87TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 2411

SELF-EMPLOYED INDIVIDUALS TAX RETIREMENT ACT OF 1962

SEPTEMBER 18, 1962.—Ordered to be printed

Mr. MILLS, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 10]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 10) to encourage the establishment of voluntary pension plans by self-employed individuals, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

That this Act may be cited as the "Self-Employed Individuals Tax Retirement Act of 1962".

SEC. 2. QUALIFICATION OF PLANS.

Section 401 of the Internal Revenue Code of 1954 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended—

(1) by adding at the end of paragraph (5) of subsection (a) the following new sentence: "For purposes of this paragraph and paragraph (10), the total compensation of an individual who is an employee within the meaning of subsection (c)(1) means such individual's earned income (as defined in subsection (c)(2)), and the basic or regular rate of compensation of such an individual shall be determined, under regulations prescribed by the Secretary or his delegate, with respect to that portion of his earned income which bears the same ratio to his earned income as the basic or regular compensation of the employees under the plan bears to the total compensation of such employees.";

(2) by adding at the end of subsection (a) the following new paragraphs:

"(7) *A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, upon its termination or upon complete discontinuance of contributions under the plan, the rights of all employees to benefits accrued to the date of such termination or discontinuance, to the extent then funded, or the amounts credited to the employees' accounts, are nonforfeitable. This paragraph shall not apply to benefits or contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by paragraph (4), may not be used for designated employees in the event of early termination of the plan.*

"(8) *A trust forming part of a pension plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.*

"(9) *In the case of a plan which provides contributions or benefits for employees some or all of whom are employees within the meaning of subsection (c)(1), a trust forming part of such plan shall not constitute a qualified trust under this section unless, under the plan, the entire interest of each employee—*

"(A) *either will be distributed to him not later than his taxable year in which he attains the age of 70½ years, or, in the case of an employee other than an owner-employee (as defined in subsection (c)(3)), in which he retires, whichever is the later, or*

"(B) *will be distributed, commencing not later than such taxable year, (i) in accordance with regulations prescribed by the Secretary or his delegate, over the life of such employee or over the lives of such employee and his spouse, or (ii) in accordance with such regulations, over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and his spouse.*

A trust shall not be disqualified under this paragraph by reason of distributions under a designation, prior to the date of the enactment of this paragraph, by any employee under the plan of which such trust is a part, of a method of distribution which does not meet the terms of the preceding sentence.

"(10) *In the case of a plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3))—*

"(A) *paragraph (3) and the first and second sentences of paragraph (5) shall not apply, but—*

"(i) *such plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of or on behalf of employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, and*

"(ii) *such plan shall not be considered discriminatory within the meaning of paragraph (4) solely because under the plan contributions described in subsection (e)(3)(A) which are in excess of the amounts which may be deducted under section 404 (determined without regard to section 404(a)(10)) for the taxable year may be made on behalf of any owner-employee; and*

"(B) *a trust forming a part of such plan shall constitute a a qualified trust under this section only if the requirements in subsection (d) are also met.*"; *and*

(3) *by redesignating subsection (c) as subsection (h) and inserting after subsection (b) the following new subsections:*

"(c) DEFINITIONS AND RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—*For purposes of this section—*

"(1) EMPLOYEE.—*The term 'employee' includes, for any taxable year, an individual who has earned income (as defined in paragraph (2)) for the taxable year. To the extent provided in regulations prescribed by the Secretary or his delegate, such term also includes, for any taxable year—*

"(A) *an individual who would be an employee within the meaning of the preceding sentence but for the fact that the trade or business carried on by such individual did not have net profits for the taxable year, and*

"(B) *an individual who has been an employee within the meaning of the preceding sentence for any prior taxable year.*

"(2) EARNED INCOME.—

"(A) IN GENERAL.—*The term 'earned income' means the net earnings from self-employment (as defined in section 1402(a)) to the extent that such net earnings constitute earned income (as defined in section 911(b) but determined with the application of subparagraph (B)), but such net earnings shall be determined—*

"(i) *without regard to paragraphs (4) and (5) of section 1402(c),*

"(ii) *in the case of any individual who is treated as an employee under sections 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and*

"(iii) *without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.*

For purposes of this subparagraph, sections 911(b) and 1402, as in effect for a taxable year ending on December 31, 1962, and subparagraph (B), as in effect for a taxable year beginning on January 1, 1963, shall be treated as having been in effect for all taxable years ending before such date.

"(B) EARNED INCOME WHEN BOTH PERSONAL SERVICES AND CAPITAL ARE MATERIAL INCOME-PRODUCING FACTORS.—*In applying section 911(b) for purposes of subparagraph (A), in the case of an individual who is an employee within the meaning of paragraph (1) and who is engaged in a trade or business in which both personal services and capital are material income-producing factors and with respect to which the individual actually renders personal services on a full-time, or substantially full-time, basis, so much of his share of the net profits of such trade or business as does not exceed $2,500 shall be considered as earned income. In the case of any such individual who is engaged in more than one trade or business with respect to which he actually renders substantial personal services, if with respect to all such trades or businesses he actually renders personal services on a full-time, or substantially full-time, basis, there shall be considered as earned income with respect to the trades or businesses in which both personal services and capital are material income-producing factors—*

"(i) so much of his share of the net profits of such trades or businesses as does not exceed $2,500, reduced by

"(ii) his share of the net profits of any trade or business in which only personal services is a material income-producing factor.

The preceding sentences shall not be construed to reduce the share of net profits of any trade or business which under the second sentence of section 911(b) would be considered as earned income of any such individual.

"(3) OWNER-EMPLOYEE.—The term 'owner-employee' means an employee who—

"(A) owns the entire interest in an unincorporated trade or business, or

"(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

To the extent provided in regulations prescribed by the Secretary or his delegate, such term also means an individual who has been an owner-employee within the meaning of the preceding sentence.

"(4) EMPLOYER.—An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

"(5) CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—The term 'contribution on behalf of an owner-employee' includes, except as the context otherwise requires, a contribution under a plan—

"(A) by the employer for an owner-employee, and

"(B) by an owner-employee as an employee.

"(d) ADDITIONAL REQUIREMENTS FOR QUALIFICATION OF TRUSTS AND PLANS BENEFITING OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the following requirements of this subsection are met by the trust and by the plan of which such trust is a part:

"(1) In the case of a trust which is created on or after the date of the enactment of this subsection, or which was created before such date but is not exempt from tax under section 501(a) as an organization described in subsection (a) on the day before such date, the trustee is a bank, but a person (including the employer) other than a bank may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments (including reinvestments, disposals, and exchanges) or by disapproving proposed investments (including reinvestments, disposals, and exchanges). This paragraph shall not apply to a trust created or organized outside the United States before the date of the enactment of this subsection if, under section 402(c), it is treated as exempt from tax under section 501(a) on the day before such date; or, to the extent provided under regulations prescribed by the Secretary or his delegate, to a trust which uses annuity, endowment, or life insurance contracts of a life insurance company exclusively to fund the benefits prescribed by the trust, if the life insurance company supplies annually such information about trust transactions affecting owner-employees as the Secretary or his delegate shall by forms or regula-

tions prescribe. For purposes of this paragraph, the term 'bank' means a bank as defined in section 581, a corporation which under the laws of the State of its incorporation is subject to supervision and examination by the commissioner of banking or other officer of such State in charge of the administration of the banking laws of such State, and, in the case of a trust created or organized outside the United States, a bank or trust company, wherever incorporated, exercising fiduciary powers and subject to supervision and examination by governmental authority.

"(2) Under the plan—

"(A) the employees' rights to or derived from the contributions under the plan are nonforfeitable at the time the contributions are paid to or under the plan; and

"(B) in the case of a profit-sharing plan, there is a definite formula for determining the contributions to be made by the employer on behalf of employees (other than owner-employees).

Subparagraph (A) shall not apply to contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by subsection (a)(4), may not be used to provide benefits for designated employees in the event of early termination of the plan.

"(3) The plan benefits each employee having a period of employment of 3 years or more. For purposes of the preceding sentence, the term 'employee' does not include any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year.

