(b) generally provides that amounts contributed by an employer for an annuity contract are excluded from the gross income of the employee for the taxable year if certain requirements are satisfied.

[452] Simplified employee pension ("SEP") plans under section 408(k) and SIMPLE IRA plans under section 408(p) are employer-sponsored retirement plans funded using IRAs for employees.

[453] Sec. 408(c).

[454] Sec. 402A.

[455] Sec. 403(b)(1)(C).

403(b) Custodial Accounts

Alternatively, such contributions may be held in custodial accounts established for each employee if those accounts satisfy certain requirements.

Contributions to a section 403(b) plan that are held in a custodial account are treated as contributions to an annuity contract[456] if the assets (1) are held by a bank[457] or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which the assets will be held is consistent with the requirements for a qualified retirement plan[458] and (2) are invested only in regulated investment company stock.[459]

Retirement Income Accounts

Assets of a section 403(b) plan generally must be invested in annuity contracts or mutual funds.[460] However, the restrictions on investments do not apply to a retirement income account, which is a type of 403(b) plan that is a defined contribution program established or maintained by a church, or a convention or association of churches, to provide benefits under the plan to employees of a religious, charitable or similar tax-exempt organization.[461]

Certain rules prohibiting discrimination in favor of highly compensated employees, which apply to section 403(b) plans generally, do not apply to a plan maintained by a church or qualified church-controlled organization.[462] For this purpose, church means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches, and includes a qualified church-controlled organization. A qualified church-controlled organization is any church-controlled tax-exempt organization other than an organization that (1) offers

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[456] Sec. 403(b)(7).

[457] A "bank" is defined as any bank as defined in section 581, an insured credit union within the meaning of section 101, paragraph (6) or (7) of the Federal Credit Union Act, and a corporation which, under the laws of the State of its incorporation, is subject to supervision and examination by the Commissioner of Banking or other officer of such State in charge of the administration of the banking laws of such State. Sec. 408(n).

[458] Sec. 401(f)(2) and Treas. Reg. sec. 1.401(f)-1. A custodial account that satisfies the requirements of section 401(f)(2) is treated as an organization described in section 401(a) solely for purposes of subchapter F of chapter 1 of Subtitle A (secs. 501-530) and subtitle F (pertaining to procedure and administration) with respect to amounts received by the account and with respect to any income from the investment of those amounts.

[459] Sec. 403(b)(7) and Treas. Reg. sec. 1.403(b)-8(d)(2)(i).

[460] Sec. 403(b)(1)(A) and (7).

[461] Sec. 403(b)(9)(B), referring to organizations exempt from tax under section 501(c)(3). For this purpose, a church or a convention or association of churches includes an organization described in section 414(e)(3)(A), that is, an organization, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, provided that the organization is controlled by, or associated with, a church or a convention or association of churches.

[462] Sec. 403(b)(1)(D) and (12).

goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities that are sold at a nominal charge substantially less than the cost of providing the goods, services, or facilities, and (2) normally receives more than 25 percent of its support from either governmental sources, or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities that are not unrelated trades or businesses, or from both. Church-controlled organizations that are not qualified church-controlled organizations are generally referred to as "nonqualified church-controlled organizations."

Church plans

A church plan is a plan established and maintained for employees (or their beneficiaries) by the church or by a convention or association of churches that is exempt from tax.[463] Church plans include plans maintained by an organization, whether a corporation or otherwise, that has as its principal purpose or function the administration or funding of a plan or program for providing retirement or welfare benefits for the employees of the church or convention or association of churches.[464]

Multiple employer plans under the Code

In general

Qualified retirement plans, either defined contribution or defined benefit plans, are categorized as single employer plans or multiple employer plans ("MEPs"). A single employer plan is a plan maintained by one employer. For this purpose, businesses and organizations that are members of a controlled group of corporations, a group under common control, or an affiliated service group are treated as one employer (referred to as "aggregation").[465]

A MEP generally is a single plan maintained by two or more unrelated employers (that is, employers that are not treated as a single employer under the aggregation rules).[466] MEPs are commonly maintained by employers in the same industry and are used also by professional

[463] Sec. 414(e). The plan is exempt from tax under section 501.

[464] Sec. 414(e)(3)(A). With respect to certain provisions (*e.g.*, the exemption for church plans from nondiscrimination rules applicable for tax-sheltered annuities), the more limited definition of church under the employment-tax rules applies (secs. 3121(w)(3)(A) and (B)).

[465] Sec. 414(b), (c), (m) and (o).

[466] Sec. 413(c). Multiple employer status does not apply if the plan is a multiemployer plan. Multiemployer plans are different from single employer plans and MEPs. A multiemployer plan is defined under section 414(f) as a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s). Multiemployer plans are also known as Taft-Hartley plans.

employer organizations ("PEOs") to provide qualified retirement plan benefits to employees working for PEO clients.[467]

There is no specific provision in the Code that provides for section 403(b) plans maintained by more than one employer.[468]

Application of Code requirements to MEPs

Some requirements are applied to a MEP on a plan-wide basis.[469] For example, all employees covered by the plan are treated as employees of all employers participating in the plan for purposes of the exclusive benefit rule. Similarly, an employee's service with all participating employers is taken into account in applying the minimum participation and vesting requirements. In applying the limits on contributions and benefits, compensation, contributions, and benefits attributable to all employers are taken into account.[470] Other requirements are applied separately, including the minimum coverage requirements, nondiscrimination requirements (both the general requirements and the special tests for section 401(k) plans), and the top-heavy rules.[471]

"One bad apple" rule

The qualified status of the plan as a whole is determined with respect to all employers maintaining the plan, and the failure by one employer (or by the plan itself) to satisfy an applicable qualification requirement may result in disqualification of the plan with respect to all employers (sometimes referred to as the "one bad apple" rule).[472]

The SECURE Act" provided relief from the "one bad apple" rule under the Code for certain MEPs.[473] MEPs that satisfy certain requirements (referred to herein as a "covered MEP") may avoid the consequences of the "one bad apple rule." A "covered MEP" is a multiple employer qualified defined contribution plan[474] or a plan that consists of IRAs (referred to herein

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[467] Rev. Proc. 2003-86, 2003-2 C.B. 1211, and Rev. Proc. 2002-21, 2002-1 C.B. 911, address the application of the MEP rules to qualified defined contribution plans maintained by PEOs.

[468] Section 413(c) provides rules governing MEPs subject to sections 401(a), 410(a) and 411, in other words tax-qualified retirement plans, but does not apply those rules to section 403(b) plans.

[469] Sec. 413(c).

[470] Treas. Reg. sec. 1.415(a)-1(e).

[471] Treas. Reg. secs. 1.413-2(a)(3)(ii)-(iii) and 1.416-1, G-2.

[472] Treas. Reg. sec. 1.413-2(a)(3)(iv).

[473] Sec. 101. With respect to plans described under section 413(e)(1)(A), other than providing relief from the "one bad apple" rule if certain requirements are met and adding certain reporting requirements, the provision generally did not change present law and related guidance applicable to such MEPs under the Code or ERISA.

[474] To which section 413(c) applies.

as an "IRA plan"), including under an IRA trust,[475] that either (1) is maintained by employers which have a common interest other than having adopted the plan, or (2) in the case of a plan not described in (1), has a pooled plan provider (referred to herein as a "pooled provider plan"),[476] and which meets certain other requirements as described below.

Relief from the "one bad apple" rule does not apply to a plan unless the terms of the plan provide that, in the case of any employer in the plan failing to take required actions (referred to herein as a "noncompliant employer"):

- Plan assets attributable to employees of the noncompliant employer (or beneficiaries of such employees) will be transferred to a plan maintained only by that employer (or its successor), to a tax-favored retirement plan for each individual whose account is transferred,[477] or to any other arrangement that the Secretary determines is appropriate, unless the Secretary determines it is in the best interests of the employees of the noncompliant employer (and beneficiaries of such employees) to retain the assets in the plan, and
- The noncompliant employer (and not the plan with respect to which the failure occurred or any other employer in the plan) is, except to the extent provided by the Secretary, liable for any plan liabilities attributable to employees of the noncompliant employer (or beneficiaries of such employees).

In addition, in the case of a pooled provider plan, if the pooled plan provider does not perform substantially all the administrative duties required of the provider (as described below) for any plan year, the Secretary may provide that the determination as to whether the plan meets the Code requirements for tax-favored treatment will be made in the same manner as would be made without regard to the relief under the provision.

"Pooled" MEPs under the Code

As described above, the SECURE Act provided relief from the "one bad apple" rule under the Code for certain MEPs. The SECURE Act also introduced the concept of a "pooled" MEP for purposes of the Code. Various requirements apply to a "pooled provider plan" under the Code.

Pooled provider plan

A "pooled provider plan" is a qualified defined contribution plan that is established or maintained for the purpose of providing benefits to the employees of a MEP administered by a

[475] In applying the exclusive benefit requirement under section 408(c) to an IRA plan with an IRA trust covering employees of unrelated employers, all employees covered by the plan are treated as employees of all employers participating in the plan.

[476] Sec. 413(e)(1).

[477] For this purpose, a tax-favored retirement plan means an eligible retirement plan as defined in section 402(c)(8)(B), that is, an IRA, a qualified retirement plan, a tax-deferred annuity plan under section 403(b), or an eligible deferred compensation plan of a State or local governmental employer under section 457(b).

"pooled plan provider." A pooled provider plan does not include a plan maintained by employers that have a common interest other than having adopted the plan.

In the case of a pooled provider plan, if the pooled plan provider does not perform substantially all the administrative duties required of the provider (as described below) for any plan year, the Secretary may provide that the determination as to whether the plan meets the Code requirements for tax-favored treatment will be made in the same manner as would be made without regard to the relief under the provision.

Pooled plan provider

A "pooled plan provider" with respect to a plan means a person that:

- Is designated by the terms of the plan as a named fiduciary under ERISA,[478] as the plan administrator, and as the person responsible to perform all administrative duties (including conducting proper testing with respect to the plan and the employees of each employer in the plan) that are reasonably necessary to ensure that the plan meets the Code requirements for tax-favored treatment and the requirements of ERISA and to ensure that each employer in the plan takes actions as the Secretary or the pooled plan provider determines necessary for the plan to meet Code and ERISA requirements, including providing to the pooled plan provider any disclosures or other information that the Secretary may require or that the pooled plan provider otherwise determines are necessary to administer the plan or to allow the plan to meet Code and ERISA requirements,
- Registers with the Secretary as a pooled plan provider and provides any other information that the Secretary may require, before beginning operations as a pooled plan provider,
- Acknowledges in writing its status as a named fiduciary under ERISA and as the plan administrator, and
- Is responsible for ensuring that all persons who handle plan assets or are plan fiduciaries are bonded in accordance with ERISA requirements.

The Secretary may perform audits, examinations, and investigations of pooled plan providers as may be necessary to enforce and carry out the purposes of the statute.

In addition, in determining whether a person meets the requirements to be a pooled plan provider with respect to any plan, all persons who perform services for the plan and who are treated as a single employer[479] are treated as one person.

[478] Within the meaning of ERISA section 402(a)(2).

[479] Under subsection (b), (c), (m), or (o) of section 414.

Plan sponsor

Except with respect to the administrative duties (as a named fiduciary, as the plan administrator, and as the person responsible for the performance of all administrative duties) for which the pooled plan provider is responsible as described above, each employer in a plan which has a pooled plan provider is treated as the plan sponsor with respect to the portion of the plan attributable to that employer's employees (or beneficiaries of such employees).

Guidance

The Secretary is directed to issue guidance (that the Secretary determines appropriate) (1) to identify the administrative duties and other actions required to be performed by a pooled plan provider, (2) that describes the procedures to be taken to terminate a plan that fails to meet the requirements to be a covered MEP, including the proper treatment of, and actions needed to be taken by, any employer in the plan and plan assets and liabilities attributable to employees of that employer (or beneficiaries of such employees), and (3) to identify appropriate cases in which corrective action will apply with respect to noncompliant employers.[480] For purposes of (3), the Secretary is to take into account whether the failure of an employer or pooled plan provider to provide any disclosures or other information, or to take any other action, necessary to administer a plan or to allow a plan to meet the Code requirements for tax-favored treatment, has continued over a period of time that demonstrates a lack of commitment to compliance. An employer or pooled plan provider is not treated as failing to meet a requirement of guidance issued by the Secretary if, before the issuance of such guidance, the employer or pooled plan provider complies in good faith with a reasonable interpretation of the provisions to which the guidance relates.

The Secretary is directed to publish model plan language that meets the Code and ERISA requirements and that may be adopted in order for the plan to be treated as a pooled employer plan under ERISA.

The Secretary (or the Secretary's delegate) has the authority to provide for the proper treatment of a failure to meet any Code requirement with respect to any employer (and its employees) in a MEP.

Form 5500 reporting

Under the Code, an employer maintaining a qualified retirement plan generally is required to file an annual return containing information required under regulations with respect to the qualification, financial condition, and operation of the plan.[481] This filing requirement is

[480] On March 28, 2022, the IRS issued proposed regulations with respect to multiple employer plans. 87 Fed. Reg. 17225. That document also withdrew proposed regulations under section 413(c) that were published on July 3, 2019, 84 Fed. Reg. 31777, prior to the enactment of the SECURE Act.

[481] Sec. 6058. In addition, under section 6059, the plan administrator of a defined benefit plan subject to the minimum funding requirements is required to file an annual actuarial report. Under section 414(g) and ERISA section 3(16), plan administrator generally means the person specifically so designated by the terms of the plan document. In the absence of a designation, the plan administrator generally is (1) in the case of a plan maintained by

met by filing a completed Form 5500, Annual Return/Report of Employee Benefit Plan. Forms 5500 are filed with DOL, and information from Forms 5500 is shared with the IRS.[482]

In the case of a MEP (including a pooled employer plan), the Form 5500 filing must include a list of participating employers in the plan; a good faith estimate of the percentage of total contributions made by the participating employers during the plan year; and the aggregate account balances attributable to each employer in the plan (determined as the sum of the account balances of the employees of each employer (and the beneficiaries of such employees)); and with respect to a pooled employer plan, the identifying information for the person designated under the terms of the plan as the pooled plan provider. The Secretary of Labor may prescribe simplified reporting for a MEP that covers fewer than 1,000 participants, but only if no single employer in the plan has 100 or more participants covered by the plan.

Description of Proposal[483]

Section 403(b) MEPs under the Code

In general

The proposal clarifies that a section 403(b) plan may be established and maintained as a MEP. Specifically, it provides that, except in the case of a church plan, section 403(b) annuity contracts and 403(b) custodial accounts[484] do not fail to qualify as section 403(b) plans solely by reason of such contracts being purchased or accounts being established under a plan maintained by more than one employer.

For purposes of this proposal, a section 403(b) plan includes such a plan sponsored by (1) tax-exempt entities (described in section 501(c)(3) which are exempt from tax under section 501(a)) and (2) public schools (including State colleges and universities).

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a single employer, the employer, (2) in the case of a plan maintained by an employee organization, the employee organization, or (3) in the case of a plan maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties that maintain the plan. Under ERISA, the party described in (1), (2), or (3) is referred to as the "plan sponsor."

[482] Information is shared also with the PBGC, as applicable. Form 5500 filings are also publicly released in accordance with section 6104(b) and Treas. Reg. sec. 301.6104(b)-1 and ERISA sections 104(a)(1) and 106(a).

[483] Modifications to Labor provisions are necessary to effectuate this proposal.

[484] Sec. 403(b)(7) provides that amounts paid by a tax-exempt employer to a custodial account which satisfy the requirements of section 401(f)(2) are treated as amounts contributed by such employer for an annuity contract for its employee if the amounts are to be invested in regulated investment company stock to be held in that custodial account. Also see the proposal in section D.1 of this document, that would permit section 403(b)(7) custodial accounts to invest in group trusts as well as in regulated investment company stock.

Relief from "one bad apple" rule

Under the proposal, as long as such a section 403(b) plan maintained by more than one employer satisfies rules similar to certain rules that apply to qualified retirement MEPs,[485] the section 403(b) plan will not fail to be treated as such merely because one or more employers of employees covered by the plan fail to meet the requirements of section 403(b). The rules applicable to qualified retirement MEPs require that where one or more employers of employees covered by the MEP fails to meet the applicable qualification requirements:

- the assets of the plan attributable to employees of such employer (or beneficiaries of such employees) will be transferred to a plan maintained only by such employer (or its successor), to an eligible retirement plan[486] for each individual whose account is transferred, or to any other arrangement that the Secretary determines is appropriate, unless the Secretary determines it is in the best interests of the employees of such employer (and the beneficiaries of such employees) to retain the assets in the plan, and
- such employer (and not the plan with respect to which the failure occurred or any other employer in such plan) will, except to the extent provided by the Secretary, be liable for any liabilities with respect to such plan attributable to employees of such employer (or beneficiaries of such employees).

In addition, in the case of a section 403(b) MEP maintained by tax-exempt entities, such a plan must also satisfy rules similar to either the commonality rule (being maintained by employers which have a common interest other than having adopted the plan)[487] or having a pooled plan provider. This requirement does not apply to plans maintained by governmental employers.

Disclosure Rules

Special disclosure rules for tax-exempt employers joining a section 403(b) MEP

As noted above, there is an exception from ERISA for certain tax-sheltered annuity programs established by tax-exempt entities which consist of a program for the purchase of annuity contracts or the establishment of custodial accounts pursuant to salary reduction agreements or agreements to forego an increase in salary where the tax-exempt entity has very limited involvement in the program. However, if a tax-exempt employer who had participated in such a non-ERISA program decides to become a participating employer in a section 403(b) MEP, that employer will become subject to ERISA because of the fiduciary responsibilities imposed on each employer in a section 403(b) MEP.

[485] Under section 413(e)(2).

[486] As defined in section 402(c)(8)(B).

[487] Sec. 413(e)(1)(A).

To ensure that such tax-exempt employers are aware of their ERISA fiduciary duties, the proposal imposes additional disclosure to such employers. First, the proposal directs the Secretary (or the Secretary's delegate) to modify the model plan language applicable to qualified retirement MEPs[488] to include language which notifies participating tax-exempt employers that the plan is subject to ERISA and that each such employer is a plan sponsor with respect to its employees participating in the MEP, and, as such, has certain fiduciary duties with respect to the plan and the employees. Second, Treasury must undertake necessary education and outreach efforts to increase awareness to tax-exempt employers that MEPs are subject to ERISA, that such employers are plan sponsors with respect to their employees participating in the MEP and, as such, have certain fiduciary duties with respect to the plan and to its employees.

