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Pensions: Major Provisions of the Retirement Security and Savings Act of 2000

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Summary

On September 13, 2000, the Senate Finance Committee reported H.R. 1102 (S.Rept. 106-411) as a tax reconciliation bill known as the Retirement Security and Savings Act of 2000. This bill contained many provisions similar to the Comprehensive Retirement Security and Pension Reform Act of 2000, H.R. 1102 as passed by the House of Representatives on July 19, 2000. The main additions in the Senate bill were provisions that would have provided (1) a nonrefundable tax credit to low- and middle-income taxpayers 18 and over who contribute to a qualified retirement plan or individual retirement account (IRA), and (2) a tax credit to small employers to defray some of the start-up costs of establishing an employee pension or retirement savings plan. The Joint Committee on Taxation estimated that the proposals in the Chairman's Mark and its modifications would result in a revenue loss of $26.7 billion over 5 years and $42.3 billion over 10 years. A separate report describes the House-passed version of H.R. 1102.[1] Although the Senate approved a motion to consider the conference report on H.R. 2614 which included the pension provisions of H.R. 1102, the measure was not passed before the 106th Congress adjourned in December 2000. This report will not be updated.

Individual retirement accounts. The $2,000 annual contribution limit for individual retirement accounts (IRAs) is not indexed to the rate of inflation. Had the original 1975 limit of $1,500 been adjusted yearly to account for increases in the Consumer Price Index, it would have reached $5,353 in 2000. If the $2,000 limit set by Congress in 1981 had been adjusted annually, it would have reached $4,158 in 2000. Proponents of raising the limit on IRA contributions argue that it will encourage people to save more for retirement. Opponents say that it will result in little new saving because a substantial part of additional IRA contributions will consist of funds that would have been saved anyway. The bill would have increased the annual limit on IRA contributions to $3,000 in 2001, $4,000 in 2002, and $5,000 in 2003. In years after 2003, the limit would have been indexed to

[1] CRS Report RS20629, *Pensions: Major Provisions of the Comprehensive Retirement Security and Pension Reform Act,* by Patrick Purcell.

inflation in $500 increments. For individuals age 50 and older, the limit on annual contributions would equal 150% of the otherwise applicable limit.

The phase-out range in adjusted gross income (AGI) for deductible contributions to IRAs, which is presently $52,000-$62,000 for joint filers who are eligible for an employer pension plan and $32,000-$42,000 for single filers would have increased by $4,000 a year until they reached $80,000-$100,000 for joint returns in 2007 and $50,000-$60,000 for all others in 2005. Employees would have been allowed to contribute to a separate account that could be set up within their employer's plan that would be deemed an IRA and follow IRA rules. The bill would have permitted tax-free withdrawals from IRAs for qualified charitable contributions. The $100,000 AGI limit for conversions to a Roth IRA would have been extended to married taxpayers filing separately and would have been raised to $200,000 for joint filers. The phase-out range for contributions to a Roth IRA by joint filers would have been double the $95,000-$110,000 range for all others.

The Joint Committee on Taxation (JCT) estimated that the IRA provisions other than the new phase-out ranges for contributions to a Roth IRA would result in a revenue loss of $11.3 billion over 5 years and $21.7 billion over 10 years.

Employer-sponsored pensions and retirement savings plans. The bill contained provisions intended to expand pension coverage, promote pension fairness for women, increase portability of pension benefits for workers who change jobs, strengthen legal protections for pension participants, and reduce regulatory burdens on plan sponsors.

Expanding coverage. Beginning in 2001, the annual benefit limit for defined benefit[2] (DB) plans would have increased from $135,000 to $160,000. Thereafter, it would have been indexed for inflation in $5,000 increments. The limit would have been lower for retirement before age 62 and higher after age 65. The $30,000 annual contribution limit for defined contribution (DC) plans would have been indexed in $1,000 increments. The limit on compensation that may be taken into account for purposes of determining contributions and benefits under a plan would have been raised to $200,000 from $170,000 and indexed in $5,000 increments.

Currently, annual elective salary deferrals under §401(k) plans, §403(b) annuities, and salary-reduction simplified employee pensions (SARSEPs) are limited to $10,500, which is indexed to inflation in $500 increments. Beginning in 2001, the limit would have been increased to $11,000 and then in $1,000 annual increments until reaching $15,000 in 2005. The maximum annual elective deferral to a savings incentive match plan for employees of small employers (SIMPLE) was $6,000 in 2000. The bill would have increased this limit in annual $1,000 increments until it reaches $10,000 in 2004. The $15,000 and $10,000 dollar limits would have been indexed for inflation in $500 increments thereafter. The maximum deferral under a §457 plan would have increased from $8,000 to $11,000 in 2001 and then in $1,000 annual increments until reaching $15,000 in 2005, with indexing in $500 increments thereafter. For the 3 years immediately preceding retirement, the limit on deferrals would have been twice the otherwise applicable dollar limit.

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[2] A *defined benefit* plan uses a formula that ties benefits to either a worker's salary or to a specific dollar amount and is funded on a group basis. A *defined contribution* plan invests employer and employee contributions in individual accounts from which benefits are paid after retirement.