"(4) Under the plan—

"(A) contributions or benefits are not provided for any owner-employee unless such owner-employee has consented to being included under the plan; and

"(B) no benefits may be paid to any owner-employee, except in the case of his becoming disabled (within the meaning of section 213(g)(3)), prior to his attaining the age of 59½ years.

"(5) The plan does not permit—

"(A) contributions to be made by the employer on behalf of any owner-employee in excess of the amounts which may be deducted under section 404 (determined without regard to section 404(a)(10)) for the taxable year;

"(B) in the case of a plan which provides contributions or benefits only for owner-employees, contributions to be made on behalf of any owner-employee in excess of the amounts which may be deducted under section 404 (determined without regard to section 404(a)(10)) for the taxable year; and

"(C) if a distribution under the plan is made to any employee and if any portion of such distribution is an amount described in section 72(m)(5)(A)(i), contributions to be made on behalf of such employee for the 5 taxable years succeeding the taxable year in which such distribution is made.

Subparagraphs (A) and (B) shall not apply to any contribution which is not considered to be an excess contribution (as defined in subsection (e)(1)) by reason of the application of subsection (e)(3).

"(6) Except as provided in this paragraph, the plan meets the requirements of subsection (a)(4) without taking into account for

any purpose contributions or benefits under chapter 2 (relating to tax on self-employment income), chapter 21 (relating to Federal Insurance Contributions Act), title II of the Social Security Act, as amended, or any other Federal or State law. If—

"(A) of the contributions deductible under section 404 (determined without regard to section 404(a)(10)), not more than one-third is deductible by reason of contributions by the employer on behalf of owner-employees, and

"(B) taxes paid by the owner-employees under chapter 2 (relating to tax on self-employment income), and the taxes which would be payable under such chapter 2 by the owner-employees but for paragraphs (4) and (5) of section 1402(c), are taken into account as contributions by the employer on behalf of such owner-employees,

then taxes paid under section 3111 (relating to tax on employers) with respect to an employee may, for purposes of subsection (a)(4), be taken into account as contributions by the employer for such employee under the plan.

"(7) Under the plan, if an owner-employee dies before his entire interest has been distributed to him, or if distribution has been commenced in accordance with subsection (a)(9)(B) to his surviving spouse and such surviving spouse dies before his entire interest has been distributed to such surviving spouse, his entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of his surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaires) and which will be immediately distributed to such beneficiary or beneficiaries. The preceding sentence shall not apply if distribution of the interest of an owner-employee has commenced and such distribution is for a term certain over a period permitted under subsection (a)(9)(B)(ii).

"(8) Under the plan—

"(A) any contribution which is an excess contribution, together with the income attributable to such excess contribution, is (unless subsection (e)(2)(E) applies) to be repaid to the owner-employee on whose behalf such excess contribution is made;

"(B) if for any taxable year the plan does not, by reason of subsection (e)(2)(A), meet (for purposes of section 404) the requirements of this subsection with respect to an owner-employee, the income for the taxable year attributable to the interest of such owner-employee under the plan is to be paid to such owner-employee; and

"(C) the entire interest of an owner-employee is to be repaid to him when required by the provisions of subsection (e)(2)(E).

"(9)(A) If the plan provides contributions or benefits for an owner-employee who controls, or for two or more owner-employees who together control, the trade or business with respect to which the plan is established, and who also control as an owner-employee or as owner-employees one or more other trades or businesses, such plan

and the plans established with respect to such other trades or businesses, when coalesced, constitute a single plan which meets the requirements of subsection (a) (including paragraph (10) thereof) and of this subsection with respect to the employees of all such trades or businesses (including the trade or business with respect to which the plan intended to qualify under this section is established).

"(B) For purposes of subparagraph (A), an owner-employee, or two or more owner-employees, shall be considered to control a trade or business if such owner-employee, or such two or more owner-employees together—

"(i) own the entire interest in an unincorporated trade or business, or

"(ii) in the case of a partnership, own more than 50 percent of either the capital interest or the profits interest in such partnership.

For purposes of the preceding sentence, an owner-employee, or two or more owner-employees, shall be treated as owning any interest in a partnership which is owned, directly or indirectly, by a partnership which such owner-employee, or such two or more owner-employees, are considered to control within the meaning of the preceding sentence.

"(10) The plan does not provide contributions or benefits for any owner-employee who controls (within the meaning of paragraph (9)(B)), or for two or more owner-employees who together control, as an owner-employee or as owner-employees, any other trade or business, unless the employees of each trade or business which such owner-employee or such owner-employees control are included under a plan which meets the requirements of subsection (a) (including paragraph (10) thereof) and of this subsection, and provides contributions and benefits for employees which are not less favorable than contributions and benefits provided for owner-employees under the plan.

"(11) Under the plan, contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established.

"(e) EXCESS CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—

"(1) EXCESS CONTRIBUTION DEFINED.—For purposes of this section, the term 'excess contribution' means, except as provided in paragraph (3)—

"(A) if, in the taxable year, contributions are made under the plan only on behalf of owner-employees, the amount of any contribution made on behalf of any owner-employee which (without regard to this subsection) is not deductible under section 404 (determined without regard to section 404(a)(10)) for the taxable year; or

"(B) if, in the taxable year, contributions are made under the plan on behalf of employees other than owner-employees—

"(i) the amount of any contribution made by the employer on behalf of any owner-employee which (without regard to this subsection) is not deductible under section 404 (determined without regard to section 404(a)(10)) for the taxable year;

"(ii) the amount of any contribution made by any owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees;

"(iii) the amount of any contribution made by any owner-employee (as an employee) which exceeds the lesser of $2,500 or 10 percent of the earned income for such taxable year derived by such owner-employee from the trade or business with respect to which the plan is established; and

"(iv) in the case of any individual on whose behalf contributions are made under more than one plan as an owner-employee, the amount of any contribution made by such owner-employee (as an employee) under all such plans which exceeds $2,500; and

"(C) the amount of any contribution made on behalf of an owner-employee in any taxable year for which, under paragraph (2)(A) or (E), the plan does not (for purposes of section 404) meet the requirements of subsection (d) with respect to such owner-employee.

For purposes of this subsection, the amount of any contribution which is allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

"(2) EFFECT OF EXCESS CONTRIBUTION.—

"(A) IN GENERAL.—If an excess contribution (other than an excess contribution to which subparagraph (E) applies) is made on behalf of an owner-employee in any taxable year, the plan with respect to which such excess contribution is made shall, except as provided in subparagraphs (C) and (D), be considered, for purposes of section 404, as not meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year and for all succeeding taxable years.

"(B) INCLUSION OF AMOUNTS IN GROSS INCOME OF OWNER-EMPLOYEES.—For any taxable year for which any plan does not meet the requirements of subsection (d) with respect to an owner-employee by reason of subparagraph (A), the gross income of such owner-employee shall, for purposes of this chapter, include the amount of net income for such taxable year attributable to the interest of such owner-employee under such plan.

"(C) REPAYMENT WITHIN PRESCRIBED PERIOD.—Subparagraph (A) shall not apply to an excess contribution with respect to any taxable year, if, on or before the close of the 6-month period beginning on the day on which the Secretary or his delegate sends notice (by certified or registered mail) to the person to whom such excess contribution was paid of the amount of such excess contribution, the amount of such excess contribution, and the net income attributable thereto, is repaid to the owner-employee on whose behalf such excess contribution was made. If the excess contribution is an excess contribution as defined in paragraph (1)(A) or (B)(i), or is an excess contribution as defined in paragraph (1)(C) with respect to which a deduction has been claimed under section 404, the notice required by the preceding sentence shall not be mailed prior to

the time that the amount of the tax under this chapter of such owner-employee for the taxable year in which such excess contribution was made has been finally determined.

"(D) REPAYMENT AFTER PRESCRIBED PERIOD.—If an excess contribution, together with the net income attributable thereto, is not repaid within the 6-month period referred to in subparagraph (C), subparagraph (A) shall not apply to an excess contribution with respect to any taxable year beginning with the taxable year in which the person to whom such excess contribution was paid repays the amount of such excess contribution to the owner-employee on whose behalf such excess contribution was made, and pays to such owner-employee the amount of net income attributable to the interest of such owner-employee which, under subparagraph (B), has been included in the gross income of such owner-employee for any prior taxable year.

