Calendar No. 802

106TH CONGRESS
2d Session

SENATE

REPORT
106–411

RETIREMENT SECURITY AND SAVINGS ACT OF 2000

R E P O R T

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

TO ACCOMPANY

H.R. 1102

SEPTEMBER 13, 2000.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
79–012 WASHINGTON : 2000

CONTENTS

	Page
I. Legislative Background	1
II. Explanation of the Bill	2
Title I. Individual Retirement Arrangements (“IRAs”)	2
Title II. Expanding Coverage	7
A. Increase in Benefit and Contribution Limits	7
B. Plan Loans for Subchapter S Shareholders, Partners, and Sole Proprietors	9
C. Modification of Top-Heavy Rules	11
D. Elective Deferrals Not Taken into Account for Purposes of Deduction Limits	15
E. Repeal of Coordination Requirements for Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations	16
F. Deduction Limits	17
G. Option to Treat Elective Deferrals as Roth After-Tax Contributions	18
H. Credit for Low- and Middle-Income Savers	20
I. Small Business Tax Credit for Qualified Retirement Plan Contributions	22
J. Small Business Tax Credit for New Retirement Plan Expenses	24
Title III. Enhancing Fairness for Women	25
A. Additional Salary Reduction Catch-Up Contributions	25
B. Equitable Treatment for Contributions of Employees to Defined Contribution Plans	27
C. Faster Vesting of Employer Matching Contributions	29
D. Simplify and Update the Minimum Distribution Rules	30
E. Clarification of Tax Treatment of Division of Section 457 Plan Benefits Upon Divorce	33
F. Modifications Relating to Hardship Withdrawals	34
G. Pension Coverage for Domestic and Similar Workers	35
Title IV. Increasing Portability for Participants	36
A. Rollovers of Retirement Plan and IRA Distributions	36
B. Waiver of 60-Day Rule	40
C. Treatment of Forms of Distribution	40
D. Rationalization of Restrictions on Distributions	43
E. Purchase of Service Credit under Governmental Pension Plans	44
F. Employers May Disregard Rollovers for Purposes of Cash-Out Rules	45
G. Time of Inclusion of Benefits Under Section 457 Plans	46
Title V. Strengthening Pension Security and Enforcement	47
A. Phase in Repeal of 155 Percent of Current Liability Funding Limit; Deduction For Contributions to Fund Termination Liability	47
B. Excise Tax Relief for Sound Pension Funding	49
C. Notice of Significant Reduction in Plan Benefit Accruals	50
D. Modifications to Section 415 Limits for Multiemployer Plans	56
E. Investment of Employee Contributions in 401(k) Plans	57
F. Periodic Pension Benefit Statements	58
G. Prohibited Allocations of Stock in an S Corporation ESOP	59
Title VI. Reducing Regulatory Burdens	62
A. Modification of Timing of Plan Valuations	62
B. ESOP Dividends May Be Reinvested Without Loss of Dividend Deduction	63
C. Repeal Transition Rule Relating to Certain Highly Compensated Employees	64

Page

Title VI. Reducing Regulatory Burdens—Continued
D. Employees of Tax-Exempt Entities ... 65
E. Treatment of Employer-Provided Retirement Advice ... 66
F. Reporting Simplification ... 67
G. Improvement to Employee Plans Compliance Resolution System ... 68
H. Repeal of the Multiple Use Test ... 69
I. Flexibility in Nondiscrimination and Line of Business Rules ... 71
J. Extension to All Governmental Plans of Moratorium on Application of Certain Nondiscrimination Rules Applicable to State and Local Government Plans ... 72
K. Notice and Consent Period Regarding Distributions; Disclosure of Optional Forms of Benefit ... 73
L. Annual Report Dissemination ... 74
M. Modifications to SAVER Act ... 75
N. Studies ... 76
Title VII. Provisions Relating to Plan Amendments ... 77
Title VIII. Compliance With Congressional Budget Act ... 77
III. Budget Effects of the Bill ... 78
A. Committee Estimates ... 78
B. Budget Authority and Tax Expenditures ... 82
C. Consultation with the Congressional Budget Office ... 82
IV. Votes of the Committee ... 82
V. Regulatory Impact and Other Matters ... 82
A. Regulatory Impact ... 82
B. Unfunded Mandates Statement ... 83
C. Tax Complexity Analysis ... 83
VI. Changes to Existing Law Made by the Bill as Reported ... 83

Calendar No. 802

106TH CONGRESS 2d Session | SENATE | REPORT 106–411

RETIREMENT SECURITY AND SAVINGS ACT OF 2000

SEPTEMBER 13, 2000.—Ordered to be printed

Mr. ROTH, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 1102]

The Committee on Finance reported a substitute to H.R. 1102 to provide for pension reform, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

I. LEGISLATIVE BACKGROUND

Committee markup

On September 7, 2000, the Senate Committee on Finance marked up H.R. 1102 and ordered the bill, as amended, favorably reported by a roll call vote of 17 yeas and 0 nays (the vote would be 19 yeas and 0 nays if votes by proxy were included in the tally of votes for favorably reporting a bill out of Committee). The Committee action on the bill was in response to the reconciliation instructions contained in section 104 of the concurrent resolution on the budget for fiscal year 2001 (H. Con. Res. 290) for a net tax reduction of up to $16 billion for fiscal year 2001 (adjusted from $11.6 billion by the Chairman of the Senate Budget Committee on July 20, 2000) and of up to $150 billion for fiscal years 2001–2005.

Committee hearings

The following related Committee hearings were held during the 106th Congress:

- President's fiscal year 2000 budget and tax proposals (February 2, 1999);
- Increasing savings for retirement (February 24, 1999);
- Complexity of the individual income tax (April 15, 1999); and
- Pension reform proposals (June 30, 1999).

79-411

II. EXPLANATION OF THE BILL

TITLE I. INDIVIDUAL RETIREMENT ARRANGEMENTS ("IRAs")

(SECS. 101–104 OF THE BILL AND SECS. 219, 408, AND 408A OF THE CODE)

PRESENT LAW

In general

There are two general types of individual retirement arrangements ("IRAs") under present law: traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs. The Federal income tax rules regarding each type of IRA (and IRA contribution) differ.

Traditional IRAs

Under present law, an individual may make deductible contributions to an IRA up to the lesser of $2,000 or the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. In the case of a married couple, deductible IRA contributions of up to $2,000 can be made for each spouse (including, for example, a homemaker who does not work outside the home), if the combined compensation of both spouses is at least equal to the contributed amount. If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 deduction limit is phased out for taxpayers with modified adjusted gross income ("AGI") over certain levels for the taxable year.

The AGI phase-out limits for taxpayers who are active participants in employer-sponsored plans are as follows:

Single Taxpayers

Taxable years beginning in:	*AGI Phase-out range*
2000	$32,000–42,000
2001	33,000–43,000
2002	34,000–44,000
2003	40,000–50,000
2004	45,000–55,000
2005 and thereafter	50,000–60,000

Taxpayers Filing Joint Returns

Taxable years beginning in:	*Phase-out range*
2000	$52,000–62,000
2001	53,000–63,000
2002	54,000–64,000
2003	60,000–70,000
2004	65,000–75,000
2005	70,000–80,000
2006	75,000–85,000
2007 and thereafter	80,000–100,000

The AGI phase-out range for married taxpayers filing a separate return is $0 to $10,000.

If the individual is not an active participant in an employer-sponsored retirement plan, but the individual's spouse is, the $2,000 deduction limit is phased out for taxpayers with AGI between $150,000 and $160,000.

To the extent an individual cannot or does not make deductible contributions to an IRA or contributions to a Roth IRA, the individual may make nondeductible contributions to a traditional IRA.

Amounts held in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Includible amounts withdrawn prior to attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, is used to purchase health insurance for an unemployed individual, is used for education expenses, or is used for first-time homebuyer expenses of up to $10,000.

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that may be made to a Roth IRA is the lesser of $2,000 or the individual's compensation for the year. The contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. As under the rules relating to IRAs generally, a contribution of up to $2,000 for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for single taxpayers with AGI between $95,000 and $110,000 and for taxpayers filing a joint return with AGI between $150,000 and $160,000. For married taxpayers filing a separate return, the phase-out range is $0 to $10,000.

Taxpayers with modified AGI of $100,000 or less generally may convert a traditional IRA into a Roth IRA. The amount converted is includible in income as if a withdrawal had been made, except that the 10-percent early withdrawal tax does not apply and, if the conversion occurred in 1998, the income inclusion may be spread ratably over 4 years. Married taxpayers who file separate returns cannot convert a traditional IRA into a Roth IRA.

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are neither includible in income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) which 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.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings, and subject to the 10-percent early withdrawal tax (unless an exception applies).[1] The same exceptions to the early withdrawal tax that apply to IRAs apply to Roth IRAs.

[1] Early distribution of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4-year rule applicable to 1998 conversions.

Taxation of charitable contributions

Generally, a taxpayer who itemizes deductions may deduct cash contributions to charity, as well as the fair market value of contributions of property. The amount of the deduction otherwise allowable for the taxable year with respect to a charitable contribution 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.

For donations of cash by individuals, total deductible contributions to public charities may not exceed 50 percent of a taxpayer's AGI for a taxable year. To the extent a taxpayer has not exceeded the 50-percent limitation, contributions of cash to private foundations and certain other nonprofit organizations and contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's AGI. If a taxpayer makes a contribution in one year which exceeds the applicable 50-percent or 30-percent limitation, the excess amount of the contribution may be carried over and deducted during the next five taxable years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with AGI in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 1999 is $126,600 ($63,300 for married individuals filing separate returns). For those deductions that are subject to the reduction, the total amount of itemized deductions is reduced by 3 percent of AGI over the threshold amount, but not by more than 80 percent of itemized deductions subject to the reduction. The effect of this reduction may be to limit a taxpayer's ability to deduct charitable contributions.

REASONS FOR CHANGE

The Committee is concerned about the low national savings rate and that individuals may not be saving adequately for retirement. Present law provides tax incentives for savings, including the opportunity to make contributions to traditional and Roth IRAs. However, deductible contributions to traditional IRAs and Roth IRAs are not available to all Americans. The Committee believes that IRAs should be available to more individuals.

The present-law IRA contribution limit has not been increased since 1981. The Committee believes that the limit should be raised in order to allow greater savings opportunities.

The Committee believes it is appropriate to eliminate the marriage penalties with respect to the Roth IRA provisions.

The Committee believes it appropriate to facilitate the making of charitable contributions from IRAs.

EXPLANATION OF PROVISION

Increase in annual contribution limits

The bill increases the maximum annual dollar contribution limit for IRA contributions from $2,000 to $3,000 in 2001, $4,000 in 2002, and $5,000 in 2003. The limit is indexed in $500 increments in 2004 and thereafter.

Increase in AGI limits for deductible IRA contributions

Under the bill, the increases in the AGI phase-out limits for active participants in an employer-sponsored plan are evened out. In addition, the phase-out range for married taxpayers filing separately is conformed to the phase-out range for single taxpayers. The AGI phase-out limits under the bill are as follows.

Taxpayers Filing Returns Other Than Joint Returns

Taxable years beginning in:	*AGI Phase-out range*
2001	$36,000–46,000
2002	40,000–50,000
2003	44,000–54,000
2004	48,000–58,000
2005 and thereafter	50,000–60,000

Taxpayers Filing Joint Returns

Taxable years beginning in:	*AGI Phase-out range*
2001	$56,000–66,000
2002	60,000–70,000
2003	64,000–74,000
2004	68,000–78,000
2005	72,000–82,000
2006	76,000–86,000
2007 and thereafter	80,000–100,000

The present-law income phase-out range for an individual who is not an active participant in an employer-sponsored plan, but whose spouse is, remains at $150,000 to $160,000.

Roth IRAs

The bill increases the income phase-out range for Roth IRA contributions to $190,000 to $220,000 for married couples filing a joint return. In addition, the bill applies to married taxpayers filing a separate return the same phase-out range that applies to single taxpayers.

Under the bill, the income limit for conversions of traditional IRAs to Roth IRAs is $200,000 for married couples filing a joint return. For all other taxpayers (including married taxpayers filing a separate return), the limit is $100,000.

Additional catch-up contributions

The bill provides that individuals who have attained age 50 may make additional catch-up IRA contributions. The otherwise maximum contribution limit (before application of the AGI phase-out limits) for an individual who has attained age 50 before the end of the taxable year is increased by 50 percent.

Deemed IRAs under employer plans

The bill provides that, if an eligible retirement plan permits employees to make voluntary employee contributions to a separate account or annuity that (1) is established under the plan, and (2) meets the requirements applicable to either traditional IRAs or Roth IRAs, then the separate account or annuity is deemed a traditional IRA or a Roth IRA, as applicable, for all purposes of the Code. For example, the reporting requirements applicable to IRAs apply. The deemed IRA, and contributions thereto, are not subject to the Code rules pertaining to the eligible retirement plan. In addition, the deemed IRA, and contributions thereto, are not taken

into account in applying such rules to any other contributions under the plan. The deemed IRA, and contributions thereto, are subject to the exclusive benefit and fiduciary rules of ERISA to the extent otherwise applicable to the plan, and are not subject to the ERISA reporting and disclosure, participation, vesting, funding, and enforcement requirements that apply to the eligible retirement plan.[2] An eligible retirement plan is a qualified plan (sec. 401(a)), tax-sheltered annuity (sec. 403(b)), or a governmental section 457 plan.

Tax-free IRA withdrawals for charitable purposes

The bill provides an exclusion from gross income for qualified charitable distributions from an IRA: (1) to a charitable organization to which deductible contributions can be made; (2) to a charitable remainder annuity trust or charitable remainder unitrust; (3) to a pooled income fund (as defined in sec. 642(c)(5)); or (4) for the issuance of a charitable gift annuity. The exclusion applies with respect to distributions described in (2), (3), or (4) only if no person holds an income interest in the trust, fund, or annuity attributable to such distributions other than the IRA owner, his or her spouse, or a charitable organization.

In determining the character of distributions from a charitable remainder annuity trust or a charitable remainder unitrust to which a qualified charitable distribution from an IRA is made, the charitable remainder trust is required to treat as ordinary income the portion of the distribution from the IRA to the trust which would have been includible in income but for the provision, and is required to treat any remaining portion of the distribution as corpus. Similarly, in determining the amount includible in gross income by reason of a payment from a charitable gift annuity purchased with a qualified charitable distribution from an IRA, the taxpayer is not permitted to treat the portion of the distribution from the IRA that would have been taxable but for the provision and which is used to purchase the annuity as an investment in the annuity contract.

A qualified charitable distribution is any distribution from an IRA which (1) is made after age 70½ of the account holder, (2) qualifies as a charitable contribution (within the meaning of sec. 170(c)), and (3) is made directly to the charitable organization or to a charitable remainder annuity trust, charitable remainder unitrust, pooled income fund, or charitable gift annuity (as described above).[3] A taxpayer is not permitted to claim a charitable contribution deduction for amounts transferred from his or her IRA to a charity or to a trust, fund, or annuity that, because of the provision, are excluded from the taxpayer's income. Conversely, if the amounts transferred would otherwise be nontaxable, e.g., a qualified distribution from a Roth IRA, the regularly applicable deduction rules would apply.

[2] The provision does not specify the treatment of deemed IRAs for purposes other than the Code and ERISA.

[3] It is intended that, in the case of transfer to a trust, fund, or annuity, the full amount distributed from an IRA will meet the definition of a qualified charitable distribution if the charitable organization's interest in the distribution would qualify as a charitable contribution under section 170.

EFFECTIVE DATE

The provision is generally effective for taxable years beginning after December 31, 2000. The provision relating to deemed IRAs under employer plans is effective for plan years beginning after December 31, 2001. The provision relating to tax-free withdrawals from IRAs for charitable purposes is effective for distributions after December 31, 2000.

TITLE II. EXPANDING COVERAGE

A. Increase in Benefit and Contribution Limits (Sec. 201 of the Bill and Secs. 401(a)(17), 402(g), 408(p) 415, and 457 of the Code)

PRESENT LAW

In general

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415), the amount of compensation that may be taken into account under a plan for determining benefits (sec. 401(a)(17)), the maximum amount of elective deferrals that an individual may make to a salary reduction plan or tax sheltered annuity (sec. 402(g)), and deferrals under an eligible deferred compensation plan of a tax-exempt organization or a State or local government (sec. 457).

Limitations on contributions and benefits

Under present law, the limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined contribution plan, the qualification rules limit the annual additions to the plan with respect to each plan participant to the lesser of (1) 25 percent of compensation or (2) $30,000 (for 2000). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The $30,000 limit is indexed for cost-of-living adjustments in $5,000 increments.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) $135,000 (for 2000). The dollar limit is adjusted for cost-of-living increases in $5,000 increments.

Under present law, in general, the dollar limit on annual benefits is reduced if benefits under the plan begin before the social security retirement age (currently, age 65) and increased if benefits begin after social security retirement age.

Compensation limitation

Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to $170,000 (for 2000). The compensation limit is indexed for cost-of-living adjustments in $10,000 increments.

Elective deferral limitations

Under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity"), or a salary reduction simplified employee pension plan ("SEP") is $10,500 (for 2000). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,000. These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,000 (for 2000) or (2) 33⅓ percent of compensation. The $8,000 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 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.

REASONS FOR CHANGE

The tax benefits provided under tax-favored retirement plans are a departure from the normally applicable income tax rules. The special tax benefits for such plans are generally justified on the ground that they serve an important social policy objective, i.e., the provision of retirement benefits to a broad group of employees. The limits on contributions, benefits, and compensation that may be taken into account under a plan serve to limit the tax benefits associated with such plans. The level at which to place such limits involves a balancing of different policy objectives and a judgment as to what limits are most likely to best further such policy goals.

One of the factors that may influence the decision of an employer, particularly a small employer, to adopt a plan is the extent to which the owners of the business, the decision-makers, or other highly compensated employees will benefit under the plan. The Committee believes that increasing the benefit limits under qualified plans will encourage employers to establish tax-favored retirement plans for their employees.

The Committee understands that, in recent years, section 401(k) plans have become prevalent. The Committee believes it is important to increase the amount of employee elective deferrals allowed under such plans, and other plans that allow elective deferrals, to better enable plan participants to save for their retirement.

EXPLANATION OF PROVISION

Limits on contributions and benefits

The bill provides faster indexing of the $30,000 limit on annual additions to a defined contribution plan. Under the bill, this limit is indexed in $1,000 increments.[4]

The bill increases the $135,000 annual benefit limit under a defined benefit plan to $160,000. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.

Compensation limitation

The bill increases the limit on compensation that may be taken into account under a plan to $200,000. This amount is indexed in $5,000 increments.

Elective deferral limitations

In 2001, the bill increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs to $11,000. In 2002 and thereafter, these limits increase in $1,000 annual increments until the limits reach $15,000 in 2005, with indexing in $500 increments thereafter. Beginning in 2001, the bill increases the maximum annual elective deferrals that may be made to a SIMPLE plan in $1,000 annual increments until the limit reaches $10,000 in 2004. Beginning after 2004, the $10,000 dollar limit is indexed in $500 increments.

Section 457 plans

The bill increases the dollar limit on deferrals under a section 457 plan to conform to the elective deferral limitation. Thus, the limit is $11,000 in 2001, and is increased in $1,000 annual increments thereafter until the limit reaches $15,000 in 2005. The limit is indexed thereafter in $500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.[5]

EFFECTIVE DATE

The provisions are effective for years beginning after December 31, 2000.

B. PLAN LOANS FOR SUBCHAPTER S SHAREHOLDERS, PARTNERS, AND SOLE PROPRIETORS (SEC. 202 OF THE BILL AND SEC. 4975 OF THE CODE)

PRESENT LAW

The Internal Revenue Code prohibits certain transactions ("prohibited transactions") between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan

[4] The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the bill.