Other disclosures

The proposal also provides that the Secretary also publish model plan language similar to the model plan language published for qualified plan MEPs[489] for section 403(b) MEPs sponsored by nongovernmental employers.

Reporting requirements for section 403(b) MEPs

In the case of any annuity contract described in section 403(b) that is a MEP, such plan is treated as a single plan for purposes of the reporting requirements under the Code relating to the annual registration statement and the annual return for certain plans[490] As a result, the plan can file a single Form 8955-SSA, Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits, and a single Form 5500, Annual Return/Report of Employee Benefit Plan, rather than having each participating employer in the section 403(b) MEP file their own form. These filing requirements only apply to tax-exempt employers because governmental employers are not subject to ERISA.

Regulations

The Secretary (or the Secretary's delegate) must prescribe such regulations as may be necessary to clarify the treatment of an employer departing a section 403(b) MEP in connection with such employer's failure to meet MEP requirements.[491]

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[488] Sec. 413(e)(5).

[489] Under section 413(e)(5).

[490] The reporting requirement relating to the annual registration statement is under section 6057, and the requirement relating to the annual return is under 6058. These requirements only apply in the case of a section 403(b) plan that is otherwise subject to such requirements.

[491] As described in section 403(b)(15).

No inference with respect to church plans

The proposal provides that regarding any application of section 403(b) to an annuity contract purchased under a church plan,[492] maintained by more than one employer, or to any application of rules similar to the rules that apply to qualified retirement MEPs[493] to such a plan, no inference is to be made from the rules applicable to section 403(b) MEPs not applying to such plans.

Effective Date

The proposal is generally applicable to plan years beginning after the date of enactment.

Nothing in the amendments made by the general rule is to be construed as limiting the authority of the Secretary or the Secretary's delegate (determined without regard to such amendment) to provide for the proper treatment of a failure to meet any requirement applicable under such Code with respect to one employer (and its employees) in the case of a section 403(b) MEP.[494]

[492] As defined in section 414(e).

[493] Sec. 413(e).

[494] As described in section 403(b)(15).

E. Disaster Relief

1. Special rules for use of retirement funds in connection with qualified federally declared disasters

Present Law

Distributions from tax-favored retirement plans

A distribution from a tax-qualified plan described in section 401(a) (a "qualified retirement plan"), a tax-sheltered annuity plan (a "section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed.[495] These plans are referred to collectively as "eligible retirement plans."[496] In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[497]

In general, a distribution from an eligible retirement plan may be rolled over to another eligible retirement plan within 60 days, in which case the amount rolled over generally is not includible in income. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual.[498]

The terms of a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan generally determine when distributions are permitted. However, in some cases, restrictions may apply to distributions before an employee's termination of employment, referred to as "in-service" distributions. Despite such restrictions, an in-service distribution may be permitted under certain types of plans in the case of financial hardship or an unforeseeable emergency.

Loans from tax-favored retirement plans

Employer-sponsored retirement plans are permitted, but not required, to provide loans to participants. Unless the loan satisfies certain requirements in both form and operation, the

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[495] Secs. 401(a), 403(a), 403(b), 457(b) and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

[496] Sec. 402(c)(8)(B). Eligible retirement plans also include annuity plans described in section 403(a).

[497] Sec. 72(t). The 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

[498] Rev. Proc. 2016-47, 2016-37 I.R.B. 346, provides for a self-certification procedure (subject to verification on audit) that may be used by a taxpayer claiming eligibility for a waiver of the 60-day requirement with respect to a rollover into a plan or IRA in certain specified circumstances.

amount of a retirement plan loan is a deemed distribution from the retirement plan. Among the requirements that the loan must satisfy are that (1) the loan amount must not exceed the lesser of 50 percent of the participant's account balance or $50,000 (generally taking into account outstanding balances of previous loans), and (2) the loan's terms must provide for a repayment period of not more than five years (except for a loan specifically to purchase a home) and for level amortization of loan payments to be made not less frequently than quarterly.[499] Thus, if an employee stops making payments on a loan before the loan is repaid, a deemed distribution of the outstanding loan balance generally occurs. A deemed distribution of an unpaid loan balance is generally taxed as though an actual distribution occurred, including being subject to a 10-percent early withdrawal tax, if applicable. A deemed distribution is not eligible for rollover to another eligible retirement plan. The rules generally do not limit the number of loans an employee may obtain from a plan except to the extent that any additional loan would cause the aggregate loan balance to exceed limitations.

Tax-favored retirement plan compliance

Tax-favored retirement plans are generally required to be operated in accordance with the terms of the plan document, and amendments to reflect changes to the plan generally must be adopted within a limited period.

Disaster relief

Congress has at times liberalized the plan distribution and loan provisions for individuals affected by certain natural disasters.[500]

Congress has also provided relief from the plan distribution and loan provisions for individuals affected by COVID-19.[501]

Description of Proposal

Distributions and recontributions

The proposal allows an exception to the 10-percent early withdrawal tax for a "qualified disaster recovery distribution" from a qualified retirement plan, a section 403(b) plan, or an IRA.[502] The proposal also allows a taxpayer to include income attributable to a qualified disaster

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[499] Sec. 72(p).

[500] See, *e.g.*, sec. 20102 of Pub. L. No. 115-123 (providing relief in response to 2017 California wildfires); sec. 502 of Pub. L. No. 115-63 (providing relief in response to Hurricanes Harvey, Irma, and Maria); former sec. 1400Q (providing relief in response to Hurricanes Katrina, Rita, and Wilma); sec. 202 of Div. Q of Pub. L. No. 116-94; and secs. 301 and 302 of Div. EE of Pub. L. No. 116-260. For a more detailed description of the most recently enacted provision, see Joint Committee on Taxation, *General Explanation of Certain Tax Legislation Enacted in the 116th Congress* (JCS-1-22), March 8, 2022, pp. 243-247.

[501] See sec. 2202 of Pub. L. No. 116-136 (providing relief for "coronavirus-related distributions").

[502] This exception also applies to an annuity plan described in section 403(a). The 10-percent early withdrawal tax generally does not apply to section 457 plans. Sec. 72(t)(1).

recovery distribution ratably over three years and to recontribute the amount of the distribution to an eligible retirement plan within three years.

A "qualified disaster recovery distribution" is any distribution from a qualified retirement plan, section 403(b) plan, governmental section 457(b) plan, or an IRA, made on or after the first day of the incident period of a qualified disaster and before the date which is 180 days after the applicable date with respect to such disaster, to an individual whose principal place of abode at any time during the incident period is located in the qualified disaster area and who has sustained an economic loss by reason of such disaster.[503]

The "applicable date" means the latest of: (1) the date of enactment, (2) the first day of the incident period with respect to the qualified disaster, or (3) the date of the disaster declaration with respect to the qualified disaster.

A "qualified disaster" means[504] any disaster with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act after December 27, 2020. A "qualified disaster area" means, with respect to any qualified disaster, the area with respect to which the major disaster was declared under the Robert T. Stafford Disaster Relief and Emergency Assistance Act; however, the term does not include any area which is a qualified disaster area solely by reason of section 301 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020. The term "incident period" means, with respect to any qualified disaster, the period specified by the Federal Emergency Management Agency as the period during which such disaster occurred.

A plan is not treated as violating any Code requirement merely because it treats a distribution as a qualified disaster recovery distribution, provided that the aggregate amount of such distributions from plans maintained by the employer and members of the employer's controlled group or affiliated service group[505] does not exceed $22,000 with respect to each qualified disaster. The total amount of distributions to an individual from all eligible retirement plans that may be treated as qualified disaster recovery distributions with respect to each qualified disaster is $22,000. Thus, a plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $22,000, taking into account distributions from plans of other employers or IRAs, or because an individual may have been affected by more than one qualified disaster.

[503] A qualified disaster recovery distribution is subject to income tax withholding unless the recipient elects otherwise. Mandatory 20-percent withholding does not apply.

[504] With respect to this provision and sec. 72(t)(8).

[505] As defined in Code secs. 414(b),(c),(m) and (o).

Any amount required to be included in income as a result of a qualified disaster recovery distribution is included in income ratably over the three-year period beginning with the year of distribution unless the individual elects not to have ratable inclusion apply.[506]

Any portion of a qualified disaster recovery distribution may, at any time during the three-year period beginning on the day after the date on which the distribution was received, be recontributed in one or more contributions to an eligible retirement plan to which a rollover can be made. Any amount recontributed within the three-year period is treated as a rollover and thus is not includible in income.

For example, if an individual receives a qualified disaster recovery distribution in 2020, that amount is included in income, generally ratably over the year of the distribution and the following two years and is not subject to the 10-percent early withdrawal tax. If, in 2022, the amount of the qualified disaster recovery distribution is recontributed to an eligible retirement plan, the individual may file amended returns to claim a refund of the tax attributable to the amounts previously included in income. In addition, if, under the ratable inclusion proposal, a portion of the distribution has not yet been included in income at the time of the contribution, the remaining amount is not includible in income.

For purposes of satisfying the requirements to offer a participant the right to have a direct trustee to trustee transfer of an eligible rollover distribution,[507] to provide a written explanation to a recipient of distributions eligible for rollover treatment, [508]and satisfying withholding requirements,[509] a qualified disaster recovery distribution will not be treated as an eligible rollover distribution.

A qualified disaster recovery distribution will be treated as meeting the qualification requirements for distributions from section 401(k) plans, section 403(b) plans, from eligible deferred compensation plans under section 457(b) and from the Thrift Savings Plan.[510] In the case of a money purchase pension plan, a qualified disaster recovery distribution which is an in-service withdrawal will be treated as meeting the section 401(a) distribution requirements.

Recontributions of withdrawals for purchase of a home

Any individual who received a qualified distribution during the period beginning on the date which is 180 adays before the first day of the incident period of such qualified disaster and ending on the date which is 30 days after the last day of such incident period, which was a

[506] And rules similar to the special rules of subparagraph (a) of section 408A(d)(3) will apply to qualified disaster recovery distributions.

[507] Sec. 401(a)(31).

[508] Sec. 402(f).

[509] Sec. 3405.

[510] Secs. 401(k)(2)(B)(i), 403(b)(7)(A)(i), 403(b)(11), 457(d)(1)(A) and under 5 U.S.C. sec. 8433(h)(1), respectively.

qualified first-time homebuyer distribution and was to be used to purchase or construct a principal residence in a qualified disaster area, but which was not so used on account of the qualified disaster with respect to such area, may, during the "applicable period," make one or more contributions in an aggregate amount not to exceed the amount of such qualified distribution to an eligible retirement plan[511] of which such individual is a beneficiary and to which a rollover contribution of such distribution could be made.[512] The "applicable period" is, in the case of a principal residence in a qualified disaster area with respect to any qualified disaster, the period beginning on the first day of the incident period of such qualified disaster and ending on the date which is 180 days after the applicable date.

Loans

The proposal modifies the rules applicable to loans, providing that for a qualified individual, in order for the loan not to be treated as a distribution, the permitted maximum loan amount from a qualified employer plan[513] during the applicable period is the lesser of the present value of the nonforfeitable accrued benefit of the employee under the plan or $100,000.[514] For this purpose, "qualified individual" has the same meaning as persons eligible to receive qualified disaster recovery distributions and the definition of "applicable date" is the same as that used for qualified disaster recovery distributions. The "applicable period" with respect to any disaster is the period beginning on the applicable date with respect to such disaster and ending on the date that is 180 days after such applicable date.

In the case of a qualified individual (with respect to any qualified disaster) with an outstanding loan from a qualified employer plan (on or after the applicable date of such qualified disaster), the proposal delays by one year the due date for any repayment with respect to such loan, if the due date for any repayment otherwise would fall during the period beginning on the first day of the incident period of such qualified disaster and ending on the date which is 180 days after the last day of such incident period. Under the proposal, any subsequent repayments are appropriately adjusted to reflect the delay in the earlier repayment due date and any interest accruing during that delay. The repayment delay is disregarded for purposes of the requirement that a loan be repaid within five years.

GAO Report

The proposal requires that the Comptroller General of the United States submit a report to the Committees on Finance and Health, Education, Labor and Pensions of the Senate and the Committees on Ways and Means and Education and Labor of the House of Representatives on taxpayer utilization of the retirement disaster relief permitted by this proposal and prior legislation, including a comparison of utilization by higher and lower income taxpayers, and

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[511] As defined in section 402(c)(8)(B).

[512] Under sections 402(c), 403(a)(4), 403(b)(8), or 408(d)(3), as the case may be.

[513] For this purpose, qualified employer plan is defined in section 72(p)(4).

[514] See sec. 72(p)(2)(A).

whether the $22,000 threshold on distributions provides adequate relief for taxpayers who suffer from a disaster.

Effective Date

With respect to qualified disaster recovery distributions and recontributions of withdrawals for home purchases, the proposal is applicable to distributions with respect to disasters the incident period for which begins on or after 30 days after the date of enactment of the Taxpayer Certainty and Disaster Tax Relief Act, which is January 26, 2021.

With respect to plan loans from qualified plans, the proposal applies to loans made with respect to disasters the incident period for which begins on or after 30 days after the date of enactment of the Taxpayer Certainty and Disaster Tax Relief Act, which is January 26, 2021.

F. Employers Plans

1. Credit for employers with respect to modified safe harbor requirements

Present Law

Automatic enrollment

A qualified defined contribution plan may include a qualified cash or deferred arrangement under which employees may elect to have plan contributions ("elective deferrals") made rather than receive cash compensation (commonly called a "section 401(k) plan"). A SIMPLE IRA plan is an employer-sponsored retirement plan funded with individual retirement arrangements ("IRAs") that also allows employees to make elective deferrals.[515] Additional background on SIMPLE IRA plans is in section A.6 of this document.

Section 401(k) plans and SIMPLE IRA plans may be designed so that the employee will receive cash compensation unless the employee affirmatively elects to make elective deferrals to the plan. Alternatively, a plan may provide that elective deferrals are made at a specified rate (when the employee becomes eligible to participate) unless the employee elects otherwise (*i.e.*, affirmatively elects not to make contributions or to make contributions at a different rate). This alternative plan design is referred to as automatic enrollment. For background on automatic enrollment 401(k) safe harbor plans, see section 101, "Secure deferral arrangements," of this document.

Small employer credit

For tax years beginning after December 31, 2019, a nonrefundable income tax credit is available for an eligible employer that establishes an eligible automatic contribution arrangement under a qualified employer plan, requiring the plan to include a cash or deferred arrangement under which participants are treated as having made an election to make elective contributions at a uniform percentage of compensation.[516] Qualified employer plans include 401(a) plans, 403(a) plans, SIMPLE IRA plans and SEPs but exclude governmental plans and plans maintained by tax-exempt employers.

The credit is equal to $500 for any taxable year of an eligible employer that occurs during the period of three taxable years beginning with the first taxable year for which an eligible employer includes an eligible automatic contribution arrangement in a qualified employer plan that it sponsors. No taxable year is treated as occurring within the credit period unless the eligible automatic contribution arrangement is included in the plan for that year.

[515] Sec. 408(p).

[516] Sec. 45T.

An eligible employer is an employer that with respect to any year, had no more than 100 employees with compensation of at least $5,000 or more for the preceding year.[517] Certain related employers are treated as a single employer for purposes of these requirements.[518] All eligible employer plans of an employer are treated as a single plan.

Description of Proposal

The proposal described in section A.1 of this document establishes a new automatic enrollment safe harbor ("secure deferral arrangement") in addition to the existing automatic enrollment 401(k) safe harbor plan. The secure deferral arrangement is required to satisfy certain requirements, including providing for certain minimum qualified percentages of elective deferrals and certain minimum matching contributions.

Under the proposal, a nonrefundable income tax credit is available to eligible small employers who maintain a secure deferral arrangement on behalf of employees who are not highly compensated employees. The total amount of the credit is equal to the total of such employer's matching contributions under the secure deferral arrangement, determined with respect to contributions made on behalf of any employee only during the first five years the employee participates in the secure deferral arrangement and not to exceed two percent of the compensation of such employee for the taxable year.

For purposes of this credit, the definition of eligible employer parallels the definition that is used for the retirement auto-enrollment credit. Members of controlled groups, business under common control, and affiliated service groups are treated as a single employer for purposes of these requirements.[519] All eligible employer plans of an employer are treated as a single plan.

No deduction is allowed for any contribution with respect to which this credit is allowed. A taxpayer may elect to not have this credit apply for any taxable year.

Effective Date

The proposal is effective for taxable years which include any portion of a plan year beginning after December 31, 2023.

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[517] An eligible employer who establishes and maintains a plan for one of more years, but who fails to be an eligible employer for any later year is treated as an eligible employer for the two years following the last year the employer was an eligible employer, unless the failure is due to any acquisition, disposition, or similar transaction involving an eligible employer.

[518] Secs. 52(a) or (b) and 414(m). See also Notice 2020-68, 2020-38 I.R.B. 567, September 14, 2020.

[519] Secs. 52(a) or (b) and 414(m) or (o).

2. Application of top-heavy rules to defined contribution plans covering excludible employees

Present Law

Top-heavy requirements

Top-heavy requirements apply to limit the extent to which accumulated benefits or account balances under a qualified retirement plan can be concentrated with key employees.[520] Whereas the general nondiscrimination requirements are designed to test annual contributions or benefits for highly compensated employees compared to those of non-highly compensated employees, the top-heavy rules test the portion of the total plan contributions or benefits that have accumulated for the benefit of key employees as a group. If a plan is top-heavy, minimum contributions or benefits must be provided for non-key employees and, in some cases, faster vesting is required. In general, for a defined contribution plan, this minimum contribution is three percent of the participant's compensation; however, such contribution is limited by the percentage at which contributions are made for the key employee with the highest percentage of contributions.

For this purpose, a key employee is an officer with annual compensation greater than $200,000 (for 2022), a five-percent owner, or a one-percent owner with compensation in excess of $150,000. A defined benefit plan generally is top-heavy if the present value of cumulative accrued benefits for key employees exceeds 60 percent of the cumulative accrued benefits for all employees. A defined contribution plan is top-heavy if the aggregate of accounts for key employees exceeds 60 percent of the aggregate accounts for all employees. As a result, plans of large businesses with many employees are less likely to be top-heavy than plans of smaller employers in which the owners participate.