"(E) SPECIAL RULE IF EXCESS CONTRIBUTION WAS WILLFULLY MADE.—If an excess contribution made on behalf of an owner-employee is determined to have been willfully made, then—

"(i) subparagraphs (A), (B), (C), and (D) shall not apply with respect to such excess contribution;

"(ii) there shall be distributed to the owner-employee on whose behalf such excess contribution was willfully made his entire interest in all plans with respect to which he is an owner-employee; and

"(iii) no plan shall, for purposes of section 404, be considered as meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year in which it is determined that such excess contribution was willfully made and for the 5 taxable years following such taxable year.

"(F) STATUTE OF LIMITATIONS.—In any case in which subparagraph (A) applies, the period for assessing any deficiency arising by reason of—

"(i) the disallowance of any deduction under section 404 on account of a plan not meeting the requirements of subsection (d) with respect to the owner-employee on whose behalf an excess contribution was made, or

"(ii) the inclusion, under subparagraph (B), in gross income of such owner-employee of income attributable to the interest of such owner-employee under a plan,

for the taxable year in which such excess contribution was made or for any succeeding taxable year shall not expire prior to one year after the close of the 6-month period referred to in subparagraph (C).

"(3) CONTRIBUTIONS FOR PREMIUMS ON ANNUITY, ETC., CONTRACTS.—A contribution by the employer on behalf of an owner-employee shall not be considered to be an excess contribution within the meaning of paragraph (1), if—

"(A) under the plan such contribution is required to be applied (directly or through a trustee) to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of such owner-employee issued under the plan,

"(B) the amount of such contribution exceeds the amount deductible under section 404 (determined without regard to section 404(a)(10)) with respect to contributions made by the employer on behalf of such owner-employee under the plan, and

"(C) the amount of such contribution does not exceed the average of the amounts which were deductible under section 404 (determined without regard to section 404(a)(10)) with respect to contributions made by the employer on behalf of such owner-employee under the plan (or which would have been deductible under such section if such section had been in effect) for the first 3 taxable years (i) preceding the year in which the last such annuity, endowment, or life insurance contract was issued under the plan and (ii) in which such owner-employee derived earned income from the trade or business with respect to which the plan is established, or for so many of such taxable years as such owner-employee was engaged in such trade or business and derived earned income therefrom.

In the case of any individual on whose behalf contributions described in subparagraph (A) are made under more than one plan as an owner-employee during any taxable year, the preceding sentence shall not apply if the amount of such contributions under all such plans for such taxable year exceeds $2,500. Any contribution which is not considered to be an excess contribution by reason of the application of this paragraph shall, for purposes of subparagraphs (B) (ii), (iii), and (iv) of paragraph (1), be taken into account as a contribution made by such owner-employee as an employee to the extent that the amount of such contribution is not deductible under section 404 (determined without regard to section 404(a)(10)) for the taxable year, but only for the purpose of applying such subparagraphs to other contributions made by such owner-employee as an employee.

"(f) CERTAIN CUSTODIAL ACCOUNTS.—

"(1) TREATMENT AS QUALIFIED TRUST.—For purposes of this title, a custodial account shall be treated as a qualified trust under this section, if—

"(A) such custodial account would, except for the fact that it is not a trust, constitute a qualified trust under this section;

"(B) the custodian is a bank (as defined in subsection (d)(1));

"(C) the investment of the funds in such account (including all earnings) is to be made—

"(i) solely in regulated investment company stock with respect to which an employee is the beneficial owner, or

"(ii) solely in annuity, endowment, or life insurance contracts issued by an insurance company;

"(D) the shareholder of record of any such stock described in subparagraph (C)(i) is the custodian or its nominee; and

"(E) the contracts described in subparagraph (C)(ii) are held by the custodian until distributed under the plan.

For purposes of this title, in the case of a custodial account treated as a qualified trust under this section by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

"(2) DEFINITION.—For purposes of paragraph (1), the term 'regulated investment company' means a domestic corporation which—

"(A) is a regulated investment company within the meaning of section 851(a), and

"(B) issues only redeemable stock.

"(g) ANNUITY DEFINED.—For purposes of this section and sections 402, 403, and 404, the term 'annuity' includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a–2); but does not include any contract or certificate issued after December 31, 1962, which is transferable, if any person other than the trustee of a trust described in section 401(a) which is exempt from tax under section 501(a) is the owner of such contract or certificate."

SEC. 3. DEDUCTIBILITY OF CONTRIBUTIONS TO PLANS.

(a) INCLUSION OF SELF-EMPLOYED INDIVIDUALS.—Section 404(a) of the Internal Revenue Code of 1954 (relating to the deductibility of contributions to pension, annuity, profit-sharing, or stock bonus plans or plans of deferred compensation) is amended—

(1) by striking out in paragraph (2) "and (6)," and inserting in lieu thereof "(6), (7), and (8), and, if applicable, the requirements of section 401(a) (9) and (10) and of section 401(d) (other than paragraph (1)),"; and

(2) by adding after paragraph (7) the following new paragraphs:

"(8) SELF-EMPLOYED INDIVIDUALS.—In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1), for purposes of this section—

"(A) the term 'employee' includes an individual who is an employee within the meaning of section 401(c)(1), and the employer of such individual is the person treated as his employer under section 401(c)(4);

"(B) the term 'earned income' has the meaning assigned to it by section 401(c)(2);

"(C) the contributions to such plan on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall be considered to satisfy the conditions of section 162 or 212 to the extent that such contributions do not exceed the earned income of such individual derived from the trade or business with respect to which such plan is established, and to the extent that such contributions are not allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance; and

"(D) any reference to compensation shall, in the case of an individual who is an employee within the meaning of section 401(c)(1), be considered to be a reference to the earned income of such individual derived from the trade or business with respect to which the plan is established.

"(9) PLANS BENEFITING SELF-EMPLOYED INDIVIDUALS.—In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1)—

"(A) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of employees (other than employees within the meaning of section 401(c)(1)), as if such employees were the only employees for whom contributions and benefits are provided under the plan;

"(B) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of employees within the meaning of section 401(c)(1)—

"(i) as if such employees were the only employees for whom contributions and benefits are provided under the plan, and

"(ii) without regard to paragraph (1)(D), the second and third sentences of paragraph (3), and the second sentence of paragraph (7); and

"(C) the amounts deductible under paragraphs (1), (2), (3), and (7), with respect to contributions on behalf of any employee within the meaning of section 401(c)(1), shall not exceed the applicable limitation provided in subsection (e).

"(10) SPECIAL LIMITATION ON AMOUNT ALLOWED AS DEDUCTION FOR SELF-EMPLOYED INDIVIDUALS.—Notwithstanding any other provision of this section, the amount allowable as a deduction under paragraphs (1), (2), (3), and (7) in any taxable year with respect to contributions made on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall be an amount equal to one-half of the contributions made on behalf of such individual in such taxable year which are deductible under such paragraphs (determined with the application of paragraph (9) and of subsection (e) but without regard to this paragraph). For purposes of section 401, the amount which may be deducted, or the amount deductible, under this section with respect to contributions made on behalf of such individual shall be determined without regard to the preceding sentence."

(b) LIMITATIONS ON DEDUCTIBLE CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS.—Section 404 of the Internal Revenue Code of 1954 (relating to the deductibility of contributions to pension, annuity, profit-sharing, or stock bonus plans or plans of deferred compensation) is amended by adding after subsection (d) the following new subsections:

"(e) SPECIAL LIMITATIONS FOR SELF-EMPLOYED INDIVIDUALS.—

"(1) IN GENERAL.—In the case of a plan included in subsection (a) (1), (2), or (3), which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1), the amounts deductible under subsection (a) (determined without regard to paragraph (10) thereof) in any taxable year with respect to contributions on behalf of any employee within the meaning of section 401(c)(1) shall, subject to the provisions of paragraph (2), not exceed $2,500, or 10 percent of the earned income derived by such employee from the trade or business with respect to which the plan is established, whichever is the lesser.