[5] Another provision of the bill increases the 33⅓ percentage of compensation limit to 100 percent.

participants and beneficiaries.[6] Certain types of transactions are exempt from the prohibited transaction rules, including loans from the plan to plan participants, if certain requirements are satisfied. In addition, the Secretary of Labor can grant an administrative exemption from the prohibited transaction rules if she finds the exemption is administratively feasible, in the interest of the plan and plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. Pursuant to this exemption process, the Secretary of Labor grants exemptions both with respect to specific transactions and classes of transactions.

The statutory exemptions to the prohibited transaction rules do not apply to certain transactions in which the plan makes a loan to an owner-employee.[7] Loans to participants other than owner-employees are permitted if loans are available to all participants on a reasonably equivalent basis, are not made available to highly compensated employees in an amount greater than made available to other employees, are made in accordance with specific provisions in the plan, bear a reasonable rate of interest, and are adequately secured. In addition, the Code places limits on the amount of loans and repayment terms.

For purposes of the prohibited transaction rules, an owner-employee means (1) a sole proprietor, (2) a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership, (3) an employee or officer of an S corporation who owns more than 5 percent of the outstanding stock of the corporation, and (4) the owner of an IRA. The term owner-employee also includes certain family members of an owner-employee and certain corporations owned by an owner-employee.

Under the Internal Revenue Code, a two-tier excise tax is imposed on disqualified persons who engage in a prohibited transaction. The first level tax is equal to 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period, and is equal to 100 percent of the amount involved.

REASONS FOR CHANGE

The Committee believes that the present-law prohibited transaction rules regarding loans unfairly discriminate against the owners of unincorporated businesses and S corporations. For example, under present law, the sole shareholder of a C corporation may take advantage of the statutory exemption to the prohibited transaction rules for loans, but an individual who does business as a sole proprietor may not.

EXPLANATION OF PROVISION

The bill generally eliminates the special present-law rules relating to plan loans made to an owner-employee. Thus, the general statutory exemption applies to such transactions. Present law continues to apply with respect to IRAs.

---

[6] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), also contains prohibited transaction rules. The Code and ERISA provisions are substantially similar, although not identical.

[7] Certain transactions involving a plan and Subchapter S shareholders are permitted.

EFFECTIVE DATE

The provision is effective with respect to years beginning after December 31, 2000. Thus, a loan that is a prohibited transaction solely because of the present-law restriction would cease to be a prohibited transaction on January 1, 2000. However, the loan would continue to be a prohibited transaction prior to January 1, 2000.

C. Modification of Top-Heavy Rules (Sec. 203 of the Bill and Sec. 416 of the Code)

PRESENT LAW

In general

Under present law, additional qualification requirements apply to plans that primarily benefit an employer's key employees ("top-heavy plans"). These additional requirements provide (1) more rapid vesting for plan participants who are non-key employees and (2) minimum nonintegrated employer contributions or benefits for plan participants who are non-key employees.

Definition of top-heavy plan

In general, a top-heavy plan is a plan under which more than 60 percent of the contributions or benefits are provided to key employees. A defined benefit plan is a top-heavy plan if more than 60 percent of the cumulative accrued benefits under the plan are for key employees. A defined contribution plan is top heavy if the sum of the account balances of key employees is more than 60 percent of the total account balances under the plan. For each plan year, the determination of top-heavy status generally is made as of the last day of the preceding plan year ("the determination date").

For purposes of determining whether a plan is a top-heavy plan, benefits derived both from employer and employee contributions, including employee elective contributions, are taken into account. In addition, the accrued benefit of a participant in a defined benefit plan and the account balance of a participant in a defined contribution plan includes any amount distributed within the 5-year period ending on the determination date.

An individual's accrued benefit or account balance is not taken into account in determining whether a plan is top-heavy if the individual has not performed services for the employer during the 5-year period ending on the determination date.

In some cases, two or more plans of a single employer must be aggregated for purposes of determining whether the group of plans is top-heavy. The following plans must be aggregated: (1) plans which cover a key employee (including collectively bargained plans); and (2) any plan upon which a plan covering a key employee depends for purposes of satisfying the Code's nondiscrimination rules. The employer may be required to include terminated plans in the required aggregation group. In some circumstances, an employer may elect to aggregate plans for purposes of determining whether they are top heavy.

SIMPLE plans are not subject to the top-heavy rules.

Definition of key employee

A key employee is an employee who, during the plan year that ends on the determination date or any of the 4 preceding plan years, is (1) an officer earning over one-half of the defined benefit plan dollar limitation of section 415 ($67,500 for 2000), (2) a 5-percent owner of the employer, (3) a 1-percent owner of the employer earning over $150,000, or (4) one of the 10 employees earning more than the defined contribution plan dollar limit ($30,000 for 2000) with the largest ownership interests in the employer. A family ownership attribution rule applies to the determination of 1-percent owner status, 5-percent owner status, and largest ownership interest. Under this attribution rule, an individual is treated as owning stock owned by the individual's spouse, children, grandchildren, or parents.

Minimum benefit for non-key employees

A minimum benefit generally must be provided to all non-key employees in a top-heavy plan. In general, a top-heavy defined benefit plan must provide a minimum benefit equal to the lesser of (1) 2 percent of compensation multiplied by the employee's years of service, or (2) 20 percent of compensation. A top-heavy defined contribution plan must provide a minimum annual contribution equal to the lesser of (1) 3 percent of compensation, or (2) the percentage of compensation at which contributions were made for key employees (including employee elective contributions made by key employees and employer matching contributions).

For purposes of the minimum benefit rules, only benefits derived from employer contributions (other than amounts employees have elected to defer) to the plan are taken into account, and an employee's social security benefits are disregarded (i.e., the minimum benefit is nonintegrated). Employer matching contributions may be used to satisfy the minimum contribution requirement; however, in such a case the contributions are not treated as matching contributions for purposes of applying the special nondiscrimination requirements applicable to employee elective contributions and matching contributions under sections 401(k) and (m). Thus, such contributions would have to meet the general nondiscrimination test of section 401(a)(4). [8]

Top-heavy vesting

Benefits under a top-heavy plan must vest at least as rapidly as under one of the following schedules: (1) 3-year cliff vesting, which provides for 100 percent vesting after 3 years of service; and (2) 2–6 year graduated vesting, which provides for 20 percent vesting after 2 years of service, and 20 percent more each year thereafter so that a participant is fully vested after 6 years of service. [9]

Qualified cash or deferred arrangements

Under a qualified cash or deferred arrangement (a "section 401(k) plan"), an employee may elect to have the employer make

[8] Tres. Reg. sec. 1.416–1 Q&A M–19.

[9] Benefits under a plan that is not top heavy must vest at least as rapidly as under one of the following schedules: (1) 5-year cliff vesting; and (2) 3-7 year graded vesting, which provides for 20 percent vesting after 3 years and 20 percent more each year thereafter so that a participant is fully vested after 7 years of service.

payments as contributions to a qualified plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. A special nondiscrimination test applies to elective deferrals under cash or deferred arrangements, which compares the elective deferrals of highly compensated employees with elective deferrals of nonhighly compensated employees. (This test is called the actual deferral percentage test or the "ADP" test). Employer matching contributions under qualified defined contribution plans are also subject to a similar nondiscrimination test. (This test is called the actual contribution percentage test or the "ACP" test.)

Under a design-based safe harbor, a cash or deferred arrangement is deemed to satisfy the ADP test if the plan satisfies one of two contribution requirements and satisfies a notice requirement. A plan satisfies the contribution requirement under the safe harbor rule for qualified cash or deferred arrangements if the employer either (1) satisfies a matching contribution requirement or (2) makes a nonelective contribution to a defined contribution plan of at least 3 percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the arrangement without regard to the permitted disparity rules (sec. 401(1)). A plan satisfies the matching contribution requirement if, under the arrangement: (1) the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to (a) 100 percent of the employee's elective deferrals up to 3 percent of compensation and (b) 50 percent of the employee's elective deferrals from 3 to 5 percent of compensation; and (2), the rate of match with respect to any elective contribution for highly compensated employees is not greater than the rate of match for nonhighly compensated employees. Matching contributions that satisfy the design-based safe harbor for cash or deferred arrangements are deemed to satisfy the ACP test. Certain additional matching contributions are also deemed to satisfy the ACP test.

REASONS FOR CHANGE

The top-heavy rules primarily affect the plans of small employers. While the top-heavy rules were intended to provide additional minimum benefits to rank-and-file employees, the Committee is concerned that in some cases the top-heavy rules may act as a deterrent to the establishment of a plan by a small employer. The Committee believes that simplification of the top-heavy rules will help alleviate the additional administrative burdens the rules place on small employers. The Committee also believes that, in applying the top-heavy minimum benefit rules, the employer should receive credit for all contributions the employer makes, including matching contributions.

The Committee understands that some employers may have been discouraged from adopting a safe harbor section 401(k) plan due to concerns about the top-heavy rules. The Committee believes that facilitating the adoption of such plans will broaden coverage. Thus, the Committee believes it appropriate to provide that such plans are not subject to the top-heavy rules.

EXPLANATION OF PROVISION

Definition of top-heavy plan

The bill provides that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching or nonelective contributions provided under such a plan may be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans.[10]

In determining whether a plan is top-heavy, the bill provides that distributions during the year ending on the date the top-heavy determination is being made are taken into account. The present-law 5-year rule applies with respect to in-service distributions. Similarly, the proposal provides that an individual's accrued benefit or account balance is not taken into account if the individual has not performed services for the employer during the 1-year period ending on the date the top-heavy determination is being made.

Definition of key employee

The bill (1) provides that an employee is not considered a key employee by reason of officer status unless the employee earns more than the compensation limit for determining whether an employee is highly compensated ($85,000 for 2000)[11] and (2) repeals the top-10 owner key employee category. The proposal repeals the 4-year lookback rule for determining key employee status and provides that an employee is a key employee only if he or she is a key employee during the preceding plan year. An employee who was not an employee in the preceding plan year, or who was an employee only for part of the year, is treated as a key employee if it can be reasonably anticipated that the employee will meet the definition of a key employee for current plan year.

Thus, under the bill, an employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of $85,000 (for 2000), (2) a 5-percent owner, or (3) a 1-percent owner with compensation in excess of $150,000. The present- law limits on the number of officers treated as key employees under (1) continue to apply.

The family ownership attribution rule no longer applies solely in determining whether an individual is a 5-percent owner of the employer for purposes of the top-heavy rules. The family ownership attribution rule continues to apply to other provisions that cross reference the top-heavy rules, such as the definition of highly compensated employee and the definition of 1-percent owner under the top-heavy rules.

[10] This provision is not intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

[11] The compensation limit would be determined without regard to the top-paid group election.

Minimum benefit for non-key employees

Under the bill, matching contributions are taken into account in determining whether the minimum benefit requirement has been satisfied.[12]

The bill provides that, in determining the minimum benefit required under a defined benefit plan, a year of service does not include any year in which no key employee benefits under the plan (as determined under sec. 410).

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

D. Elective Deferrals Not Taken Into Account for Purposes of Deduction Limits (Sec. 204 of the Bill and Sec. 404 of the Code)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

For purposes of the deduction limits, employee elective deferral contributions to a section 401(k) plan are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.

Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

REASONS FOR CHANGE

Subjecting elective deferrals to the normally applicable deduction limits may cause employers either to restrict the amount of elective contributions an employee may make or restrict employer contributions to the plan, thereby reducing participants' ultimate retire-

[12] Thus, this provision overrides the provision in Treasury regulations that, if matching contributions are used to satisfy the minimum benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

ment benefits and their ability to save adequately for retirement. The Committee believes that the amount of elective deferrals otherwise allowable should not be further limited through application of the deduction rules.

EXPLANATION OF PROVISION

Under the bill, elective deferral contributions are not subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan does not take into account elective deferral contributions.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

E. REPEAL OF COORDINATION REQUIREMENTS FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS (SEC. 205 OF THE BILL AND SEC. 457 OF THE CODE)

PRESENT LAW

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local government employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,000 (in 2000) or (2) 33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments. Under a special catch-up rule, a section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 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.

The $8,000 limit (as modified under the catch-up rule), applies to all deferrals under all section 457 plans in which the individual participates. In addition, in applying the $8,000 limit, contributions under a tax-sheltered annuity ("section 403(b) annuity"), elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), salary reduction contributions under a simplified employee pension plan ("SEP"), and contributions under a SIMPLE plan are taken into account. Further, the amount deferred under a section 457 plan is taken into account in applying a special catch-up rule for section 403(b) annuities.

REASONS FOR CHANGE

The Committee believes that individuals participating in a section 457 plan should also be able to participate fully in a section 403(b) annuity or section 401(k) plan of the employer. Eliminating the coordination rule may also encourage the establishment of section 403(b) or 401(k) plans by tax-exempt and governmental employers (as permitted under present law).

EXPLANATION OF PROVISION

The bill repeals the rules coordinating the section 457 dollar limit with contributions under other types of plans.[13]

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

F. DEDUCTION LIMITS (SEC. 206 OF THE BILL AND SEC. 404 OF THE CODE)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan. Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In some cases, the amount of deductible contributions is limited by compensation. In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

In the case of an employee stock ownership plan ("ESOP"), principal payments on a loan used to acquire qualifying employer securities are deductible up to 25 percent of compensation.

For purposes of the deduction limits, employee elective deferral contributions to a qualified cash or deferred arrangement ("section 401(k) plan") are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.[14]

For purposes of the deduction limits, compensation means the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plan, and the beneficiaries under a profit-sharing or stock bonus plan are the employees who benefit under the plan with respect to the employer's contribution.[15] An employee who is eligible to make elective deferrals under a section 401(k)

---

[13] The limits on deferrals under a section 457 plan are modified under other provisions of the bill.

[14] Another provision of the bill provides that elective deferrals are not subject to the deduction limits.

[15] Rev. Rul. 65–295, 1965–2 C.B. 148.

plan is treated as benefitting under the arrangement even if the employee elects not to defer.[16]

For purposes of the deduction rules, compensation generally includes only taxable compensation, and thus does not include salary reduction amounts, such as elective deferrals under a section 401(k) plan or a tax-sheltered annuity ("section 403(b) annuity"), elective contributions under a deferred compensation plan of a tax-exempt organization or a State or local government ("section 457 plan"), and salary reduction contributions under a section 125 cafeteria plan. For purposes of the contribution limits under section 415, compensation does include such salary reduction amounts.

REASONS FOR CHANGE

The Committee believes that compensation unreduced by employee elective contributions is a more appropriate measure of compensation for plan purposes, including deduction limits, than the present-law rule. Applying the same definition of compensation for deduction purposes as is generally used for other qualified plan purposes will also simplify application of the qualified plan rules. The Committee also believes that the 15 percent of compensation limit may restrict the amount of employer contributions to the plan, thereby reducing participants' ultimate retirement benefits and their ability to adequately save for retirement.

EXPLANATION OF PROVISION

Under the bill, the definition of compensation for purposes of the deduction rules would include salary reduction amounts treated as compensation under section 415. In addition, the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan would be increased from 15 percent to 25 percent of compensation of the employees covered by the plan for the year.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

G. Option to Treat Elective Deferrals as Roth After-Tax Contributions (Sec. 207 of the Bill and Sec. 402A of the Code)

PRESENT LAW

A qualified cash or deferred arrangement ("section 401(k) plan") or a tax-sheltered annuity ("section 403(b) annuity") may permit a participant to elect to have the employer make payments as contributions to the plan or to the participant directly in cash. Contributions made to the plan at the election of a participant are elective deferrals. Elective deferrals must be nonforfeitable and are subject to an annual dollar limitation (sec. 402(g)) and distribution restrictions. In addition, elective deferrals under a section 401(k) plan are subject to special nondiscrimination rules. Elective deferrals (and earnings attributable thereto) are not includible in a participant's gross income until distributed from the plan.

[16] Treas. Reg. sec. 1.410(b)–3.

Individuals with adjusted gross income below certain levels generally may make nondeductible contributions to a Roth IRA and may convert a deductible or nondeductible IRA into a Roth IRA. Amounts held in a Roth IRA that are withdrawn as a qualified distribution are neither includible in income nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, is made on account of death or disability, or is a qualified special purpose distribution (i.e., for first-time homebuyer expenses of up to $10,000). A distribution from a Roth IRA that is not a qualified distribution is includible in income to the extent attributable to earnings, and is subject to the 10-percent tax on early withdrawals (unless an exception applies).[17]

REASONS FOR CHANGE

The recently-enacted Roth IRA provisions have provided individuals with another form of tax-favored retirement savings. For a variety of reasons, some individuals may prefer to save through a Roth IRA rather than a traditional deductible IRA. The Committee believes that similar savings choices should be available to participants in section 401(k) plans and tax-ssheltered annuities.

EXPLANATION OF PROVISION

A section 401(k) plan or a section 403(b) annuity 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 designated Roth contributions. Designated Roth contributions are elective deferrals that the participant designates (at such time and in such manner as the Secretary may prescribe)[18] as not excludable from the participant's gross income.

The annual dollar limitation on a participant's designated Roth contributions is the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated Roth contributions. Designated Roth contributions are treated as any other elective deferral for purposes of nonforfeitability requirements and distribution restrictions.[19] Under a section 401(k) plan, designated Roth contributions also are treated as any other elective deferral for purposes of the special nondiscrimination requirements.[20]

The plan would be required to establish a separate account, and maintain separate recordkeeping, for a participant's designated Roth contributions (and earnings allocable thereto). A qualified dis-

---

[17] Early distributions of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4–year rule applicable to 1998 conversions.

[18] It is intended that the Secretary will generally not permit retroactive designations of elective deferrals as Roth contributions.

[19] Similarly, Roth contributions to a section 403(b) annuity are treated the same as other salary reduction contributions to the annuity (except that Roth contributions are includible in income).

[20] It is intended that the Secretary will provide ordering rules regarding the return of excess contributions under the special nondiscrimination rules (pursuant to sec. 401(k)(8)) in the event a participant has made both regular elective deferrals and Roth contributions. It is intended that such rules will generally permit a plan to allow participants to designate which contributions are returned first or to permit the plan to specify which contributions are returned first.

tribution from a participant's designated Roth contributions account would not be includible in the participant's gross income. A qualified distribution is a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled.[21] The nonexclusion period is the 5-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated Roth contribution to any designated Roth contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated Roth contribution account that is the source of the distribution from a designated Roth contribution account established for the participant under another plan, the first taxable year for which the participant made a designated Roth contribution to the previously established account.

A distribution from a designated Roth contributions account that is a corrective distribution of an elective deferral (and income allocable thereto) that exceeds the section 402(g) annual limit on elective deferrals or a distribution of excess contributions (and income allocable thereto) is not is a qualified distribution.[22]

A participant is permitted to roll over a distribution from a designated Roth contributions account only to another designated Roth contributions account or a Roth IRA of the participant.

The Secretary of the Treasury is directed to require the plan administrator of each section 401(k) plan or section 403(b) annuity that permits participants to make designated Roth contributions to make such returns and reports regarding designated Roth contributions to the Secretary, plan participants and beneficiaries, and other persons that the Secretary may designate.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

H. CREDIT FOR LOW-AND MIDDLE-INCOME SAVERS (SEC. 208 OF THE BILL AND NEW SEC. 25B OF THE CODE)

PRESENT LAW

Present law provides favorable tax treatment for a variety of retirement savings vehicles, including employer-sponsored retirement plans and individual retirement arrangements ("IRAs").

Several different types of tax-favored employer-sponsored retirement plans exist, such as section 401(a) qualified plans (including plans with a section 401(k) qualified cash-or-deferred arrangement), section 403(a) qualified annuity plans, section 403(b) annuities, section 408(k) simplified employee pensions ("SEPs"), section 408(p) SIMPLE retirement accounts, and section 457(b) eligible deferred compensation plans. In general, an employer and, in certain cases, employees, contribute to the plan. Taxation of the contribu-

[21] A qualified special purpose distribution, as defined under the rules relating to Roth IRAs, does not qualify as a tax-free distribution from a designated Roth contributions account.