Minimum coverage requirements

As part of the general nondiscrimination requirements, a qualified retirement plan must satisfy the minimum coverage requirement.[521] Under the minimum coverage requirement, the plan's coverage of employees must be nondiscriminatory. This is determined by calculating the plan's ratio percentage, that is, the ratio of the percentage of non-highly compensated employees (of all non-highly compensated employees in the workforce) covered under the plan over the percentage of highly compensated employees covered. If the plan's ratio percentage is 70 percent or greater, the plan satisfies the minimum coverage requirement. If the plan's ratio percentage is less than 70 percent, a multi-part test applies.[522] In addition, the average benefit percentage test must be satisfied. Under the average benefit percentage test, the average rate of contributions or benefit accruals for all non-highly compensated employees in the workforce

[520] Secs. 401(a)(10)(B) and 416.

[521] Sec. 410(b).

[522] The plan must cover a group (or classification) of employees that is reasonable and established under objective business criteria, such as hourly or salaried employees (referred to as a reasonable classification), and the plan's ratio percentage must be at or above a specific level specified in the regulations.

(taking into account all plans of the employer) must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.

The minimum coverage and general nondiscrimination requirements apply annually on the basis of the plan year. Employees who have not satisfied minimum age and service conditions under the plan, certain nonresident aliens, and employees covered by a collective bargaining agreement are generally disregarded.[523] However, a plan that covers employees with less than a year of service or who are under age 21 ("otherwise excludable employees") must generally include those employees in any nondiscrimination test for the year but can test the plan for nondiscrimination in two parts: (1) by separately testing the portion of the plan covering otherwise excludable employees and treating all such employees as the only employees of the employer; and (2) then testing the rest of the plan taking into account the rest of the employees of the employer and excluding the otherwise excludable employees.

Description of Proposal

Under the proposal, if a top-heavy defined contribution plan covers employees who do not meet the minimum age or service requirements under the Code, such employees may be excluded from consideration in determining whether any plan of the employer satisfies the top-heavy minimum contribution requirement.

Effective Date

The proposal applies to plan years beginning after the date of enactment.

3. Increase in credit limitation for small employer pension plan startup costs of certain employers

Present Law

Present law provides a nonrefundable income tax credit equal to 50 percent of the qualified start-up costs paid or incurred during the taxable year by an eligible employer[524] that adopts a new eligible employer plan[525], provided that the plan covers at least one non-highly compensated employee.[526] Qualified start-up costs are expenses connected with the

[523] Qualified plans generally cannot delay an employee's participation in the plan beyond the later of completion of one year of service (*i.e.*, a 12-month period with at least 1,000 hours of service) or attainment of age 21. Sec. 410(a)(1). A plan or portion of a plan covering collectively bargained employees is generally deemed to satisfy the nondiscrimination requirements.

[524] An eligible employer has the meaning given such term by section 408(p)(2)(C)(i).

[525] An eligible employer plan means a qualified employer plan within the meaning of section 4972(d) and includes a section 401(a) qualified retirement plan, a section 403 annuity, any simplified employee pension ("SEP") within the meaning of section 408(k), and any simple retirement account ("SIMPLE") within the meaning of section 408(p). An eligible employer plan does not include a plan maintained by a tax-exempt employer or a governmental plan, as defined in section 414(d).

[526] A non-highly compensated employee is an employee who is not a highly compensated employee as defined under section 414(q).

establishment or administration of the plan and retirement-related education of employees with respect to the plan. The amount of the credit for any taxable year is limited to the greater of (1) $500 or (2) the lesser of (a) $250 multiplied by the number of non-highly compensated employees of the eligible employer who are eligible to participate in the plan or (b) $5,000. The credit applies for up to three consecutive taxable years beginning with the taxable year the plan is first effective, or, at the election of the employer, with the year preceding the first plan year.

An eligible employer is an employer that, for the preceding year, had no more than 100 employees, each with compensation of $5,000 or more.[527] In addition, the employer must not have had a qualified employer plan covering substantially the same employees as the new plan with respect to which contributions were made or benefits were accrued during the three years preceding the first year for which the credit would apply. Members of controlled groups and affiliated service groups are treated as a single employer for purposes of these requirements.[528] All eligible employer plans of an employer are treated as a single plan.

No deduction is allowed for the portion of qualified start-up costs paid or incurred for the taxable year equal to the amount of the credit.

Description of Proposal

The proposal increases from 50 percent to 75 percent of qualified start-up costs, the amount of the nonrefundable income tax credit allowed to an eligible employer with no more than 25 employees who received at least $5,000 of compensation from the employer for the preceding year.

Effective Date

The proposal applies to taxable years beginning after December 31, 2023.

4. Expansion of Employee Plans Compliance Resolution System

Present Law

Employee Plans Compliance Resolution System

A general description of the Employee Plans Compliance Resolution System ("EPCRS") that this proposal modifies may be found in B.7 of this document.

The current EPCRS program does not provide corrections for individual IRAs although it does provide for certain corrections for SIMPLE plans and SEPs. SCP and VCP[529] are available

[527] As defined in section 408(p)(2)(C)(i).

[528] Sec. 52(a) or (b) and 414(m) or (o).

[529] Sec. 6.11 of Rev. Proc. 2021-30.

to a SEP or SIMPLE plan.[530] SCP is only available to such a plan to correct insignificant operational failures,[531] and only if the SEP or SIMPLE plan is established and maintained on a document approved by the IRS.

Loans

EPCRS is available for plan loans that do not comply with one or more Code requirements[532] (for example, including, the amount of the loan must not exceed the lesser of 50 percent of the participant's account balance or $50,000[533] (generally taking into account outstanding balances of previous loans)); the terms of the loan must provide for a repayment period of not more than five years[534] and provide for level amortization of loan payments (with payments not less frequently than quarterly); and the terms of the loan must be legally enforceable) and are corrected through VCP or Audit CAP.

Unless correction is made, a deemed distribution[535] in connection with a failure relating to a loan to a participant made from a plan must be reported[536] with respect to the affected participant and any applicable income tax withholding amount that was required to be paid in connection with the failure must be paid by the employer. As part of VCP and Audit CAP, the deemed distribution may be reported with respect to the affected participant for the year of correction (instead of the year of the failure) if the plan sponsor requests such reporting relief. Where certain requirements in EPCRS are met, no reporting may be required but this relief applies only if the plan sponsor requests the relief and provides an explanation supporting the request.

VFCP

The DOL also has a correction program entitled the Voluntary Fiduciary Correction Program ("VFCP")[537] under ERISA designed to encourage the voluntary correction of fiduciary

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[530] Sec. 1.03 of Rev. Proc. 2021-30. A SEP is a plan intended to satisfy the requirements of Code section 408(k); a SIMPLE plan is a plan intended to satisfy the requirements of Code section 408(p). Secs. 5.06 and 5.07 of Rev. Proc. 2021-30.

[531] Sec. 4.01(c) of Rev. Proc. 2021-30.

[532] Sec. 72(p)(2).

[533] There are certain exceptions to these rules for loans, for example, individuals eligible to receive a coronavirus-related distribution under section 2202 of the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, March 27, 2020, may take a loan during a specified period of time equal to the lesser of the present value of the nonforfeitable accrued benefit of the employee under the plan or $100,000 and certain other rules apply to such loans. Special rules for loans also apply for certain individuals impacted by specified disasters, see, e.g., section 302 of Div. EE of the Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, December 27, 2020.

[534] Loans specifically for home purchases may be repaid over a longer period.

[535] Under sec. 72(p)(1).

[536] On IRS Form 1099-R.

[537] 71 Fed. Reg. 20261, April 19, 2006.

violations under Title I of ERISA. VFCP also provides for the correction of certain participant loan failures including situations where participant loans exceed the Code section 72(p) limitations in amount or duration.

Description of Proposal

In general

The proposal provides that, except as otherwise provided in guidance prescribed by the Secretary (or the Secretary's delegate), any eligible inadvertent failure to comply with the rules applicable to certain tax-qualified retirement plans[538] may be self-corrected under EPCRS,[539] except to the extent that such failure was identified by the Secretary prior to any actions which demonstrate a commitment to implement a self-correction. As of the date of the enactment of this Act, EPCRS is deemed amended to provide that, the correction period[540] for an eligible inadvertent failure, except as otherwise provided under the Code or in guidance prescribed by the Secretary, is indefinite and has no last day, other than with respect to failures identified by the Secretary prior to any self-correction.

Loan errors

Under this proposal, in the case of an eligible inadvertent plan loan failure relating to a loan from a plan to a participant, such failure may be self-corrected according to the rules of EPCRS,[541] including the provisions related to whether a deemed distribution must be reported on Form 1099-R, (rather than being corrected in VCP or Audit CAP).[542]

IRAs

The proposal also directs the Secretary to expand EPCRS to allow custodians of IRAs[543] to address eligible inadvertent failures with respect to an IRA, including:

[538] Under section 401(a), 403(a), 403(b), 408(p), or 408(k).

[539] For purposes of this proposal, references to corrections under EPCRS refers to those described under Rev. Proc. 2021-30 or any successor guidance.

[540] Under sec. 9.02 of Rev. Proc. 2021-30 or any successor guidance.

[541] According to the rules of section 6.07 of Rev. Proc. 2021-30 (or any successor guidance).

[542] Effectuation of this aspect of the proposal requires a modification of Labor provisions.

[543] As defined in section 7701(a)(37).

(1) waivers of the excise tax[544] that would otherwise apply to certain accumulations in an IRA where the amount distributed during a taxable year of a participant or beneficiary is less than the minimum required distribution for such taxable year; and

(2) rules permitting a nonspouse beneficiary to return distributions to an inherited individual IRA[545] where, due to an eligible inadvertent error by a service provider, the beneficiary had reason to believe that the distribution could be rolled over without inclusion in income of any part of the distributed amount.

Guidance

The Secretary is directed to issue guidance on correction methods that are required to be used to correct eligible inadvertent failures, including general principles of correction if a specific correction method is not specified by the Secretary.

Definition of eligible inadvertent failure

An eligible inadvertent failure means a failure that occurs despite the existence of practices and procedures which either (1) satisfy the standards set forth in EPCRS;[546] or (2) satisfy similar standards in the case of an individual retirement plan. However, an eligible inadvertent failure does not include any failure which is egregious, relates to the diversion or misuse of plan assets, or is directly or indirectly related to an abusive tax avoidance transaction.

Deadline to provide guidance

Any regulations or other guidance, or revision to any such regulations or other guidance, required by this proposal, shall be promulgated not later than the date which is two years after the date of the enactment of this Act.

Effective Date

The proposal is effective on the date of enactment.

[544] Sec. 4974.

[545] As described in section 408(d)(3)(C).

[546] Sec. 4.04 of Rev. Proc. 2021-30 (or any successor guidance). Section 4.04 provides that the plan sponsor or plan administrator has established practices and procedures in place which are reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code provisions and such practices and procedures have been in place and are routinely followed.

5. Application of credit for small employer pension plan start-up costs to employers which join an existing plan

Present Law

Present law provides a nonrefundable income tax credit equal to 50 percent of the qualified start-up costs paid or incurred during the taxable year by an eligible employer[547] that adopts a new eligible employer plan,[548] provided that the plan covers at least one non-highly compensated employee.[549] Qualified start-up costs are expenses connected with the establishment or administration of the plan and retirement-related education of employees with respect to the plan. The amount of the credit for any taxable year is limited to the greater of (1) $500 or (2) the lesser of (a) $250 multiplied by the number of non-highly compensated employees of the eligible employer who are eligible to participate in the plan or (b) $5,000. The credit applies for up to three consecutive taxable years beginning with the taxable year the plan is first effective, or, at the election of the employer, with the year preceding the first plan year.

An eligible employer is an employer that, for the preceding year, had no more than 100 employees, each with compensation of $5,000 or more.[550] In addition, the employer must not have had a qualified employer plan covering substantially the same employees as the new plan with respect to which contributions were made or benefits were accrued during the three years preceding the first year for which the credit would apply. Members of controlled groups and affiliated service groups are treated as a single employer for purposes of these requirements. [551] All eligible employer plans of an employer are treated as a single plan.

No deduction is allowed for the portion of qualified start-up costs paid or incurred for the taxable year equal to the amount of the credit.

Description of Proposal

The proposal clarifies that the first credit year is the taxable year which includes the date that the eligible employer plan to which such costs relate becomes effective with respect to the eligible employer.

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[547] An eligible employer has the meaning given such term by section 408(p)(2)(C)(i).

[548] An eligible employer plan means a qualified employer plan within the meaning of section 4972(d) and includes a section 401(a) qualified retirement plan, a section 403 annuity, any simplified employee pension ("SEP") within the meaning of section 408(k), and any simple retirement account ("SIMPLE") within the meaning of section 408(p). An eligible employer plan does not include a plan maintained by a tax-exempt employer or a governmental plan, as defined in section 414(d).

[549] A non-highly compensated employee is an employee who is not a highly compensated employee as defined under section 414(q).

[550] As defined in section 408(p)(2)(C).

[551] Sec. 52(a) or (b) and 414(m) or (o).

Effective Date

The proposal applies to eligible employer plans which become effective with respect to the eligible employer after the date of enactment.

6. Safe harbor for corrections of employee elective deferral failures

Present Law

Background on automatic enrollment features in retirement plans may be found in section A.1 of this document.

A general description of the Employee Plans Compliance Resolution System that this proposal modifies may be found in section B.7 of this document.

Special safe harbor correction method for failures related to automatic contribution features in a section 401(k) or 403(b) plan

Employee Elective Deferral Failures

A safe harbor correction method is available for certain employee elective deferral failures associated with missed elective deferrals for eligible employees who ae subject to an automatic contribution feature in a section 401(k) or 403(b) plan (including employees who made affirmative elections in lieu of automatic contributions but whose elections were not implemented correctly).[552]

An "employee elective deferral failure"[553] is a failure to implement elective deferrals correctly in a section 401(k) plan or 403(b) plan, including elective deferrals pursuant to an affirmative election or pursuant to an automatic contribution feature under such a plan, and a failure to afford an employee the opportunity to make an affirmative election because the employee was improperly excluded from the plan. Automatic contribution features include automatic enrollment and automatic escalation features that are affirmatively elected.[554]

If the failure to implement an automatic contribution feature for an affected eligible employee or the failure to implement an affirmative election of an eligible employee who is otherwise subject to an automatic contribution feature does not extend beyond the end of the nine and one-half month period after the end of the plan year of the failure (which is generally the filing deadline of the Form 5500 series return, including automatic extensions), no qualified

[552] Sec. 2.05(8) of Appendix A of Rev. Proc. 2021-30.

[553] Sec. 2.05(10) of Appendix A of Rev. Proc. 2021-30.

[554] Sec. 2.05(10) of Appendix A of Rev. Proc. 2021-30.

nonelective contribution ("QNEC")[555] for the missed elective deferrals is required, provided that the following conditions are satisfied:

1. Correct deferrals begin no later than the earlier of the first payment of compensation made on or after the last day of the nine and one-half month period after the end of the plan year in which the failure first occurred for the affected eligible employee or, if the plan sponsor was notified of the failure by the affected eligible employee, the first payment of compensation made on or after the end of the month after the month of notification;

2. Notice of the failure, that satisfies the content requirements described below, is given to the affected eligible employee not later than 45 days after the date on which correct deferrals begin; and

3. If the eligible employee would have been entitled to additional matching contributions had the missed deferrals been made, the plan sponsor makes a corrective allocation (adjusted for earnings) on behalf of the employee equal to the matching contributions that would have been required under the terms of the plan as if the missed deferrals had been contributed to the plan in accordance with the timing requirements under SCP for significant operational failures. This correction method provides an alternative safe harbor method for calculating earnings for Employee Elective Deferral Failures under section 401(k) plans or 403(b) plans.[556]

Content of notice requirement

The required notice must include the following information:

1. General information relating to the failure, such as the percentage of eligible compensation that should have been deferred, and the approximate date that the compensation should have begun to be deferred. The general information need not include a statement of the dollar amounts that should have been deferred;

2. A statement that appropriate amounts have begun to be deducted from compensation and contributed to the plan (or that appropriate deductions and contributions will begin shortly);

[555] A QNEC, as defined in Treas. Reg. sec. 1.401(k)-6 means "employer contributions, other than elective contributions or matching contributions, that, except as provided otherwise in § 1.401(k)–1(c) and (d), satisfy the requirements of § 1.401(k)–1(c) and (d) as though the contributions were elective contributions, without regard to whether the contributions are actually taken into account under the ADP test under § 1.401(k)–2(a)(6) or the ACP test under § 1.401(m)–2(a)(6). Thus, the nonelective contributions must satisfy the nonforfeitability requirements of § 1.401(k)-1(c) and be subject to the distribution limitations of § 1.401(k)-1(d) when they are allocated to participants' accounts."

[556] The plan may also use the earnings adjustment methods set forth in section 3 of Appendix B of Rev. Proc. 2021-30.

3. A statement that corrective allocations relating to missed matching contributions have been made (or that corrective allocations will be made). Information relating to the date and the amount of corrective allocations need not be provided;

4. An explanation that the affected participant may increase his or her deferral percentage in order to make up for the missed deferral opportunity, subject to applicable limits for elective deferrals;[557] and

5. The name of the plan and plan contact information (including name, street address, email address, and telephone number of a plan contact).

Sunset of safe harbor correction method

The safe harbor correction method is available for plans only with respect to failures that begin on or before December 31, 2023.

Description of Proposal

Under the proposal, the Secretary shall modify the special safe harbor correction method contained in EPCRS guidance[558] for failures related to automatic contribution features in a section 401(k) plan or a section 403(b) plan to (1) provide that such safe harbor correction method is not limited to failures that begin on or before December 31, 2023 and (2) to clarify that EPCRS correction methods for failures related to automatic contribution features that require notices to a participant can be satisfied without regard to whether the participant remains employed at the time corrections are made.

Effective Date

The proposal applies to any errors with respect to which the date that is nine and one-half months after the end of the plan year during which the error occurred is after December 31, 2023.

7. Reform of family attribution rule

Present Law

Nondiscrimination requirements

A qualified retirement plan is prohibited from discriminating in favor of highly compensated employees, referred to as the nondiscrimination requirements. These requirements are intended to ensure that a qualified retirement plan provides meaningful benefits to an employer's rank-and-file employees as well as highly compensated employees so that qualified retirement plans achieve the goal of retirement security for both lower-paid and higher-paid employees. The nondiscrimination requirements consist of a minimum coverage requirement

[557] Under sec. 402(g).