"(2) CONTRIBUTIONS MADE UNDER MORE THAN ONE PLAN.—

"(A) OVERALL LIMITATION.—In any taxable year in which amounts are deductible with respect to contributions under two or more plans on behalf of an individual who is an employee within the meaning of section 401(c)(1) with respect to such plans, the aggregate amount deductible for such taxable year under all such plans with respect to contributions on behalf of such employee (determined without regard to subsection (a)(10)) shall not exceed $2,500, or 10 percent of the earned

income derived by such employee from the trades or businesses with respect to which the plans are established, whichever is the lesser.

"(B) ALLOCATION OF AMOUNTS DEDUCTIBLE.—In any case in which the amounts deductible under subsection (a) (with the application of the limitations of this subsection) with respect to contributions made on behalf of an employee within the meaning of section 401(c)(1) under two or more plans are, by reason of subparagraph (A), less than the amounts deductible under such subsection determined without regard to such subparagraph, the amount deductible under subsection (a) (determined without regard to paragraph (10) thereof) with respect to such contributions under each such plan shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

"(3) CONTRIBUTIONS ALLOCABLE TO INSURANCE PROTECTION.—For purposes of this subsection, contributions which are allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

"(f) CERTAIN LOAN REPAYMENTS CONSIDERED AS CONTRIBUTIONS.—For purposes of this section, any amount paid, directly or indirectly, by an owner-employee (within the meaning of section 401(c)(3)) in repayment of any loan which under section 72(m)(4)(B) was treated as an amount received under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as a part of a plan described in section 403(a) shall be treated as a contribution to which this section applies on behalf of such owner-employee to such trust or to or under such plan."

SEC. 4. TAXABILITY OF DISTRIBUTIONS.

(a) EMPLOYEES' ANNUITIES.—Section 72(d)(2) of the Internal Revenue Code of 1954 (relating to employees' annuities) is amended to read as follows:

"(2) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (1).—For purposes of paragraph (1)—

"(A) if the employee died before any amount was received as an annuity under the contract, the words 'receivable by the employee' shall be read as 'receivable by a beneficiary of the employee'; and

"(B) any contribution made with respect to the contract while the employee is an employee within the meaning of section 401(c)(1) which is not allowed as a deduction under section 404 shall be treated as consideration for the contract contributed by the employee."

(b) SPECIAL RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—Section 72 of the Internal Revenue Code of 1954 (relating to annuities, etc.) is amended by redesignating subsection (m) as subsection (o) and by inserting after subsection (l) the following new subsections:

"(m) SPECIAL RULES APPLICABLE TO EMPLOYEE ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE PLANS.—

"(1) CERTAIN AMOUNTS RECEIVED BEFORE ANNUITY STARTING DATE.—Any amounts received under an annuity, endowment, or

life insurance contract before the annuity starting date which are not received as an annuity (within the meaning of subsection (e)(2)) shall be included in the recipient's gross income for the taxable year in which received to the extent that—

"(A) such amounts, plus all amounts theretofore received under the contract and includible in gross income under this paragraph, do not exceed

"(B) the aggregate premiums or other consideration paid for the contract while the employee was an owner-employee which were allowed as deductions under section 404 for the taxable year and all prior taxable years.

Any such amounts so received which are not includible in gross income under this paragraph shall be subject to the provisions of subsection (e).

"(2) COMPUTATION OF CONSIDERATION PAID BY THE EMPLOYEE.—In computing—

"(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract),

"(B) the consideration for the contract contributed by the employee for purposes of subsection (d)(1) (relating to employee's contributions recoverable in 3 years), and

"(C) the aggregate premiums or other consideration paid for purposes of subsection (e)(1)(B) (relating to certain amounts not received as an annuity),

any amount allowed as a deduction with respect to the contract under section 404 which was paid while the employee was an employee within the meaning of section 401(c)(1) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the employee was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary or his delegate) to the cost of life, accident, health, or other insurance.

"(3) LIFE INSURANCE CONTRACTS.—

"(A) This paragraph shall apply to any life insurance contract—

"(i) purchased as a part of a plan described in section 403(a), or

"(ii) purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

"(B) Any contribution to a plan described in subparagraph (A)(i) or a trust described in subparagraph (A)(ii) which is allowed as a deduction under section 404, and any income of a trust described in subparagraph (A)(ii), which is determined in accordance with regulations prescribed by the Secretary or his delegate to have been applied to purchase the life insurance protection under a contract described in subparagraph (A), is includible in the gross income of the participant for the taxable year when so applied.

"(C) *In the case of the death of an individual insured under a contract described in subparagraph (A), an amount equal to the cash surrender value of the contract immediately before the death of the insured shall be treated as a payment under such plan or a distribution by such trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under this section and shall be treated as provided in section 101.*

"(4) AMOUNTS CONSTRUCTIVELY RECEIVED.—

"(A) ASSIGNMENTS OR PLEDGES.—*If during any taxable year an owner-employee assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a trust described in section 401(a) which is exempt from tax under section 501(a) or any portion of the value of a contract purchased as part of a plan described in section 403(a), such portion shall be treated as having been received by such owner-employee as a distribution from such trust or as an amount received under the contract.*

"(B) LOANS ON CONTRACTS.—*If during any taxable year, an owner-employee receives, directly or indirectly, any amount from any insurance company as a loan under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as part of a plan described in section 403(a), and issued by such insurance company, such amount shall be treated as an amount received under the contract.*

"(5) PENALTIES APPLICABLE TO CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES.—

"(A) *This paragraph shall apply—*

"(i) *to amounts (other than any amount received by an individual in his capacity as a policyholder of an annuity, endowment, or life insurance contract which is in the nature of a dividend or similar distribution) which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) and which are received by an individual, who is, or has been, an owner-employee, before such individual attains the age of 59½ years, for any reason other than the individual's becoming disabled (within the meaning of section 213(g)(3)), but only to the extent that such amounts are attributable to contributions paid on behalf of such individual (whether or not paid by him) while he was an owner-employee,*

"(ii) *to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, an owner-employee, or by the successor of such individual, but only to the extent that such amounts are determined, under regulations prescribed by the Secretary or his delegate, to exceed the benefits provided for such individual under the plan formula, and*

"(iii) *to amounts which are received, by an individual who is, or has been, an owner-employee, by reason of the distribution under the provisions of section 401(e)(2)(E) of his entire interest in all qualified trusts described in*

section 401(a) and in all plans described in section 403(a).

"(B)(i) If the aggregate of the amounts to which this paragraph applies received by any person in his taxable year equals or exceeds $2,500, the increase in his tax for the taxable year in which such amounts are received and attributable to such amounts shall not be less than 110 percent of the aggregate increase in taxes, for the taxable year and the 4 immediately preceding taxable years, which would have resulted if such amounts had been included in such person's gross income ratably over such taxable years.

"(ii) If deductions have been allowed under section 404 for contributions paid on behalf of the individual while he is an owner-employee for a number of prior taxable years less than 4, clause (i) shall be applied by taking into account a number of taxable years immediately preceding the taxable year in which the amount was so received equal to such lesser number.

"(C) If subparagraph (B) does not apply to a person for the taxable year, the increase in tax of such person for the taxable year attributable to the amounts to which this paragraph applies shall be 110 percent of such increase (computed without regard to this subparagraph).

"(D) Subparagraph (A)(ii) of this paragraph shall not apply to any amount to which section 402(a)(2) or 403(a)(2) applies.

"(E) For special rules for computation of taxable income for taxable years to which this paragraph applies, see subsection (n)(3).

"(6) OWNER-EMPLOYEE DEFINED.—For purposes of this subsection, the term 'owner-employee' has the meaning assigned to it by section 401(c)(3).

"(n) TREATMENT OF CERTAIN DISTRIBUTIONS WITH RESPECT TO CONTRIBUTIONS BY SELF-EMPLOYED INDIVIDUALS.—

"(1) APPLICATION OF SUBSECTION.—

"(A) DISTRIBUTIONS BY EMPLOYEES' TRUST.—Subject to the provisions of subparagraph (C), this subsection shall apply to amounts distributed to a distributee, in the case of an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if the total distributions payable to the distributee with respect to an employee are paid to the distributee within one taxable year of the distributee—

"(i) on account of the employee's death,

"(ii) after the employee has attained the age of 59½ years, or

"(iii) after the employee has become disabled (within the meaning of section 213(g)(3)).