[22] Such distributions are not includible in income to the extent they are a return of Roth contributions, because the initial contribution is includible in income.

tions and earnings thereon is generally deferred until benefits are distributed from the plan to participants or their beneficiaries.[23] Contributions and benefits under tax-favored employer-sponsored retirement plans are subject to specific limitations.

Coverage and nondiscrimination rules also generally apply to tax-favored employer-sponsored retirement plans to ensure that plans do not disproportionately cover higher-paid employees and that benefits provided to moderate- and lower-paid employees are generally proportional to those provided to higher-paid employees.

IRAs include both traditional IRAs and Roth IRAs. In general, an individual makes contributions to an IRA, and investment earnings on those contributions accumulate on a tax-deferred basis. Total annual IRA contributions per individual are limited to $2,000 (or the compensation of the individual or the individual's spouse, if smaller). Contributions to a traditional IRA may be deducted from gross income if an individual's adjusted gross income ("AGI") is below certain levels or the individual is not an active participant in certain employer-sponsored retirement plans. Contributions to a Roth IRA are not deductible from gross income, regardless of adjusted gross income. A distribution from a traditional IRA is includible in the individual's gross income except to the extent of individual contributions made on a nondeductible basis. A qualified distribution from a Roth IRA is excludable from gross income.

Taxable distributions made from employer retirement plans and IRAs before the employee or individual has reached age 59½ are subject to a 10-percent additional tax, unless an exception applies.

REASONS FOR CHANGE

The Committee recognizes that the rate of private savings in the United States is low; in particular many low- and middle-income individuals have inadequate savings or no savings at all. A key reason for these low levels of saving is that lower-income families are likely to be more budget constrained with competing needs such as food, clothing, shelter, and medical care taking a larger portion of their income. The Committee believes providing an additional tax incentive for low- and middle-income individuals will enhance their ability to save adequately for retirement.

EXPLANATION OF PROVISION

The bill provides a temporary nonrefundable tax credit for contributions made by eligible taxpayers to a qualified plan. The maximum annual contribution eligible for the credit is $2,000. The credit rate depends on the adjusted gross income ("AGI")[24] of the taxpayer. Only taxpayers filing joint returns with AGI of $50,000 or less, taxpayers filing head of household returns of $37,500 or less, and taxpayers filing single returns of $25,000 or less are eligible for the credit.[25] The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability. The credit is available to individuals age 18 or over, other

[23] In the case of after-tax employee contributions, only earnings are taxed upon withdrawal.
[24] AGI is determined without regard to the exclusion provided by sections 911, 931, or 933.
[25] The AGI limits applicable to taxpayers filing single returns apply to married taxpayers filing separate returns.

than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

The credit is available with respect to (1) elective contributions to a section 401(k) plan, tax-sheltered annuity, eligible deferred compensation arrangement of a State or local government (a "sec. 457 plan"), SIMPLE, or SEP; (2) contributions to a traditional or Roth IRA; and (3) voluntary after-tax employee contributions to a qualified retirement plan. The present-law rules governing such contributions continue to apply. Thus, for example, an individual is not entitled to a deduction for contributions to a Roth IRA to which the credit applies; distributions of such contributions are taxable under the rules applicable to Roth IRAs.

The amount of any contribution eligible for the credit is reduced by taxable distributions received by the taxpayer and his or her spouse from any savings arrangement described above or any other qualified retirement plan during the taxable year for which the credit is claimed, the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year and prior to the due date (including extensions) for filing the taxpayer's return for the year. This rule applies to any distributions from a Roth IRA which are not rolled over.[26]

The credit rates based on AGI are as shown in the following table.

Joint filers	Heads of households	All other filers	Credit rate (in percent)
$0–$20,000	$0–$15,000	$0–$10,000	50
$20,001–$25,000	$15,001–$18,750	$10,001–$12,500	30
$25,001–$30,000	$18,751–$22,500	$12,501–$15,000	25
$30,001–$35,000	$22,501–$26,250	$15,001–$17,500	20
$35,001–$40,000	$26,250–$30,000	$17,501–$20,000	15
$40,001–$45,000	$30,001–$33,750	$20,001–$22,500	10
$45,001–$50,000	$33,751–$37,500	$22,501–$25,000	5
Over $50,000	Over $37,500	Over $25,000	0

The bill directs the General Accounting Office to report annually to the Senate Finance Committee and the House Committee on Ways and Means regarding the number of individuals who claim the credit.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000, and before January 1, 2006.

I. Small Business Tax Credit for Qualified Retirement Plan Contributions (Sec. 209 of the Bill and New Sec. 450 of the Code)

PRESENT LAW

The timing of an employer's deduction for compensation paid to an employee generally corresponds to the employee's recognition of

[26] The following distributions are excluded for purposes of the rule reducing the credit: (1) loans treated as distributions (sec. 72(p)); (2) distributions of excess contributions under a 401(k) plan (sec. 401(k)(8)); (3) distributions of excess matching or after-tax voluntary contributions (sec. 401(m)(6)); (4) distributions of elective deferrals that exceed the limits on such deferrals (sec. 402(g)); (5) distributions of ESOP dividends (404(k)); (6) returns of certain IRA contributions (sec. 408(d)(4)); and (7) distributions from a traditional IRA that are converted to a Roth IRA.

the compensation. However, an employer that contributes to a qualified retirement plan is entitled to a deduction (within certain limits) for the employer's contribution to the plan on behalf of an employee even though the employee does not recognize income with respect to the contribution until the amount is distributed to the employee.

REASONS FOR CHANGE

The Committee understands that many small employers are reluctant to establish a qualified retirement plan for employees that provides nonelective or matching contributions to all employees. Plans that offer only salary reduction contributions may not provide sufficient incentive for lower- and middle-income employees to save. The Committee believes that providing a credit for employers who provide nonelective and matching contributions for nonhighly compensated employees will result in greater retirement saving for such employees.

EXPLANATION OF PROVISION

The bill provides a nonrefundable income tax credit for small employers equal to 50 percent of certain qualifying employer contributions made to new qualified retirement plans on behalf of nonhighly compensated employees.[27] For purposes of the provision, a small employer means an employer with no more than 50 employees who received at least $5,000 of earnings in the preceding year. A nonhighly compensated employee is defined as an employee who neither (1) was a five-percent owner of the employer at any time during the current year or the preceding year, nor (2) for the preceding year, had compensation in excess of $80,000 (indexed for inflation).[28] The credit is available for the first three plan years.

A plan is considered a new plan if, during the 3-taxable year period immediately preceding the first taxable year for which the credit is allowable, neither the employer (or any member of the employer's controlled group) established or maintained a qualified retirement plan with respect to which contributions were made or benefits accrued for substantially the same employees covered by the plan with respect to which the credit is claimed.

The bill requires a small employer to make nonelective contributions equal to at least one percent of compensation to qualify for the credit. The credit applies to both qualifying nonelective employer contributions and qualifying employer matching contributions, but only up to a total of three percent of the nonhighly compensated employee's compensation. The credit is available for 50 percent of qualifying benefit accruals under a nonintegrated defined benefit plan if the benefits are equivalent, as defined in regulations, to a three-percent nonelective contribution to a defined contribution plan. For purposes of applying the limit on contributions with respect to which the credit may be claimed, all plans of the employer are treated as a single plan.

---

[27] The credit is not available with respect to contributions to a SIMPLE IRA or SEP.

[28] The top paid group election, which under present law permits an employer to classify an employee as a nonhighly compensated employee if the employee had compensation in excess of $80,000 during the preceding year but was not among the top 20 percent of employees of the employer when ranked on the basis of compensation paid to employees during the preceding year, would not be taken into account in determining nonhighly compensated employees for purposes of the proposal.

To qualify for the credit, the nonelective and matching contributions to a defined contribution plan and the benefit accruals under a defined benefit plan are required to vest at least as rapidly as under either a three-year cliff vesting schedule or a graded schedule that provides 20-percent vesting per year for five years. In order to qualify for the credit, contributions to plans other than pension plans must be subject to the same distribution restrictions that apply to qualified nonelective employer contributions to a section 401(k) plan, i.e., distribution only upon separation from service, death, disability, attainment of age 59½, plan termination without a successor plan, or acquisition of a subsidiary or substantially all the assets of a trade or business that employs the participant.[29] Qualifying contributions to pension plans are subject to the distribution restrictions applicable to such plans.

The plan to which the small employer makes the qualifying contributions (and any plan aggregated with that plan for nondiscrimination testing purposes) are required to allocate any nonelective employer contributions proportionally to participants' compensation from the employer (or on a flat-dollar basis) and, accordingly, without the use of permitted disparity or cross-testing.

Forfeited nonvested qualifying contributions or accruals for which the credit was claimed generally results in recapture of the credit at a rate of 35 percent. However, recapture does not apply to the extent that forfeitures of contributions are reallocated to nonhighly compensated employees or applied to future contributions on behalf of nonhighly compensated employees. The Secretary of the Treasury is authorized to issue administrative guidance, including de minimis rules, to simplify or facilitate claiming and recapturing the credit.

The credit is a general business credit.[30] The 50 percent of qualifying contributions that are effectively offset by the tax credit are not deductible; the other 50 percent of the qualifying contributions (and other contributions) are deductible to the extent otherwise permitted.

EFFECTIVE DATE

The credit is effective for taxable years beginning after December 31, 2000, with respect to plans established after such date.

J. SMALL BUSINESS TAX CREDIT FOR NEW RETIREMENT PLAN EXPENSES (SEC. 210 OF THE BILL AND NEW SEC. 45E OF THE CODE)

PRESENT LAW

The costs incurred by an employer related to the establishment and maintenance of a retirement plan (e.g., payroll system changes, investment vehicle set-up fees, consulting fees) generally are deductible by the employer as ordinary and necessary expenses in carrying on a trade or business.

[29] The rules relating to distribution upon separation from service are modified under another provision of the bill.

[30] The credit could not be carried back to years before the effective date.

REASONS FOR CHANGE

One of the reasons some small employers may not adopt a tax-favored retirement plan is the administrative costs associated with such plans. The Committee believes that providing a tax credit for certain administrative costs will reduce one of the barriers to retirement plan coverage.

EXPLANATION OF PROVISION

The bill provides a nonrefundable income tax credit for 50 percent of the administrative and retirement-education expenses for any small business that adopts a new qualified defined benefit or defined contribution plan (including a section 401(k) plan), SIMPLE plan, or simplified employee pension ("SEP"). The credit applies to 50 percent of the first $1,000 in administrative and retirement-education expenses for the plan for each of the first three years of the plan.

A plan is considered a new plan if, during the 3-taxable year period immediately preceding the first taxable year for which the credit is allowable, neither the employer (or any member of the employer's controlled group) established or maintained a qualified retirement plan with respect to which contributions were made or benefits accrued for substantially the same employees covered by the plan with respect to which the credit is claimed.

The credit is available to an employer that did not employ, in the preceding year, more than 100 employees with compensation in excess of $5,000. In order for an employer to be eligible for the credit, the plan must cover at least one nonhighly compensated employee.

The credit is a general business credit.[31] The 50 percent of qualifying expenses that are effectively offset by the tax credit are not deductible; the other 50 percent of the qualifying expenses (and other expenses) are deductible to the extent otherwise permitted.

EFFECTIVE DATE

The credit is effective for taxable years beginning after December 31, 2000, with respect to plans established after such date.

TITLE III. ENHANCING FAIRNESS FOR WOMEN

A. Additional Salary Reduction Catch-Up Contributions (Sec. 301 of the Bill and Sec. 414 of the Code)

PRESENT LAW

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is

[31] The credit may not be carried back to years before the effective date.

$10,500 (for 2000). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,000. These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,000 (for 2000) or (2) 33⅓ percent of compensation. The $8,000 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 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.

REASONS FOR CHANGE

Although the Committee believes that individuals should be saving for retirement throughout their working lives, as a practical matter, many individuals simply do not focus on the amount of retirement savings they need until they near retirement. In addition, many individuals may have difficulty saving more in earlier years, e.g., because an employee leaves the workplace to care for a family. Some individuals may have a greater ability to save as they near retirement.

The Committee believes that the pension laws should assist individuals who are nearing retirement to save more for their retirement.

EXPLANATION OF PROVISION

The bill provides that individuals who have attained age 50 may be permitted to make additional catch-up elective contributions to employer-sponsored retirement plans.[32]

In the case of employer-sponsored retirement plans, the provision applies to elective deferrals under a section 401(k) plan, section 403(b) annuity, SIMPLE, or a section 457 plan. Additional contributions may be made by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan.[33] Under the bill, the additional amount of elective contributions that could be made by an eligible individual participating in such a plan is the lesser of (1) the applicable percent of the maximum dollar amount of elective deferrals otherwise excludable from the gross income of the participant for the year (under sec. 402(g)) or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.[34] The applicable percent is 10 per-

[32] Another provision of the bill provides for catch-up contributions to IRAs.

[33] A plan is not required to permit participants to make catch-up contributions.

[34] In the case of a section 457 plans, this catch-up rule does not apply during the participant's last 3 years before retirement (in those years, the regularly applicable dollar limit is doubled).

cent in 2001, and increases by 10 percentage points until the applicable percent is 50 in 2005 and thereafter.

Catch-up contributions made under the bill 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 otherwise applicable nondiscrimination rules.

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.

The following examples illustrate the application of the provision, assuming the catch-up percentage is 50 percent.

Example 1: Employee A is a highly compensated employee who is over 50 and who participates in a section 401(k) plan sponsored by A's employer. The plan provides for catch-up contributions up to the maximum permitted by law. The maximum annual deferral limit (without regard to the catch-up provision) is $15,000. After application of the special nondiscrimination rules applicable to section 401(k) plans, the maximum elective deferral A may make for the year is $10,000. Under the bill, A is able to make additional catch-up salary reduction contributions of up to $7,500.

Example 2: Employee B, who is over 50, is a participant in a section 401(k) plan. The plan provides for catch-up contributions up to the maximum permitted by law. B's compensation for the year is $30,000. The maximum annual deferral limit (without regard to the provision) is $15,000. Under the terms of the plan, the maximum permitted deferral is 10 percent of compensation or, in B's case, $3,000. Under the bill, B can contribute up to $10,500 for the year ($3,000 under the normal operation of the plan, and an additional $7,500 under the provision).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

B. EQUITABLE TREATMENT FOR CONTRIBUTIONS OF EMPLOYEES TO DEFINED CONTRIBUTION PLANS (SEC. 302 OF THE BILL AND SECS. 413(b), 415, AND 452 OF THE CODE)

PRESENT LAW

Present law imposes limits on the contributions that may be made to tax-favored retirement plans.

Defined contribution plans

In the case of a tax-qualified defined contribution plan, the limit on annual additions that can be made to the plan on behalf of an employee is the lesser of $30,000 (for 2000) or 25 percent of the employee's compensation (sec. 415(c)). Annual additions include employer contributions, including contributions made at the election of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee. For this purpose, compensation means taxable compensation of the employee, plus elective deferrals, and similar salary reduction contributions. A separate limit applies to benefits under a defined benefit plan.

For years before January 1, 2000, an overall limit applies if an employee is a participant in both a defined contribution plan and a defined benefit plan of the same employer.

Tax-sheltered annuities

In the case of a tax-sheltered annuity (a "section 403(b) annuity"), the annual contribution generally cannot exceed the lesser of the exclusion allowance or the section 415(c) defined contribution limit. The exclusion allowance for a year is equal to 20 percent of the employee's includible compensation, multiplied by the employee's years of service, minus excludable contributions for prior years under qualified plans, tax-sheltered annuities or section 457 plans of the employer.

In addition to this general rule, employees of nonprofit educational institutions, hospitals, home health service agencies, health and welfare service agencies, and churches may elect application of one of several special rules that increase the amount of the otherwise permitted contributions. The election of a special rule is irrevocable; an employee may not elect to have more than one special rule apply.

Under one special rule, in the year the employee separates from service, the employee may elect to contribute up to the exclusion allowance, without regard to the 25 percent of compensation limit under section 415. Under this rule, the exclusion allowance is determined by taking into account no more than 10 years of service.

Under a second special rule, the employee may contribute up to the lesser of: (1) the exclusion allowance; (2) 25 percent of the participant's includible compensation; or (3) $15,000.

Under a third special rule, the employee may elect to contribute up to the section 415(c) limit, without regard to the exclusion allowance. If this option is elected, then contributions to other plans of the employer are also taken into account in applying the limit.

For purposes of determining the contribution limits applicable to section 403(b) annuities, includible compensation means the amount of compensation received from the employer for the most recent period which may be counted as a year of service under the exclusion allowance. In addition, includible compensation includes elective deferrals and similar salary reduction amounts.

Treasury regulations include provisions regarding application of the exclusion allowance in cases where the employee participates in a section 403(b) annuity and a defined benefit plan. The Taxpayer Relief Act of 1997 directed the Secretary of the Treasury to revise these regulations, effective for years beginning after December 31, 1999, to reflect the repeal of the overall limit on contributions and benefits.

Section 457 plans

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local governmental employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,000 (in 2000) or (2) 33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments.

REASONS FOR CHANGE

The present-law rules that limit contributions to defined contribution plans by a percentage of compensation reduce the amount that non-highly paid workers can save for retirement. The present-law limits may not allow such workers to accumulate adequate retirement benefits, particularly if a defined contribution plan is the only type of retirement plan maintained by the employer.

Conforming the contribution limits for tax-sheltered annuities to the limits applicable to retirement plans will simplify the administration of the pension laws, and provide more equitable treatment for participants in similar types of plans.

EXPLANATION OF PROVISION

Increase in defined contribution plan limit

The bill increases the 25 percent of compensation limitation on annual additions under a defined contribution plan to 100 percent.[35]

Conforming limits on tax-sheltered annuities

The bill repeals the exclusion allowance applicable to contributions to tax-sheltered annuities. Thus, such annuities are subject to the limits applicable to tax-qualified plans.

The bill also directs the Secretary of the Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance. For taxable years beginning after December 31, 1999, the regulatory provisions regarding the exclusion allowance are to be applied as if the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance were void.

Section 457 plans

The bill increases the 33⅓ percent of compensation limitation on deferrals under a section 457 plan to 100 percent of compensation.

EFFECTIVE DATE

The provision generally is effective for years beginning after December 31, 2000. The provision regarding the regulations under section 403(b)(2) is effective on the date of enactment.

C. Faster Vesting of Employer Matching Contributions (Sec. 303 of the Bill and Sec. 417 of the Code)

PRESENT LAW

Under present law, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeit-

[35] Another provision of the bill increases the defined contribution plan dollar limit.

able right to at least 20 percent of the participant's accrued benefit derived from employer contributions after 3 years of service, 40 percent after 4 years of service, 60 percent after 5 years of service, 80 percent after 6 years of service, and 100 percent after 7 years of service.[36]

REASONS FOR CHANGE

The Committee understands that many employees, particularly lower- and middle-income employees, do not take full advantage of the retirement savings opportunities provided by their employer's section 401(k) plan. The Committee believes that providing faster vesting for matching contributions will make section 401(k) plans more attractive for employees, particularly lower- and middle-income employees, and will encourage employees to save more for their own retirement. In addition, faster vesting for matching contributions will enable short-service employees to accumulate greater retirement savings.

EXPLANATION OF PROVISION

The bill applies faster vesting schedules to employer matching contributions. Under the provision, employer matching contributions must vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of 3 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after 6 years of service.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The provision does not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date must be taken into account.

D. Simplify and Update the Minimum Distribution Rules (Sec. 304 of the Bill and Secs. 401(a)19 and 457 of the Code)

PRESENT LAW

In general

Minimum distribution rules apply to all types of tax-favored retirement vehicles, including qualified plans, individual retirement arrangements ("IRAs"), tax-sheltered annuities ("section 403(b) annuities"), and eligible deferred compensation plans of tax-exempt and State and local government employers ("section 457 plans"). In general, under these rules, distribution of minimum benefits must begin no later than the required beginning date. Minimum dis-

[36] The minimum vesting requirements are also contained in Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

tribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the individual plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax can be waived if the individual establishes to the satisfaction of the Secretary that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall.