[558] See sec. .05(8) of Appendix A to Rev. Proc. 2021-30.

and general nondiscrimination requirements.[559] For purposes of these requirements, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of $135,000 (for 2022).[560]

The minimum coverage and general nondiscrimination requirements apply annually on the basis of the plan year. In applying these requirements, as discussed below, employees of all members of a controlled group or affiliated service group are treated as employed by a single employer. Employees who have not satisfied minimum age and service conditions under the plan, certain nonresident aliens, and employees covered by a collective bargaining agreement are generally disregarded.[561] However, a plan that covers employees with less than a year of service or who are under age 21 must generally include those employees in any nondiscrimination test for the year but can test the plan for nondiscrimination in two parts: (1) by separately testing the portion of the plan covering employees who have not completed a year of service or are under age 21 and treating all of the employer's employees with less than a year of service or under age 21 as the only employees of the employer; and (2) then testing the rest of the plan taking into account the rest of the employees of the employer and excluding those employees. If a plan does not satisfy the nondiscrimination requirements on its own, it may in some circumstances be aggregated with another plan, and the two plans tested together as a single plan.

Aggregation rules for groups under common control

In general, in applying the requirements for tax-favored treatment for retirement plans, employees of employers (including corporations and other entities) that are members of a group under common control are treated as employed by a single employer (referred to as aggregation rules).[562] For example, in applying the nondiscrimination requirements, the employees of all the members of a group, and the benefits provided under plans maintained by any member of the group, are generally taken into account. In the case of taxable entities, common control is generally based on the percentage of equity ownership with a general threshold of 80 percent

[559] Sections 401(a)(3) and 410(b) address the minimum coverage requirement; section 401(a)(4) describes the general nondiscrimination requirements, with related rules in section 401(a)(5). Detailed regulations implement the statutory requirements. Governmental plans are generally exempt from these requirements.

[560] Sec. 414(q). At the election of the employer, employees who are highly compensated based on compensation may be limited to the top 20 percent highest paid employees. A non-highly compensated employee is an employee other than a highly compensated employee.

[561] A plan or portion of a plan covering collectively bargained employees is generally deemed to satisfy the nondiscrimination requirements.

[562] Sec. 414(c) and the regulations thereunder provide for aggregation of groups under common control. Section 414(b), (m) and (o) also provide aggregation rules for a controlled group of corporations and affiliated service groups. Under section 414(t), the aggregation rules apply also for purposes of various benefits other than retirement benefits. In addition, other provisions incorporate the aggregation rules by reference, such as section 4980H, requiring certain employers to offer health coverage to full-time employees.

ownership. Other tests apply for entities that do not involve ownership. Employees of the members of an affiliated service group are similarly treated as employed by a single employer.[563]

Family attribution rules

The family attribution rules address the scenarios in which a person is treated as having an ownership interest in a business based upon a family relationship.[564] For example, an individual is generally attributed the individual's spouse's ownership unless certain criteria are satisfied.[565]

One common exception to spousal attribution is for individuals who are legally separated under a divorce decree.[566] Other exceptions include (1) spouses who do not directly own any stock in the business during the taxpayer year; (2) a spouse who is neither an employee or director nor participates in the management of the business at any time during the year; (3) where no more than 50 percent of the business' gross income derives from passive investments, and (4) where the stock is transferable (i.e., is not subject to restrictions) and in favor of the individual or his or her minor children (e.g., the business owner cannot be required to offer a right of first refusal to his or her spouse or their children before selling the business to a third party).

A parent is generally attributed the ownership of a minor child under the age of 21 and is attributed the ownership of an adult child, age 21 or older, if the parent owns more than 50 percent of the business. A minor child is attributed the ownership of a parent while an adult child is attributed the ownership of a parent only if the adult child owns more than 50 percent of the business. There is no exception to the application of the family attribution rules for a minor child of individuals who are separated or divorced. For example, ownership of a business may be attributed to a divorced spouse through his or her minor child to the extent the exceptions for marital attribution do not apply.

The application of the family attribution rules is also impacted by the laws on familial property ownership in community property States.[567] In such a State, spouses may be deemed to own half of the property acquired during a marriage, except under limited circumstances. Accordingly, spouses in community property states may fail to satisfy the criteria that a spouse does not directly own any stock in the business during the taxable year.

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[563] Sec. 414(m).

[564] Family attribution can address interests owned between spouses or among parents and children or grandparents and grandchildren.

[565] Sec. 1563(e)(5). For example, if a husband and wife each owned 25 percent of a business, generally both spouses would be treated as owning 50 percent of that business.

[566] Sec. 1563(e).

[567] For a broader discussion of community property laws, see "Internal Revenue Manual – 25.18.1 Basic Principles of Community Property Law", *available at* https://www.irs.gov/irm/part25/irm_25-018-001 (accessed June 154, 2022). Community property rules exists in nine states (Arizona, California, Idaho, Louisiana, New Mexico, Nevada, Texas, Washington and Wisconsin) and two territories (Guam and Puerto Rico). *Id.*

Description of Proposal

The proposal adds special rules to address family attribution and to disregard community property laws for purposes of determining ownership of a business. For purposes of applying the attribution rules,[568] community property laws are disregarded for purposes of determining ownership. In addition, in the case of stock of an individual that is not attributed to the individual's spouse under the spousal attribution rules[569] (for example, due to the spouse's legal separation), such stock is not attributed to such spouse by reason of a minor child's ownership of an option to acquire such stock.[570] And, except as provided by the Secretary, stock in different corporations that is attributed to a minor child from each parent,[571] but that is not attributed to such parents as spouses,[572] shall not by itself result in such corporations being members of the same controlled group. Similar rules apply in the case of affiliated service groups. Under the proposal, if these modifications cause two or more entities to be a controlled group or an affiliated service group, or to no longer be in a controlled group or affiliated service group, such change is treated as a transaction to which the special minimum coverage rule for certain dispositions or acquisitions applies.[573]

Effective Date

The proposal applies to plan years beginning on or after December 31, 2023.

8. Contribution limit for SIMPLE IRAs

Present Law

Background on SIMPLE plans may be found in section A.6 of this document.

Description of Proposal

The proposal increases the limit on the amount of elective deferrals that an employee may contribute to a SIMPLE IRA or SIMPLE 401(k) plan to $16,500 in the case of certain employers. This increased limit applies to: (1) an employer that had no more than 25 employees who received at least $5,000 of compensation from the employer for the preceding year, and (2) an employer that is eligible to elect to apply the higher limit, and so elects ("eligible electing

[568] Under section 318 (with respect to affiliated service groups) and section 1563 (with respect to controlled groups).

[569] Sec. 1563(e)(5).

[570] Ownership of the individual's stock is not attributed to the individual's spouse by reason of the combined application of sections 1563(e)(1) and 1563(e)(6)(A).

[571] Under section 1563(e)(6)(A).

[572] Under section 1563(e)(5).

[573] Sec. 410(b)(6)(C).

employer").[574] In the case of a plan to which this increased limit applies, the plan may also permit catch-up contributions of up to $4,750. The $16,500 and $4,750 amounts will be adjusted for inflation for taxable years beginning after 2024.

In order to qualify as an eligible electing employer, the employer (and any member of the employer's controlled group) must not have established or maintained, during the three preceding taxable years, a qualified retirement plan, section 403(a) annuity plan, or section 403(b) plan under which contributions were made, or benefits accrued, for substantially the same employees that are eligible to participate in the SIMPLE plan.

In the case of an eligible electing employer that elects to apply the increased elective deferral limit, such employer must provide an increased matching or nonelective contribution under the plan. If a matching contribution is provided, it must generally be four percent of compensation (rather than three percent),[575] and if a nonelective contribution is provided, it must be three percent of compensation (rather than two percent).

The proposal also requires the trustee or issuer of a SIMPLE plan to provide the Secretary a copy of the plan document at the time the arrangement is established (or, in the case of existing arrangements, no later than December 31, 2024).

The Secretary must, not later than December 31, 2024 and annually thereafter, report to the Committees on Finance and Health, Education, Labor, and Pensions of the Senate, and the Committees on Ways and Means and Education and Labor of the House of Representatives, the following data (together with any recommendations that the Secretary deems appropriate): (1) the number of SIMPLE IRA and SIMPLE 401(k) plans that are maintained or established during a year; (2) the number of eligible participants for such plans for such year; (3) median contribution amounts; (4) the most common types of investments; and (5) the fee levels charged in connection with the maintenance of accounts under the plans. The proposal requires such data to be collected separately for each type of plan. The Secretary may use such data as is otherwise available to the Secretary for publication and may use such approaches as are appropriate under the circumstances, including the use of voluntary surveys and collaboration on studies.

Effective Date

The proposal applies to taxable years beginning after December 31, 2023.

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[574] In both cases the employer must be otherwise eligible to have a SIMPLE IRA plan. In the case of an employer described in (1), a two-year grace period applies for subsequent years in which the employer has more than 25 employees who receive at least $5,000 in compensation. Under the grace period rule, the employer is treated as having 25 employees who receive at least $5,000 in compensation for the 2 years following the last year the employer had not more than 25 such employees.

[575] An employer is permitted to elect a lower matching contribution if certain requirements are met. Sec. 408(p)(2)(C)(2)(ii).

9. Employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year

Present Law

Background on section 401(k) plans may be found in section A.1 of this document. Background on SIMPLE IRA plans may be found in section A.6 of this document.

Description of Proposal

The proposal permits an employer to elect (in such form and manner as the Secretary may provide) at any time during a year, to terminate a SIMPLE IRA plan and replace it with a section 401(k) safe harbor plan,[576] provided certain requirements are met. First, the employer must establish and maintain the section 401(k) safe harbor plan as of the day after the termination date. In addition, the aggregate elective contributions of an employee under the terminated arrangement during its last plan year and under the section 401(k) safe harbor plan during its transition year[577] may not exceed the sum of (1) the total elective contributions that the employee is eligible to contribute to the SIMPLE IRA plan for the last plan year, multiplied by a fraction equal to the number of days in such plan year divided by 365, and (2) the total elective deferrals that the employee is eligible to contribute to the section 401(k) safe harbor plan for the transition year, multiplied by a fraction equal to the number of days in such transition year divided by 365.[578]

The proposal also provides an exception to the rollover rules that apply to a distribution from a SIMPLE IRA for certain rollovers to a section 401(k) plan or 403(b) plan. Under the proposal, if an employer terminates a SIMPLE IRA plan and establishes a section 401(k) plan or 403(b) plan, a payment by an individual of an amount distributed from the employer's SIMPLE IRA plan to the newly-established section 401(k) or 403(b) plan will not fail to qualify as a rollover contribution merely because it is paid to such plan within two years of the first date of the individual's participation in the SIMPLE IRA plan.

Effective Date

The proposal applies to plan years beginning after December 31, 2023.

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[576] For this purpose, a "section 401(k) safe harbor plan" includes a SIMPLE 401(k) plan, a basic 401(k) safe harbor plan, or an automatic enrollment 401(k) safe harbor plan. Secs. 401(k)(11), (12), and (13).

[577] Defined as the period beginning after the termination date and ending on the last day of the calendar year during which the termination occurs.

[578] In determining the total amount that may be contributed under either plan, catch up contributions are included. If this requirement is not satisfied, the terminating SIMPLE IRA plan is treated as violating the limit on elective contributions under section 408(p)(2)(A)(ii), and the section 401(k) safe harbor plan is treated as violating the limit on elective deferrals under section 401(a)(30).

10. Starter 401(k) plans for employers with no retirement plan

Present Law

Section 401(k) plans

A section 401(k) plan is a type of profit-sharing or stock bonus plan that contains a qualified cash or deferred arrangement. Background on section 401(k) plans may be found in section A.1 of this document.

Tax-sheltered annuities ("section 403(b) plans")

Section 403(b) plans are a form of tax-favored employer-sponsored plan that provides tax benefits similar to qualified retirement plans. Section 403(b) plans may be maintained only by (1) charitable tax-exempt organizations, and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities). Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans. For example, employer contributions (other than elective deferrals) and after-tax employee contributions made under a section 403(b) plan must satisfy nondiscrimination requirements in the same manner as a qualified plan.[579]

Additional background on section 403(b) plans may be found in section D.1 of this document.

Description of Proposal

The provision establishes two new plan designs: a new type of section 401(k) plan, a "starter 401(k) deferral-only arrangement" and a new type of 403(b) plan, a "safe harbor 403(b) plan."

Starter 401(k) deferral-only plans

A "starter 401(k) deferral-only arrangement" is a cash or deferred arrangement maintained by an eligible employer that meets certain requirements relating to (1) automatic enrollment, (2) contributions, (3) eligibility, and (4) employee notices. It is treated as satisfying the actual deferral percentage test, or "ADP" nondiscrimination test.[580]

Under the starter 401(k) deferral-only arrangement, each employee who is eligible to participate must be treated (unless the employee elects otherwise) as having elected to have the employer make elective contributions in an amount equal to the applicable qualified percentage of compensation. All employees of the employer must be eligible to participate in the arrangement other than those that do not meet the age and service requirements. Union

[579] Sec. 403(b)(12). These nondiscrimination requirements include rules relating to nondiscrimination in contributions, benefits, and coverage, a limitation on the amount of compensation that can be taken into account, and the average contribution percentage rules of section 401(m).

[580] Sec. 401(k)(3)(A)(ii).

employees and nonresident aliens with no earned income which constitutes income from sources within the United States may also be excluded.

The qualified percentage is determined under the terms of the arrangement, but must not be less than three percent or more than 15 percent and must be applied uniformly. The election to make elective deferrals at the qualified percentage ceases to apply to an employee if the employee makes an affirmative election not to contribute or to contribute at a different level.

Under the starter 401(k) deferral-only arrangement, the only contributions that may be permitted are elective contributions of employees eligible to participate. Thus, the employer may not make matching or nonelective contributions to the starter 401(k) deferral-only arrangement.

An employer is eligible to offer a starter 401(k) deferral-only arrangement if neither the employer nor a predecessor employer maintains another qualified plan for the year in which the determination is being made.[581] There is a limited exception for an employer who maintains a plan in which the only participants are employees covered by a collective bargaining agreement. A transition rule would also apply in the case of an employer who may fail to meet this requirement due to an acquisition, disposition, or other similar transaction during a specified transition period.

The aggregate amount of any employee's elective contributions for a calendar year may not exceed $6,000, adjusted for cost of living.[582] Catch-up contributions are permitted (for an employee who attains age 50 by the end of the taxable year) up to $1,000, indexed for inflation.

The starter 401(k) deferral-only arrangement also must satisfy the notice requirement applicable to a matching contribution automatic enrollment section 401(k) safe harbor plan. Similar to section 401(k) safe harbor plans, starter 401(k) deferral-only arrangements are not treated as top-heavy plans.[583]

Safe harbor deferral-only plan

The provision also establishes a new type of 403(b) plan, a "safe harbor deferral-only plan." Similar conditions to those described with starter 401(k) deferral-only arrangements apply for purposes of a safe harbor deferral-only plan. That is, a safe harbor deferral-only plan must also satisfy certain requirements that generally parallel the requirements described above.

[581] For this purpose, a qualified plan is a plan, contract, pension, account, or trust described in sec. 219(g)(5).

[582] Within the same manner as sec. 402(g)(4) (except that "2022" is substituted for "2005").

[583] Top-heavy requirements apply under the Code to limit the extent to which accumulated benefits or account balances under a qualified retirement plan can be concentrated with key employees. Sec. 416.

All employees of the employer must be eligible to participate in a safe harbor deferral-only plan with certain limited exceptions.[584] A safe harbor deferral-only plan is treated as satisfying the universal availability requirement applicable to 403(b) plans.

Effective Date

The provision is effective for plan years beginning after December 31, 2023.

11. Credit for small employers that adopt an automatic portability arrangement

Present Law

A general description of distributions and rollovers may be found in section A.18 of this document

Currently, there are no special credits for small employers that adopt an automatic portability arrangement as part of a retirement plan maintained by the employer.

Description of Proposal

The proposal allows eligible small employers to take a new nonrefundable income tax credit in the amount of $500 in the taxable year during which the eligible employer adopts an automatic portability arrangement as part of an eligible plan maintained by the employer ("the automatic portability arrangement credit"). An eligible small employer is an employer that, for the preceding year, had no more than 100 employees, each with compensation of $5,000 or more. An eligible plan is a section 401(a) plan, a section 403(a) plan, a section 403(b) plan, a section 408(k) simplified employee pension ("SEP") plan, or a section 408(p) SIMPLE plan.

An automatic portability arrangement is an arrangement providing for automatic portability transactions. An automatic portability transaction means a transaction in which amounts distributed as a mandatory distribution[585] from a plan to an individual retirement plan established on behalf of an individual are subsequently transferred to an eligible plan in which such individual is an active participant, after such individual has been given advance notice of the transfer and has not affirmatively opted out of such transfer.

Effective Date

The proposal applies to taxable years beginning after the date of enactment.

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[584] Sec. 403(b)(12)(A)(ii). Nonresident aliens, students, and employees who normally work less than 20 hours per week may be excluded.

[585] Sec. 401(a)(31)(B)(i). A mandatory distribution, where the present value of the nonforfeitable accrued benefit of the participant (as determined under section 411(a)(11)) is in excess of $1,000 but does not exceed $5,000, must be directly rolled over to an IRA chosen by the plan administrator or the payor, unless a participant elects otherwise.

12. Re-enrollment credit

Present Law

Section 401(k) plans

A qualified defined contribution plan may include a qualified cash or deferred arrangement, under which employees may elect to have contributions made to the plan (referred to as "elective deferrals") rather than receive the same amount as current compensation (referred to as a "section 401(k) plan").[586] The maximum annual amount of elective deferrals that can be made by an employee for a year is $20,500 (for 2022) or, if less, the employee's compensation.[587] For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is increased by $6,500 (for 2022) (called "catch-up contributions").[588] The dollar limits for elective deferrals, including catch-up contributions, are indexed for inflation. An employee's elective deferrals must be fully vested (nonforfeitable to the employee).[589] A section 401(k) plan may also provide for employer matching and nonelective contributions, which may be subject to vesting conditions. A matching contribution is conditioned on the employee making elective deferrals,[590] while a nonelective contribution is not conditioned on whether an employee has elected to make contributions to the plan.