"(B) ANNUITY PLANS.—Subject to the provisions of subparagraph (C), this subsection shall apply to amounts paid to a payee, in the case of an annuity plan described in section 403(a), if the total amounts payable to the payee with respect to an employee are paid to the payee within one taxable year of the payee—

"(i) on account of the employee's death,

"(ii) after the employee has attained the age of 59½ years, or

"(iii) after the employee has become disabled (within the meaning of section 213(g)(3)).

"(C) LIMITATIONS AND EXCEPTIONS.—*This subsection shall apply—*

"(i) *only with respect to so much of any distribution or payment to which (without regard to this subparagraph) subparagraph (A) or (B) applies as is attributable to contributions made on behalf of an employee while he was an employee within the meaning of section 401(c)(1), and*

"(ii) *if the recipient is the employee on whose behalf such contributions were made, only if contributions which were allowed as a deduction under section 404 have been made on behalf of such employee while he was an employee within the meaning of section 401(c)(1) for 5 or more taxable years prior to the taxable year in which the total distributions payable or total amounts payable, as the case may be, are paid.*

This subsection shall not apply to amounts described in clauses (ii) and (iii) of subparagraph (A) of subsection (m)(5) (but, in the case of amounts described in clause (ii) of such subparagraph, only to the extent that subsection (m)(5) applies to such amounts).

"(2) LIMITATION OF TAX.—*In any case to which this subsection applies, the tax attributable to the amounts to which this subsection applies for the taxable year in which such amounts are received shall not exceed whichever of the following is the greater:*

"(A) *5 times the increase in tax which would result from the inclusion in gross income of the recipient of 20 percent of so much of the amount so received as is includible in gross income, or*

"(B) *5 times the increase in tax which would result if the taxable income of the recipient for such taxable year equaled 20 percent of the amount of the taxable income of the recipient for such taxable year determined under paragraph (3)(A).*

"(3) DETERMINATION OF TAXABLE INCOME.—*Notwithstanding section 63 (relating to definition of taxable income), for purposes only of computing the tax under this chapter attributable to amounts to which this subsection or subsection (m)(5) applies and which are includible in gross income—*

"(A) *the taxable income of the recipient for the taxable year of receipt shall be treated as being not less than the amount by which (i) the aggregate of such amounts so includible in gross income exceeds (ii) the amount of the deductions allowed for such taxable year under section 151 (relating to deductions for personal exemptions); and*

"(B) *in making ratable inclusion computations under paragraph (5)(B) of subsection (m), the taxable income of the recipient for each taxable year involved in such ratable inclusion shall be treated as being not less than the amount required by such paragraph (5)(B) to be treated as includible in gross income for such taxable year.*

In any case in which the preceding sentence results in an increase in taxable income for any taxable year, the resulting increase in the taxes imposed by section 1 or 3 for such taxable year shall not be

reduced by any credit under part IV of subchapter A (other than section 31 thereof) which, but for this sentence, would be allowable."

(c) CAPITAL GAINS TREATMENT OF CERTAIN EMPLOYEES' TRUST DISTRIBUTIONS.—Section 402(a)(2) of the Internal Revenue Code of 1954 (relating to capital gains treatment for certain distributions) is amended by adding at the end thereof the following new sentence: "This paragraph shall not apply to distributions paid to any distributee to the extent such distributions are attributable to contributions made on behalf of the employee while he was an employee within the meaning of section 401(c)(1)."

(d) CAPITAL GAINS TREATMENT OF CERTAIN EMPLOYEES' ANNUITY PAYMENTS.—Section 403(a) of the Internal Revenue Code of 1954 (relating to taxability of a beneficiary under a qualified annuity plan) is amended—

(1) by striking out in paragraph (2)(A)(i) "which meets the requirements of section 401(a) (3), (4), (5), and (6)" and inserting in lieu thereof "described in paragraph (1)";

(2) by adding at the end of paragraph (2)(A) the following new sentence: "This subparagraph shall not apply to amounts paid to any payee to the extent such amounts are attributable to contributions made on behalf of the employee while he was an employee within the meaning of section 401(c)(1)."; and

(3) by adding after paragraph (2) the following new paragraph:

"(3) SELF-EMPLOYED INDIVIDUALS.—For purposes of this subsection, the term 'employee' includes an individual who is an employee within the meaning of section 401(c)(1), and the employer of such individual is the person treated as his employer under section 401(c)(4)."

SEC. 5. PLANS FOR PURCHASE OF UNITED STATES BONDS.

(a) QUALIFIED BOND PURCHASE PLANS.—Part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 (relating to deferred compensation, etc.) is amended by adding at the end thereof the following new section:

"SEC. 405. QUALIFIED BOND PURCHASE PLANS.

"(a) REQUIREMENTS FOR QUALIFICATION.—A plan of an employer for the purchase for and distribution to his employees or their beneficiaries of United States bonds described in subsection (b) shall constitute a qualified bond purchase plan under this section if—

"(1) the plan meets the requirements of section 401(a) (3), (4), (5), (6), (7), and (8) and, if applicable, the requirements of section 401(a) (9) and (10) and of section 401(d) (other than paragraphs (1), (5)(B), and (8)); and

"(2) contributions under the plan are used solely to purchase for employees or their beneficiaries United States bonds described in subsection (b).

"(b) BONDS TO WHICH APPLICABLE.—

"(1) CHARACTERISTICS OF BONDS.—This section shall apply only to a bond issued under the Second Liberty Bond Act, as amended, which by its terms, or by regulations prescribed by the Secretary under such Act—

"(A) provides for payment of interest, or investment yield, only upon redemption;

"(B) may be purchased only in the name of an individual;

"(C) ceases to bear interest, or provide investment yield, not later than 5 years after the death of the individual in whose name it is purchased;

"(D) may be redeemed before the death of the individual in whose name it is purchased only if such individual—

"(i) has attained the age of 59½ years, or

"(ii) has become disabled (within the meaning of section 213(g)(3)); and

"(E) is nontransferable.

"(2) MUST BE PURCHASED IN NAME OF EMPLOYEE.—This section shall apply to a bond described in paragraph (1) only if it is purchased in the name of the employee.

"(c) DEDUCTION FOR CONTRIBUTIONS TO BOND PURCHASE PLANS.—Contributions paid by an employer to or under a qualified bond purchase plan shall be allowed as a deduction in an amount determined under section 404 in the same manner and to the same extent as if such contributions were made to a trust described in section 401(a) which is exempt from tax under section 501(a).

"(d) TAXABILITY OF BENEFICIARY OF QUALIFIED BOND PURCHASE PLAN.—

"(1) GROSS INCOME NOT TO INCLUDE BONDS AT TIME OF DISTRIBUTION.—For purposes of this chapter, in the case of a distributee of a bond described in subsection (b) under a qualified bond purchase plan, or from a trust described in section 401(a) which is exempt from tax under section 501(a), gross income does not include any amount attributable to the receipt of such bond. Upon redemption of such bond, the proceeds shall be subject to taxation under this chapter, but the provisions of section 72 (relating to annuities, etc.) and section 1232 (relating to bonds and other evidences of indebtedness) shall not apply.

"(2) BASIS.—The basis of any bond received by a distributee under a qualified bond purchase plan—

"(A) if such bond is distributed to an employee, or with respect to an employee, who at the time of purchase of the bond, was an employee other than an employee within the meaning of section 401(c)(1), shall be the amount of the contributions by the employee which were used to purchase the bond, and

"(B) if such bond is distributed to an employee, or with respect to an employee, who, at the time of purchase of the bond, was an employee within the meaning of section 401(c)(1), shall be the amount of the contributions used to purchase the bond which were made on behalf of such employee and were not allowed as a deduction under subsection (c).

The basis of any bond described in subsection (b) received by a distributee from a trust described in section 401(a) which is exempt from tax under section 501(a) shall be determined under regulations prescribed by the Secretary or his delegate.

"(e) CAPITAL GAINS TREATMENT NOT TO APPLY TO BONDS DISTRIBUTED BY TRUSTS.—Section 402(a)(2) shall not apply to any bond described in subsection (b) distributed to any distributee and, for purposes of applying such section, any such bond distributed to any distributee and any such bond to the credit of any employee shall not be taken into account.