Distributions prior to the death of the individual

In the case of distributions prior to the death of the plan participant, the minimum distribution rules are satisfied if either (1) the participant's entire interest in the plan is distributed by the required beginning date, or (2) the participant's interest in the plan is to be distributed (in accordance with regulations), beginning not later than the required beginning date, over a permissible period. The permissible periods are (1) the life of the participant, (2) the lives of the participant and a designated beneficiary, (3) the life expectancy of the participant, or (4) the joint life and last survivor expectancy of the participant and a designated beneficiary. In calculating minimum required distributions, life expectancies of the participant and the participant's spouse may be recomputed annually.

In the case of qualified plans, tax-sheltered annuities, and section 457 plans, the required beginning date is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, in the case of a 5-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the 5-percent owner attains age 70½. If commencement of benefits is delayed beyond age 70½ from a defined benefit plan, then the accrued benefit of the employee must be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan.[37] In the case of distributions from an IRA other than a Roth IRA, the required beginning date is the April 1 following the calendar year in which the IRA owner attains age 70½. The pre-death minimum distribution rules do not apply to Roth IRAs.

In general, under proposed regulations, in order to satisfy the minimum distribution rules, annuity payments under a defined benefit plan must be paid in period payments made at intervals not longer than one year over a permissible period, and must be nonincreasing, or increase only as a result of the following: (1) cost-of-living adjustments; (2) cash refunds of employee contributions; (3) benefit increases under the plan; or (4) an adjustment due to death of the employee's beneficiary. In the case of a defined contribution plan, the minimum required distribution is determined by dividing the employee's benefit by the applicable life expectancy.

[37] State and local government plans and church plans are not required to actuarially increase benefits that begin after age 70½.

Distributions after the death of the plan participant

The minimum distribution rules also apply to distributions to beneficiaries of deceased participants. In general, if the participant dies after minimum distributions have begun, the remaining interest must be distributed at least as rapidly as under the minimum distribution method being used as of the date of death. If the participant dies before minimum distributions have begun, then the entire remaining interest must generally be distributed within 5 years of the participant's death. The 5-year rule does not apply if distributions begin within 1 year of the participant's death and are payable over the life of a designated beneficiary or over the life expectancy of a designated beneficiary. A surviving spouse beneficiary is not required to begin distribution until the date the deceased participant would have attained age 70½.

Special rules for section 457 plans

Eligible deferred compensation plans of State and local and tax-exempt employers ("section 457 plans") are subject to the minimum distribution rules described above. Such plans are also subject to additional minimum distribution requirements (sec. 457(d)(2)(b)).

REASONS FOR CHANGE

The Committee believes that the minimum distribution rules are among the most complex of the rules relating to tax-favored savings arrangements. While a plan or IRA trustee may assist the individual in complying with the minimum distribution rules, ultimately the responsibility for compliance falls on the individual. Many of the complexities of the present-law rules are contained in Treasury regulations, which have not yet been finalized. The Committee believes that the present-law rules impose undue burdens on individuals and plan administrators.

The sanction for failure to comply with the minimum distribution rules is severe. The Committee believes this sanction is inappropriate, particularly given the complexity of the rules, and the likelihood of inadvertent mistakes.

EXPLANATION OF PROVISION

Modification of post-death distribution rules

The provision applies the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. Thus, in general, if the employee dies before his or her entire interest has been distributed, distribution of the remaining interest is required to be made within 5 years of the date of death, or begin within one year of the date of death and paid over the life or life expectancy of a designated beneficiary. In the case of a surviving spouse, distributions would not be required to begin until the surviving spouse attains age 70½. Minimum distributions that have already begun would be permitted to be recalculated under the new rule.

Reduction in excise tax

The bill reduces the excise tax on failures to satisfy the minimum distribution rules to 10 percent of the amount that was required to be distributed but was not distributed.

Treasury regulations

The Secretary of the Treasury is directed to update, simplify, and finalize the regulations relating to the minimum distribution rules by December 31, 2001. The Secretary is directed to reflect in the regulations current life expectancies and to revise the required distribution methods so that, under reasonable assumptions, the amount of the required distribution does not decrease over time. The regulations are to permit recalculation of distributions for future years to reflect the change in the regulations, and to permit the election of a new designated beneficiary and method of calculating life expectancy. The regulations are to apply regardless of whether minimum distributions had begun.

Section 457 plans

The bill repeals the special minimum distribution rules applicable to section 457 plans. Thus, such plans are subject to the same minimum distribution rules applicable to other types of tax-favored arrangements.

EFFECTIVE DATE

In general, the provision is effective for years beginning after December 31, 2000. The provision regarding Treasury regulations is effective on the date of enactment.

E. Clarification of Tax Treatment of Division of Section 457 Plan Benefits Upon Divorce (Sec. 305 of the Bill and Sec. 457 of the Code)

PRESENT LAW

Under present law, benefits provided under a qualified retirement plan for a participant may not be assigned or alienated to creditors of the participant, except in very limited circumstances. One exception to the prohibition on assignment or alienation rule is a qualified domestic relations order ("QDRO"). A QDRO is a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant, and that meets certain procedural requirements.

Under present law, a distribution from a governmental plan or a church plan is treated as made pursuant to a QDRO if it is made pursuant to a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant. Such distributions are not required to meet the procedural requirements that apply with respect to distributions from qualified plans.

Under present law, amounts distributed from a qualified plan generally are taxable to the participant in the year of distribution. However, if amounts are distributed to the spouse (or former spouse) of the participant by reason of a QDRO, the benefits are taxable to the spouse (or former spouse). Amounts distributed pursuant to a QDRO to an alternate payee other than the spouse (or former spouse) are taxable to the plan participant.

Section 457 of the Internal Revenue Code provides rules for deferral of compensation by an individual participating in an eligible deferred compensation plan ("section 457 plan") of a tax-exempt or

State and local government employer. The QDRO rules do not apply to section 457 plans.

REASONS FOR CHANGE

The Committee believes that the rules regarding qualified domestic relations orders should apply to all types of employer-sponsored retirement plans.

EXPLANATION OF PROVISION

The bill applies the taxation rules for qualified plan distributions pursuant to a QDRO to distributions made pursuant to a domestic relations order from a section 457 plan. In addition, a section 457 plan is not treated as violating the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO. The special rule applicable to governmental plans and church plans applies for purposes of determining whether a distribution is pursuant to a QDRO.

EFFECTIVE DATE

The provision relating to taxation of distributions is effective for transfers, distributions, and payments made after December 31, 2000. The other provisions are effective on January 1, 2001, except that, in the case of a domestic relations order entered into before such date, the plan administrator (1) shall treat such order as a QDRO if the administrator is paying benefits pursuant to the order and (2) may treat any other such order entered into before the effective date as a QDRO.

F. MODIFICATIONS RELATING TO HARDSHIP WITHDRAWALS (SEC. 306 OF THE BILL AND SECS. 401(k) AND 402 OF THE CODE)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement (a "section 401(k) plan") may not be distributable prior to the occurrence of one or more specified events. One event upon which distribution is permitted is the financial hardship of the employee. Applicable Treasury regulations[38] 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 heavy need.

The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution.

Under present law, hardship withdrawals of elective deferrals from a qualified cash or deferred arrangement (or 403(b) annuity) are not eligible rollover distributions. Other types of hardship distributions, e.g., employer matching contributions distributed on account of hardship, are eligible rollover distributions. Eligible roll-

[38] Treas. Reg. sec. 1.401(k)–1.

over distributions that are not directly rolled over are subject to withholding at a flat rate of 20-percent.

REASONS FOR CHANGE

Although the Committee believes that it is appropriate to restrict the circumstances in which an in-service distribution from a 401(k) plan is permitted and to encourage participants to take such distributions only when necessary to satisfy an immediate and heavy financial need, the Committee is concerned about the impact that a 12-month suspension of contributions may have on the retirement savings of a participant who experiences a hardship. The Committee believes that the combination of a 6-month contribution suspension and the other elements of the regulatory safe harbor will provide an adequate incentive for a participant to seek sources of funds other than his or her 401(k) plan account balance in order to satisfy financial hardships.

The present-law rules regarding the ability to rollover hardship distributions create administrative burdens for plan administrators and confusion on the part of plan participants. The Committee believes that providing a uniform rule for all hardship distributions will simplify application of the rollover rules.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to revise the applicable regulations to reduce from 12 months to 6 months the period during which an employee must be prohibited from making elective contributions and employee contributions in order for a distribution to be deemed necessary to satisfy an immediate and heavy financial need.

The bill also provides that any hardship distribution made pursuant to the terms of a plan is not an eligible rollover distribution. The bill does not modify the rules under which hardship distributions may be made. For example, as under present law, hardship distributions of qualified employer matching contributions may only be made under the rules applicable to elective deferrals.

EFFECTIVE DATE

The provision relating to safe harbor hardship distributions is effective for years beginning after December 31, 2000.

The provision providing that hardship distributions are not eligible rollover distributions is effective for distributions made after December 31, 2000. The Secretary has the authority to issue transitional guidance with respect to this provision to provide sufficient time for plans to implement the new rule.

G. PENSION COVERAGE FOR DOMESTIC AND SIMILAR WORKERS (SEC. 307 OF THE BILL AND SEC. 4972 OF THE CODE)

PRESENT LAW

Under present law, within limits, employers may make deductible contributions to qualified retirement plans for employees. Subject to certain exception, a 10-percent excise tax applies to nondeductible contributions to such plans.

Employers of household workers may establish a pension plan for such workers. Contributions to such plans are not deductible.

REASONS FOR CHANGE

Under present law, individuals who employ domestic and similar workers may be discouraged from providing pension plan coverage for such employees because of the possible adverse tax consequences from making nondeductible contributions. As a result, such workers, who are typically lower income, may be denied the opportunity for tax-favored retirement savings. The Committee believes that such individuals who employ such workers should be encouraged to provide pension coverage.

EXPLANATION OF PROVISION

Under the provision, the 10-percent excise tax on nondeductible contributions does not apply to contributions to a SIMPLE plan or a SIMPLE IRA which are nondeductible solely because the contributions are not a trade or business expense under section 162. Thus, for example, employers of household workers could make contributions to such plans without imposition of the excise tax. As under present law, the contributions are not deductible. The present-law rules applicable to such plans, e.g., contribution limits and nondiscrimination rules, continue to apply. The provision does not apply with respect to contributions on behalf of the individual and members of his or her family.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

TITLE IV. INCREASING PORTABILITY FOR PARTICIPANTS

A. Rollovers of Retirement Plan and IRA Distributions (Secs. 401–403 of the Bill and Secs. 401, 402, 403(b), 408, 457, and 3405 of the Code)

PRESENT LAW

In general

Present law permits the rollover of funds from a tax-favored retirement plan to another tax-favored retirement plan. The rules that apply depend on the type of plan involved. Similarly, the rules regarding the tax treatment of amounts that are not rolled over depend on the type of plan involved.

Distributions from qualified plans

Under present law, an "eligible rollover distribution" from a tax-qualified employer- sponsored retirement plan may be rolled over tax free to a traditional individual retirement arrangement ("IRA") [39] or another qualified plan.[40] An "eligible rollover distribution" means any distribution to an employee of all or any portion

[39] A "traditional" IRA refers to IRAs other than Roth IRAs or SIMPLE IRAs. All references to IRAs refers only to traditional IRAs.

[40] An eligible rollover distribution may either be rolled over by the distributee within 60 days of the date of the distribution or, as described below, directly rolled over by the distributing plan.

of the balance to the credit of the employee in a qualified plan, except the term does not include (1) any distribution which is one of a series of substantially equal periodic payments made (a) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (b) for a specified period of 10 years or more, (2) any distribution to the extent such distribution is required under the minimum distribution rules, and (3) certain hardship distributions. The maximum amount that can be rolled over is the amount of the distribution includible in income, i.e., after-tax employee contributions cannot be rolled over. Qualified plans are not required to accept rollovers.

Distributions from tax-sheltered annuities

Eligible rollover distributions from a tax-sheltered annuity ("section 403(b) annuity") may be rolled over into an IRA or another section 403(b) annuity. Distributions from a section 403(b) annuity cannot be rolled over into a tax-qualified plan. Section 403(b) annuities are not required to accept rollovers.

IRA distributions

Distributions from a traditional IRA, other than minimum required distributions, can be rolled over into another IRA. In general, distributions from an IRA cannot be rolled over into a qualified plan or section 403(b) annuity. An exception to this rule applies in the case of so-called "conduit IRAs." Under the conduit IRA rule, amounts can be rolled from a qualified plan into an IRA and then subsequently rolled back to another qualified plan if the amounts in the IRA are attributable solely to rollovers from a qualified plan. Similarly, an amount may be rolled over from a section 403(b) annuity to an IRA and subsequently rolled back into a section 403(b) annuity if the amounts in the IRA are attributable solely to rollovers from a section 403(b) annuity.

Distributions from section 457 plans

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. In some cases, different rules apply under section 457 to governmental plans and plans of tax-exempt employers. For example, governmental section 457 plans are like qualified plans in that plan assets are required to be held in a trust for the exclusive benefit of plan participants and beneficiaries. In contrast, benefits under a section 457 plan of a tax-exempt employer are unfunded, like nonqualified deferred compensation plans of private employers.

Section 457 benefits can be transferred to another section 457 plan. Distributions from a section 457 plan cannot be rolled over to another section 457 plan, a qualified plan, a section 403(b) annuity, or an IRA.

Rollovers by surviving spouses

A surviving spouse that receives an eligible rollover distribution may roll over the distribution into an IRA, but not a qualified plan or section 403(b) annuity.

Direct rollovers and withholding requirements

Qualified plans and section 403(b) annuities are required to provide that a plan participant has the right to elect that an eligible rollover distribution be directly rolled over to another eligible retirement plan. If the plan participant does not elect the direct rollover option, then withholding is required on the distribution at a 20-percent rate.

Notice of eligible rollover distribution

The plan administrator of a qualified plan or a section 403(b) annuity is required to provide a written explanation of rollover rules to individuals who receive a distribution eligible for rollover. In general, the notice is to be provided within a reasonable period of time before making the distribution and is to include an explanation of (1) the provisions under which the individual may have the distribution directly rolled over to another eligible retirement plan, (2) the provision that requires withholding if the distribution is not directly rolled over, (3) the provision under which the distribution may be rolled over within 60 days of receipt, and (4) if applicable, certain other rules that may apply to the distribution. The Treasury Department has provided more specific guidance regarding timing and content of the notice.

Taxation of distributions

As is the case with the rollover rules, different rules regarding taxation of benefits apply to different types of tax-favored arrangements. In general, distributions from a qualified plan, section 403(b) annuity, or IRA are includible in income in the year received. In certain cases, distributions from qualified plans are eligible for capital gains treatment and averaging. These rules do not apply to distributions from another type of plan. Distributions from a qualified plan, IRA, and section 403(b) annuity generally are subject to an additional 10-percent early withdrawal tax if made before age 59½. There are a number of exceptions to the early withdrawal tax. Some of the exceptions apply to all three types of plans, and others apply only to certain types of plans. For example, the 10-percent early withdrawal tax does not apply to IRA distributions for educational expenses, but does apply to similar distributions from qualified plans and section 403(b) annuities. Benefits under a section 457 plan are generally includible in income when paid or made available. The 10-percent early withdrawal tax does not apply to section 457 plans.

REASONS FOR CHANGE

Present law encourages individuals who receive distributions from qualified plans and similar arrangements to save those distributions for retirement by facilitating tax-free rollovers to an IRA or another qualified plan. The Committee believes that expanding the rollover options for individuals in employer-sponsored retirement plans and owners of IRAs will provide further incentives for individuals to continue to accumulate funds for retirement. The Committee believes it appropriate to extend the same rollover rules to governmental section 457 plans; like qualified plans, such plans are required to hold plan assets in trust for employees.

EXPLANATION OF PROVISION

In general

The bill provides that eligible rollover distributions from qualified retirement plans, section 403(b) annuities, and governmental section 457 plans generally may be rolled over to any of such plans or arrangements. Similarly, distributions from an IRA generally may be rolled over into a qualified plan, section 403(b) annuity, or governmental section 457 plan. The direct rollover and withholding rules are extended to distributions from a governmental section 457 plan, and such plans are required to provide the written notification regarding eligible rollover distributions. The rollover notice (with respect to all plans) is required to include a description of the provisions under which distributions from the plan to which the distribution is rolled over may be subject to restrictions and tax consequences different than those applicable to distributions from the distributing plan. Qualified plans, section 403(b) annuities, and section 457 plans are not required to accept rollovers.

Some special rules apply in certain cases. A distribution from a qualified plan is not eligible for capital gains or averaging treatment if there was a rollover to the plan that would not have been permitted under present law. Thus, in order to preserve capital gains and averaging treatment for a qualified plan distribution that is rolled over, the rollover must be made to a "conduit IRA" as under present law, and then rolled back into a qualified plan. Amounts distributed from a section 457 plan are subject to the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan. Section 457 plans are required to separately account for such amounts.

Rollover of after-tax contributions

The bill provides that employee after-tax contributions may be rolled over into another qualified plan or a traditional IRA. In the case of a rollover from a qualified plan to another qualified plan, the rollover may be accomplished only through a direct rollover. In addition, a qualified plan is permitted to accept rollovers of after-tax contributions unless the plan provides separate accounting for such contributions (and earnings thereon). After-tax contributions (including nondeductible contributions to an IRA) may not be rolled over from an IRA into a qualified plan, tax-sheltered annuity, or section 457 plan.

In the case of a distribution from a traditional IRA that is rolled over into an eligible rollover plan that is not an IRA, the distribution is attributed first to amounts other than after-tax contributions.

Expansion of spousal rollovers

The bill provides that surviving spouses may roll over distributions to a qualified plan, section 403(b) annuity, or governmental section 457 plan in which the spouse participates.

Treasury regulations

The Secretary is directed to prescribe rules necessary to carry out the provisions. Such rules may include, for example, reporting requirements and mechanisms to address mistakes relating to roll-

overs. It is expected that the IRS will develop forms to assist individuals who roll over after-tax contributions to an IRA in keeping track of such contributions. Such forms could, for example, expand Form 8606—Nondeductible IRAs, to include information regarding after-tax contributions.

EFFECTIVE DATE

The provisions are effective for distributions made after December 31, 2001.

B. WAIVER OF 60-DAY RULE (SEC. 404 OF THE BILL AND SECS. 402 AND 408 OF THE CODE)

PRESENT LAW

Under present law, amounts received from an IRA or qualified plan may be rolled over tax free if the rollover is made within 60 days of the date of the distribution. The Secretary does not have the authority to waive the 60-day requirement.

REASONS FOR CHANGE

The inability of the Secretary to waive the 60-day rollover period can result in adverse tax consequences for individuals. The Committee believes such harsh results are inappropriate and that providing for waivers of the rule will help facilitate rollovers.

EXPLANATION OF PROVISION

The bill provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.

EFFECTIVE DATE

The provision applies to distributions made after December 31, 2000.

C. TREATMENT OF FORMS OF DISTRIBUTION (SEC. 405 OF THE BILL AND SEC. 411(d)(6) OF THE CODE)

PRESENT LAW

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant. An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit (sec. 411(d)(6)).[41]

The prohibition against the elimination of an optional form of benefit applies to plan mergers, spinoffs, transfers, and transactions amending or having the effect of amending a plan or plans to transfer plan benefits. For example, if Plan A, a profit-sharing plan that provides for distribution of benefits in annual install-

[41] A similar provision is contained in Title I of ERISA.

ments over ten or twenty years, is merged with Plan B, a profit-sharing plan that provides for distribution of benefits in annual installments over life expectancy at the time of retirement, the merged plan must preserve the ten- or twenty-year installment option with respect to benefits accrued under Plan A as of the date of the merger and the installments over life expectancy with respect to benefits accrued under Plan B as of the date of the merger. Similarly, for example, if a participant's benefit under a defined contribution plan is transferred to another defined contribution plan maintained by the same or a different employer, the optional forms of benefit available with respect to the participant's accrued benefit under the transferor plan must be preserved.[42]

A plan that is a transferee of a plan that is subject to the joint and survivor rules is also subject to those rules.