Automatic enrollment

A section 401(k) plan must provide each eligible employee with an effective opportunity to make or change an election to make elective deferrals at least once each plan year.[591] Whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including the adequacy of notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections.

Section 401(k) plans are generally designed so that an employee will receive cash compensation unless the employee affirmatively elects to make elective deferrals to the section 401(k) plan. Alternatively, a plan may provide that elective deferrals are made at a specified rate when an employee becomes eligible to participate unless the employee elects otherwise (that is,

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[586] Elective deferrals are generally made on a pretax basis and distributions attributable to elective deferrals are includible in income. However, a section 401(k) plan is permitted to include a "qualified Roth contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as after-tax Roth contributions. Certain distributions from a designated Roth account are excluded from income, even though they include earnings not previously taxed.

[587] Sec. 402(g).

[588] Sec. 414(v).

[589] Sec. 411(a).

[590] Matching contributions may also be conditioned on the employee making Roth contributions or after-tax contributions.

[591] Treas. Reg. sec. 1.401(k)-1(e)(2)(ii)

affirmatively elects not to make contributions or to make contributions at a different rate). This plan design is referred to as automatic enrollment.

Automatic enrollment safe harbor 401(k) plan design

One safe harbor applies for a section 401(k) plan that includes automatic enrollment ("automatic enrollment 401(k) safe harbor plan").[592] An automatic enrollment section 401(k) safe harbor plan must provide that, unless an employee elects otherwise, the employee is treated as electing to make elective deferrals at a default rate equal to a percentage of compensation as stated in the plan that is at least (1) three percent of compensation through the end of the first plan year that begins after the first deemed election applies to the participant, (2) four percent during the second plan year, (3) five percent during the third plan year, and (4) six percent during the fourth plan year and thereafter.[593] An automatic enrollment section 401(k) safe harbor plan generally may provide for default rates higher than these minimum rates, but the default rate cannot exceed 15 percent for any year (10 percent during the first year).

The automatic enrollment section 401(k) safe harbor plan also must satisfy either (1) a matching contribution requirement, or (2) provide for a nonelective contribution. The matching contribution requirement under the matching contribution automatic enrollment 401(k) safe harbor plan is 100 percent of elective contributions of the employee for contributions not in excess of one percent of compensation, and 50 percent of elective contributions for contributions that exceed one percent of compensation but do not exceed six percent, for a total matching contribution of up to 3.5 percent of compensation. Alternatively, the plan can provide that the employer will make a nonelective contribution of three percent. For an automatic enrollment 401(k) safe harbor plan, the matching and nonelective contributions are required to become 100 percent vested only after two years of service (rather than being required to be immediately vested when made).

Safe harbor notice

The matching contribution automatic enrollment section 401(k) safe harbor plan is subject to a notice requirement.[594] A written notice must be provided to each employee eligible to participate, within a reasonable period before each plan year and must describe the employee's rights and obligations under the arrangement. Such notice must be (1) sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and (2) written in a manner calculated to be understood by the average employee to whom the arrangement applies.

In the case of a matching contribution automatic enrollment section 401(k) safe harbor plan, the notice must also (1) explain the employee's right under the arrangement to elect not to

[592] Sec. 401(k)(13).

[593] Sec. 401(k)(13)(C)(iii). These automatic increases in default contribution rates are required for plans using the safe harbor. Rev. Rul. 2009–30, 2009-39 I.R.B. 391, provides guidance for including automatic increases in other plans using automatic enrollment, including under a plan that includes an eligible automatic contribution arrangement.

[594] Secs. 401(k)(12)(A); 401(k)(13)(B).

have elective contributions made on the employee's behalf (or to elect to have such contributions made at a different percentage), (2) in the case of an arrangement under which the employee may elect among 2 or more investment options, explain how contributions made under the arrangement will be invested in the absence of any investment election by the employee. Additionally, the employee must have a reasonable period of time after receipt of the notice and before the first elective contribution is made to make either such election.

Small employer credit

For tax years beginning after December 31, 2019, a nonrefundable income tax credit is available for an eligible employer that establishes an eligible automatic contribution arrangement under a qualified employer plan, requiring the plan to include a cash or deferred arrangement under which participants are treated as having made an election to make elective contributions at a uniform percentage of compensation until the participant specifically elects not to have such contributions made (or elects to have such contributions made at a different percentage).[595] Qualified employer plans include 401(a) plans, 403(a) plans, SIMPLE IRA plans and SEPs but exclude governmental plans and plans maintained by tax-exempt employers.

The credit is equal to $500 for any taxable year of an eligible employer that occurs during the period of three taxable years beginning with the first taxable year for which an eligible employer includes an eligible automatic contribution arrangement in a qualified employer plan that it sponsors. No taxable year is treated as occurring within the credit period unless the eligible automatic contribution arrangement is included in the plan for that year.

An eligible employer is an employer that with respect to any year, had no more than 100 employees with compensation of at least $5,000 or more for the preceding year.[596] Certain related employers are treated as a single employer for purposes of these requirements.[597] All eligible employer plans of an employer are treated as a single plan.

Re-enrollment credit

There is not currently a credit for re-enrollment.

Description of Proposal

Under the proposal, a new nonrefundable income tax credit is available for an eligible employer that establishes an eligible automatic contribution arrangement under a qualified employer plan, requiring the plan to include a cash or deferred arrangement under which participants are treated as having made an election to make elective contributions at a uniform

[595] Sec. 45T.

[596] An eligible employer who establishes and maintains a plan for one or more years, but who fails to be an eligible employer for any later year is treated as an eligible employer for the two years following the last year the employer was an eligible employer, unless the failure is due to any acquisition, disposition, or similar transaction involving an eligible employer.

[597] Secs. 52(a) or (b) and 414(m). See also Notice 2020-68, 2020-38 I.R.B. 567, September 14, 2020.

percentage of compensation until the participant specifically elects not to have such contributions made (or elects to have such contributions made at a different percentage) and which contains a re-enrollment provision. Qualified employer plans include 401(a) plans, 403(a) plans, SIMPLE IRA plans and SEPs but exclude governmental plans and plans maintained by tax-exempt employers.

A re-enrollment provision means a provision of an eligible automatic contribution arrangement under which each employee eligible to participate in the arrangement who is not contributing or is contributing less than the percentage applicable to an eligible employee in the first year of eligibility is treated as being in such first year of eligibility in each applicable year with respect to the employee. The election treated as having been made will cease to apply to the employee if the employee makes an affirmative election to either (1) not have such contributions made or (2) have elective contributions made at a different level, as specified in such affirmative election. An "applicable year" means, with respect to an employee, such employee's first plan year of eligibility under the arrangement, and all subsequent plan years of eligibility. However, following any applicable year of an employee (determined after the application of this sentence), the plan may elect to treat the next one or two plan years as not being applicable years with respect to such employee.

The credit is equal to $500 for any taxable year of an eligible employer that occurs during the period of three taxable years beginning with the first taxable year for which an eligible employer includes a re-enrollment provision in an eligible automatic contribution arrangement in a qualified employer plan that it sponsors. No taxable year is treated as occurring within the credit period unless the re-enrollment provision is included in the plan for such year. The credit is zero for any other taxable year.

An eligible employer is an employer that with respect to any year, had no more than 100 employees with compensation of at least $5,000 or more for the preceding year.[598] Certain related employers are treated as a single employer for purposes of these requirements. All eligible employer plans of an employer are treated as a single plan.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2023.

[598] An eligible employer who establishes and maintains a plan for one or more years, but who fails to be an eligible employer for any later year is treated as an eligible employer for the two years following the last year the employer was an eligible employer, unless the failure is due to any acquisition, disposition, or similar transaction involving an eligible employer.

13. Corrections of mortality tables

Present Law

Minimum funding standards apply to certain plans, generally including defined benefit plans.[599]

Mortality tables prescribed by the Secretary and periodically revised

Under legislation enacted in 2006,[600] the Secretary is directed to prescribe by regulation the mortality tables to be used in determining present value or making any computation under the funding rules.[601] Such tables are to be based on the actual experience of pension plans and projected trends in such experience. In prescribing tables, the Secretary is to take into account results of available independent studies of mortality of individuals covered by pension plans.

The Secretary is required (at least every 10 years) to revise any table in effect to reflect the actual experience of pension plans and projected trends in such experience.[602]

Substitute mortality tables

Separate mortality tables are required to be used with respect to disabled participants.[603] The provision also provides for the use of a separate mortality table upon request of the plan sponsor and approval by the Secretary.[604] A plan sponsor must submit a separate mortality table to the Secretary for approval at least seven months before the first day of the period for which the table is to be used. A mortality table submitted to the Secretary for approval is treated as in effect as of the first day of the period unless the Secretary, during the 180-day period beginning on the date of the submission, disapproves of the table and provides the reasons that the table fails to meet the applicable criteria. The 180-day period is to be extended upon mutual agreement of the Secretary and the plan sponsor.

Lump-sum distributions

In determining any present value or making any computation, the probability that future benefits will be paid in optional forms of benefit provided under the plan must be taken into account (including the probability of lump-sum distributions determined on the basis of the

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[599] Sec. 412. Section 412(e) describes plans to which minimum funding standards apply.

[600] The Pension Protection Act of 2006, Pub. L. No. 109-280, sec. 303.

[601] Sec. 430(h)(3). Final regulations were issued in 2017 (82 Fed. Reg. 46388 (Oct 5, 2017)).

[602] Proposed regulations were issued in April, 2022, setting forth the methodology Treasury and IRS intend to use to update the generally applicable mortality tables for determining present value or making any computation under section 430 (87 Fed. Reg. 25161, April 28, 2022).

[603] Sec. 430(h)(3)(D).

[604] Sec. 430(h)(3)(C).

plan's experience and other related assumptions).[605] The assumptions used to determine optional forms of benefit under a plan may differ from the assumptions used to determine present value for purposes of the funding rules under the provision. Differences in the present value of future benefit payments that result from the different assumptions used to determine optional forms of benefit under a plan must be taken into account in determining any present value or making any computation for purposes of the funding rules.

Description of Proposal

The proposal requires the Secretary (or the Secretary's delegate) to amend the regulation relating to "Mortality Tables for Determining Present Value Under Defined Benefit Pension Plans" (82 Fed. Reg. 46388 (October 5, 2017)). Under the amended regulations, for valuation dates occurring during or after 2022, mortality improvement rates will not assume future mortality improvements at any age which are greater than 0.78 percent.

Further regulatory amendments are to be made to modify the 0.78 percent figure as necessary to reflect material changes in the overall rate of improvement projected by the Social Security Administration.

Effective Date

The proposal is effective on the date of enactment.

In addition, the provision provides that the required regulatory amendments shall be deemed to have been made as of the date of the enactment, and as of such date all applicable laws shall be applied in all respects as though the required actions of the Secretary (or the Secretary's delegate) had been taken.

14. Enhancing retiree health benefits in pension plans

Present Law

Subject to various conditions, a qualified transfer of excess pension assets of a defined benefit plan may be made to a retiree medical account or life insurance account within the plan to fund retiree health benefits and group term life insurance benefits ("applicable retiree benefits").[606] For this purpose, excess pension assets generally means the excess, if any, of the value of the plan's assets[607] over 125 percent of the sum of the plan's funding target and target

[605] Sec. 430(h)(4).

[606] Sec. 420. Qualified transfers of excess assets are generally made within single-employer defined benefit plans, but are permitted also within multiemployer plans.

[607] For this purpose, the value of the plan's assets is the lesser of (1) the fair market value of the plan's assets (reduced by the prefunding balance and funding standard carryover balance determined under section 430(f), or the value of plan assets determined under section 430(g)(3) after reduction under section 430(f). See sec. 420(e)(2).

normal cost for the plan year.[608] A qualified transfer does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. No deduction is allowed to the employer for (1) a qualified transfer, or (2) the payment of applicable retiree benefits out of transferred funds (and any income thereon).[609]

In order for the transfer to be qualified, accrued retirement benefits under the plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation).[610] In addition, at least 60 days before the date of a qualified transfer, the employer must notify the Secretary, the Secretary of Labor, employee representatives, and the plan administrator of the transfer, and the plan administrator must notify each plan participant and beneficiary of the transfer.[611]

In addition, during the five-year period beginning with the year in which a qualified transfer is made ("the cost maintenance period"), the employer must provide health benefits or life insurance benefits at a cost that is the highest of the applicable employer costs for each of the two tax years immediately preceding the tax year in which the qualified transfer occurred.[612] The applicable employer cost means with respect to any taxable year, the amount determined by dividing the qualified current retiree liabilities of the employer for each taxable year (determined separately with respect to applicable health benefits and applicable life insurance benefits), by the number of individuals to whom coverage was provided during such taxable year for the benefits with respect to which the determination is being made.

No more than one qualified transfer may be made in any taxable year. For this purpose, a transfer to a retiree medical account and a transfer to a retiree life insurance account in the same year are treated as one transfer. No qualified transfer may be made after December 31, 2025.

Description of Proposal

Under the proposal, the expiration date for qualified transfers is extended to December 31, 2032. Thus, qualified transfers are permitted through that date.

The proposal also includes a special rule for de minimis transfers. In the case of a transfer of an amount that is not more than 1.75 percent of the amount of pension assets of an applicable plan, the determination of excess plan assets is made by substituting "110 percent" for "125 percent."[613] For purposes of this proposal, a plan is an "applicable plan" if, as of any

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[608] As determined under the section 430 funding rules for single-employer plans.

[609] Sec. 420(d).

[610] Sec. 420(c)(2).

[611] Sec. 101(e) of ERISA.

[612] Sec. 420(c)(3). A special rule applies to certain collectively bargained transfers under section 420(f)(2)(E)(i)(III).

[613] In section 420(e)(2)(B).

valuation date in each of the two plan years immediately preceding the plan year in which the transfer occurs, the amount of the excess plan assets exceeds 110 percent of the sum of the funding target and target normal cost for such plan year. In addition, with respect to a de minimis transfer, the cost maintenance period is seven years, rather than five years. This de minimis rule would not apply to collectively bargained plans.

Effective Date

The proposal is applicable to transfers made after the date of enactment.

15. Deferral of tax for certain sales of employer stock to employee stock ownership plan sponsored by S corporation

Present Law

In general

An employee stock ownership plan ("ESOP") is a stock bonus plan that is designated as an ESOP and is designed to invest primarily in stock of the employer, referred to as "qualifying employer securities."[614] An ESOP can be maintained by either a C corporation or an S corporation.[615] For purposes of ESOP investments, a "qualifying employer security" is generally defined as: (1) common stock of the employer or a member of the same controlled group that is readily tradable on an established securities market; (2) if there is no such readily tradable common stock, common stock of the employer (or member of the same controlled group) that has both voting power and dividend rights at least as great as any other class of common stock; or (3) noncallable preferred stock that is convertible into common stock described in (1) or (2) and that meets certain requirements.[616] In some cases, an employer may design a class of preferred stock that meets these requirements and that is held only by the ESOP.

An ESOP can be an entire plan or it can be a portion of a defined contribution plan. An ESOP may provide for different types of contributions, including employer nonelective contributions and others. For example, an ESOP may include a section 401(k) feature that permits employees to make elective deferrals. ESOPs are subject to additional requirements that do not apply to other plans that hold employer stock. For example, voting rights must generally be passed through to ESOP participants and employees must generally have the right to receive benefits in the form of stock. Certain of these requirements differ depending on whether the employer securities held by the ESOP are readily tradable on an established securities market. A security is considered readily tradable on an established securities market if the security is traded

[614] Sec. 4975(e)(7). Participant accounts in other types of defined contribution plans can also be invested in employer stock.

[615] A C corporation is so named because its tax treatment is governed by subchapter C of the Code. An S corporation is so named because its tax treatment is governed by subchapter S of the Code. An S corporation is a passthrough entity for income tax purposes. That is, income tax does not apply at the S corporation level. Rather, items of income, gain, or loss are taken into account for tax purposes by the S corporation shareholders on their own tax returns.

[616] Sec. 409(l).

on a national securities exchange that is registered under section six of the Securities Exchange Act of 1934 or the security is traded on a foreign national securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority and the security is deemed by the Securities and Exchange Commission ("SEC") as having a "ready market."[617]

Diversification requirements for ESOPs

ESOPs are subject to a requirement that a participant who has attained age 55 and who has at least 10 years of participation in the plan must be permitted to diversify the investment of the participant's account in assets other than employer securities.[618] The diversification requirement applies to a participant for six years, starting with the year in which the individual first meets the eligibility requirements (*i.e.*, age 55 and 10 years of participation). The participant must be allowed to elect to diversify up to 25 percent of the participant's account (50 percent in the sixth year), reduced by the portion of the account diversified in prior years.

The participant must be given 90 days after the end of each plan year in the election period to make the election to diversify. In the case of participants who elect to diversify, the plan satisfies the diversification requirement if: (1) the plan distributes the applicable amount to the participant within 90 days after the election period; (2) the plan offers at least three alternative investment options and, within 90 days of the election period, invests the applicable amount in accordance with the participant's election; or (3) the applicable amount is transferred within 90 days of the election period to another qualified defined contribution plan of the employer providing investment options in accordance with (2).[619]

If employer securities are not readily tradable on an established securities market, valuations with respect to activities carried out by the plan must be by an independent appraiser.[620] Valuations must be made in good faith and based on all relevant factors for determining the fair market value of securities.[621] In the case of a transaction between a plan and a disqualified person, value must be determined as of the date of the transaction. An independent appraisal will not in itself be a good faith determination of value in the case of a transaction

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[617] Treas. Reg. sec. 1.401(a)(35)-1(f)(5)(ii). "Ready market" is defined with reference to 17 CFR § 240.15c3-1. Under IRS guidance, this definition of readily tradable applies generally for purposes of the ESOP rules in the Code, including for purposes of sections 401(a)(22), 401(a)(28)(C), 409(h)(1)(B), 409(l), and 1042(c)(1)(A). Notice 2011-19, 2011-11 I.R.B. 550, March 14, 2011.

[618] Sec. 401(a)(28). Under sec. 401(a)(35) and ERISA sec. 204(j), special diversification rules apply to ESOPs that hold publicly traded employer securities, which are employer securities that are readily tradable on an established securities market. However, such rules do not apply to an ESOP if (A) there are no contributions or earnings held in the ESOP that are subject to sections 401(k) or 401(m); and (B) the ESOP is a separate plan for purposes of section 414(l) with respect to any other defined benefit plan or defined contribution plan maintained by the same employer or employers. Sec. 401(a)(35)(E). ESOPs that are not subject to section 401(a)(35) are subject to diversification rules under section 401(a)(28).