"(f) EMPLOYEE DEFINED.—For purposes of this section, the term 'employee' includes an individual who is an employee within the meaning of section 401(c)(1), and the employer of such individual shall be the person treated as his employer under section 401(c)(4).

"(g) PROOF OF PURCHASE.—At the time of purchase of any bond to which this section applies, proof of such purchase shall be furnished in such form as will enable the purchaser, and the employee in whose name such bond is purchased, to comply with the provisions of this section.

"(h) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section."

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 405. Qualified bond purchase plans."

SEC. 6. PROHIBITED TRANSACTIONS.

Section 503 of the Internal Revenue Code of 1954 (relating to prohibited transactions) is amended by adding at the end thereof the following new subsection:

"(j) TRUSTS BENEFITING CERTAIN OWNER-EMPLOYEES.—

"(1) PROHIBITED TRANSACTIONS.—In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)) who control (within the meaning of section 401(d)(9)(B)) the trade or business with respect to which the plan is established, the term 'prohibited transaction' also means any transaction in which such trust, directly or indirectly—

"(A) lends any part of the corpus or income of the trust to;

"(B) pays any compensation for personal services rendered to the trust to;

"(C) makes any part of its services available on a preferential basis to; or

"(D) acquires for the trust any property from, or sells any property to;

any person described in subsection (c) or to any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

"(2) SPECIAL RULE FOR LOANS.—For purposes of the application of paragraph (1)(A), the following rules shall apply with respect to a loan made before the date of the enactment of this subsection which would be a prohibited transaction if made in a taxable year beginning after December 31, 1962:

"(A) If any part of the loan is repayable prior to December 31, 1965, the renewal of such part of the loan for a period not extending beyond December 31, 1965, on the same terms, shall not be considered a prohibited transaction.

"(B) If the loan is repayable on demand, the continuation of the loan beyond December 31, 1965, shall be considered a prohibited transaction."

SEC. 7. OTHER SPECIAL RULES, TECHNICAL CHANGES, AND ADMINISTRATIVE PROVISIONS.

(a) RETIREMENT INCOME CREDIT.—Section 37(c)(1) of the Internal Revenue Code of 1954 (relating to definition of retirement income) is amended—

(1) by striking out subparagraph (A) and inserting in lieu thereof the following:

"(A) pensions and annuities (including, in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1), distributions by a trust described in section 401(a) which is exempt from tax under section 501(a)),"; and

(2) by striking out "and" at the end of subparagraph (C), by striking out "or" at the end of subparagraph (D) and inserting in lieu thereof "and", and by adding after subparagraph (D) the following new subparagraph:

"(E) bonds described in section 405(b)(1) which are received under a qualified bond purchase plan described in section 405(a) or in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a), or".

(b) ADJUSTED GROSS INCOME.—Section 62 of the Internal Revenue Code of 1954 (relating to the definition of adjusted gross income) is amended by inserting after paragraph (6) the following new paragraph:

"(7) PENSION, PROFIT-SHARING, ANNUITY, AND BOND PURCHASE PLANS OF SELF-EMPLOYED INDIVIDUALS.—In the case of an individual who is an employee within the meaning of section 401(c)(1), the deductions allowed by section 404 and section 405(c) to the extent attributable to contributions made on behalf of such individual."

(c) DEATH BENEFITS.—Section 101(b) of the Internal Revenue Code of 1954 (relating to employees' death benefits) is amended—

(1) by striking out clause (ii) of paragraph (2)(B) and inserting in lieu thereof the following:

"(ii) under an annuity contract under a plan described in section 403(a), or"; and

(2) by adding at the end thereof the following new paragraph:

"(3) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.—For purposes of this subsection, the term 'employee' does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals)."

(d) AMOUNTS RECEIVED THROUGH ACCIDENT OR HEALTH INSURANCE.—Section 104(a) of the Internal Revenue Code of 1954 (relating to compensation for injuries or sickness) is amended by adding at the end thereof the following new sentence:

"For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee."

(e) AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.—Section 105 of the Internal Revenue Code of 1954 (relating to amounts

received under accident and health plans) is amended by adding at the end thereof the following new subsection:

"(g) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.—For purposes of this section, the term 'employee' does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals)."

(f) NET OPERATING LOSS DEDUCTION.—Section 172(d)(4) of the Internal Revenue Code of 1954 (relating to nonbusiness deductions of taxpayers other than corporations) is amended—

(1) by striking out "and" at the end of subparagraph (B);

(2) by striking out the period at the end of subparagraph (C) and inserting "; and"; and

(3) by adding after subparagraph (C) the following new subparagraph:

"(D) any deduction allowed under section 404 or section 405(c) to the extent attributable to contributions which are made on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall not be treated as attributable to the trade or business of such individual."

(g) CERTAIN LIFE INSURANCE RESERVES.—Section 805(d)(1) of the Internal Revenue Code of 1954 (relating to pension plan reserves) is amended—

(1) by striking out in subparagraph (B) "meeting the requirements of section 401(a) (3), (4), (5), and (6) or" and inserting in lieu thereof "described in section 403(a), or plans meeting"; and

(2) by striking out in subparagraph (C) "and (6)" and inserting in lieu thereof "(6), (7), and (8)".

(h) UNINCORPORATED BUSINESSES ELECTING TO BE TAXED AS CORPORATIONS.—Section 1361(d) of the Internal Revenue Code of 1954 (relating to unincorporated business enterprises electing to be taxed as domestic corporations) is amended by inserting before the period at the end thereof the following: "other than an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), or for purposes of section 405 (relating to qualified bond purchase plans) other than an employee described in section 405(f)".

(i) ESTATE TAX EXEMPTION OF EMPLOYEES' ANNUITIES.—Section 2039 of the Internal Revenue Code of 1954 (relating to exemption from the gross estate of annuities under certain trusts and plans) is amended—

(1) by striking out in subsection (c)(2) "met the requirements of section 401(a) (3), (4), (5), and (6)" and inserting "was a plan described in section 403(a)"; and

(2) by adding at the end of subsection (c) the following new sentence: "For purposes of this subsection, contributions or payments on behalf of the decedent while he was an employee within the meaning of section 401(c)(1) made under a trust or plan described in paragraph (1) or (2) shall be considered to be contributions or payments made by the decedent."

(j) GIFT TAX EXEMPTION OF EMPLOYEES' ANNUITIES.—Section 2517 of the Internal Revenue Code of 1954 (relating to exclusion from gift tax in case of certain annuities under qualified plans) is amended—

(1) by striking out in subsection (a)(2) "met the requirements of section 401(a) (3), (4), (5), and (6)" and inserting in lieu thereof "was a plan described in section 403(a)"; and

(2) by adding at the end of subsection (b) the following new sentence: "For purposes of this subsection, payments or contributions on behalf of an individual while he was an employee within the meaning of section 401(c)(1) made under a trust or plan described in subsection (a) (1) or (2) shall be considered to be payments or contributions made by the employee."

(k) FEDERAL UNEMPLOYMENT TAX ACT.—Section 3306(b)(5) of the Internal Revenue Code of 1954 (relating to definition of wages) is amended by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraphs:

"(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a), or

"(C) under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a);".

(l) WITHHOLDING OF INCOME TAX.—Section 3401(a)(12) of the Internal Revenue Code of 1954 (relating to definition of wages) is amended by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraphs:

"(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

"(C) under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a)."

(m) INFORMATION REQUIREMENTS.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to information concerning transactions with other persons) is amended by adding after section 6046 the following new section:

"SEC. 6047. INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY AND BOND PURCHASE PLANS.

"(a) TRUSTEES AND INSURANCE COMPANIES.—The trustee of a trust described in section 401(a) which is exempt from tax under section 501(a) to which contributions have been paid under a plan on behalf of any owner-employee (as defined in section 401(c)(3)), and each insurance company or other person which is the issuer of a contract purchased by such a trust, or purchased under a plan described in section 403(a), contributions for which have been paid on behalf of any owner-employee, shall file such returns (in such form and at such times), keep such records, make such identification of contracts and funds (and accounts within such funds), and supply such information, as the Secretary or his delegate shall by forms or regulations prescribe.