REASONS FOR CHANGE

The Committee understands that the application of the prohibition against the elimination of any optional form of benefit frequently results in complexity and confusion, especially in the context of business acquisitions and similar transactions, and makes it difficult for participants to understand their benefit options and make choices that are best-suited to their needs. The Committee believes that it is appropriate to permit the elimination of duplicative benefit options that develop following plan mergers and similar events while ensuring that meaningful early retirement benefit payment options and subsidies may not be eliminated.

EXPLANATION OF PROVISION

A defined contribution plan to which benefits are transferred is not treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, and (4) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution. The provision does not modify the rules relating to survivor annuities under section 417. Thus, as under present law, if the transferor plan is required to provide an annuity as the normal form of benefit, the transferee plan must comply with the rules of section 417.

Furthermore, the provision directs the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit do not apply to plan amendments

[42] Treas. Reg. sec. 1.411(d)–4, Q&A–2(a)(3)(i).

that eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants, but only if such an amendment does not adversely affect the rights of any participant in more than a de minimis manner.

For this purpose, the factors to be considered in determining whether an amendment has more than a de minimis adverse effect on any participant include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable), (4) the amount of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation,[43] and (5) the number of years before the plan amendment is effective.

This provision of the bill does not affect the rules relating to involuntary cash outs (sec. 411(a)(11))[44] or survivor annuity requirements (sec. 417). Accordingly, if a participant is entitled to protections of the joint and survivor rules, those protections may not be eliminated. The intent of the provision authorizing regulations is solely to permit the elimination of early retirement benefits, retirement-type subsidies, or optional forms of benefit that have no more than a de minimis effect on any participant but create disproportionate burdens and complexities for a plan and its participants.

For example, assume the following. Employer A acquires employer B and merges B's defined benefit plan into A's defined benefit plan. The defined benefit plan maintained by B before the merger provides an early retirement subsidy for individuals age 55 with a specified number of years of service. E1 and E2 are employees of B and who transfer to A in connection with the merger. E1 is 25 years old and has compensation of $40,000. The present value of E1's early retirement subsidy under B's plan is $75. E2 is 50 years old and also has compensation of $40,000. The present value of E2's early retirement subsidy under B's plan is $10,000.

Assume that A's plan has an early retirement subsidy for individuals who have attained age 50 with a specified number of years of service, but the subsidy is not the same as under B's plan. Under A's plan, the present value of E2's early retirement subsidy is $9,500. Maintenance of both subsidies would create burdens for the plan and complexities for the plan and its participants.

Treasury regulations could permit E1's early retirement subsidy under B's plan to be eliminated entirely (i.e., even if A's plan did not have an early retirement subsidy). Taking into account all relevant factors, including the value of the benefit, E1's compensation, and the number of years until E1 would be eligible to receive the

[43] In determining the amount of any subsidy under the provision, it is expected that the regulations will value the subsidy by reference to the date on which it would be the most valuable with respect to the participant.

[44] Another provision of the bill provides that rollover amounts are not taken into account for purposes of the cash-out rules.

subsidy, the subsidy is de minimis. Treasury regulations could permit E2's early retirement subsidy under B's plan to be eliminated as to be replaced by the subsidy under A's plan, because the difference in the subsidies is de minimis. However, A's subsidy could not be entirely eliminated.

The Secretary is directed to issue, not later than December 31, 2001, regulations under section 411(d)(6), including regulations required under the provision.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000, except that the direction to the Secretary is effective on the date of enactment.

D. RATIONALIZATION OF RESTRICTIONS ON DISTRIBUTIONS (SEC. 406 OF THE BILL AND SECS. 401(k), 403(b), AND 457 OF THE CODE)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), tax-sheltered annuity ("section 403(b) annuity"), or an eligible deferred compensation plan of a tax-exempt organization or State or local government ("section 457 plan"), may not be distributable prior to the occurrence of one or more specified events. These permissible distributable events include "separation from service."

A separation from service occurs only upon a participant's death, retirement, resignation or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, consolidation or other similar corporate transaction. A severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan. Under a so-called "same desk rule," a participant's severance from employment does not necessarily result in a separation from service.[45]

In addition to separation from service and other events, a section 401(k) plan that is maintained by a corporation may permit distributions to certain employees who experience a severance from employment with the corporation that maintains the plan but does not experience a separation from service because the employee continues on the same job for a different employer as a result of a corporate transaction. If the corporation disposes of substantially all of the assets used by the corporation in a trade or business, a distributable event occurs with respect to the accounts of the employees who continue employment with the corporation that acquires the assets. If the corporation disposes of its interest in a subsidiary, a distributable event occurs with respect to the accounts of the employees who continue employment with the subsidiary.

REASONS FOR CHANGE

The Committee believes that application of the "same desk" rule is inappropriate because it hinders portability of retirement benefits, creates confusion for employees, and results in significant ad-

[45] Rev. Rul. 79–336, 1979–2 C.B. 187.

ministrative burdens for employers that engage in business acquisition transactions.

EXPLANATION OF PROVISION

The bill modifies the distribution restrictions applicable to section 401(k) plans, section 403(b) annuities, and section 457 plans to provide that distribution may occur upon severance from employment rather than separation from service. In addition, the provisions for distribution from a section 401(k) plan based upon a corporation's disposition of its assets or a subsidiary is repealed; this special rule is no longer be necessary as a result of the changes made by the provision.

EFFECTIVE DATE

The provision is effective for distributions after December 31, 2000, regardless of when the severance of employment occurred.

E. Purchase of Service Credit Under Governmental Pension Plans (Sec. 407 of the Bill and Secs. 403(b) and 457 of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government employer may provide that a participant may make aftertax employee contributions in order to purchase permissive service credit, subject to certain limits (sec. 415). Permissive service credit means credit for a period of service recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of service and that is in addition to the regular employee contributions, if any, under the plan.

In the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State), any such repayment is not taken into account for purposes of the section 415 limits on contributions and benefits. Also, service credit obtained as a result of such a repayment is not considered permissive service credit for purposes of the section 415 limits.

A participant may not use a rollover or direct transfer of benefits from a tax-sheltered annuity ("section 403(b) annuity") or an eligible deferred compensation plan of a tax-exempt organization of a State or local government ("section 457 plan") to purchase permissive service credits or repay contributions and earnings with respect to a forfeiture of service credit.

REASONS FOR CHANGE

The Committee understands that many employees work for multiple State or local government employers during their careers. The Committee believes that allowing such employees to use their section 403(b) annuity and section 457 plan accounts to purchase permissive service credits or make repayments with respect to forfeit-

ures of service credit will result in more significant retirement benefits.

EXPLANATION OF PROVISION

A participant in a State or local governmental plan is not required to include in gross income a direct trustee-to-trustee transfer to a governmental defined benefit plan from a section 403(b) annuity or a section 457 plan if the transferred amount is used (1) to purchase permissive service credits under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State).

EFFECTIVE DATE

The provision is effective for transfers after December 31, 2000.

F. Employers May Disregard Rollovers for Purposes of Cash-out Rules (Sec. 408 of the Bill and Sec. 411(a)(11) of the Code)

PRESENT LAW

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.[46]

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan.[47]

REASONS FOR CHANGE

The present-law cash-out rule reflects a balancing of various policies. On the one hand is the desire to assist individuals to save for retirement by making it easier to keep retirement funds in tax-favored vehicles. On the other hand is the recognition that keeping track of small account balances of former employees creates administrative burdens for plans.

The Committee is concerned that, in some cases, the cash-out rule may discourage plans from accepting rollovers because the rollover will increase participants' benefits to above the cash-out amount, and increase administrative burdens. The Committee believes that disregarding rollovers for purposes of the cash-out rule will further the intent of the cash-out rule by removing a possible disincentive for plans to accept rollovers.

---

[46] A similar provision is contained in Title I of ERISA.

[47] Other provisions of the bill expand the kinds of plans to which benefits may be rolled over.

EXPLANATION OF PROVISION

A plan is permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions (and any earnings allocable thereto) for purposes of the cash-out rule.

EFFECTIVE DATE

The proposal would be effective for distributions after December 31, 2000.

G. Time of Inclusion of Benefits Under Section 457 Plans (Sec. 409 of the Bill and Sec. 457 of the Code)

PRESENT LAW

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, amounts deferred under a section 457 plan cannot exceed certain limits. Amounts deferred under a section 457 plan are generally includible in income when paid or made available. Amounts deferred under a plan of deferred compensation of a State or local government or tax-exempt employer that does not meet the requirements of section 457 are includible in income when the amounts are not subject to a substantial risk of forfeiture, regardless of whether the amounts have been paid or made available.[48]

The limits on section 457 plans were first applied to plans of tax-exempt employers pursuant to the Tax Reform Act of 1986 (the "1986 Act"), generally effective for taxable years beginning after December 31, 1986. The limitations of section 457 do not apply to amounts deferred under a plan of a tax-exempt employer by an individual covered under such a plan on August 16, 1986, if the amounts (1) were deferred from taxable years beginning before January 1, 1987, or (2) are deferred from taxable years beginning after December 31, 1986, pursuant to an agreement that was in writing on August 16, 1986, and on such date provided for a deferral for each taxable year covered by the agreement of a fixed amount or of an amount determined pursuant to a fixed formula. The provision in (2) ceases to apply if there is any modification to the agreement or formula.

REASONS FOR CHANGE

The Committee believes that the rules for timing of inclusion of benefits under a governmental section 457 plan should be conformed to the rules relating to qualified plans.

The Committee believes it appropriate to extend the grandfather rule for certain section 457 plan benefits to cost-of-living adjustments.

[48] This rule of inclusion does not apply to amounts deferred under a tax-qualified retirement plan or similar plans.

EXPLANATION OF PROVISION

The bill provides that amounts deferred under a section 457 plan of a State or local government are includible in income when paid.

In addition, the bill modifies the transition rule adopted in the 1986 Act relating to deferred compensation plans of tax-exempt employers. Under the bill, the transition rule applies to agreements providing cost-of-living adjustments to amounts that otherwise satisfy the requirements of the transition rule. The grandfather does not apply to the extent that the annual amount provided under such an agreement exceeds the annual grandfathered amount multiplied by the cumulative increase in the Consumer Price Index (as published by the Department of Labor).

EFFECTIVE DATE

The provision relating to governmental section 457 plans would be effective for distributions beginning after December 31, 2000. The provision relating to plans of tax-exempt organizations is effective for taxable years ending after the date of enactment for cost-of-living increases after September 1993.

TITLE V. STRENGTHENING PENSION SECURITY AND ENFORCEMENT

A. PHASE IN REPEAL OF 155 PERCENT OF CURRENT LIABILITY FUNDING LIMIT; DEDUCTION FOR CONTRIBUTIONS TO FUND TERMINATION LIABILITY (SECS. 501 AND 502 OF THE BILL AND SECS. 404(a)(1), 412(c)(7), AND 4972(c) OF THE CODE)

PRESENT LAW

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 155 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)).[49] In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[50] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

[49] The minimum funding requirements, including the full funding limit, are also contained in title I of ERISA.

[50] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, and adopted the scheduled increases described in the text.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

REASONS FOR CHANGE

The Committee is concerned that the current liability full funding limit may result in inadequate funding of pension plans and thus jeopardize pension security. Also, the Committee believes that the special deduction rule should be expanded to give more plan sponsors incentives to adequately fund their plans.

EXPLANATION OF PROVISION

Current liability full funding limit

The bill gradually increases and then repeals the current liability full funding limit. The current liability full funding limit is 160 percent of current liability for plan years beginning in 2001, 165 percent for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit is repealed for plan years beginning in 2004 and thereafter. Thus, in 2004 and thereafter, the full funding limit will be the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the value of the plan's assets.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the provision applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.[51]

The bill also modifies the rule by providing that the deduction is for up to 100 percent of unfunded termination liability, determined as if the plan terminated at the end of the plan year. In the case of a plan with less than 100 participants for the plan year, termination liability does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment which was made or became effective, whichever is later, within the last two years.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

[51] The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

B. Excise Tax Relief for Sound Pension Funding (Sec. 503 of the Bill and Sec. 4972 of the Code)

PRESENT LAW

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 155 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)). In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[52] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

Present law also provides that contributions to defined contribution plans are deductible, subject to certain limitations.

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. The 10-percent excise tax does not apply to contributions to certain terminating defined benefit plans. The 10-percent excise tax also does not apply to contributions of up to 6 percent of compensation to a defined contribution plan for employer matching and employee elective deferrals.

REASONS FOR CHANGE

The Committee believes that employers should be encouraged to adequately fund their pension plans. Therefore, the Committee does not believe that an excise tax should be imposed on employer contributions that do not exceed the accrued liability full funding limit.

[52] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, and adopted the scheduled increases described in the text. Another proposal would gradually increase and then repeal the current liability full funding limit.

EXPLANATION OF PROVISION

In determining the amount of nondeductible contributions, the employer is permitted to elect not to take into account contributions to a defined benefit pension plan except to the extent they exceed the accrued liability full funding limit. Thus, if an employer elects, contributions in excess of the current liability full funding limit are not subject to the excise tax on nondeductible contributions. An employer making such an election for a year is not permitted to take advantage of the present-law exceptions for certain terminating plans and certain contributions to defined contribution plans. The provision applies to terminated plans as well as ongoing plans.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

C. NOTICE OF SIGNIFICANT REDUCTION IN PLAN BENEFIT ACCRUALS (SEC. 504 OF THE BILL AND SECS. 411(d) AND 417(e) AND NEW SEC. 4980F OF THE CODE)

PRESENT LAW

Section 204(h) of Title I of ERISA provides that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice ("section 204(h) notice"), setting forth the plan amendment (or a summary of the amendment written in a manner calculated to be understood by the average plan participant) and its effective date. The plan administrator must provide the section 204(h) notice to each plan participant, each alternate payee under an applicable qualified domestic relations order ("QDRO"), and each employee organization representing participants in the plan. The applicable Treasury regulations[53] provide, however, that a plan administrator need not provide the section 204(h) notice to any participant or alternate payee whose rate of future benefit accrual is reasonably expected not to be reduced by the amendment, nor to an employee organization that does not represent a participant to whom the section 204(h) notice must be provided. In addition, the regulations provide that the rate of future benefit accrual is determined without regard to optional forms of benefit, early retirement benefits, retirement-type subsidiaries, ancillary benefits, and certain other rights and features.

A covered amendment generally will not become effective with respect to any participants and alternate payees whose rate of future benefit accrual is reasonably expected to be reduced by the amendment but who do not receive a section 204(h) notice. An amendment will become effective with respect to all participants and alternate payees to whom the section 204(h) notice was required to be provided if the plan administrator (1) has made a good

[53] Treas. Reg. sec. 1.411(d)–6.

faith effort to comply with the section 204(h) notice requirements, (2) has provided a section 204(h) notice to each employee organization that represents any participant to whom a section 204(h) notice was required to be provided, (3) has failed to provide a section 204(h) notice to no more than a de minimis percentage of participants and alternate payees to whom a section 204(h) notice was required to be provided, and (4) promptly upon discovering the oversight, provides a section 204(h) notice to each omitted participant and alternate payee.

The Internal Revenue Code does not require any notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual.

The Internal Revenue Code prohibits the reduction of a participant's accrued benefit by plan amendment (sec. 411(d)(6)), and, for this purpose, except to the extent set forth in Treasury regulations, treats the elimination or reduction of an early retirement benefit or retirement-type subsidy or an optional form of benefit as a reduction of a participant's accrued benefit. However, this prohibition does not prevent a plan amendment from ceasing or reducing future accruals.

In the case of a pension plan that is subject to the joint and survivor annuity rules, the Internal Revenue Code (sec. 417(e)) restricts distributions before normal retirement age without the consent of the participant and the participant's spouse unless the value of the distribution does not exceed a dollar limit ($5,000 under sec. 411(a)(11)(A)). For this purpose, under Treasury regulations, a specific interest rate and mortality table are prescribed for purposes of determining whether the distribution exceeds the dollar limit and prohibits a lump sum distribution of an amount less than the amount determined under the applicable interest rate and mortality table even if the distribution exceeds the dollar limit.

REASONS FOR CHANGE

The Committee is aware of recent significant publicity concerning conversions of traditional defined benefit pension plans to "cash balance" plans, with particular focus on the impact such conversions have on affected workers. Several legislative proposals have been introduced to address some of the issues relating to such conversions.

The Committee believes that employees are entitled to meaningful disclosure concerning plan amendments that may result in reductions of future benefit accruals. The Committee has determined that present law does not require employers to provide such disclosure, particularly in cases where traditional defined benefit plans are converted to cash balance plans. The Committee also believes that any disclosure requirements applicable to plan amendments should strike a balance between providing meaningful disclosure and avoiding the imposition of unnecessary administrative burdens on employers.

The Committee understands that there are other issues in addition to disclosure that have arisen with respect to the conversion of defined benefit plans to cash balance or other hybrid plans, particularly situations in which plan participants do not earn any additional benefit under the plan for some time after conversion (called a "wear away"). The Committee believes that the Internal

Revenue Code and ERISA should contain requirements designed to prevent the use of "wear away" provisions in these conversions.

EXPLANATION OF PROVISION

The provision adds to the Internal Revenue Code a requirement that the plan administrator of a pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy.[54] The notice is required to set forth: (1) a summary of the amendment and the effective date of the amendment; (2) a statement that the amendment is expected to significantly reduce the rate of future benefit accrual; (3) a description of the classes of employees reasonably expected to be affected by the reduction in the rate of future benefit accrual; (4) examples illustrating the plan changes for these classes of employees; (5) in the event of an amendment that results in a conversion of a traditional defined benefit plan to a cash balance plan (described below), a notice that the plan administrator will provide, generally no later than 15 days prior to the effective date of the amendment, a "benefit estimation tool kit" (described below) that will enable affected participants who have completed at least 1 year of participation to personalize the illustrative examples; and (6) notice of each affected participant's right to request, and of the procedures for requesting, an annual benefit statement as provided under present law. The plan administrator is required to provide the notice not less than 45 days before the effective date of the plan amendment.

The notice requirement does not apply to plans to which ERISA sec. 204(h) does not apply, including governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)).

The plan administrator is required to provide this generalized notice to each affected participant and each affected alternate payee. For purposes of the provision, an affected participant or alternate payee is a participant or alternate payee to whom the reduction in the rate of future benefit accrual, including any elimination or significant reduction in early retirement benefit or retirement-type subsidy, is reasonably expected to apply.

As noted above, the provision requires the plan administrator to provide a benefit estimation tool kit, no later than 15 days prior to the amendment effective date, to a participant for whom the amendment may reasonably be expected to produce a significant reduction in the rate of future benefit accrual if the amendment has the effect of converting a traditional defined benefit plan to a cash balance plan. The plan administrator is not required to provide this benefit estimation tool kit to any participant who has less than 1 year of participation in the plan. For purposes of the provision, a "cash balance plan" means a defined benefit plan under

[54] The provision also modifies the present-law notice requirement contained in section 204(h) of Title I of ERISA to provide that an applicable pension plan may not be amended to provide for a significant reduction in the rate of future benefit accrual in the event of an egregious failure by the plan administrator to comply with a notice requirement similar to the notice requirement that the provision adds to the Internal Revenue Code. In addition, the provision expands the current ERISA notice requirement regarding significant reductions in normal retirement benefit accrual rates to early retirement benefits and retirement-type subsidies.

which the accrued benefit is determined as an amount other than an annual benefit commencing at normal retirement age, and any defined benefit plan, or portion of such a plan, that has an effect similar to a defined benefit plan under which the accrued benefit is determined as an amount other than an annual benefit commencing at normal retirement age (as determined under Treasury regulations). If the benefits of 2 or more defined benefit plans established or maintained by an employer are coordinated in such a manner as to have the effect of a conversion to a cash balance plan, the provision treats the sponsor of the plan or plans providing for such coordination as having adopted such a conversion as of the date such coordination begins. If a plan sponsor represents in communications to participants and beneficiaries that a plan amendment has an effect equivalent to a cash balance conversion, such amendment is (to the extent provided in Treasury regulations) treated as a cash balance conversion. In addition, the provision provides for the Secretary of the Treasury to issue regulations to prevent avoidance of the requirements of the provision through the use of 2 or more plan amendments rather than a single amendment.