[619] Notice 88-56, 1988-1 C.B. 540, Q&A-16.

[620] Sec. 401(a)(28)(C). For purposes of this section, "independent appraiser" means any appraiser meeting requirements similar to the requirements of the regulations prescribed under section 170(a)(1).

[621] 26 CFR § 54.4975-11

between a plan and a disqualified person. However, in other cases, an independent determination of fair market value based on at least an annual appraisal will be deemed to be a good faith determination of value.

Right to demand employer securities and put option

A participant who is entitled to a distribution from the plan has a right to demand that his benefits be distributed in the form of employer securities.[622] If the employer securities are not readily tradable on an established market, a participant who is entitled to a distribution from the plan has a right to require that the employer repurchase employer securities under a fair valuation formula.[623]

Special ESOP rules

Certain benefits are available to ESOPs that are not available to other types of qualified retirement plans that hold employer stock. Under an exception to the prohibited transaction rules, an employer maintaining an ESOP may lend money to the ESOP, or the employer may guarantee a loan made by a third-party lender to the ESOP, to finance the ESOP's purchase of employer securities.[624] An ESOP that borrows funds to acquire employer securities is generally called a leveraged ESOP.

In the case of an ESOP maintained by a C corporation, payments of principal on the ESOP loan are deductible to the extent permitted under the general deduction limits for contributions to qualified retirement plans (which generally limit the deduction for contribution to a defined contribution plan for a year to 25 percent of the participants' compensation), and interest payments are deductible without regard to the limitation.[625] In addition, a C corporation may deduct dividends paid on employer stock held by an ESOP if the dividends are used to repay a loan, if they are distributed to plan participants, or if the plan gives participants the opportunity to elect either to receive the dividends or have them reinvested in employer stock under the ESOP and the dividends are reinvested at the participants' election.[626] This deduction is also allowed without regard to the general deduction limits on contributions to qualified plans.

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[622] Sec. 409(h)(1)(A).

[623] Sec. 409(h)(1)(B).

[624] Sec. 4975(d)(3). To qualify for the loan exemption, the loan must be primarily for the benefit of participants and beneficiaries of the plan, the interest on the loan must be at a reasonable rate, and any collateral given to a disqualified person by the plan must consist only of qualifying employer securities.

[625] Sec. 404(a)(9).

[626] Sec. 404(k). If a dividend is paid with respect to stock allocated to a participant's account and is used to make a payment on an ESOP loan, the plan must allocate employer securities with a fair market value of not less than the amount of such dividend to the participant's account for the year in which such dividend would have been allocated to such participant. Distributions with respect to S corporation stock held in an ESOP may also be used to repay an ESOP loan under similar conditions, but the distribution is not deductible by the S corporation.

Moreover, subject to certain requirements, a taxpayer may elect to defer the recognition of long-term capital gain on the sale of qualified securities to an ESOP maintained by a C corporation.[627]

ESOPs maintained by S corporations are subject to special rules. Generally, if a tax-exempt entity, including a trust holding qualified retirement plan assets, holds S corporation stock, it is treated as holding an interest in an unrelated trade or business and is subject to unrelated business income tax ("UBIT").[628] However, an ESOP holding employer securities issued by an S corporation is exempt from UBIT.

In part to prevent interests in income attributable to employer stock of an S corporation held by an ESOP (and thus not subject to current taxation) from being concentrated in a small group of persons, a number of adverse tax consequences may apply if a "nonallocation year" occurs with respect to an ESOP maintained by an S corporation. If any "disqualified person" has an interest in the S corporation in the form of "synthetic equity"[629] during a nonallocation year, an excise tax is imposed on the S corporation equal to 50 percent of the amount of such synthetic equity. If there are "prohibited allocations"[630] for the benefit of disqualified persons during a nonallocation year, the amount of the prohibited allocations is treated as distributed to the disqualified persons; an excise tax equal to 50 percent of the amount of the prohibited allocation applies to the S corporation; the qualified plan ceases to be an ESOP; and there is a potential for disqualification of the plan.

A "nonallocation year" is a plan year of an ESOP maintained by an S corporation in which disqualified persons own (directly or indirectly) at least 50 percent of the S corporation shares. For this purpose, a person's interest in the S corporation in the form of synthetic equity is treated as ownership of S corporation shares and is taken into account, but only if taking it into

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[627] Sec. 1042. See Part IV.C.3 for a further discussion of this provision.

[628] Sec. 512(e). Section 511 imposes UBIT on a tax-exempt entity's income from an unrelated trade or business.

[629] Pursuant to Sec. 409(p)(5) and (6)(C), and Treas. Reg. sec. 1.409(p)-1(f),"synthetic equity" is any stock option, warrant, restricted stock, deferred issuance stock right, or similar interest that gives the holder the right to acquire or receive stock of the S corporation in the future; a stock appreciation right, phantom stock unit, or similar right to a future cash payment based on the value of such stock or appreciation in such value; and rights to nonqualified deferred compensation (even though it is neither payable in, nor calculated by reference to, stock in the S corporation) and rights to acquire interests in certain related entities. A person can be a disqualified person, and a nonallocation year can occur based solely on interests in the S Corporation in the form of synthetic equity, even if the person is not a participant in the ESOP. Synthetic equity is an interest in income attributable to employer stock held by an ESOP, and reduces the ESOP's economic ownership of the S corporation. It is possible in certain circumstances to grant options or warrants for S corporation stock (or other synthetic equity) to a single person that, when combined with the outstanding shares of the S corporation, are options for up to 49 percent of the S corporation stock without causing a nonallocation year.

[630] Generally a "prohibited allocation" for the benefit of a disqualified person occurs during a nonallocation year to the extent that S corporation employer stock owned by the ESOP (and any assets attributable to such stock) is held for the benefit of a disqualified person during the nonallocation year (whether the stock is allocated to the person's account under the ESOP during the nonallocation year or an earlier year).

account causes a plan year to be a nonallocation year or a person to be a disqualified person.[631] Thus, both determinations are done with and without synthetic equity. "Disqualified persons" generally are persons who have at least a 10-percent interest (or who are a member of a family group having at least a 20-percent interest) in the portion of the S corporation shares held by the ESOP, either by having shares of S corporation employer stock allocated to the person's account under the ESOP (or being treated as having a portion of unallocated shares), or by having an interest in the S corporation in the form of synthetic equity.

Election to defer gain on sale to ESOP

A taxpayer may elect to defer the recognition of long-term capital gain on the sale of qualified securities to an ESOP if certain requirements are met.632 Nonrecognition applies to the extent that the taxpayer reinvests the sale proceeds in qualified replacement property within a specified replacement period. Qualified securities (discussed below) are certain securities issued by a C corporation. Thus, this rule does not apply to the sale of S corporation stock.

For a taxpayer to be eligible for nonrecognition treatment, (1) the qualified securities must be sold to an ESOP; (2) the ESOP or eligible employee worker-owned cooperative must own, immediately after the sale, at least 30 percent of each class of outstanding stock, or the total value of all outstanding stock of the corporation issuing the qualified securities; and (3) the taxpayer must provide certain information to the Secretary. In addition, the taxpayer's holding period with respect to the qualified securities must be at least three years at the time of the sale.

The ESOP must preclude the allocation to certain individuals of assets attributable to the qualified securities received in the sale; an excise tax may apply in the case of a prohibited allocation.[633] In addition, an excise tax may apply if the ESOP or eligible employee worker-owned cooperative disposes of the qualified securities within three years of the date of the sale.[634]

Qualified securities

Qualified securities are qualifying employer securities (as defined for ESOP purposes) that (1) are issued by a domestic C corporation that, for at least one year before and immediately

[631] An ESOP maintained by an S corporation may be able prevent a nonallocation year (or a prohibited allocation during a nonallocation year) by transferring S corporation employer stock allocated to the account of disqualified persons (or persons expected to become disqualified persons) to a separate portion of the qualified plan (or another qualified retirement plan of the S corporation) that is not designated as an ESOP and allocate it to the accounts of those persons under the separate portion (or other plan). In that case, the qualified retirement plan is subject to UBIT with respect to those transferred shares of S corporation stock.

[632] Sec. 1042. Deferred recognition of gain may apply also to a sale of qualified securities to an eligible worker-owned cooperative. A sale of securities to an ESOP or eligible employee worker-owned cooperative by an underwriter in the ordinary course of the trade or business as an underwriter (whether or not guaranteed), or by a C corporation, is not eligible for nonrecognition treatment under section 1042. Special rules apply in the case of a sale of stock of an agricultural or horticultural refiner or processor to an eligible farmers' cooperative.

[633] Secs. 409(n) and 4979A.

[634] Sec. 4978.

after the sale, has no readily tradable securities outstanding (and no member of the C corporation's controlled group has readily tradable securities outstanding), and (2) have not been received by the seller as a distribution from a qualified plan or as a transfer pursuant to an option or similar right to acquire stock granted to an employee by an employer.

Qualified replacement property

Qualified replacement property consists of any security[635] issued by a domestic operating corporation, which did not, for the corporation's taxable year preceding the taxable year in which the security was purchased by the taxpayer seeking nonrecognition treatment, have passive investment income[636] exceeding 25 percent of the corporation's gross receipts for such preceding taxable year. In addition, securities of the domestic corporation that issued the qualified securities (and of any member of a controlled group of corporations with such corporation) are not qualified replacement property.

The qualified replacement property must be purchased within a replacement period beginning on the date three months prior to the date the qualified securities are sold and ending twelve months after the date of the sale.

The basis of the taxpayer in qualified replacement property acquired during the replacement period is reduced by an amount not greater than the amount of gain realized on the sale that was not recognized pursuant to the taxpayer's election. If more than one item of qualified replacement property is acquired, an allocation rule applies to determine the taxpayer's basis in each item. Under the allocation rule, the basis of each item designated as qualified replacement property is reduced by an amount determined by multiplying the total gain eligible for nonrecognition treatment by a fraction. The numerator of the fraction is the cost of the item of replacement property and the denominator is the total cost of all such items.

Recapture of gain

If a taxpayer disposes of any qualified replacement property, notwithstanding any other provision of the Code, gain (if any) must be recognized to the extent of the gain that was not recognized on the sale of stock to the ESOP or eligible employee worker-owned cooperative, subject to certain exceptions. Exceptions to recapture include transfers by gift or by reason of the death of the individual.

Description of Proposal

The proposal amends the definition of qualified securities to remove the requirement that the securities be issued by a C corporation. Thus, subject to the present-law requirements applicable with respect to the sale of qualified securities to an ESOP, a taxpayer may elect to

[635] Security is defined for this purpose as under section 165(g), *i.e.*, a share of stock in a corporation; a right to subscribe for, or to receive, a share of stock in a corporation; or a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

[636] Passive investment income is defined for this purpose as under section 1362(d)(3)(D).

defer the recognition of long-term capital gain on the sale of qualified securities of an S corporation to an ESOP. However, in the case of a sale of S corporation securities, the election to defer recognition of gain may not be made with respect to more than 10 percent of the amount realized on the sale. Such election must take into account the portion of adjusted basis that is properly allocable to the portion of the amount realized with respect to which the election is made.

Effective Date

This proposal applies to sales after December 31, 2027.

G. Notices

1. Review and report to Congress relating to reporting and disclosure requirements

Present Law

Under the Code and ERISA, plans must satisfy requirements relating to reporting and disclosure of plan information. These requirements include information required to be reported to the IRS, the DOL, and the PBGC, as well as to participants and beneficiaries.[637]

For example, plan administrators generally must file an annual return with the IRS, an annual report with the DOL, and certain information annually with the PBGC. Form 5500, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 with the DOL. Other information required to be reported to the IRS includes plan distributions, excise taxes imposed on the plan, and separated participants with deferred vested benefits.[638] Defined benefit plans must report certain information to the PBGC, including information relating funding, terminations, and reportable events.

With respect to participants and beneficiaries, the reporting and disclosure requirements include the provision of a summary plan description, which describes the plan's eligibility requirements for participation and benefits, vesting provisions, procedures for claiming benefits under the plan, and other information.[639] Plans must also furnish participants and beneficiaries with periodic benefit statements that indicate the total benefits accrued and the nonforfeitable benefits (or the earliest date on which benefits become nonforfeitable).[640] Certain information is required to be provided upon certain events, such as termination of employment,[641] plan termination,[642] reduction in future benefit accruals,[643] or a plan distribution that is eligible for rollover treatment.[644] Certain requirements also apply depending on the type of plan. For

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[637] In certain cases, plan information also must be provided to other interested parties such as unions (in the case of multiemployer plans).

[638] This information is reported on the Form 1099-R (plan distributions), Form 5330 (excise tax), and Form 8955-SSA (separated participants with deferred vested benefits).

[639] ERISA sec. 102; 29 C.F.R. sec. 2520.102-2 and -3. Plans must also provide summaries of material modifications to the plan. ERISA sec. 102.

[640] ERISA sec. 105.

[641] ERISA sec. 209.

[642] 29 C.F.R. sec. 2550.404a-3 (relating to termination of individual account plans); ERISA sec. 4041(a)(2) (relating to termination of single-employer defined benefits plans). Single employer defined benefit plans also must report plan termination to the PBGC.

[643] Sec. 4980F; ERISA sec. 204(h).

[644] Sec. 402(f).

example, section 401(k) plans and section 403(b) plans must advise employees of opportunities to make or change elective deferrals under the plan,[645] and section 401(k) safe harbor plans and plans with automatic enrollment features have special notice requirements.[646] Certain notices must be provided to participants and beneficiaries in individual account plans who are permitted to exercise control over account assets.[647] In the case of defined benefit plans, notices relating to plan funding, such as an annual funding notice, must be furnished to participants and beneficiaries.[648]

Description of Proposal

The proposal requires the Secretary, the Secretary of Labor, and the PBGC to review the reporting and disclosure requirements that apply to pension plans[649] under Title I of ERISA and that apply to qualified retirement plans[650] under the Code. Such review must take place as soon as practicable after the date of enactment, and, no later than two years after such date, after consultation with a balanced group of participant and employer representatives, the agencies must report on the effectiveness of the reporting and disclosure requirements and make certain recommendations, as described below, to the Committee on Education and Labor and the Committee on Ways and Means of the House of Representatives, and the Committee on Health, Education, Labor, and Pensions and the Committee on Finance of the Senate. The agencies must conduct appropriate surveys and data collection to obtain any needed information.

The report must include the following:

- Recommendations as may be appropriate to consolidate, simplify, standardize, and improve such requirements so as to simplify reporting for such plans and ensure that plans can furnish and participants and beneficiaries timely receive and better understand the information they need to monitor their plans, plan for retirement, and obtain the benefits they have earned; and
- To assess the effectiveness of the applicable reporting and disclosure requirements, an analysis, based on plan data, of how participants and beneficiaries are providing preferred contact information, the methods by which plan sponsors and plans are furnishing disclosures, and the rate at which participants and beneficiaries (grouped by key demographics) are receiving, accessing, and retaining disclosures.

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[645] Treas. Reg. sec. 1.401(k)-1(e)(2)(ii); Treas. Reg. sec. 1.403(b)-5(b)(2). This requirement also applies to SIMPLE plans. Sec. 408(p)(5)(C).

[646] Sec. 401(k)(12)(D); sec. 401(k)(13)(E); sec. 414(w)(4).

[647] ERISA sec. 404(c).

[648] ERISA sec. 101. Certain notices related to plan funding also must be provided to the PBGC.

[649] ERISA sec. 3(2).

[650] For this purpose, qualified retirement plans include plans qualified under section 401(a), annuity plans described in section 403(a), and section 403(b) plans. Sec. 4974(c)(1), (2), and (3).

Effective Date

The proposal is effective on the date of enactment.

2. Report to Congress on section 402(f) notices

Present Law

Section 402(f) requires the plan administrator of any plan, before making an eligible rollover distribution, to provide a written explanation to the recipient, known as the 402(f) notice. The 402(f) notice must explain rules that may apply to the distribution, such as rules relating to a direct transfer to an eligible retirement plan, the possible application of tax withholding to certain distributions, rules for rollovers within 60 days, and other rules that could apply to the distribution.

In Notice 2020-62,[651] the IRS provides updated safe harbor explanations that generally may be used by plan administrators and payors to satisfy section 402(f).

Description of Proposal

The proposal requires that the Comptroller General of the United States submit a report to the Committees on Finance and Health, Education, Labor, and Pensions of the Senate and the Committees on Ways and Means and Education and Labor of the House of Representatives on the notices provided by retirement plan administrators to plan participants under section 402(f). The report is to analyze the effectiveness of such notices and make recommendations, as warranted by the findings, to facilitate better understanding by recipients of different distribution options and corresponding tax consequences, including spousal rights.

The report is due not later than 18 months after the date of enactment.

Effective Date

The proposal is effective on the date of enactment.

3. Eliminating unnecessary plan requirements related to unenrolled participants

Present Law

Background on the reporting and disclosure requirements that apply to plans under the Code and ERISA may be found in section G.1 of this document.

[651] Notice 2020-62, 2020-35 I.R.B. 476 (Aug. 10, 2020), provides guidance regarding 402(f) notices and updates previous 402(f) notice guidance, Notice 2018-74, 2018-40 I.R.B. 529 (Sept. 24, 2018), to reflect intervening legislation.

Description of Proposal

The proposal generally exempts defined contribution plans from requirements under the Code[652] to provide disclosures, notices, and other plan documents to unenrolled participants, provided that the unenrolled participant receives: (1) an annual reminder notice[653] of the participant's eligibility to participate in the plan and any applicable election deadlines, and (2) any document the participant requests that the participant would be entitled to if not for this proposal.

The proposal defines "unenrolled participant" as an employee who (1) is eligible to participate in a defined contribution plan; (2) has received the summary plan description and any other notices related to eligibility under the plan that are required to be furnished under the Code or ERISA in connection with the participant's initial eligibility to participate in the plan; (3) is not participating the plan; (4) does not have an account balance in the plan; and (5) satisfies such other criteria as the Secretary may determine is appropriate, as prescribed in guidance in consultation with the Secretary of Labor. For this purpose, any eligibility to participate in the plan following any period of ineligibility is treated as initial eligibility.

Effective Date

The proposal is effective for plan years beginning after the date of enactment.