"(b) OWNER-EMPLOYEES.—Every individual on whose behalf contributions have been paid as an owner-employee (as defined in section 401(c)(3))—

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

"(2) to an insurance company or other person under a plan described in section 403(a),

shall furnish the trustee, insurance company, or other person, as the case may be, such information at such times and in such form and manner as the Secretary or his delegate shall prescribe by forms or regulations.

"(c) EMPLOYEES UNDER QUALIFIED BOND PURCHASE PLANS.—Every individual in whose name a bond described in section 405(b)(1) is purchased by his employer under a qualified bond purchase plan described in section 405(a), or by a trust described in section 401(a) which is exempt from tax under section 501(a), shall furnish—

"(1) to his employer or to such trust, and

"(2) to the Secretary (or to such person as the Secretary may by regulations prescribe),

such information as the Secretary or his delegate shall by forms or regulations prescribe.

"(d) CROSS REFERENCE.—

"For criminal penalty for furnishing fraudulent information, see section 7207."

(2) CLERICAL AMENDMENT.—The table of sections for such subpart B is amended by adding after the reference to section 6046 the following:

"Sec. 6047. Information relating to certain trusts and annuity and bond purchase plans."

(3) PENALTY.—Section 7207 of the Internal Revenue Code of 1954 (relating to fraudulent returns, statements, or other documents) is amended by adding at the end thereof the following new sentence: "Any person required pursuant to section 6047 (b) or (c) to furnish any information to the Secretary or any other person who willfully furnishes to the Secretary or such other person any information known by him to be fraudulent or to be false as to any material matter shall be fined not more than $1,000, or imprisoned not more than 1 year, or both."

SEC. 8. EFFECTIVE DATE.

The amendments made by this Act shall apply to taxable years beginning after December 31, 1961.

And the Senate agree to the same.

W. D. MILLS,
HALE BOGGS,
EUGENE J. KEOGH,
NOAH MASON,
JOHN W. BYRNES,
HOWARD H. BAKER,
Managers on the Part of the House.

HARRY F. BYRD,
ROBT. S. KERR,
RUSSELL B. LONG,
GEO. A. SMATHERS,
JOHN J. WILLIAMS,
FRANK CARLSON,
WALLACE F. BENNETT,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 10) to encourage the establishment of voluntary pension plans by self-employed individuals submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

The Senate amendment struck out all of the text of the bill as passed by the House and inserted new text. Under the conference agreement, the House recedes from its disagreement to the Senate amendment and agrees to the same with an amendment which inserts new text in the nature of a substitute. The important differences between the bill as passed by the House, the Senate amendment, and the conference substitute are explained below.

Time of payment of benefits under a qualified plan.—The bill as passed by the House provided (in proposed sec. 401(a)(8)) that no trust was to constitute a qualified trust under section 401 unless the entire interest of the employee will be distributed to him not later than the taxable year in which he attains age 70½ or, in the case of an employee other than an owner-employee, a later taxable year in which he retires. An alternative method was provided in which the distribution must begin not later than the taxable year specified in the preceding sentence and must be completed within a period based on the life, or life expectancy, of the employee or of the employee and his spouse.

The Senate amendment (in proposed sec. 401(a)(9)) makes the above rules applicable only in the case of a trust providing contributions or benefits for employees some or all of whom are self-employed individuals or are owner-employees, including corporate owner-employees. The conference substitute inserts a new paragraph (9) in section 401(a) which makes the above rules applicable in the case of a trust providing contributions or benefits for employees some or all of whom are self-employed individuals.

The Senate amendment, and the conference substitute, contain a provision that these new rules will not apply to any distribution under a designation of a method of distribution, where such designation was made by the employee before the date of the enactment of the bill.

Coverage requirements where plan benefits an owner-employee.—The bill as passed by the House (proposed sec. 401(a)(10)) provided that those plans providing for current or future contributions for an owner-employee who has, or has had, more than three employees had to include all employees having more than 3 years of service, other than part-time or seasonal employees. In a case where the owner-employee has less than four employees, the bill as passed by the House provided that coverage for such other employees was discretionary.

The Senate amendment and the conference substitute provide (see proposed sec. 401(d)(3)) that any plan which benefits an owner-employee must provide benefits for all employees with three or more years of service, other than part-time or seasonal employees.

Self-employment earnings.—The bill as passed by the House provided that a proprietor or partner may be covered under a qualified retirement plan if he has "self-employment earnings," and that such earnings are the basis for determining the amount of the deduction for contributions for self-employed persons. In general, the term "self-employment earnings" was defined (in proposed sec. 401(c)(3)) to mean net earnings from a trade or business of a self-employed individual, thus including return on capital invested in the trade or business, as well as income for personal services.

Under the Senate amendment and the conference substitute, coverage under the bill depends on "earned income", and such income is the basis for computing deductible contributions for self-employed individuals. This term (see proposed sec. 401(c)(2)) means, in general, net earnings from self-employment to the extent such earnings constitute earned income within the meaning of section 911(b) of the 1954 code (such as professional fees and other compensation for personal services). Where personal services and invested capital are material income-producing factors, the term "earned income" means not more than 30 percent of the net profits from the business, but, in those cases in which the self-employed person renders full-time personal services, not less than the first $2,500 of such net profits.

Definition of owner-employee.—Certain of the provisions of the bill are applicable to owner-employees or to plans covering owner-employees. The bill as passed by the House provided (in proposed sec. 401(c)(4)) that an owner-employee means a self-employed individual who derives self-employment earnings from a trade or business carried on by him or who is a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership.

The Senate amendment (see proposed sec. 401(c)(3)) included in the definition of an owner-employee (in addition to proprietors and more than 10 percent partners) corporate employees who own more than 10 percent of the value or voting power of the stock of a corporation. Plans covering these corporate employees therefore would have become subject to the new requirements for qualification of retirement plans covering owner-employees and the limitations on the amount deductible with respect to contributions made on behalf of owner-employees. The definition of owner-employee in the conference substitute (see proposed sec. 401(c)(3)) does not include the corporate employees described in the preceding sentences.

Constructive ownership rules.—The Senate amendment added a new provision to the bill (proposed sec. 401(c)(5)) containing rules of constructive ownership for purposes of section 401 of the 1954 code. In general, an individual would have been treated as constructively owning any interest in an unincorporated trade or business or in a corporation which is owned, directly or indirectly, by his spouse, minor children, or ancestors. The conference substitute eliminates these constructive ownership rules.

Requirement that trustee be a bank.—The bill as passed by the House provided (in proposed sec. 401(d)(1)) that the trustee of an exempt employees' trust under a plan providing contributions or

benefits for owner-employees must be a bank or other specified financial institution, but that another person (who may be the employer) could be given power to control investments of the trust fund.

The Senate amendment and the conference substitute (see proposed sec. 401(d)(1)) retain this provision, but provide that a trust which exclusively uses annuity, endowment, or life insurance contracts of a life insurance company to fund the benefits prescribed by the trust is excepted from the requirement that a bank or other specified financial institution be the trustee of the retirement funds. The Secretary of the Treasury or his delegate is authorized to prescribe by regulations the extent to which this exception will apply and the information which the insurance company must furnish regarding trust transactions.

Consent to be covered.—The Senate amendment and the conference substitute provide (in proposed sec. 401(d)(4)(A)) that an owner-employee, to be covered by a plan established for the trade or business of which he is an owner-employee, must consent to such coverage.

Vesting.—The bill as passed by the House (see proposed sec. 401(d)(3)) required immediate vesting of the employee's rights under the plan of an owner-employee with more than 3 employees.

The Senate amendment and the conference substitute provide (see proposed sec. 401(d)(2)(A)) that any plan providing contributions or benefits for an owner-employee must provide for immediate vesting of the rights of the other employees covered by the plan.

Integraiion with social security of qualified plans covering owner-employees.—Under present law, a plan is not considered discriminatory merely because the contributions or benefits under the plan are integrated with retirement benefits under social security. The rules relating to the integration of qualified plans with social security now assume that the employer has paid for that portion of the social security benefit of his employees which the employees themselves have not paid for. The bill as passed by the House provided (see proposed sec. 401(d)(5)(B)) that integration with social security was permitted for plans covering owner-employees with more than three employees only if contributions for the owner-employees did not exceed one-third of the total deductible contributions. Furthermore, the owner-employee was given credit only for his actual social security contributions on behalf of his other employees.