The benefit estimation tool kit is designed to enable participants to estimate benefits under the old and new plan provisions. The provision permits the tool kit to be in the form of software (for use at home, at a workplace kiosk, or on a company intranet), worksheets, or calculation instructions, or other formats to be determined by the Secretary of the Treasury. The tool kit is required to include any necessary actuarial assumptions and formulas and to permit the participant to estimate both a single life annuity at appropriate ages and, when available, a lump sum distribution. The tool kit is required to disclose the interest rate used to compute a lump sum distribution and whether the value of early retirement benefits is included in the lump sum distribution.

The provision requires the benefit estimation tool kit to accommodate employee-provided variables with respect to age, years of service, retirement age, covered compensation, and interest rate (when variable rates apply). The tool kit is required to permit employees to recalculate estimated benefits by changing the values of these variables. The provision does not require the tool kit to accommodate employee variables with respect to qualified domestic relations orders, factors that result in unusual patterns of credited service (such as extended time away from the job), special benefit formulas for unusual situations, offsets from other plans, and forms of annuity distributions.

In the case of a cash balance conversion that occurs in connection with a business disposition or acquisition transaction and within 1 year following the date of the transaction, the provision requires the plan administrator to provide the benefit estimation tool kit prior to the end of the 2-year period following the date of the transaction to the affected participants who become participants as a result of the transaction.

The provision permits a plan administrator to provide any notice required under the provision to a person designated in writing by the individual to whom it would otherwise be provided. In addition, the provision authorizes the Secretary of the Treasury to allow any

notice required under the provision to be provided by using new technologies.

The provision imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. For failures due to reasonable cause and not to willful neglect, the total excise tax imposed during a taxable year of the employer will not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax is excessive or otherwise inequitable relative to the failure involved.

The provision adds to the Internal Revenue Code and ERISA requirements designed to prevent the use of "wear away" provisions under which participants earn no additional benefits for a period of time after a conversion of a traditional defined benefit plan to a cash balance plan. These requirements are in addition to the other provisions of the Internal Revenue Code that prohibit the reduction of a participant's accrued benefit by plan amendment (sec. 411(d)(6)). In the event of a conversion of a traditional defined benefit plan to a cash balance plan, the provision applies a minimum benefit requirement. This minimum benefit requirement requires a participant's accrued benefit under the cash balance plan to equal not less than (1) the benefit accrued for years of service prior to the conversion under the traditional defined benefit plan formula (not taking into account any early retirement benefit or retirement-type subsidy), plus (2) any benefit accrued for years of service after the conversion under the cash balance plan benefit formula. If the amendment provides that the accrued benefit initially credited to a participant's accumulation account (or its equivalent) on the effective date of the amendment satisfies the present value rules described below, the plan will not be treated as failing to provide to the participant an accrued benefit that includes such pre-conversion accrued benefit at any time after the effective date of the amendment merely because of a fluctuation in interest rates. The provision does not apply the minimum benefit requirement designed to prevent "wear away" to a cash balance conversion amendment to the extent that the amendment permits a participant to continue to accrue benefits in the same manner as under the terms of the plan in effect prior to the amendment (for example, by providing for the participant to receive the greater of the old or new formulas).

Under the provision, a plan is treated as satisfying the minimum benefit requirement designed to prevent "wear away" if a plan amendment provides that the present value of a participant's benefit accrued under a traditional defined benefit plan formula prior to a cash balance conversion is not less than the greater of (1) the present value determined using the applicable mortality table and the applicable interest rate in effect under the plan on the effective date of the cash balance conversion, or (2) the amount of the lump sum distribution that would be payable as of such effective date if the participant were eligible to receive a distribution under the terms of the plan as in effect immediately before such effective date, but not taking into account any early retirement benefit or retirement-type subsidy.

Except as provided in regulations, the provision generally requires the present value of the accrued benefit of any participant under a cash balance plan to be equal to the balance in the participant's accumulation account (or its equivalent) as of the time of the present value determination. This requirement will not apply to any portion of the participant's benefit accrued prior to a cash balance conversion except to the extent the plan provides that the amount initially credited to a participant's accumulation account (or its equivalent) on the effective date of the conversion is not less than the benefit accrued for years of service prior to the conversion under the traditional defined benefit formula (not taking into account any early retirement benefit or retirement-type subsidy). This provision is solely intended to permit plan sponsors to provide interest credits in an amount greater than the amount currently permitted under the Internal Revenue Code. Regulations may condition satisfaction of this requirement on the plan crediting interest at rates not in excess of a maximum and not less than a minimum specified in the regulations.

Failure to comply with the requirements of the provision designed to prevent "wear away" results in the disqualification of the plan.

The provision directs the Secretary of the Treasury to define in regulations, within 12 months after the date of enactment, the terms "early retirement benefit" and "retirement-type subsidy." In addition, with respect to a participant who is eligible to accrue benefits under the terms of a defined benefit plan as in effect either before or after an amendment that results in a conversion to a cash balance plan, the provision directs the Secretary of the Treasury to prescribe regulations under which (1) the plan will be treated as meeting the requirements of sec. 411(b)(1)(A), (B), or (C) if such requirements are met separately with respect to each of the plan's methods of accruing benefits, and (2) the plan will not be treated as failing to meet the requirements of sec. 401(a)(4) merely because only participants as of the effective date of the amendment are so eligible, if the plan met the requirements of sec. 401(a)(4) under the terms of the plan as in effect before the amendment (subject to the terms and conditions provided by the regulations).

Under the provision, no inference is intended with respect to the proper treatment of cash balance plans or conversions to cash balance plans under the laws in effect prior to the effective date of the provision or under laws not affected by the provision. In addition, the provision is not intended to result in the treatment of a cash balance plan as a defined contribution plan, or to affect the rules relating to involuntary cash outs (sec. 411(a)(11))[55] or survivor annuity requirements (sec. 417).

EFFECTIVE DATE

The provision is effective for plan amendments taking effect on or after the date of enactment, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The period for providing any notice required under the provision will not end before the last day of the 3-month period following the

[55] Another provision provides that rollover amounts are not taken into account for purposes of the cash-out rules.

date of enactment. The notice requirements under the provision do not apply to any plan amendment taking effect on or after the date of enactment if, before September 5, 2000, notice is provided to participants and beneficiaries adversely affected by the plan amendment (or their representatives) that is reasonably expected to notify them of the nature and effective date of the plan amendment.

D. Modifications to Section 415 Limits for Multiemployer Plans (Sec. 505 of the Bill and Sec. 415 of the Code)

PRESENT LAW

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415). The limits on contributions and benefits under qualified plans are based on the type of plan.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation for the highest three years, or (2) $135,000 (for 2000). The dollar limit is adjusted for cost-of-living increases in $5,000 increments. The dollar limit is reduced in the case of retirement before the social security retirement age and increases in the case of retirement after the social security retirement age.

A special rule applies to governmental defined benefit plans. In the case of such plans, the defined benefit dollar limit is reduced in the case of retirement before age 62 and increased in the case of retirement after age 65. In addition, there is a floor on early retirement benefits. Pursuant to this floor, the minimum benefit payable at age 55 is $75,000.

In the case of a defined contribution plan, the limit on annual is additions if the lesser of (1) 25 percent of compensation [56] or (2) $30,000 (for 2000). In applying the limits on contributions and benefits, plans of the same employer are aggregated.

REASONS FOR CHANGE

The Committee understands that, because pension benefits under multiemployer plans are typically based upon factors other than compensation, the 100 percent of compensation limit frequently results in benefit reductions for employees in industries in which wages vary annually.

EXPLANATION OF PROVISION

Under the bill, the 100 percent of compensation defined benefit plan limit does not apply to multiemployer plans. In addition, multiemployer plans are not aggregated with single-employer defined benefit plans maintained by an employer contributing to the multiemployer plan for purposes of applying the 100 percent of compensation limit to such single-employer plan.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

---

[56] Another provision of the bill increases this limit to 100 percent of compensation.

E. Investment of Employee Contributions in 401(k) Plans (Sec. 506 of the Bill and Sec. 1524(b) of the Taxpayer Relief Act of 1997)

PRESENT LAW

The Employee Retirement Income Security Act of 1974, as amended ("ERISA") prohibits certain employee benefit plans from acquiring securities or real property of the employer who sponsors the plan if, after the acquisition, the fair market value of such securities and property exceeds 10 percent of the fair market value of plan assets. The 10-percent limitation does not apply to any "eligible individual account plans" that specifically authorize such investments. Generally, eligible individual account plans are defined contribution plans, including plans containing a cash or deferred arrangement ("401(k) plans").

The term "eligible individual account plan" does not include the portion of a plan that consists of elective deferrals (and earnings on the elective deferrals) made under section 401(k) if elective deferrals equal to more than 1 percent of any employee's eligible compensation are required to be invested in employer securities and employer real property. Eligible compensation is compensation that is eligible to be deferred under the plan. The portion of the plan that consists of elective deferrals (and earnings thereon) is still treated as an individual account plan, and the 10-percent limitation does not apply, as long as elective deferrals (and earnings thereon) are not required to be invested in employer securities or employer real property.

The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan does not apply if individual account plans are a small part of the employer's retirement plans. In particular, that rule does not apply to an individual account plan for a plan year if the value of the assets of all individual account plans maintained by the employer do not exceed 10 percent of the value of the assets of all pension plans maintained by the employer (determined as of the last day of the preceding plan year). Multiemployer plans are not taken into account in determining whether the value of the assets of all individual account plans maintained by the employer exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan does not apply to an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code.

The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan applies to elective deferrals for plan years beginning after December 31, 1998 (and earnings thereon). It does not apply with respect to earnings on elective deferrals for plan years beginning before January 1, 1999.

REASONS FOR CHANGE

The Committee believes that the effective date provided in the Taxpayer Relief Act of 1997 with respect to the rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan has produced unintended results.

EXPLANATION OF PROVISION

The bill modifies the effective date of the rule excluding certain elective deferrals (and earnings thereon) from the definition of individual account plan by providing that the rule does not apply to any elective deferral used to acquire an interest in the income or gain from employer securities or employer real property acquired (1) before January 1, 1999, or (2) after such date pursuant to a written contract which was binding on such date and at all times thereafter.

EFFECTIVE DATE

The provision is effective as if included in the section of the Taxpayer Relief Act of 1997 that contained the rule excluding certain elective deferrals (and earnings thereon).

F. PERIODIC PENSION BENEFIT STATEMENTS (SEC. 507 OF THE BILL AND SEC. 105(a) OF ERISA)

PRESENT LAW

Title I of ERISA provides that a pension plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. This statement must indicate, on the basis of the latest available information, (1) the participant's or beneficiary's total accrued benefit, and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than 1 benefit statement during any 12-month period. The plan administrator must furnish the benefit statement no later than 60 days after receipt of the request or, if later, 120 days after the close of the immediately preceding plan year.

In addition, the plan administrator must furnish a benefit statement to each participant whose employment terminates or who has a 1-year break in service. For purposes of this benefit statement requirement, a "1-year break in service" is a calendar year, plan year, or other 12-month period designated by the plan during which the participant does not complete more than 500 hours of service for the employer. A participant is not entitled to receive more than 1 benefit statement with respect to consecutive breaks in service. The plan administrator must provide a benefit statement required upon termination of employment or a break in service no later than 180 days after the end of the plan year in which the termination of employment or break in service occurs.

REASONS FOR CHANGE

The Committee believes that periodic disclosure concerning the value of retirement benefits, especially the value of benefits accumulating in a defined contribution plan account, is necessary to increase employee awareness and appreciation of the importance of retirement savings.

EXPLANATION OF PROVISION

A plan administrator of a defined contribution plan generally is required to furnish a benefit statement to each participant at least once annually and to a beneficiary upon written request.

In addition to providing a benefit statement to a beneficiary upon written request, the plan administrator of a defined benefit plan generally is required either (1) to furnish a benefit statement at least once every 3 years to each participant who has a vested accrued benefit and who is employed by the employer at the time the plan administrator furnishes the benefit statements to participants, or (2) to annually furnish written, electronic, telephonic, or other appropriate notice to each participant of the availability of and the manner in which the participant may obtain the benefit statement.

The plan administrator of a multiemployer plan or a multiple employer plan is required to furnish a benefit statement only upon written request of a participant or beneficiary.[57]

The plan administrator is required to write the benefit statement in a manner calculated to be understood by the average plan participant and is permitted to furnish the statement in written, electronic, telephonic, or other appropriate form.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

G. PROHIBITED ALLOCATIONS OF STOCK IN AN S CORPORATION ESOP (SEC. 508 OF THE BILL AND SEC. 409 AND 4979A OF THE CODE)

PRESENT LAW

The Small Business Job Protection Act of 1996 allowed qualified retirement plan trusts described in section 401(a) to own stock in an S corporation. That Act treated the plan's share of the S corporation's income (and gain on the disposition of the stock) as includible in full in the trust's unrelated business taxable income ("UBTI").

The Tax Relief Act of 1997 repealed the provision treating items of income or loss of an S corporation as UBTI in the case of an employee stock ownership plan ("ESOP"). Thus, the income of an S corporation allocable to an ESOP is not subject to current taxation.

Present law provides a deferral of income on the sales of certain employer securities to an ESOP (sec. 1042). A 50-percent excise tax is imposed on certain prohibited allocations of securities acquired by an ESOP in a transaction to which section 1042 applies. In addition, such allocations are currently includible in the gross income of the individual receiving the prohibited allocation.

REASONS FOR CHANGE

In enacting the 1996 Act provision allowing ESOPs to be shareholders of S corporations, the Congress intended to encourage em-

[57] A multiple employer plan is a plan that is maintained by 2 or more unrelated employers but that is not maintained pursuant to a collective-bargaining agreement (sec. 413(c)).

ployee ownership of closely-held businesses, and to facilitate the establishment of ESOPs by S corporations. At the same time, the Congress provided that all income flowing through to an ESOP (or other tax-exempt S shareholder), and gains and losses from the disposition of the stock, was treated as unrelated business taxable income. This treatment was consistent with the premise underlying the S corporation rules that all income of an S corporation (including all gains of the sale of the stock of the corporation) should be subject to a shareholder-level tax.

In enacting the present-law rule relating to S corporation ESOPs in 1997, the Congress was concerned that the 1996 Act rule imposed double taxation on such ESOPs and ESOP participants. The Congress believed such a result was inappropriate. Since the enactment of the 1997 Act, however, the Committee has become aware that the present-law rules allow inappropriate deferral and possibly tax avoidance in some cases.

The Committee continues to believe that S corporations should be able to encourage employee ownership through an ESOP. The Committee does not believe, however, that ESOPs should be used by S corporations owners to obtain inappropriate tax deferral or avoidance. Specifically, the Committee believes that the tax deferral opportunities provided by an S corporation ESOP should be limited to those situations in which there is broad-based employee coverage under the ESOP and the ESOP benefits rank-and-file employees as well as highly compensated employees and historical owners.

EXPLANATION OF PROVISION

In general

Under the provision, if there is a nonallocation year with respect to an ESOP maintained by an S corporation: (1) the amount allocated in a prohibited allocation to an individual who is a disqualified person is treated as distributed to such individual (i.e., the value of the prohibited allocation is includible in the gross income of the individual receiving the prohibited allocation); (2) an excise tax is imposed on the S corporation equal to 50 percent of the amount involved in a prohibited allocation; and (3) an excise tax is imposed on the S corporation with respect to any synthetic equity owned by a disqualified person.[58]

It is intended that the provision will limit the establishment of ESOPs by S corporations to those that provide broad-based employee coverage and that benefit rank-and-file employees as well as highly compensated employees and historical owners.

Definition of nonallocation year

A nonallocation year means any plan year of an ESOP holding shares in an S corporation if, at any time during the plan year, disqualified persons own at least 50 percent of the number of outstanding shares of the S corporation.

A person is a disqualified person if the person is either (1) a member of a "deemed 20-percent shareholder group" or (2) a "deemed 10-percent shareholder." A person is a member of a "deemed 20-percent shareholder group" if the aggregate number of

[58] The plan is not disqualified merely because an excise tax is imposed under the provision.

deemed-owned shares of the person and his or her family members is at least 20 percent of the number of deemed-owned shares of stock in the S corporation.[59] A person is a deemed 10-percent shareholder if the person is not a member of a deemed 20-percent shareholder group and the number of the person's deemed-owned shares is at least 10 percent of the number of deemed-owned shares of stock of the corporation.

In general, "deemed-owned shares" means: (1) stock allocated to the account of an individual under the ESOP, and (2) an individual's share of unallocated stock held by the ESOP. An individual's share of unallocated stock held by an ESOP is determined in the same manner as the most recent allocation of stock under the terms of the plan.

For purposes of determining whether there is a nonallocation year, ownership of stock generally is attributed under the rules of section 318,[60] except that: (1) the family attribution rules are modified to include certain other family members, as described below, (2) option attribution does not apply (but instead special rules relating to synthetic equity described below apply), and (3) "deemed-owned shares" held by the ESOP are treated as held by the individual with respect to whom they are deemed owned.

Under the provision, family members of an individual include (1) the spouse[61] of the individual, (2) an ancestor or lineal descendant of the individual or his or her spouse, (3) a sibling of the individual (or the individual's spouse) and any lineal descendant of the brother or sister, and (4) the spouse of any person described in (2) or (3).

The bill contains special rules applicable to synthetic equity interests. Except to the extent provided in regulations, the stock on which a synthetic equity interest is based is treated as outstanding stock of the S corporation and as deemed-owned shares of the person holding the synthetic equity interest if such treatment would result in the treatment of any person as a disqualified person or the treatment of any year as a nonallocation year. Thus, for example, disqualified persons for a year include those individuals who are disqualified persons under the general rule (i.e., treating only those shares held by the ESOP as deemed-owned shares) and those individuals who are disqualified individuals if synthetic equity interests are treated as deemed-owned shares.

"Synthetic equity" means 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. Except to the extent provided in regulations, synthetic equity also includes 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.[62]

Ownership of synthetic equity is attributed in the same manner as stock is attributed under the provision (as described above). In

---

[59] A family member of a member of a "deemed 20-percent shareholder group" with deemed owned shares also is treated as a disqualified person.

[60] These attribution rules also apply to stock treated as owned by reason of the ownership of synthetic equity.

[61] As under section 318, an individual's spouse is not treated as a member of the individual's family if the spouses are legally separated.

[62] The provisions relating to synthetic equity do not modify the rules relating to S corporations, e.g., the circumstances in which options or similar interests are treated as creating a second class of stock.

addition, ownership of synthetic equity is attributed under the rules of section 318(a) (2) and (3) in the same manner as stock.

Definition of prohibited allocation

An ESOP of an S corporation is required to provide that no portion of the assets of the plan attributable to (or allocable in lieu of) S corporation stock may, during a nonallocation year, accrue (or be allocated directly or indirectly under any qualified plan of the S corporation) for the benefit of a disqualified person. A "prohibited allocation" refers to violations of this provision. A prohibited allocation occurs, for example, if income on S corporation stock held by an ESOP is allocated to the account of an individual who is a disqualified person.

Application of excise tax

In the case of a prohibited allocation, the S corporation is liable for an excise tax equal to 50 percent of the amount of the allocation. For example, if S corporation stock is allocated in a prohibited allocation, the excise tax is equal to 50 percent of the fair market value of such stock.