[652] Modifications to Labor provisions are necessary to effectuate this proposal.

[653] As defined in section 111(c) of ERISA.

H. Technical Modifications

1. Repayment of qualified birth or adoption distributions limited to three years

Present Law

Distributions from tax-favored retirement plans

A distribution from a qualified retirement plan, a tax-sheltered annuity plan (a "section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), or an IRA generally is included in income for the year distributed.[654] These plans are referred to collectively as "eligible retirement plans." In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[655]

In general, a distribution from an eligible retirement plan may be rolled over to another eligible retirement plan within 60 days, in which case the amount rolled over generally is not includible in income. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual.

The terms of a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan generally determine when distributions are permitted. However, in some cases, restrictions may apply to distributions before an employee's termination of employment, referred to as "in-service" distributions. Despite such restrictions, an in-service distribution may be permitted in the case of financial hardship or an unforeseeable emergency.

Distributions in the event of a qualified birth or adoption

An exception to the 10-percent early withdrawal tax applies in the case of a qualified birth or adoption distribution from an applicable eligible retirement plan (as defined). In addition, qualified birth or adoption distributions may be recontributed to an individual's applicable eligible retirement plans, subject to certain requirements.

A qualified birth or adoption distribution is a permissible distribution from an applicable eligible retirement plan which, for this purpose, encompasses eligible retirement plans other than

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[654] Secs. 401(a), 403(a), 403(b), 457(b), and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

[655] Sec. 72(t). Under present law, the 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

defined benefit plans, including qualified retirement plans, section 403(b) plans, governmental section 457(b) plans, and IRAs.[656]

A qualified birth or adoption distribution is a distribution from an applicable eligible retirement plan to an individual if made during the one-year period beginning on the date on which a child of the individual is born or on which the legal adoption by the individual of an eligible adoptee is finalized. An eligible adoptee means any individual (other than a child of the taxpayer's spouse) who has not attained age 18 or is physically or mentally incapable of self-support. The name, age, and taxpayer identification number of the child or eligible adoptee to which any qualified birth or adoption distribution relates must be provided on the tax return of the individual taxpayer for the taxable year.

The maximum aggregate amount which may be treated as qualified birth or adoption distributions by any individual with respect to a birth or adoption is $5,000. The maximum aggregate amount applies on an individual basis. Therefore, each spouse separately may receive a maximum aggregate amount of $5,000 of qualified birth or adoption distributions (with respect to a birth or adoption) from applicable eligible retirement plans in which each spouse participates or holds accounts.

An employer plan is not treated as violating any Code requirement merely because it treats a distribution (that would otherwise be a qualified birth or adoption distribution) to an individual as a qualified birth or adoption distribution, provided that the aggregate amount of such distributions to that individual from plans maintained by the employer and members of the employer's controlled group[657] does not exceed $5,000. Under such circumstances an employer plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $5,000 as a result of distributions from plans of other employers or IRAs.

Recontributions to applicable eligible retirement plans

Generally, any portion of a qualified birth or adoption distribution may, at any time after the date on which the distribution was received, be recontributed to an applicable eligible retirement plan to which a rollover can be made. Such a recontribution is treated as a rollover and thus is not includible in income. If an employer adds the ability for plan participants to receive qualified birth or adoption distributions from a plan, the plan must permit an employee who has received qualified birth or adoption distributions from that plan to recontribute only up to the amount that was distributed from that plan to that employee, provided the employee otherwise is eligible to make contributions (other than recontributions of qualified birth or adoption distributions) to that plan. Any portion of a qualified birth or adoption distribution from an individual's applicable eligible retirement plans (whether employer plans or IRAs) may

[656] A qualified birth or adoption distribution is subject to income tax withholding unless the recipient elects otherwise. Mandatory 20-percent withholding does not apply.

[657] The term "controlled group" means any group treated as a single employer under subsection (b), (c), (m), or (o) of section 414.

be recontributed to an IRA held by such an individual which is an applicable eligible retirement plan to which a rollover can be made.

Description of Proposal

Under the proposal, a recontribution of any portion of a qualified birth or adoption distribution, may, at any time during the three-year period beginning on the day after the date on which the distribution was received, be recontributed to an applicable eligible retirement plan to which a rollover can be made.

Effective Date

The proposal provides that the amendment made to this section takes effect as if included in the enactment of section 113 of the SECURE Act.

2. Amendments relating to Setting Every Community Up for Retirement Enhancement Act of 2019

Present Law

Election of safe harbor 401(k) status

The SECURE Act eliminated the safe harbor notice requirement with respect to nonelective 401(k) safe harbor plans.[658] Background on section 401(k) plans and nondiscrimination requirements may be found in section A.4 of this document.

Long-term part-time workers

The SECURE Act generally required section 401(k) plans to allow long-term part-time employees to make elective deferrals under the plan.[659] Background on this provision may be found in section A.3 of this document.

Difficulty of care payments

The SECURE Act also modified certain retirement contribution limits as they apply to "difficulty of care" payments.[660] A difficulty of care payment is compensation for providing the additional care needed for certain qualified foster individuals.[661] Such payments are excludable from gross income. Generally, the amount that may be contributed to an IRA is limited by the compensation that is includible in an individual's gross income for the taxable year.[662] However,

[658] Sec. 103 of the SECURE Act.

[659] Sec. 112 of the SECURE Act.

[660] Sec. 116 of the SECURE Act.

[661] Sec. 131(c).

[662] Secs. 408(o)(2) and 408A(c)(2).

the SECURE Act modified the limit on nondeductible contributions to a traditional IRA to generally allow an individual to contribute a difficulty of care payment.[663] Under the SECURE Act, if the deductible amount of IRA contributions in effect for a taxable year (which is tied to the amount of nondeductible contributions that may be made) exceeds the individual's compensation that is includible in gross income, the individual may elect to increase the limit on nondeductible contributions by the amount of the difficulty of care payment (or, if less, the excess of the deductible amount of IRA contributions over the individual's compensation for the year).

Excise tax on excess IRA contributions

To the extent that contributions to an IRA exceed the contribution limits, the individual is subject to an excise tax equal to six percent of the excess amount.[664] This excise tax generally applies each year until the excess amount is distributed.

Description of Proposal[665]

The proposal clarifies that, similar to a traditional 401(m) safe harbor plan, a 401(m) safe harbor plan with automatic enrollment must satisfy notice requirements, regardless of whether the plan includes safe harbor matching contributions or safe harbor nonelective contributions.[666]

The proposal also includes several clarifications of the rules relating to long-term part-time employees. First, it clarifies that in addition to excluding long-term part-time employees from nondiscrimination requirements that apply to safe harbor plans under section 401(k), an employer may also elect to exclude such employees from the nondiscrimination requirements that apply to safe harbor plans under section 401(m).[667] Second, the proposal clarifies that the vesting rules apply to the plan, and not only to the cash or deferred arrangement.[668] Third, the proposal clarifies that an employee ceases to be considered a long-term part-time employee (and is instead considered to be a full-time employee) when the employee satisfies the age and service requirements that apply under a section 401(k) plan to full-time employees.[669]

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[663] Sec. 408(o)(5).

[664] Secs. 4973(b) and (f).

[665] In addition to the clarifications described below, the proposal fixes clerical errors in sections 72(t), 401(k), and 408.

[666] The plan must satisfy the notice requirements under section 401(k)(13)(E), regardless of whether it is an automatic enrollment 401(k) safe harbor plan that provides a matching contribution in accordance with section 401(k)(13)(D)(i)(I) or a nonelective contribution in accordance with section 401(k)(13)(D)(i)(II).

[667] The requirements that apply under sections 401(m)(11) and (12).

[668] Sec. 401(k)(15)(B)(iii).

[669] The requirements under section 401(k)(2)(D)(i). Thus, the proposal clarifies that the applicable age and service requirements are the requirements of section 410(a)(1), determined without regard to subparagraph (B)(i) thereof.

The proposal also clarifies that the excise tax on excess contributions to an IRA generally does not apply to difficulty of care payments contributed to an IRA.[670]

Effective Date

The amendments made by the proposal are effective as if included in the section of the SECURE Act to which the amendment relates.

3. Modification of required minimum distribution rules for special needs trusts

Present Law

General background on the requirements related to required minimum distributions may be found in section B.1 of this document.

Required minimum distribution rules in case of multiple beneficiaries and trusts

Treasury regulations include special rules for determining an employee's (or IRA owner's) designated beneficiary for purposes of calculating the distribution period for required minimum distributions in the case of multiple designated beneficiaries or in the case of a beneficiary that is a trust.

Generally, if an employee (or IRA owner) has more than one designated beneficiary, the designated beneficiary with the shortest life expectancy is the designated beneficiary for purposes of determining the distribution period.[671] A designated beneficiary must be an individual.[672] If a person other than an individual is designated as a beneficiary under the plan, the employee (or IRA owner) is generally treated as not having a designated beneficiary, even if there are other individuals who are designated as beneficiaries.[673] However, a special rule applies to trusts.

If a trust is named as an employee's (or IRA owner's) beneficiary, the beneficiaries of the trust (and not the trust itself) are treated as designated beneficiaries of the employee or IRA owner if the following requirements are met: (1) the trust is a valid trust under state law, or would be but for the fact that there is no corpus, (2) the trust is irrevocable or will, by its terms, become irrevocable upon the employee's (or IRA owner's) death, (3) the trust beneficiaries who are beneficiaries with respect to the trust's interest in the employee's (or IRA owner's) benefit

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[670] The excise tax does not apply to any designated nondeductible contribution to an IRA that does not exceed the limit on nondeductible contributions by reason of the individual's election to increase such limit to account for the difficulty of care payment. Sec. 4973(b) (as amended by this proposal).

[671] Treas. Reg. sec. 1.401(a)(9)-5, A-7. Exceptions apply in the case of certain successor beneficiaries. The IRS recently published new proposed regulations under section 401(a)(9). 87 FR 10504, Feb. 24, 2022 (corrected March 21, 2022). The amendments to Treas. Reg. §§ 1.401(a)(9)-1 through 1.401(a)(9)-9, are proposed to apply for purposes of determining RMDs for calendar years beginning on or after Jan. 1, 2022.

[672] Sec. 401(a)(9)(E)(i).

[673] Treas. Reg. sec. 1.401(a)(9)-4, A-3.

are identifiable from the trust instrument,[674] and (4) certain documentation requirements[675] are met.[676]

Special rules for trusts benefiting disabled or chronically ill individuals

Special rules apply in the case of an applicable multi-beneficiary trust. An applicable multi-beneficiary trust is a trust (1) that has more than one beneficiary, (2) all of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the required minimum distribution period, and (3) at least one of the beneficiaries of which is an eligible designated beneficiary who is disabled or chronically ill.

In the case of an applicable multi-beneficiary trust that under its terms is to be divided immediately upon the death of the employee (or IRA owner) into separate trusts for each beneficiary, the exception to the 10-year rule for eligible designated beneficiaries applies separately to any portion of the employee's (or IRA owner's) interest that is payable to a disabled or chronically ill eligible designated beneficiary. Thus, for example, if an applicable multi-beneficiary trust is to be divided immediately upon the death of the IRA owner into separate trusts for three beneficiaries, one of whom is a chronically ill eligible designated beneficiary, the exception to the 10-year rule will apply to the portion of the IRA owner's interest that is payable to the chronically ill eligible designated beneficiary's trust. The portion of the IRA owner's interest that is payable to the trusts for the other two beneficiaries must then be distributed in accordance with the 10-year rule.

In the case of an applicable multi-beneficiary trust under the terms of which no individual other than a disabled or chronically ill eligible designated beneficiary has any right to the employee's (or IRA owner's) interest in the plan until the death of all such eligible designated beneficiaries with respect to the trust ("applicable remainder multi-beneficiary trust"), the exception to the 10-year rule applies to the distribution of the employee's (or IRA owner's) interest and any beneficiary who is not a disabled or chronically ill eligible designated beneficiary is treated as a beneficiary of the eligible designated beneficiary upon the death of such eligible designated beneficiary. Thus, the 10-year rule applies to any portion of the employee's (or IRA owner's) interest remaining after the death of the disabled or chronically ill eligible designated beneficiary (or beneficiaries).

Description of Proposal

The proposal modifies the rules that apply to an applicable remainder multi-beneficiary trust. Under the proposal, a beneficiary of such trust that is a qualified charity[677] is treated as a

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[674] The beneficiary must be identifiable within the meaning of Treas. Reg. sec. 1.401(a)(9)-4, A-1.

[675] The documentation described in Treas. Reg. sec. 1.401(a)(9)-4, A-6 must be provided to the plan administrator.

[676] Treas. Reg. sec. 1.401(a)(9)-4, A-5.

[677] An organization described in section 408(d)(8)(B)(i), which are the rules that apply to qualified charitable distributions. Section 408(d)(8)(B)(i) applies to organizations described in section 170(b)(1)(A)

designated beneficiary for purposes of the requirements that apply to applicable multi-beneficiary trusts.[678] Thus, the trust will not fail to be treated as an applicable multi-beneficiary trust merely because one of the beneficiaries is a person other than an individual, provided that the beneficiary is a qualified charity. As a result, an applicable remainder multi-beneficiary trust is not precluded from having a qualified charity as a remainder beneficiary.

Effective Date

The proposal is effective for calendar years beginning after the date of enactment.

(generally, public charities), other than any organization described in section 509(a)(3) (supporting organizations) or any fund or account described in section 4966(d)(2) (donor advised funds).

[678] Sec. 401(a)(9)(H)(v).

I. Plan Amendments

1. Provisions relating to plan amendments

Present Law

Present law provides a remedial amendment period during which, under certain circumstances, a retirement plan may be amended retroactively in order to comply with tax qualification requirements.[679] In general, plan amendments to reflect changes in the law must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs (including extensions). The Secretary may extend the time by which plan amendments need to be made.

The Code and ERISA provide that, in general, accrued benefits cannot be reduced by a plan amendment.[680] This prohibition on the reduction of accrued benefits is commonly referred to as the "anti-cut-back rule."

Description of Proposal

The proposal permits certain plan amendments made pursuant to the proposals described in this document, or regulations issued thereunder, to be retroactively effective. If a plan amendment meets the requirements of the proposal, then the plan will be treated as being operated in accordance with its terms, and, to the extent provided by Secretary in guidance, the amendment will not violate the anti-cut-back rule. In order for this treatment to apply, the plan must be operated as if the plan amendment were in effect, and the amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2024 (or such later date as the Secretary may prescribe). However, if the plan is a governmental plan or a collectively-bargained plan,[681] the amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2026 (or such later date as the Secretary may prescribe).

If the amendment is required to be made to retain qualified status as a result of the changes in the law (or regulations), the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan and the plan is required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to the proposals described in this document (or applicable regulations) may be made retroactively effective as of the first day the amendment is effective.

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[679] Sec. 401(b).

[680] Code sec. 411(d)(6); ERISA sec. 204(g).

[681] Defined for this purpose as a plan maintained by one or more collective bargaining agreements between employee representatives and one or more employers ratified before the date of enactment of this proposal.

The proposal also amends the deadlines for certain plan amendments made pursuant to the SECURE Act, the Coronavirus Aid, Relief, and Economic Security Act, and the Taxpayer Certainty and Disaster Relief Act to conform with the deadlines provided under this proposal.[682]

Effective Date

The proposal is effective on the date of enactment.

[682] The proposal modifies the general deadlines for plan amendments under the SECURE Act, section 601, the deadlines for amendments relating to coronavirus-related distributions and the waiver of required minimum distributions under the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, sections 2202 and 2203, and the deadlines for amendments under the Taxpayer Certainty and Disaster Relief Act of 2020, section 302.

J. Tax Court Retirement Proposals

1. Proposals relating to judges of the Tax Court

Present Law

In general

The United States Tax Court ("Tax Court") is established by Congress pursuant to Article I of the U.S. Constitution (an "Article I" court). The salary of a Tax Court judge is the same salary as received by a U.S. District Court judge. Some employee benefits for Tax Court judges, including certain retirement and survivor benefit programs, correspond to benefits provided to U.S. District Court judges.

Retirement and survivors' benefits

A Tax Court judge may be covered under the Federal Employees Retirement System ("FERS") or, depending on when the judge began Federal employment, the Civil Service Retirement System ("CSRS"). FERS and CSRS provide annuity benefits to a retired employee and, in some cases, to survivors of a deceased employee. Employees covered by FERS are also covered by the Social Security program. Federal employees covered by FERS and CSRS generally may contribute to the Thrift Savings Plan ("TSP"). Most Federal employees covered by FERS (but not CSRS) are also eligible for agency contributions (that is, nonelective contributions and matching contributions). Like other Federal employees, a Tax Court judge is eligible to contribute to the Thrift Savings Plan. In contrast with other Federal employees who are covered by FERS, a Tax Court judge covered by FERS is not eligible for agency contributions.

An active Tax Court judge may elect at any time to be covered by a "retired pay" program of the Tax Court rather than under another Federal retirement program, such as FERS or CSRS. A Tax Court judge may also elect to participate in a plan providing annuity benefits for the judge's surviving spouse and dependent children (the "Tax Court survivors' annuity plan"). Generally, benefits under the Tax Court survivors' annuity plan are payable only if the judge has performed at least five years of service and has made contributions to the plan for at least five years of service.

The rules governing the retired pay plan for Tax Court judges and the Tax Court survivors' annuity plan provide for coordination between CSRS and the retired pay or survivors' annuity plan when a judge covered by CSRS elects into those plans. For example, if a judge covered by CSRS elects retired pay, the accumulated CSRS contributions previously made by the judge are refunded to the judge with interest. However, the rules do not address coordination with FERS.

Limit on outside earned income of a judge receiving retired pay

Under the retired pay plan for Tax Court judges, retired judges generally receive retired pay equal to the salary of an active judge and must be available for recall to perform judicial duties as needed by the court for up to 90 days a year (unless the judge consents to a longer

period). However, retired judges may elect to freeze the amount of their retired pay, and those who do so are not available for recall.

Retired Tax Court judges on recall are subject to the limitations on outside earned income that apply to active Federal employees under the Ethics in Government Act of 1978. Retired Tax Court judges who elect to freeze the amount of their retired pay (thus making themselves unavailable for recall) are not subject to the limitations on outside earned income.