A §401(k) plan or a §403(b) annuity could allow a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as "Roth" contributions. These contributions would have been subject to current tax. Qualified distributions from these "Roth plans" would not have been subject to tax. Such contributions would generally otherwise be treated the same as elective deferrals for purposes of the qualified plan rules.

The bill also would have repealed the rules coordinating an individual's dollar limit on §457 plans with his/her contributions to other types of plans. In addition, the maximum limit on deductible contributions under a profit-sharing or stock bonus plan would have been raised from 15% to 25% of the compensation of the employees covered by the plan.

The bill also would have made these changes:

- eliminated certain rules that apply to plan loans to an owner-employee,
- provided that a safe-harbor §401(k) plan is exempt from the "top-heavy" rules,
- allowed employer matching contributions to be taken into account in satisfying the minimum contribution requirements,
- simplified the definition of a "key employee" and the determination of "top-heavy" status, and
- repealed the family attribution rule used to determine whether an individual is a key employee by reason of being a 5% owner.

A major provision the Senate bill would have added to those in the House-passed version of H.R. 1102 was a nonrefundable tax credit ranging from 5% to 50% of the qualified retirement contributions of an eligible individual up to $2,000. The credit rate would depend on the taxpayer's AGI. Taxpayers over age 18 who were neither full-time students nor dependents on another taxpayer's return would have been eligible. The upper limit on AGI for the 5% credit would have been $25,000 for single filers, $50,000 for joint filers, and $37,500 for head of household filers. This tax credit would have been available for the years 2001 to 2005.

Other added provisions in this bill would have provided nonrefundable tax credits to owners of small businesses to offset 50% of qualifying employer contributions to qualified retirement plans and 50% of the first $1,000 in administrative and retirement-education expenses. These credits would have been available in each of the first 3 years of a plan established by a small employer.

The JCT estimated that the provisions intended to expand pension coverage would result in a revenue loss of $13.6 billion over 5 years and $18.4 billion over 10 years.

Enhancing fairness for women. These provisions were intended mainly to help workers with short-term or intermittent attachment to the labor force, but they could be of benefit to others as well.

Distributions from a §457 plan made pursuant to a qualified domestic relations order (QDRO) would have been made under the same tax rules that now apply to distributions from tax-qualified plans as the result of a QDRO. In addition, a §457 plan would not be

treated as violating the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO.

Vesting of employer matching contributions to a retirement plan would have been accelerated. In addition, the bill would have applied to all post-death distributions the rules that apply under current law if the participant dies before distribution of minimum benefits has begun. The bill also would have reduced the excise tax on failure to satisfy the minimum distribution rules from 50% to 10% of the amount that was required to be, but was not distributed. In addition, the Treasury Department would have been directed to update, simplify, and finalize the regulations relating to the minimum distribution rules. The bill also would have repealed the special minimum distribution rules that now apply to §457 plans and would have provided that amounts deferred in a governmental §457 plan would have been includable in income when paid.

The bill would have permitted individuals age 50 or older to make additional contributions to a §401(k) plan or similar plan. The additional amount that could be contributed would have been the lesser of (1) the "applicable percent" of the limit on deductible contributions for that year or (2) the participant's annual compensation reduced by any other elective deferrals for that year. The "applicable percent" would have been 10% in 2001, and would have increased by 10 percentage points a year until reaching 50% in 2005. Catch-up contributions to a §401(k) plan or similar plan would not be subject to any other contribution limits and would not be taken into account in applying other contribution limits, nor would they be subject to nondiscrimination rules. Any matching contributions from the employer would have been subject to the normally applicable rules.

The bill would have increased the 25% of compensation limitation on annual additions under a DC plan to 100% and would have conformed the limits on contributions to a tax-sheltered annuity to the limits applicable to tax-qualified plans. It also would have increased the 33-1/3 % of compensation limitation on deferrals under a §457 plan to 100% of compensation. (Proposed changes in dollar limits are discussed on p. 2.)

Currently, an employee is prohibited from making elective contributions and employee contributions for 12 months after a pre-retirement "hardship" distribution deemed necessary to satisfy an immediate financial need. The Secretary of the Treasury would have been directed to issue regulations reducing this period to 6 months. The bill also provided that hardship distributions would not be eligible rollover distributions.

The JCT estimated that the provisions intended to enhance pension fairness would result in a revenue loss of $1.4 billion over 5 years and $1.8 billion over 10 years.

Increasing portability for participants. The bill would have allowed eligible distributions from qualified retirement plans, §403(b) annuities, IRAs, and §457 plans to be transferred without payment of income tax (i.e., "rolled over") to any other such plan or arrangement. The rules for tax withholding applicable to rollovers from qualified plans would have been extended to distributions from §457 plans. Employee after-tax contributions could 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 would have been permitted only through a direct rollover. Surviving spouses would have been allowed to roll over distributions from inherited accounts to a qualified plan, §403(b) annuity, or §457 plan in which the spouse was a participant. The bill would have allowed the

Secretary to waive the 60-day rollover period if the failure to waive such requirement would have been against equity or good conscience.