A special rule applies in the case of the first nonallocation year, regardless of whether there is a prohibited allocation. In that year, the excise tax also applies to the fair market value of the deemed-owned shares of any disqualified person held by the ESOP, even though those shares are not allocated to the disqualified person in that year.

As mentioned above, the S corporation also is liable for an excise tax with respect to any synthetic equity interest owned by any disqualified person in a nonallocation year. The excise tax is 50 percent of the value of the shares on which synthetic equity is based.

Treasury regulations

The Treasury Department is given the authority to prescribe such regulations as may be necessary to carry out the purposes of the provision.

EFFECTIVE DATE

The provision generally is effective with respect to plan years beginning after December 31, 2001. In the case of an ESOP established after July 11, 2000, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the proposal is effective with respect to plan years ending after July 11, 2000.

TITLE VI. REDUCING REGULATORY BURDENS

A. Modification of Timing of Plan Valuations (Sec. 601 of the Bill and Sec. 412 of the Code)

PRESENT LAW

Under present law, plan valuations are generally required annually for plans subject to the minimum funding rules. Under proposed Treasury regulations, except as provided by the Commissioner, the valuation must be as of a date within the plan year to

which the valuation refers or within the month prior to the beginning of that year.[63]

REASONS FOR CHANGE

While plan valuations are necessary to ensure adequate funding of defined benefit pension plans, they also create administrative burdens for employers. The Committee believes that permitting employers to use prior-year data for valuations in certain cases will provide an appropriate balance between employer concerns and the desire that plans be adequately funded.

EXPLANATION OF PROVISION

The bill incorporates into the statute the proposed regulation regarding the date of valuations. The bill also provides, as an exception to this general rule, that the valuation date with respect to a plan year may be any date within the immediately preceding plan year if, as of such date, plan assets are not less than 125 percent of the plan's current liability. Information determined as of such date is required to be adjusted actuarially, in accordance with Treasury regulations, to reflect significant differences in plan participants. An election to use a prior plan year valuation date, once made, may only be revoked with the consent of the Secretary.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

B. ESOP Dividends May Be Reinvested Without Loss of Dividend Deduction (Sec. 602 of the Bill and Sec. 404 of the Code)

PRESENT LAW

An employer is entitled to deduct certain dividends paid in cash during the employer's taxable year with respect to stock of the employer that is held by an employee stock ownership plan ("ESOP"). The deduction is allowed with respect to dividends that, in accordance with plan provisions, are (1) paid in cash directly to the plan participants or their beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) used to make payments on loans (including payments of interest as well as principal) that were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

The Secretary may disallow the deduction for any ESOP dividend if he determines that the dividend constitutes, in substance, an evasion of taxation (sec. 404(k)(5)).

REASONS FOR CHANGE

The Committee believes that it is appropriate to provide incentives for the accumulation of retirement benefits and expansion of employee ownership. The Committee has determined that the

---

[63] Prop. reg. sec. 1.412(c)(9)–1(b)(1).

present-law rules concerning the deduction of dividends on employer stock held by an ESOP discourage employers from permitting such dividends to be reinvested in employer stock and accumulated for retirement purposes.

EXPLANATION OF PROVISION

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities.

As under present law, the Secretary may disallow the deduction for any ESOP dividend if he determines that the dividend constitutes, in substance, an evasion of taxation (sec. 404(k)(5)).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

C. Repeal Transition Rule Relating to Certain Highly Compensated Employees (Sec. 603 of the Bill and Sec. 1114(c)(4) of the Tax Reform Act of 1986)

PRESENT LAW

Under present law, for purposes of the rules relating to qualified plans, a highly compensated employee is generally defined as an employee[64] who (1) was a 5-percent owner of the employer at any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of $85,000 (for 2000) or (b) at the election of the employer, had compensation in excess of $85,000 for the preceding year and was in the top 20 percent of employees by compensation for such year.

Under a rule enacted in the Tax Reform Act of 1986, a special definition of highly compensated employee applies for purposes of the nondiscrimination rules relating to qualified cash or deferred arrangements ("section 401(k) plans") and matching contributions. This special definition applies to an employer incorporated on December 15, 1924, that meets certain specific requirements.

REASONS FOR CHANGE

The Committee believes that it is appropriate to repeal the special definition of highly compensated employee in light of the substantial modification of the general definition of highly compensated employee in the Small Business Job Protection Act of 1996.

[64] An employee includes a self-employed individual.

EXPLANATION OF PROVISION

The provision repeals the special definition of highly compensated employee under the Tax Reform Act of 1986. Thus, the present-law definition applies.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

D. Employees of Tax-Exempt Entities (Sec. 604 of the Bill)

PRESENT LAW

The Tax Reform Act of 1986 provided that nongovernmental tax-exempt employers were not permitted to maintain a qualified cash or deferred arrangement ("section 401(k) plan"). This prohibition was repealed, effective for years beginning after December 31, 1996, by the Small Business Job Protection Act of 1996.

Treasury regulations provide that, in applying the nondiscrimination rules to a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan), the employer may treat as excludable those employees of a tax-exempt entity who could not participate in the arrangement due to the prohibition on maintenance of a section 401(k) plan by such entities. Such employees may be disregarded only if more than 95 percent of the employees who could participate in the section 401(k) plan benefit under the plan for the plan year. [65]

Tax-exempt charitable organizations may maintain a tax-sheltered annuity (a "section 403(b) annuity") that allows employees to make salary reduction contributions.

REASONS FOR CHANGE

The Committee believes that it is appropriate to modify the special rule regarding the treatment of certain employees of a tax-exempt organization as excludable for section 401(k) plan nondiscrimination testing purposes in light of the provision of the Small Business Job Protection Act of 1996 that permits such organizations to maintain section 401(k) plans.

EXPLANATION OF PROVISION

The Treasury Department is directed to revise its regulations under section 410(b) to provide that employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a section 403(b) annuity may be treated as excludable employees for purposes of testing a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer if (1) no employee of such tax-exempt entity is eligible to participate in the section 401(k) or 401(m) plan and (2) at least 95 percent of the employees who are not employees of the charitable employer are eligible to participate in such section 401(k) plan or section 401(m) plan.

---

[65] Treas. Reg. sec. 1.410(b)–6(g).

The revised regulations are to be effective for years beginning after December 31, 1996.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. Treatment of Employer-Provided Retirement Advice (Sec. 605 of the Bill and Sec. 132 of the Code)

PRESENT LAW

Under present law, certain employer-provided fringe benefits are excludable from gross income (sec. 132) and wages for employment tax purposes. These excludable fringe benefits include working condition fringe benefits and de minimis fringes. In general, a working condition fringe benefit is any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction as a business expense. A de minimis fringe benefit is any property or services provided by the employer the value of which, after taking into account the frequency with which similar fringes are provided, is so small as to make accounting for it unreasonable or administratively impracticable.

In addition, if certain requirements are satisfied, up to $5,250 annually of employer- provided educational assistance is excludable from gross income (sec. 127) and wages. This exclusion expires with respect to courses beginning after December 31, 2001.[66] Education not excludable under section 127 may be excludable as a working condition fringe.

There is no specific exclusion under present law for employer-provided retirement planning services. However, such services may be excludable as employer-provided educational assistance or a fringe benefit.

REASONS FOR CHANGE

In order to plan adequately for retirement, individuals must anticipate retirement income needs and understand how their retirement income goals can be achieved. Employer-sponsored plans are a key part of retirement income planning. The Committee believes that employers sponsoring retirement plans should be encouraged to provide retirement planning services for their employees in order to assist them in preparing for retirement.

EXPLANATION OF PROVISION

Qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan are excludable from income and wages. Qualified retirement planning services are advice and information regarding retirement planning. The exclusion is not limited to information regarding the qualified plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion does not apply to services that may be related to retirement

[66] The exclusion does not apply with respect to graduate-level courses.

planning, such as tax preparation, accounting, legal, or brokerage services.

The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan.

EFFECTIVE DATE

The provision is effective with respect to taxable years beginning after December 31, 2000.

F. REPORTING SIMPLIFICATION (SEC. 606 OF THE BILL)

PRESENT LAW

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[67] The Form 5500 series annual return/report, 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 series annual return/report with the Internal Revenue Service ("IRS"), which forwards the form to the Department of Labor and the PBGC.

The Form 5500 series consists of 3 different forms: Form 5500, Form 5500–C/R, and Form 5500–EZ. Form 5500 is the most comprehensive of the forms and requires the most detailed financial information. Form 5500–C/R requires less information than Form 5500, and Form 5500–EZ, which consists of only 1 page, is the simplest of the forms.

The size of the plan determines which form a plan administrator must file. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must file Form 5500. If the plan has fewer than 100 participants at the beginning of the plan year, the plan administrator generally may file Form 5500–C/R. A plan administrator generally may file Form 5500–EZ if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500–EZ and the total value of the plan assets as of the end

[67] Treas. Reg. sec. 301.6058–1(a).

of the plan year and all prior plan years does not exceed $100,000, the plan administrator is not required to file a return.

REASONS FOR CHANGE

The Committee believes that it is appropriate to simplify the reporting requirements for plans eligible to file Form 5500–EZ, because such plans do not cover any employees of the business owner.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500–EZ to provide that if the total value of the plan assets of such a plan as of the end of the plan year and all prior plan years does not exceed $250,000, the plan administrator is not required to file a return.

EFFECTIVE DATE

The provision is effective on the date of enactment.

G. IMPROVEMENT TO EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (SEC. 607 OF THE BILL)

PRESENT LAW

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 requirements of section 401(a). 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 of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("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 requirements of section 401(a) and section 403(b), as applicable.[68] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for 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 Administrative Policy Regarding Self-Correction ("APRSC") permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (in-

[68] Rev. Proc. 98–22, 1998–12 I.R.B. 11, as modified by Rev. Proc. 99–13, 1999–5, I.R.B. 52.

cluding during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Compliance Resolution ("VCR") program, the Walk-In Closing Agreement Program ("Walk-In CAP"), and the Tax-Sheltered Annuity Voluntary Correction ("TVC") program permit 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.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

REASONS FOR CHANGE

The Committee commends the IRS for the establishment of EPCRS and agrees with the IRS that EPCRS should be updated and improved periodically. The Committee believes that future improvements should facilitate use of the compliance and correction programs by small employers and expand the flexibility of the programs.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to continue to update and improve EPCRS, giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under APRSC for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under APRSC during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

EFFECTIVE DATE

The provision is effective on the date of enactment.

H. Repeal of the Multiple Use Test (Sec. 608 of the Bill and Sec. 401(m) of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan") are subject to a special annual nondiscrimination test ("ADP test"). The ADP test compares the actual deferral percentages ("ADPs") of the highly compensated employee group and the nonhighly compensated employee group. The ADP for each group generally is the average of the deferral percentages separately calculated for the employees in the group who are eligible to make elective deferrals for all or a portion of the relevant plan year. Each eligible employee's deferral percentage generally is

the employee's elective deferrals for the year divided by the employee's compensation for the year.

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

Employer matching contributions and after-tax employee contributions under a defined contribution plan also are subject to a special annual nondiscrimination test ("ACP test"). The ACP test compares the actual deferral percentages ("ACPs") of the highly compensated employee group and the nonhighly compensated employee group. The ACP for each group generally is the average of the contribution percentages separately calculated for the employees in the group who are eligible to make after-tax employee contributions or who are eligible for an allocation of matching contributions for all or a portion of the relevant plan year. Each eligible employee's contribution percentage generally is the employee's aggregate after-tax employee contributions and matching contributions for the year divided by the employee's compensation for the year.

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 nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the nonhighly compensated employee group for the prior plan year and not more than 2 percentage points greater than the ACP of the nonhighly compensated employee group for the prior plan year.

For any year in which (1) at least one highly compensated employee is eligible to participate in an employer's plan or plans that are subject to both the ADP test and the ACP test, (2) the plan subject to the ADP test satisfies the ADP test but the ADP of the highly compensated employee group exceeds 125 percent of the ADP of the nonhighly compensated employee group, and (3) the plan subject to the ACP test satisfies the ACP test but the ACP of the highly compensated employee group exceeds 125 percent of the ACP of the nonhighly compensated employee group, an additional special nondiscrimination test ("multiple use test") applies to the elective deferrals, employer matching contributions, and after-tax employee contributions. The plan or plans generally satisfy the multiple use test if the sum of the ADP and the ACP of the highly compensated employee group does not exceed the greater of (1) the sum of (A) 1.25 times the greater of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the lesser of the ADP or the ACP of the nonhighly compensated employee group, or (2) the sum of (A) 1.25 times the lesser of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the greater of the ADP or the ACP of the nonhighly compensated employee group.

REASONS FOR CHANGE

The Committee believes that the ADP test and the ACP test are adequate to prevent discrimination in favor of highly compensated employees under 401(k) plans and has determined that the multiple use test unnecessarily complicates 401(k) plan administration.

EXPLANATION OF PROVISION

The provision repeals the multiple use test.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

I. Flexibility in Nondiscrimination and Line of Business Rules (Sec. 609 of the Bill and Secs. 401(a)(4), 410(b), and 414(r) of the Code)

PRESENT LAW

A plan is not a qualified retirement plan if the contributions or benefits provided under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)). The applicable Treasury regulations set forth the exclusive rules for determining whether a plan satisfies the nondiscrimination requirement. These regulations state that the form of the plan and the effect of the plan in operation determine whether the plan is nondiscriminatory and that intent is irrelevant.

Similarly, a plan is not a qualified retirement plan if the plan does not benefit a minimum number of employees (sec. 410(b)). A plan satisfies this minimum coverage requirement if and only if it satisfies one of the tests specified in the applicable Treasury regulations. If an employer is treated as operating separate lines of business, the employer may apply the minimum coverage requirements to a plan separately with respect to the employees in each separate line of business (sec. 414(r)). Under a so-called "gateway" requirement, however, the plan must benefit a classification of employees that does not discriminate in favor of highly compensated employees in order for the employer to apply the minimum coverage requirements separately for the employees in each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

REASONS FOR CHANGE

It has been brought to the attention of the Committee that some plans are unable to satisfy the mechanical tests used to determine compliance with the nondiscrimination and line of business requirements solely as a result of relatively minor plan provisions. The Committee believes that, in such cases, it may be appropriate to expand the consideration of facts and circumstances in the application of the mechanical tests.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to provide by regulation applicable to years beginning after December 31, 2001, that a plan

is deemed to satisfy the nondiscrimination requirements of section 401(a)(4) if the plan satisfies the pre-1994 facts and circumstances test, satisfies the conditions prescribed by the Secretary to appropriately limit the availability of such test, and is submitted to the Secretary for a determination of whether it satisfies such test (to the extent provided by the Secretary).

Similarly, a plan complies with the minimum coverage requirement of section 410(b) if the plan satisfies the pre-1989 coverage rules, is submitted to the Secretary for a determination of whether it satisfies the pre-1989 coverage rules (to the extent provided by the Secretary), and satisfies conditions prescribed by the Secretary by regulation that appropriately limit the availability of the pre-1989 coverage rules.

The Secretary of the Treasury is directed to modify, on or before December 31, 2001, the existing regulations issued under section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

EFFECTIVE DATE

The provision is effective on the date of enactment.

J. Extension to All Governmental Plans of Moratorium on Application of Certain Nondiscrimination Rules Applicable to State and Local Government Plans (Sec. 610 of the Bill, Sec. 1505 of the Taxpayer Relief Act of 1997, and Secs. 401(a) and 401(k) of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

REASONS FOR CHANGE

The Committee believes that application of the nondiscrimination and minimum participation rules to governmental plans is unnecessary and inappropriate in light of the unique circumstances under which such plans and organizations operate. Further, the Committee believes that it is appropriate to provide for consistent application of the minimum coverage, nondiscrimination, and minimum participation rules for governmental plans.

EXPLANATION OF PROVISION

The provision exempts all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2000.

K. NOTICE AND CONSENT PERIOD REGARDING DISTRIBUTIONS; DISCLOSURE OF OPTIONAL FORMS OF BENEFIT (SEC. 611 OF THE BILL AND SEC. 411 OF THE CODE)

PRESENT LAW

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.[69]

If the present value of the participant's vested accrued benefit exceeds $5,000, the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. The plan generally is required, however, to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (2) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

REASONS FOR CHANGE

The Committee understands that an employee is not always able to evaluate distribution alternatives, select the most appropriate alternative, and notify the plan of the selection within a 90–day period. The Committee believes that requiring a plan to furnish mul-

[69] Similar provisions are contained in Title I of ERISA.

tiple distribution notices to an employee who does not make a distribution election within 90 days is administratively burdensome. In addition, the Committee believes that participants who are entitled to defer distributions should be informed of the impact of a decision not to defer distribution on the taxation and accumulation of their retirement benefits.

EXPLANATION OF PROVISION

A qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 180 days before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 180 days and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

The provision also requires that plan participants be notified of the existence of certain differences between the values of optional forms of benefit. If a plan provides optional forms of benefits and the present values of such optional forms of benefits are not actuarially equivalent as of the annuity starting date, then the plan is required to provide certain information regarding such benefits in the notice required to be provided regarding joint and survivor annuities. The information must be sufficient (as determined in accordance with Treasury regulations) to allow the participant to understand the differences in the present values of the optional forms of benefits and the effect the participant's election as to the form of benefit will have on the value of the benefits provided under the plan. The information must be provided in a manner calculated to be reasonably understood by the average plan participant.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2000.

L. ANNUAL REPORT DISSEMINATION (SEC. 612 OF THE BILL AND SEC. 104(b)(3) OF ERISA)

PRESENT LAW

Title I of ERISA generally requires the plan administrator of each employee pension benefit plan and each employee welfare benefit plan to file an annual report concerning the plan with the Secretary of Labor within seven months after the end of the plan year. Within nine months after the end of the plan year, the plan administrator generally must provide to each participant and to each beneficiary receiving benefits under the plan a summary of the annual report filed with the Secretary of Labor for the plan year.

REASONS FOR CHANGE

The Committee believes that simplification of the summary annual report requirement will reduce the burden and cost of plan administration and disclosure, thereby encouraging more employers to establish and maintain retirement plans, without denying

participants the opportunity to obtain information concerning plan status and operation.

EXPLANATION OF PROVISION

Within nine months after the end of each plan year, the plan administrator is required to make available for examination a summary of the annual report filed with the Secretary of Labor for the plan year. In addition, the plan administrator is required to furnish the summary to a participant, or to a beneficiary receiving benefits under the plan, upon request.

EFFECTIVE DATE

The provision is effective for reports for years beginning after December 31, 1999.

M. Modifications to the SAVER Act (Sec. 613 of the Bill and Sec. 517 of ERISA)

PRESENT LAW

The Savings Are Vital to Everyone's Retirement ("SAVER") Act [70] initiated a public-private partnership to educate American workers about retirement savings and directed the Department of Labor to maintain an ongoing program of public information and outreach. The Act also convened a National Summit on Retirement Savings held June 4–5, 1998, and to be held again in 2001 and 2005, cohosted by the President and the bipartisan Congressional leadership. The National Summit brings together experts in the fields of employee benefits and retirement savings, key leaders of government, and interested parties from the private sector and general public. The delegates are selected by the Congressional leadership and the President. The National Summit is a public-private partnership, receiving substantial funding from private sector contributions. The goals of the National Summits are to: (1) advance the public's knowledge and understanding of retirement savings and facilitate the development of a broad-based, public education program; (2) identify the barriers which hinder workers from setting aside adequate savings for retirement and impede employers, especially small employers, from assisting their workers in accumulating retirement savings; and (3) develop specific recommendations for legislative, executive, and private sector actions to promote retirement income savings among American workers.

REASONS FOR CHANGE

The Committee believes it appropriate to make modifications and clarifications regarding the administration of future National Summits on Retirement Savings.

EXPLANATION OF PROVISION

The provision clarifies that future National Summits on Retirement Savings are to be held in the month of September in 2001 and 2005, and would add an additional National Summit in 2009. To facilitate the administration of future National Summits, the

[70] Pub. L. No. 105–92.