Description of Proposals

Thrift Savings Plan matching contributions

The proposal allows a Tax Court judge who is covered by FERS to receive agency contributions to the TSP, similar to other employees covered by FERS. If a judge covered by FERS elects retired pay, rather than FERS benefits, the judge's retired pay is offset by the amount of previous TSP distributions attributable to agency contributions (without regard to earnings on the agency contributions) made during years of service as a Tax Court judge while covered by FERS.

Retirement and survivors' benefits

Under the proposal, benefits under the survivors' annuity plan are payable if a Tax Court judge has performed at least 18 months of service and made contributions for at least 18 months (rather than five years). In addition, benefits under the survivors' annuity plan are payable if a Tax Court judge is assassinated before the judge has performed 18 months of service and made contributions for 18 months. Assassination means a killing of a judge or special trial judge motivated by the judge's performance of his or her official duties. A determination of assassination is made by the chief judge of the Tax Court and is reviewable only by the Tax Court.

The proposal amends the rules governing the retired pay plan for Tax Court judges and the Tax Court survivors' annuity plan to provide for coordination between FERS and those plans when a judge covered by FERS elects into those plans, similar to coordination with CSRS under present law.

Limit on outside earned income of a judge receiving retired pay

Under the proposal, compensation earned by a retired Tax Court judge for teaching during a calendar year is not treated as outside earned income for purposes of limitations under the Ethics in Government Act of 1978, so long as the retired judge satisfies the recall duties described in section 7444(c) for the calendar year, as certified by the chief judge.

Effective Date

The proposals are generally effective on the date of enactment. More specifically, the proposal relating to TSP contributions applies to basic pay earned while serving as a Tax Court judge on or after the date of enactment, and the proposal relating to outside earned income of a

judge receiving retired pay applies to any individual serving as a retired Tax Court judge on or after the date of enactment.

2. Proposal relating to special trial judges of the Tax Court

Present Law

The chief judge of the Tax Court may appoint special trial judges to handle certain cases. Special trial judges serve for an indefinite term. Special trial judges receive a salary of 90 percent of the salary of a Tax Court judge. Special trial judges do not have authority to impose punishment in the case of contempt of the authority of the Tax Court.

Special trial judges generally are covered by the benefit programs that apply to Federal executive branch employees, including CSRS or FERS (depending on when the judge began Federal employment). Special trial judges may contribute to TSP, and those covered by FERS are also eligible for agency contributions. Special trial judges covered by FERS are also covered by the Social Security program. Special trial judges may also elect to participate in the Tax Court survivors' annuity plan. An election into the Tax Court survivors' annuity plan must be made not later than six months after the later of the date the special trial judge takes office or the date the judge marries.

Special trial judges are required to be covered by a leave program under which they earn annual and sick leave during their period of employment. At termination of employment, a lump sum payment is made to the special trial judge for unused annual leave, and unused sick leave is credited as additional service for certain purposes under CSRS or FERS.

Description of Proposal

Retirement plan for special trial judges

The proposal establishes a new retirement plan under which a special trial judge may elect to receive retired pay under rules similar to those applicable to the regular judges of the Tax Court. A special trial judge generally must meet certain requirements to be eligible for retired pay. In general, the trial judge must attain age 65 with 15 years of service or must receive certification of permanent disability. A special trial judge who retires based on the age and service requirement receives reduced retired pay if the judge's service is less than 15 years. A special trial judge who retires based on permanent disability receives reduced retired pay if the judge's service is less than 10 years. The election to receive retired pay may be made only while an individual is a special trial judge, except that in the case of an individual who fails to be reappointed as a special trial judge, it may be made within 60 days after the individual leaves office as a special trial judge.

Recall of retired special trial judges

The proposal requires that a special trial judge must be available for recall to perform judicial duties as needed by the court for up to 90 days a year (unless the judge consents to a longer period) in the same manner as regular judges.

Effective Date

The proposal is effective on the date of enactment.

K. Revenue Provisions

1. SIMPLE and SEP Roth IRAs

Present Law

An IRA is generally established by an individual for whom the IRA is maintained.[683] In some cases, an employer may establish IRAs on behalf of employees and provide retirement contributions to the IRAs. In addition, IRA treatment may apply to accounts maintained for employees under a trust created by an employer (or an employee association) for the exclusive benefit of employees or their beneficiaries, provided that the trust complies with the relevant IRA requirements and separate accounting is maintained for the interest of each employee or beneficiary.[684] In that case, the assets of the trust may be held in a common fund for the account of all individuals who have an interest in the trust.

There are two basic types of IRAs: traditional IRAs, to which deductible or nondeductible contributions can be made, and Roth IRAs, contributions to which are not deductible. The total contributions made to all IRAs for a year cannot exceed $6,000 (for 2022), plus an additional $1,000 (not indexed) in catch-up contributions for individuals age 50 or older. Certain individuals are not permitted to make deductible contributions to a traditional IRA or to make contributions to a Roth IRA, depending on their income.

Distributions from traditional IRAs are generally includible in income, except to the extent a portion of the distribution is treated as a recovery of the individual's basis (if any). Qualified distributions from a Roth IRA are excluded from income;[685] other distributions from a Roth IRA are includible in income to the extent of earnings. IRA distributions generally can be rolled over to another IRA or qualified retirement plan; however, a distribution from a Roth IRA generally can be rolled over only to another Roth IRA or a designated Roth account.

Savings Incentive Match Plan for Employees ("SIMPLE") plans and Simplified Employee Pension ("SEP") plans are special types of employer-sponsored retirement plans to which the employer makes contributions to IRAs established for each of the employer's

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[683] Secs. 219, 408, and 408A provide the rules for IRAs. Under section 408(a)(2) and (n), only certain entities are permitted to be the trustee of an IRA. The trustee of an IRA generally must be a bank, an insured credit union, or a corporation subject to supervision and examination by the Commissioner of Banking or other officer in charge of the administration of the banking laws of the State in which it is incorporated. Alternatively, an IRA trustee may be another person who demonstrates to the satisfaction of the Secretary that the manner in which the person will administer the IRA will be consistent with the IRA requirements.

[684] Sec. 408(c).

[685] A qualified distribution is a distribution that (1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000. Sec. 408A(d)(2).

employees in accordance with the Code requirements for each type of plan.[686] SIMPLE IRAs and SEPs may not be designated as Roth IRAs.[687]

For background on SIMPLE IRA plans, see section A.6 of this document.

SEP IRA plans

A Simplified Employee Pension ("SEP") plan is a special type of employer-sponsored retirement plan whereby only the employer makes contributions to the plan.[688] Unlike SIMPLE IRA plans, any size employer may establish a SEP plan. The amount of the contribution to the SEP IRA plan is the lesser of 25 percent of the employee's compensation or the dollar limit applicable to contributions to a qualified defined contribution plan ($61,000 for 2022). A traditional IRA is set up for each eligible employee, and all contributions must be fully vested. Any employee must be eligible to participate in the SEP if the employee has (1) attained age 21, (2) performed services for the employer during at least three of the immediately preceding five years, and (3) received at least $650 (for 2022) in compensation from the employer for the year.[689] Contributions to a SEP generally must bear a uniform relationship to compensation.

Effective for taxable years beginning before January 1, 1997, certain employers with no more than 25 employees could maintain a salary reduction SEP ("SARSEP") under which employees could make elective deferrals. The SARSEP rules were generally repealed with the enactment of the SIMPLE plan rules. However, contributions may continue to be made to SARSEPs that were established before 1997. Salary reduction contributions to a SARSEP are subject to the same limit that applies to elective deferrals under a section 401(k) plan ($20,500 for 2022). An individual who has attained age 50 before the end of the taxable year may also make catch-up contributions to a SARSEP of up to $6,500 (for 2022).

Roth Contributions

Elective deferrals are generally made on a pre-tax basis. However, certain retirement plans, such as section 401(k), section 403(b), and governmental 457(b) plans, may include a qualified Roth contribution program under which elective deferrals are made on an after-tax basis (designated Roth contributions), and attributable distributions are excluded from income. The annual dollar limit on a participant's designated Roth contributions is the same as the limit on elective deferrals, reduced by the participant's elective deferrals that are not designated Roth contributions. Designated Roth contributions are generally treated the same as any other elective deferral for certain purposes, including the restrictions on distributions.

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[686] Secs. 408(p), (k).

[687] Sec. 408A(f)(1).

[688] Sec. 408(k).

[689] The annual compensation limit for SEPs is $290,000.

Description of Proposal

Under the proposal, a SEP and a SIMPLE IRA are permitted to be designated as Roth IRAs. Contributions (including employer contributions as well as elective deferrals) to a SEP or SIMPLE IRA that is a designated Roth IRA are not excludable from gross income, and qualified distributions from such Roth IRAs are excludable from gross income. With respect to SEP and SIMPLE IRAs, an individual retirement plan that is designated as a Roth IRA shall not be treated as a SEP or SIMPLE IRA unless the employee elects for the plan to be treated as such (at such time and in such manner as the Secretary may provide). In the case of any payment or distribution out of a SIMPLE IRA, with respect to which an election has been made and which is received during the two-year period beginning on the date the individual first participated in any salary reduction arrangement in a SIMPLE IRA maintained by the individual's employer,[690] a "qualified rollover distribution" shall not include any payment or distribution paid into an account other than a SIMPLE IRA.

The contribution limit for Roth IRAs generally is increased by the contributions made on the individual's behalf to the SIMPLE IRA or SEP for the taxable year, subject to certain limits. In this case of a SIMPLE IRA, the Roth IRA contribution limit is increased only to the extent that the contributions made on the individual's behalf (1) do not exceed the sum of the limit on elective contributions to a SIMPLE IRA and the required employer contribution to such IRA,[691] and (2) do not cause the individual's elective contributions to exceed the elective deferral limit.[692] In the case of a SEP plan, the Roth IRA contribution limit is increased only to the extent that the contributions made on the individual's behalf do not exceed the annual contribution limit applicable to SEPs.[693]

Effective Date

The proposal applies to taxable years beginning after December 31, 2023.

2. Elective deferrals generally limited to regular contribution limit

Present Law

Defined contribution plan limits

A defined contribution plan is a type of qualified retirement plan whereby contributions, earnings, and losses are allocated to a separate account for each participant. Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pre-tax (that is, contributions are either excluded from income or deductible) or

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[690] Sec. 72(t)(6).

[691] Sec. 408(p)(2).

[692] Sec. 402(g)(1) (taking into account any additional elective deferrals permitted as catch-up contributions under section 414(v)).

[693] Sec. 408(j).

after-tax contributions by employees. Total contributions made to an employee's account for a year cannot exceed the lesser of $61,000 (for 2022) or the employee's compensation.[694]

Under certain types of defined contribution plans, including section 401(k) plans, section 403(b) plans, or governmental section 457(b) plans, an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash. The maximum annual amount of elective deferrals that can be made by an employee for a year is $20,500 (for 2022) or, if less, the employee's compensation.[695] Elective deferrals generally cannot be distributed from the plan before the employee's severance from employment, death, disability or attainment of age 59½ or in the case of hardship or plan termination.[696]

Catch-up contributions

Certain retirement plans may permit employees to make catch-up contributions, subject to certain limitations.[697] Employees aged 50 or older ("eligible participants") generally may make annual catch-up contributions to a section 401(k), section 403(b), and governmental 457(b) plans, up to $6,500 in 2022 (indexed for inflation).[698] If elective deferral and catch-up contributions are made to both a qualified defined contribution plan and a section 403(b) plan for the same employee, a single limit applies to the elective deferrals under both plans.[699] Special contribution limits apply to certain employees under a section 403(b) plan maintained by a church. In addition, under a special catch-up rule, an increased elective deferral limit applies under a plan maintained by an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches in the case of employees who have completed 15 years of service.[700] In this case, the limit is increased by the least of (1) $3,000, (2) $15,000, reduced by the employee's total elective deferrals in prior years, or (3) $5,000 times the employee's years of service, reduced by the employee's total elective deferrals in prior years.[701]

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[694] Sec. 415(c).

[695] Secs. 402(g); 457(c). This limit applies to total elective deferrals under all of a participant's section 401(k) plans and section 403(b) plans but applies separately to any governmental section 457(b) plan.

[696] Secs. 401(k)(2)(B); 403(b)(7)(A)(i); 457(d)(1)(A).

[697] Sec. 414(v).

[698] In order to be eligible to make catch-up contributions, the participant must also be ineligible to otherwise make additional elective deferrals under the plan, due to the limits that apply to such deferrals under the Code or under the plan. Sec. 414(v)(5)(B).

[699] Treas. Reg. sec. 1.402(g)-1(b).

[700] Treas. Reg. sec. 1.403(b)-4(c)(3).

[701] Because contributions to a defined contribution plan cannot exceed an employee's compensation, contributions for an employee are generally not permitted after termination of employment. However, under a special rule, a former employee may be deemed to receive compensation for up to five years after termination of employment for purposes of receiving employer nonelective contributions under a section 403(b) plan.

The section 457(b) plan limits apply separately from the combined limit applicable to section 401(k) and 403(b) plan contributions, so that an employee covered by a governmental section 457(b) plan and a section 401(k) or 403(b) plan can contribute the full amount to each plan. In addition, under a special catch-up rule, for one or more of the participant's last three years before normal retirement age, the otherwise applicable limit is increased to the lesser of (1) two times the normal annual limit ($41,000 for 2022) or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

Roth contributions

Elective deferrals are generally made on a pre-tax basis. However, certain retirement plans, such as section 401(k), section 403(b), and governmental section 457(b) plans, may include a qualified Roth contribution program under which elective deferrals are made on an after-tax basis (designated Roth contributions), and qualified distributions from a designated Roth account are excluded from income.[702] A qualified distribution is a distribution that (1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made the contribution, and (2) is made after attainment of age 59½, or on account of death or disability.[703]

Excess deferrals treated as catch-up contributions

Under Treasury regulations, elective deferrals with respect to a catch-up eligible individual that exceed the applicable limits under the Code or the plan, or that would cause the plan to fail nondiscrimination testing,[704] must be treated as a catch-up contribution to the extent the elective deferral does not exceed the limits applicable to catch-up contributions.[705]

Description of Proposal

Under the proposal, a section 401(a) qualified plan, section 403(b) plan, or governmental section 457(b) plan that permits an eligible participant to make catch-up contributions must require such catch-up contributions to be designated Roth contributions. The proposal does not apply to a Savings Incentive Match Plan for Employees ("SIMPLE") IRA or Simplified Employee Pension ("SEP") plan.

In addition, the proposal provides that excess elective deferrals that were made on a pre-tax basis may not be treated as catch-up contributions.

Effective Date

[702] Sec. 402A.

[703] Sec. 402A(d)(2)(A).

[704] The actual deferral percentage (ADP) test under section 401(k)(3).

[705] Treas. Reg. sec. 1.414(v)-1(c).

The proposal applies to taxable years beginning after December 31, 2023.

3. Optional treatment of employer matching and nonelective contributions as Roth contributions

Present Law

Defined contribution plan contributions

Defined contribution plans may provide for nonelective contributions and matching contributions by employers and pre-tax (that is, contributions are either excluded from income or deductible) or after-tax contributions by employees. Total contributions made to an employee's account for a year cannot exceed the lesser of $61,000 (for 2022) or the employee's compensation. The deduction for employer contributions to a defined contribution plan for a year is generally limited to 25 percent of the participants' compensation. A participant must at all times be fully vested in his or her own contributions to a defined contribution plan and must vest in employer contributions under three-year cliff vesting or two-to-six-year graduated vesting.[706]

Defined contribution plans can be further categorized into different types, such as profit-sharing plans, stock bonus plans, or money purchase plans, and may include special features, such as a qualified cash or deferred arrangement (section 401(k)) or an employee stock ownership plan ("ESOP"). Under a common type of retirement arrangement, a section 401(k) plan, an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash. For 2022, elective deferrals of up to $20,500 may be made, plus, for employees aged 50 or older, up to $6,500 in catch-up contributions. Elective deferrals generally cannot be distributed from the plan before the employee's severance from employment, death, disability, or attainment of age 59½ or in the case of hardship or plan termination.

Designated Roth contributions

Elective deferrals are generally made on a pre-tax basis.[707] However, certain defined contributions plans, such as a section 401(k), 403(b), or governmental 457(b) plan, may include a qualified Roth contribution program under which elective deferrals are made on an after-tax basis (designated Roth contributions), but certain distributions ("qualified distributions"), including earnings, are excluded from income.[708] A qualified distribution is a distribution that

[706] Under the automatic enrollment 401(k) safe harbor, the matching and nonelective contributions are allowed to become 100 percent vested only after two years of service (rather than being required to be immediately vested when made).

[707] Section 401(k) plans may be designed so that elective deferrals are made only if the employee affirmatively elects them. However, a section 401(k) plan may provide for "automatic enrollment," under which elective deferrals are made at a specified rate unless the employee affirmatively elects not to make contributions or to make contributions at a different rate. Various rules have been developed to provide favorable treatment for plans that provide for automatic enrollment, subject to certain notice requirements.

[708] Sec. 402A.

(1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made the contribution, and (2) is made after attainment of age 59½, or on account of death or disability.

Employer Contributions

Employers generally are not required to make contributions to a defined contribution plan, but many employers make matching contributions or nonelective contributions. Matching contributions are employer contributions that are made only if the employee makes contributions and can relate to pre-tax elective deferrals, designated Roth contributions, or other after-tax contributions. Matching contributions are generally based on a formula that is a percentage of the employee's contribution to the plan. Alternatively, matching contributions may be made by the employer to the plan that are a flat dollar amount up to a particular percentage of the employee's compensation.

In contrast, nonelective contributions are made without regard to whether the employee makes pre-tax or after-tax contributions. Nonelective contributions by an employer are based on a fixed or discretionary formula that could take into account the participant's years of service or age. Nonelective contributions could also generally be a flat dollar amount to the plan for each eligible employee.

If an employee makes elective deferrals that are designated Roth contributions to a defined contribution plan, the employer may not make matching or nonelective contributions on a Roth basis. The employer may only allocate contributions to match designated Roth contributions into a pre-tax account.

Description of Proposal

Under the proposal, a section 401(a) qualified plan, a section 403(b) plan, or a governmental 457(b) plan may permit an employee to designate matching contributions and nonelective contributions as designated Roth contributions. In order for this rule to apply, the employee must be fully vested in the matching or nonelective contribution under the plan. An employer matching contribution or nonelective contribution that is a designated Roth contribution shall not be excludable from gross income.

Effective Date

The proposal applies to contributions made after December 31, 2023.