Provided that certain requirements were satisfied, a DC plan to which benefits were transferred would not be treated as reducing a participant's accrued benefit, even if it did not provide all of the forms of distribution that previously were available to the participant. In addition, the Secretary of the Treasury would have been directed to specify the circumstances under which early retirement benefits, subsidies, or optional forms of benefit may be reduced or eliminated without the rights of participants being materially affected.

The bill would have modified the distribution restrictions applicable to §401(k) plans, §403(b) annuities, and §457 plans to provide that distribution may occur upon severance from employment with the plan sponsor rather than separation from service under a particular plan. (This is the so-called "same desk rule," which primarily affects plan participants in firms that have been merged with or acquired by another firm.)

A participant in a state or local governmental plan would have been allowed to purchase service credits under a governmental DB plan or repay certain contributions through a direct trustee-to-trustee transfer to the plan from a §403(b) annuity or a §457 plan. A plan would have been permitted to disregard benefits attributable to rollover contributions for purposes of the cash-out rules.

The JCT estimated that the provisions intended to improve portability of pension benefits would result in a revenue loss of $0.018 billion ($18 million) over 5 years and $0.025 billion ($25 million) over 10 years.

Strengthening pension security and enforcement. The "full funding limit" for tax-qualified plans would have risen from 155% to 160% of current liability for plan years beginning in 2001, 165% for plan years beginning in 2002, and 170% for plan years beginning in 2003. The limit would have been repealed for plan years beginning in 2004 and thereafter. The special rule allowing a deduction for unfunded current liability generally would have been extended to all DB plans covered by the Pension Benefit Guaranty Corporation (PBGC). If an employer so elected, contributions in excess of the full funding limit would not be subject to the excise tax on nondeductible contributions.

The bill would have exempted multiemployer plans from the §415(b) limit of 100% of the average compensation of an individual's highest consecutive 3 years. Multiemployer plans would not have been aggregated with other DB plans of an employer contributing to the multiemployer plan for purposes of applying this limit.

In the case of DB plans, other than governmental plans and certain church plans, the bill would have required the plan administrator to notify participants in advance of any amendment that would significantly reduce the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy. An excise tax would have been levied for not providing notice. If a traditional DB pension were converted to a cash balance plan, the plan administrator would have also been required to provide a benefit estimation tool kit to enable participants to estimate their individual benefits under the old and new plan provisions and under various scenarios. The bill would have also required converted plans to provide a minimum benefit that would prevent "wear-away" periods during which participants earn no additional benefits.

An excise tax would have been levied on an employee stock ownership plan (ESOP) engaging in prohibited transactions with "disqualified individuals" deemed to be substantial shareholders of the plan sponsor. DC plans would have been required to provide an annual benefit statement to each participant, and to a beneficiary upon written request.

The JCT estimated that the provisions intended to strengthen pension security and enforcement would result in a revenue loss of $0.116 billion ($116 million) over 5 years and the same over 10 years.

Reducing regulatory burdens. A DB plan with assets equal to at least 125% of current liability would have been permitted to use a valuation date within the prior plan year. An employer would have been entitled to deduct dividends that, at the election of plan participants or their beneficiaries, were paid to the plan and reinvested in employer securities. The alternate definition of a "highly compensated employee" enacted in the Tax Reform Act of 1986 would have been repealed.

The bill would have directed the Treasury Department to revise its regulations under §410(b) to provide that, under certain circumstances, employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a §403(b) annuity could be treated as excludable employees for purposes of testing a §401(k) plan.

Qualified retirement planning services provided to an employee and a spouse by an employer maintaining a qualified plan would have generally been excluded from taxable income. The Secretary of the Treasury would have been directed to: (1) conduct studies of the rules permitting early withdrawals from IRAs and qualified plans and of the types of investment decisions made by participants; (2) exempt from the annual return requirement any plan that covered only the sole owner of a business maintaining the plan, or partners in a partnership maintaining the plan, if the total value of plan assets at the end of the plan year and all prior plan years did not exceed $250,000 and the plan met certain other requirements; (3) provide for the filing of a simplified annual return substantially similar to the Form 5500-EZ by a plan that met certain requirements; (4) update and improve the Employee Plans Compliance Resolution System in specific ways; and (5) issue regulations describing the circumstances under which a plan could be evaluated for discrimination in favor of highly-paid employees by means of a more flexible "facts and circumstances test," rather than through the formulas prescribed by current law.

Under the bill, a plan maintained by any governmental entity would have been exempt from the nondiscrimination and minimum participation rules. The multiple use test sometimes applied to determine compliance with nondiscrimination rules would have been repealed. The bill would have also extended the time when notice of a distribution may be made from 90 to 180 days before the distribution begins and required that the plan alert participants to the differences in value of optional forms of benefit.

The JCT estimated that the provisions intended to reduce regulatory burdens on pension plan sponsors would result in a revenue loss of $0.223 billion ($223 million) over 5 years and $0.225 billion ($225 million) over 10 years.