Department of Labor is given authority to enter into cooperative agreements (pursuant to the Federal Grant and Cooperative Agreement Act of 1977) with its 1999 summit partner, the American Savings Education Council.

Six new statutory delegates are added to future National Summits: the Chairman and Ranking Member of the House Ways and Means Committee, the Senate Finance Committee, and the Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce. Further, the President, in consultation with the Congressional leadership, may appoint up to three percent of the delegates (not to exceed 10) from a list of nominees provided by the private sector partner in Summit administration. The provision also clarifies that new delegates are to be appointed for each future National Summit (as was the intent of the original legislation) and sets deadlines for their appointment.

The provision also sets deadlines for the Department of Labor to publish the Summit agenda, give the Department of Labor limited reception and representation authority, and mandates that the Department of Labor consult with the Congressional leadership in drafting the post-Summit report.

EFFECTIVE DATE

The provision is effective on the date of enactment.

N. STUDIES (SEC. 614 OF THE BILL)

PRESENT LAW

No provision.

REASONS FOR CHANGE

The Committee has a continuing interest in retirement income security and the national saving rate, and believes information regarding such issues, and the effects on such issues would be useful in developing and evaluating future legislation.

EXPLANATION OF PROVISION

Report on pension coverage

The bill directs the Secretary to report to the Senate Committee on Finance and the House Committee on Ways and Means regarding the effect of the bill on pension coverage, including any expansion of coverage for low- and moderate-income workers, levels of pension benefits, quality of coverage, worker's access to and participation in plans, and retirement security. This report is required to be submitted no later than five years after the date of enactment.

Study of preretirement uses of benefits

The bill directs the Secretary to conduct a study of the present-law rules that permit individuals to access their IRA or qualified retirement plan benefits prior to retirement, including an analysis of the use of the existing rules and the extent to which such rules undermine the goal of accumulating adequate resources for retirement. In addition, the Secretary of the Treasury is directed to conduct a study of the types of investment decisions made by IRA owners and participants in self-directed qualified retirement plans,

including an analysis of the existing restrictions on investments and the extent to which additional restrictions would facilitate the accumulation of adequate income for retirement. The studies are required to be submitted to the Senate Committee on Finance and the House Committee on Ways and Means no later than January 1, 2002.

EFFECTIVE DATE

The provision is effective on the date of enactment.

TITLE VII. PROVISIONS RELATING TO PLAN AMENDMENTS

(SEC. 701 OF THE BILL)

PRESENT LAW

Plan amendments to reflect amendments to 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.

REASONS FOR CHANGE

The Committee believes that employers should have adequate time to amend their plans to reflect amendments to the law while operating their plans in compliance with such amendments.

EXPLANATION OF PROVISION

Any amendments to a plan or annuity contract made pursuant to the provisions of the bill or any regulations issued under the bill are not required to be made before the last day of the first plan year beginning on or after January 1, 2003. In the case of a governmental plan, the date for amendments is extended to the last day of the first plan year beginning on or after January 1, 2005. The delayed amendment date does not apply to any amendment required or permitted by the bill unless, during the period beginning on the date the applicable section of the bill takes effect and ending on the delayed amendment date, (1) the plan or annuity contract is operated as if such amendment were in effect, and (2) such amendment applies retroactively for such period.

EFFECTIVE DATE

The provision is effective on the date of enactment.

TITLE VIII. COMPLIANCE WITH CONGRESSIONAL BUDGET ACT

(SEC. 801 OF THE BILL)

PRESENT LAW

Reconciliation is a procedure under the Congressional Budget Act of 1974 (the "Budget Act") by which the Congress implements spending and tax policies contained in a budget resolution. The Budget Act contains numerous rules enforcing the scope of items permitted to be considered under the budget reconciliation process. One such rule, the so-called "Byrd rule," was incorporated into the Budget Act in 1990. The Byrd rule, named after its principal spon-

sor, Senator Robert C. Byrd, is contained in section 313 of the Budget Act. The Byrd rule is generally interpreted to permit members to make a motion to strike extraneous provisions (those which are unrelated to the deficit reduction goals of the reconciliation process) from either a budget reconciliation bill or a conference report on such bill.

Under the Byrd rule, a provision is considered to be extraneous if it:

(1) does not produce a change in outlays or revenues;

(2) produces an outlay increase or revenue decrease when the instructed committee is not in compliance with its instructions;

(3) is outside of the jurisdiction of the committee that submitted the title or provision for inclusion in the reconciliation measure;

(4) produces a change in outlays or revenues which is merely incidental to the non-budgetary components of the provision;

(5) would increase the deficit for a fiscal year beyond those covered by the revenue measure; or

(6) recommends a change in Social Security.

REASONS FOR CHANGE

The Committee intends to comply with the Budget Act.

EXPLANATION OF PROVISION

To ensure compliance with the Budget Act, all provisions of, and amendments made by, the bill cease to apply for years beginning after December 31, 2004.

EFFECTIVE DATE

The provision is effective on the date of enactment.

III. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the provisions of the bill as reported.

The bill, as reported, is estimated to have the following budget effects for fiscal years 2001–2010.

ESTIMATED REVENUE EFFECTS OF H.R. 1102, THE ''RETIREMENT SECURITY AND SAVINGS ACT OF 2000,'' INCLUDING CONGRESSIONAL BUDGET ACT SUNSET FOR YEARS AFTER DECEMBER 31, 2004, AS REPORTED BY THE COMMITTEE ON FINANCE

[Fiscal years 2001–2010, in millions of dollars]

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2001–05	2001–10
Individual Retirement Arrangement Provisions													
1. Modification of IRA Contribution Limits—increase the maximum contribution limit for traditional and Roth IRAs to: $3,000 in 2001, $4,000 in 2002, $5,000 in 2003, and index for inflation thereafter.	tyba 12/31/00	−395	−1,194	−2,013	−2,726	−2,050	−1,088	−1,113	−1,135	−1,155	−1,173	−8,378	−14,042
2. Increase AGI limits for deductible IRA contributions, including for married filing separately.	tyba 12/31/00	−103	−357	−475	−411	−199	−17	−13	−8	−1	([1])	−1,544	−1,584
3. Increase maximum contribution limits for IRAs for individuals age 50 and above by 50%.	yba 12/31/00	−178	−305	−236	−214	−135	−59	−58	−56	−54	−53	−1,068	−1,348
4. Increase income limits for contributions to Roth IRAs for joint filers to twice the limits for single filers.	tyba 12/31/00	−9	−54	−128	−216	−301	−343	−350	−354	−358	−361	−709	−2,475
5. Deemed IRAs under employer plans	tyba 12/31/00	Negligible Revenue Effect											
6. Allow tax-free withdrawals from IRAs for charitable purposes	tyba 12/31/00	−168	−340	−347	−416	−259	−37	−38	−38	−39	−40	−1,530	−1,722
7. Increase the income limit for conversions of an IRA to a Roth IRA to $200,000 for joint filers.	tyba 12/31/00	400	1,046	719	166	−675	−1,185	−954	−553	−128	−135	−1,656	−1,298
Total of Individual Retirement Arrangement Provisions	....	−453	−1,204	−2,480	−3,817	−3,619	−2,729	−2,526	−2,144	−1,735	−1,762	−11,573	−22,469
Provisions for Expanding Coverage													
1. Increase contribution and benefit limits:													
a. Increase limitation on exclusion for elective deferrals to: $11,000 in 2001, $12,000 in 2002, $13,000 in 2003, $14,000 in 2004, and $15,000 in 2005; index thereafter[2 3].	yba 12/31/00	−130	−310	−452	−557	−235	−84	−82	−79	−75	−71	−1,684	−2,075
b. Increase limitation on SIMPLE elective contributions to: $7,000 in 2001, $8,000 in 2002, $9,000 in 2003, and $10,000 in 2004; index thereafter[2 3].	yba 12/31/00	−4	−14	−21	−26	−11	−4	−4	−4	−3	−3	−76	−94
c. Increase defined benefit dollar limit to $160,000	yba 12/31/00	−18	−31	−40	−45	−14	....	....	....	....	....	−148	−148
d. Lower early retirement age to 62; lower normal retirement age to 65	yba 12/31/00	−3	−4	−4	−4	−1	....	....	....	....	....	−17	−17
e. Increase indexing on limitation for defined contribution plans in $1,000 increments[2].	yba 12/31/00	....	−2	−4	−5	−2	−1	−1	−1	−1	−1	−13	−16
f. Increase qualified plan compensation limit to $200,000[2]	yba 12/31/00	−43	−74	−84	−91	−40	−17	−16	−16	−15	−14	−333	−410
g. Increase limits on deferrals under deferred compensation plans of State and local governments and tax-exempt organizations to: $11,000 in 2001, $12,000 in 2002, $13,000 in 2003, $14,000 in 2004, and $15,000 in 2005; index thereafter[2,3].	yba 12/31/00	−52	−91	−104	−114	−50	−20	−20	−19	−18	−17	−410	−503
2. Plan loans for subchapter S owners, partners, and sole proprietors	pa 12/31/00	−18	−30	−33	−35	−12	−2	−2	−2	−2	−2	−128	−138
3. Modification of top-heavy rules	yba 12/31/00	−4	−9	−11	−12	−5	−2	−2	−2	−2	−2	−41	−50
4. Elective deferrals not taken into account for purposes of deduction limits	yba 12/31/00	−40	−75	−87	−94	−51	−22	−21	−20	−19	−20	−324	−426
5. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations.	yba 12/31/00	−16	−22	−22	−22	−10	−4	−4	−4	−4	−3	−92	−110
6. Definition of compensation for purposes of deduction limits[2]	yba 12/31/00	−1	−2	−3	−3	−2	−1	−1	−1	−1	−([1])	−11	−15
7. Increase stock bonus and profit sharing plan deduction limit from 15% to 25%	tyba 12/31/00	−6	−12	−14	−15	−8	−3	−3	−3	−3	−3	−51	−66
8. Option to treat elective deferrals as after-tax contributions	tyba 12/31/00	50	100	131	144	−73	−169	−171	−172	−171	−170	352	−500
9. Nonrefundable credit to certain individuals for elective deferrals and IRA contributions	tyba 12/31/00	−911	−2,052	−1,994	−1,947	−1,111	−72	−65	−64	−64	−62	−8,016	−8,344
10. Small business (50 or fewer employees) tax credit for new qualified retirement plan contributions—first 3 years of the plan.	([4])	−43	−264	−580	−895	−728	−601	−599	−582	−552	−510	−2,511	−5,355

ESTIMATED REVENUE EFFECTS OF H.R. 1102, THE ''RETIREMENT SECURITY AND SAVINGS ACT OF 2000,'' INCLUDING CONGRESSIONAL BUDGET ACT SUNSET FOR YEARS AFTER DECEMBER 31, 2004, AS REPORTED BY THE COMMITTEE ON FINANCE—Continued

[Fiscal years 2001–2010, in millions of dollars]

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2001–05	2001–10
11. Small business (100 or fewer employees) tax credit for new retirement plan expenses	(4)	−22	−31	−33	−32	−28	−19	−9	−2	−1	....	−146	−177
Total of Provisions for Expanding Coverage	....	−1,261	−2,923	−3,355	−3,753	−2,381	−1,021	−1,000	−971	−931	−878	−13,649	−18,444
Provisions for Enhancing Fairness for Women													
1. Additional catch-up contributions for individuals age 50 and above—increase maximum contribution limits for pension plans by 10% annually beginning in 2001, not to exceed 50%.	yba 12/31/00	−8	−23	−39	−57	−24	−7	−7	−6	−6	−5	−151	−181
2. Equitable treatment for contributions of employees to defined contribution plans [2]	yba 12/31/00	−51	−78	−84	−91	−40	−17	−16	−16	−15	−14	−344	−421
3. Faster vesting of certain employer matching contributions	pyba 12/31/00						Negligible Revenue Effect						
4. Simplify and update the minimum distribution rules—modify post-death distribution rules, reduce the excise tax on failures to make minimum distributions to 10%, and direct the Treasury to simplify and finalize regulations relating to the minimum distribution rules.	yba 12/31/00	−118	−212	−239	−268	−107	−39	−36	−34	−32	−30	−944	−1,115
5. Clarification of tax treatment of division of section 457 plan benefits upon divorce	tdapma 12/31/00						Negligible Revenue Effect						
6. Modification of safe harbor relief for hardship withdrawals from 401(k) plans; modify definition of hardship for rollover purposes.	yba 12/31/00						Negligible Revenue Effect						
7. Eliminate the excise tax on employers who make nondeductible contributions to SIMPLE plans on behalf of domestic and similar workers.	tyba 12/31/00	(1)	(1)	−1	−3	−4	−5	−5	−5	−5	−5	−8	−35
Total of Provisions for Enhancing Fairness for Women	....	−177	−313	−363	−419	−175	−68	−64	−61	−58	−54	−1,447	−1,752
Provisions for Increasing Portability for Participants													
1. Rollovers allowed among governmental section 457 plans, section 403(b) plans, and qualified plans.	dma 12/31/01	....	27	−5	−5	−35	−2	−2	−1	−1	−1	−18	−25
2. Rollovers of IRAs to workplace retirement plans	dma 12/31/01						Negligible Revenue Effect						
3. Rollovers of after-tax retirement plan contributions	dma 12/31/01						Negligible Revenue Effect						
4. Waiver of 60-day rule	dma 12/31/01						Negligible Revenue Effect						
5. Treatment of forms of qualified plan distributions	yba 12/31/00						Negligible Revenue Effect						
6. Rationalization of restrictions on distributions	da 12/31/00						Negligible Revenue Effect						
7. Purchase of service credit in governmental defined benefit plans	ta 12/31/00						Negligible Revenue Effect						
8. Employers may disregard rollovers for cash-out amounts	da 12/31/00						Negligible Revenue Effect						
9. Minimum distribution and inclusion requirements for section 457 plans	da 12/31/00						Considered in Other Provisions						
Total of Provisions for Increasing Portability for Participants	....	....	27	−5	−5	−35	−2	−2	−1	−1	−1	−18	−25
Provisions for Strengthening Pension Security and Enforcement													
1. Phase in repeal of 155% of current liability funding limit; extend maximum deduction rule.	pyba 12/31/00	....	−14	−20	−36	−9	....	....	....	....	....	−79	−79
2. Excise tax relief for sound pension funding	yba 12/31/00	−2	−3	−3	−3	−1	....	....	....	....	....	−12	−12
3. Notice of significant reduction in plan benefit accruals and wear-away prevention	pateo/a DOE	−1	−4	−7	−9	−2	....	....	....	....	....	−23	−23
4. Modification of section 415 aggregation rules for multiemployer plans	yba 12/31/00	−1	−1	−1	−1	(1)	....	....	....	....	....	−4	−4
5. Repeal 100% of compensation limit for multiemployer plans	yba 12/31/00	−2	−4	−4	−4	−2	....	....	....	....	....	−16	−16
6. Investment of employee contributions in 401(k) plans	aiii TRA'97						Negligible Revenue Effect						

Provision	Effective												
7. Periodic pension benefit statements	pyba 12/31/00	No Revenue Effect											
8. Prohibited allocations of stock in an ESOP of an S corporation	(15)	1	4	5	6	2	....	....	....	....	....	18	18
9. Amendments to the SAVER Act	DOE	No Revenue Effect											
Total of Provisions for Strengthening Pension Security and Enforcement		−5	−22	−30	−47	−12	(6)	(6)	(6)	(6)	(6)	−116	−116
Provisions for Reducing Regulatory Burdens													
1. Modification of timing of plan valuations	pyba 12/31/00	Negligible Revenue Effect											
2. ESOP dividends may be reinvested without loss of dividend deduction	tyba 12/31/00	−19	−44	−56	−61	−31	....	....	....	....	....	−211	−211
3. Repeal transition rule relating to certain highly compensated employees	pyba 12/31/00	−2	−3	−3	−3	−1	−1	(1)	(1)	(1)	(1)	−12	−14
4. Employees of tax-exempt entities [7]	DOE	Negligible Revenue Effect											
5. Treatment of employer-provided retirement advice	tyba 12/31/00	Negligible Revenue Effect											
6. Pension plan reporting simplification	DOE	Negligible Revenue Effect											
7. Improvement to Employee Plans Compliance Resolution System [7]	DOE	Negligible Revenue Effect											
8. Repeal of the multiple use test	yba 12/31/00	Considered in Other Provisions											
9. Flexibility in nondiscrimination, coverage, and line of business rules [7]	DOE	Negligible Revenue Effect											
10. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to State and local government plans.	pyba 12/31/00	Negligible Revenue Effect											
11. Notice and consent period regarding distributions	yba 12/31/00	No Revenue Effect											
12. Annual report dissemination	yba 12/31/00	No Revenue Effect											
Total of Provisions for Reducing Regulatory Burdens		−21	−47	−59	−64	−32	−1	((−1)	(−1)	(−1)	(−1)	−223	−225
Provisions Relating to Plan Amendments	DOE	No Revenue Effect											
Congressional Budget Act Sunset of the "Retirement Security and Savings Act of 2000" for Years Beginning After 12/31/04.	DOE	Considered in Each Individual Provisions											
Net Total		−1,917	−4,428	−6,292	−8,105	−6,254	−3,821	−3,592	−3,177	−2,725	−2,695	−27,026	−43,031

[1] Loss of less than $500,000.

[2] Provision includes interaction with other provisions in Provisions for Expanding Coverage.

[3] Provision includes interaction with the Individual Retirement Arrangement provisions.

[4] Effective for taxable years beginning after 12/31/00, with respect to plans established after such date.

[5] Generally effective with respect to years beginning after December 31, 2001. In the case of an ESOP established after July 11, 2000, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the proposal would be effective with respect to plan years ending after July 11, 2000.

[6] Negligible revenue effect.

[7] Directs the Secretary of the Treasury to modify rules through regulations.

Legend for "Effective" column: aiii TRA'97 = as if included in the Taxpayer Relief Act of 1997; da = distributions after; dma = distributions made after; DOE = date of enactment; pa = periods after; pateo/a = plan amendments taking effect on or after; pyba = plan years beginning after; ta = transfers after; tdapma = transfers, distributions, and payments made after; tyba = taxable years beginning after; and yba = years beginning after.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing income tax provisions generally involve increased tax expenditures and the revenue-raising provision (prohibited allocations of stock in an ESOP of an S corporation) involves decreased tax expenditures. (See revenue table in Part III.A., above.)

C. Consultation With the Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on this bill.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statements are made concerning the roll call votes in the Committee's consideration of the bill.

Motion to report the bill

The bill was ordered favorably reported by a roll call vote of 17 yeas and 0 nays (19 yeas and 0 nays if proxy votes were included in the tally of votes for favorably reporting a bill out of Committee) on September 7, 2000. The vote, with a quorum present, was as follows:

Yeas.—Senators Roth, Grassley, Hatch, Murkowski (proxy), Nickles, Gramm, Lott (proxy), Jeffords, Mack, Thompson, Moynihan, Baucus, Rockefeller, Breaux, Conrad, Graham, Bryan, Kerrey, and Robb.

Nays.—No Senators voted in the negative.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Impact on individuals and business

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as reported.

The bill expands retirement savings tax relief relating to individual retirement arrangements, and includes various provisions expanding pension coverage, enhancing pension fairness for women, increasing pension portability, strengthening pension security and enforcement, encouraging retirement education, and reducing pension regulatory burdens. These provisions generally will reduce the tax burdens on individuals, small businesses, and others.

Impact on personal privacy and paperwork

The bill should not have any adverse impact on personal privacy.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the following provision of the bill contains Federal mandates on the private sector (for amounts, see tables in Part III.A., above): prohibited allocation of stock in ESOP of an S corporation.

The costs required to comply with the Federal private sector mandate generally are no greater than the estimated budget effects of the provision. Benefits from the provision include improved administration of the Federal tax laws and a more accurate measurement of income for Federal income tax purposes.

The bill will not impose a Federal intergovernmental mandate on State, local, and tribal governments.

C. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has "widespread applicability" to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses.

VI. CHANGES TO EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

○