The Senate amendment and conference substitute retain (see proposed sec. 401(d)(6)) the rules of the bill as passed by the House, but provide that such rules are applicable to all plans which provide contributions or benefits for any owner-employee (whether or not more than 3 employees are covered under the plan).

Distributions after death.—The bill as passed by the House provided (see proposed sec. 401(d)(7)) that, after the death of an owner-employee, his remaining interest in the plan must, in general, either be distributed to his beneficiary within 5 years, or used within that period to purchase an immediate annuity for his beneficiary.

The Senate amendment and conference substitute retain (see proposed sec. 401(d)(7)) the provisions of the bill as passed by the House, but provide that they shall not apply if a distribution has commenced and such distribution is for a term certain over a period not extending beyond the life expectancy of the owner-employee and his spouse.

Two or more businesses.—The bill as passed by the House provides (see proposed sec. 401(d)(9)) that an owner-employee (or a group of two or more owner-employees) who controls more than one business would be required to group together all controlled businesses for the purpose of determining whether the rules relating to the qualification of the plan would be those which apply to owner-employees with 3 or fewer employees or those applicable to owner-employees with more than 3 employees.

The Senate amendment and conference substitute retain (see proposed sec. 401(d)(9)) the principle contained in the bill as passed by the House. However, the Senate amendment and conference substitute provide the same requirements for the qualification of all plans covering an owner-employee. Thus, for example, under the Senate amendment and conference substitute, any owner-employee (or any group of two or more owner-employees) who controls more than one business will be required to group together all controlled businesses for the purpose of determining whether the coverage requirements are met as to all the employees.

In addition, the Senate amendment and the conference substitute provide (see proposed sec. 401(d)(10)) that an individual who is an owner-employee in a business (whether or not he controls the business) and is also an owner-employee of another business which he controls may not be covered under the plan of the first business unless he has established a plan for the employees of the business which he controls. The plan for the business which he controls must provide contributions and benefits for employees which are at least as favorable as the contributions and benefits provided for owner-employees under the plan of the first business.

Excess contribution.—The bill as passed by the House provided (see proposed sec. 401(e)) certain rules where excess contributions are made under a qualified plan covering an owner-employee.

In general, the Senate amendment and the conference substitute incorporate the provisions of the bill as passed by the House relating to such excess contributions. Thus, an excess contribution is defined as an amount greater than the permitted deductible and nondeductible contributions made on behalf of the owner-employee (computed without regard to the special limitation which allows as a deduction only one-half of the deductible amount determined under sec. 404(e)). However, the Senate amendment and the conference substitute provide that, in the case of multiple plans, the amount of any contribution made by an owner-employee, as an employee, under all such plans which exceeds $2,500 is an excess contribution. The Senate amendment and the conference substitute also make it clear that, when an excess contribution must be returned to the owner-employee on whose behalf it was made, the income attributable to such excess contribution which is required to be returned to the owner-employee is the net income so attributable.

In addition, the Senate amendment and the conference substitute provide (see proposed sec. 401(e)(3)) an exception to the definition of an excess contribution under which an owner-employee is permitted to purchase annuity, life insurance, or endowment policies on his life from an insurance company at level premiums without fear of making an excess contribution. Under this exception, an owner-employee is permitted, in general, to contribute each year toward the purchase

price of his policy up to an amount equal to the amount he would have been allowed to contribute on the basis of his average earned income for 3 years preceding issuance of the last such policy under the plan. However, this provision does not affect the amount which is allowed as a deduction under section 404. Moreover, this exception is limited so that under no circumstances could the owner-employee obtain under one or more retirement plans level-premium policies requiring annual payments of more than $2,500.

Custodial accounts.—The bill as passed by the House (see proposed sec. 401(f)) modified the provisions of existing law which require a plan described in section 401 to use a trust. The bill as passed by the House provided that a custodial account could be used in lieu of a trust, if its investments are made solely in a regulated investment company which issues only redeemable stock and the custodian of the account was a bank as defined in section 581 of the code.

The Senate amendment and the conference substitute retain the provisions of the bill as passed by the House, but also permit the funds of the custodial account to be invested solely in annuity, endowment, or life insurance policies issued by an insurance company. In addition, the Senate amendment and the conference substitute provide that the custodian of such accounts can be any of the banking corporations described in the new section 401(d)(1) of the code.

Annuity defined.—The bill as passed by the House provided (see proposed sec. 401(g)) that the term "annuity" as used in sections 401–404 of the code included a face amount certificate which is nontransferable.

The Senate amendment and the conference substitute retain the provision of the bill as passed by the House and, in addition, provide that the term "annuity" as used in such sections does not include any contract or certificate issued after December 31, 1962, which is transferable, except where such contract or certificate is owned by a trustee of a qualified plan.

Deductible contributions.—The bill as passed by the House provided (see proposed sec. 404(e)) for limitations on the amount of deductible contributions which may be made by, or for, an owner-employee covered by a qualified plan. Under the bill as passed by the House, if the owner-employee has, or had, more than three employees, he was permitted to contribute and deduct for himself up to the same proportion of his covered income as his contributions for employees under the plan bear to their compensation. There was no maximum dollar limitation on the contributions which could be made under a plan or plans. If the owner-employer has fewer than four employees, the maximum amount deductible each year for contributions for the owner-employee was 10 percent of his self-employment income or $2,500, whichever is lesser, regardless of the number of plans such owner-employee participated in.

The Senate amendment and the conference substitute provide (see proposed sec. 404(e)) that the 10-percent $2,500 limitation is applicable regardless of the number of employees, or the number of plans, the owner-employee has. Thus, the Senate amendment and the conference substitute place the same limitation on all owner-employees, regardless of whether they have more than three employees. In addition, the Senate amendment and the conference substitute provide that the 10-percent $2,500 limitation is applicable to all self-employed individuals regardless of their ownership-interest.

The Senate amendment and the conference substitute also provide (see proposed sec. 404(a)(10)) that the deduction which will be allowed to self-employed individuals is one-half of the otherwise deductible contributions which may be made. Thus, if 10 percent of a self-employed individual's earned income from the trade or business with respect to which the plan is established is $2,000, then the amount allowed as a deduction is one-half of that sum, or $1,000, and the other $1,000 is not allowed as a deduction.

The Senate amendment also applied the limitations and rules described above to contributions made on behalf of owner-employees of corporations. The conference substitute does not contain any such provisions.

Tax treatment of certain lump-sum distributions.—The bill as passed by the House provided (in proposed sec. 72(n)) special averaging rules for the taxing of the portion of any lump-sum distribution which is derived from contributions on behalf of any self-employed person. In general, under such rules, the tax the self-employed individual would pay with respect to such distribution is limited to five times the increment in tax resulting from including one-fifth of the amount distributed in his gross income for the year in which the distribution was received.

The Senate amendment retained the provisions of the bill as passed by the House, but applied such provisions to lump-sum distributions from all qualified plans (including all existing plans) in place of the capital gains treatment provided by present law. The conference substitute retains the averaging provisions of the bill as passed by the House, without extending their application beyond self-employed individuals.

Elimination of capital gains treatment.—The Senate amendment (see sec. 8 of the bill as passed by the Senate) repealed the provisions of existing law which give capital gains treatment to lump-sum distributions from qualified employees' trusts and under qualified employees' plans. The conference substitute does not contain these provisions of the Senate amendment.

Limitations on employer contributions for employees.—The Senate amendment (see proposed sec. 404(a)(11), as added by sec. 9 of the bill as passed by the Senate) also amended existing law to provide certain limitations on the annual and lifetime contributions made for any employee under a qualified plan or plans which may be deducted by his employer. The conference substitute does not contain any such limitations.

Effective date.—The bill as passed by the House provided that the amendments made by the bill applied to taxable years beginning after December 31, 1961.

The Senate amendment and the conference substitute provide that the amendments made by the bill shall apply to taxable years beginning after December 31, 1962.

W. D. MILLS,
HALE BOGGS,
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Managers on the Part of the House.

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