

VI. PENSION AND INDIVIDUAL RETIREMENT ARRANGEMENT PROVISIONS⁵⁵

A. INDIVIDUAL RETIREMENT ARRANGEMENTS (“IRAs”) (SEC. 101 OF THE HOUSE BILL, SECS. 601-603 OF THE SENATE AMENDMENT AND SECS. 219, 408, AND 408A OF THE CODE)

PRESENT LAW

In general

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

Traditional IRAs

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

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

Single Taxpayers

<i>Taxable years beginning in:</i>	<i>Phase-out range</i>
2001	\$33,000–43,000
2002	34,000–44,000
2003	40,000–50,000
2004	45,000–55,000
2005 and thereafter	50,000–60,000

Joint Returns

<i>Taxable years beginning in:</i>	<i>Phase-out range</i>
2001	\$53,000–63,000
2002	54,000–64,000
2003	60,000–70,000
2004	65,000–75,000
2005	70,000–80,000
2006	75,000–85,000
2007 and thereafter	80,000–100,000

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

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

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

Amounts held in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions).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

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that may be made to a Roth IRA is the lesser of \$2,000 or the individual’s compensation for the year. The contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. As under the rules relating to IRAs generally, a contribution of up to \$2,000 for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for single individuals with AGI between

⁵⁵The provisions of the bill as passed by the House did not contain provisions relating to pensions and individual retirement arrangements. Provisions described under the House bill refer to the provisions of H.R. 10, the “Comprehensive Retirement Security and Pension Reform Act of 2001,” as passed by the House.

\$95,000 and \$110,000 and for joint filers with AGI between \$150,000 and \$160,000.

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

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, or subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) which is made after attainment of age 59½, on account of death or disability, or is made for first-time home-buyer expenses of up to \$10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings, and subject to the 10-percent early withdrawal tax (unless an exception applies).⁵⁶ The same exceptions to the early withdrawal tax that apply to IRAs apply to Roth IRAs.

Taxation of charitable contributions

Generally, a taxpayer who itemizes deductions may deduct cash contributions to charity, as well as the fair market value of contributions of property. The amount of the deduction otherwise allowable for the taxable year with respect to a charitable contribution may be reduced, depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.

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

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is adjusted annually for inflation. The threshold amount for 2001 is \$132,950 (\$66,475 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of AGI over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. The effect of this reduction may be to limit a taxpayer's ability to deduct some of his or her charitable contributions.

HOUSE BILL

Increase in annual contribution limits

The House bill increases the maximum annual dollar contribution limit for IRA contributions from \$2,000 to \$3,000 in 2002, \$4,000

in 2003, and \$5,000 in 2004. The limit is indexed in \$500 increments in 2005 and thereafter.

Additional catch-up contributions

The House bill accelerates the increase of the IRA maximum contribution limit for individuals who have attained age 50 before the end of the taxable year. The maximum dollar contribution limit (before application of the AGI phase-out limits) for such an individual is increased to \$5,000 in 2002 and 2003. In 2004 and thereafter, the general limit applies to all individuals.

Deemed IRAs under qualified plans

No provision.

Tax-free IRA withdrawals for charitable purposes

No provision.

Effective date

The provision is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

Increase in annual contribution limits

The Senate amendment increases the maximum annual dollar contribution limit for IRA contributions from \$2,000 to \$2,500 for 2002 through 2005, \$3,000 for 2006 and 2007, \$3,500 for 2008 and 2009, \$4,000 for 2010, and \$5,000 for 2011. After 2011, the limit is adjusted annually for inflation in \$500 increments.

Additional catch-up contributions

The Senate amendment provides that individuals who have attained age 50 may make additional catch-up IRA contributions. The otherwise maximum contribution limit (before application of the AGI phase-out limits) for an individual who has attained age 50 before the end of the taxable year is increased by \$500 for 2002 through 2005, \$1,000 for 2006 through 2009, \$1,500 for 2010, and \$2,000 for 2011 and thereafter.

Deemed IRAs under employer plans

The Senate amendment provides that, if an eligible retirement plan permits employees to make voluntary employee contributions to a separate account or annuity that (1) is established under the plan, and (2) meets the requirements applicable to either traditional IRAs or Roth IRAs, then the separate account or annuity is deemed a traditional IRA or a Roth IRA, as applicable, for all purposes of the Code. For example, the reporting requirements applicable to IRAs apply. The deemed IRA, and contributions thereto, are not subject to the Code rules pertaining to the eligible retirement plan. In addition, the deemed IRA, and contributions thereto, are not taken into account in applying such rules to any other contributions under the plan. The deemed IRA, and contributions thereto, are subject to the exclusive benefit and fiduciary rules of ERISA to the extent otherwise applicable to the plan, and are not subject to the ERISA reporting and disclosure, participation, vesting, funding, and enforcement requirements applicable to the eligible retirement plan.⁵⁷ An eligible retirement plan is a qualified plan (sec. 401(a)), tax-sheltered annuity (sec. 403(b)), or a governmental section 457 plan.

Tax-free IRA withdrawals for charitable purposes

The Senate amendment provides an exclusion from gross income for qualified charitable distributions from an IRA: (1) to a charitable organization (as described in sec. 170(c)) to which deductible contributions may be made; (2) to a charitable remainder

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

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

A qualified charitable distribution is any distribution from an IRA that is made after age 70½, that qualifies as a charitable contribution (within the meaning of sec. 170(c)), and that is made directly to the charitable organization or to a charitable remainder annuity trust, charitable remainder unitrust, pooled income fund, or charitable gift annuity (as described above).⁵⁸ A taxpayer is not permitted to claim a charitable contribution deduction for amounts transferred from his or her IRA to a charity or to a trust, fund, or annuity that, because of the Senate amendment, are excluded from the taxpayer's income. Conversely, if the amounts transferred are otherwise nontaxable, e.g., a qualified distribution from a Roth IRA, the regularly applicable deduction rules apply.

Effective date

The Senate amendment is generally effective for taxable years beginning after December 31, 2001. The provision relating to deemed IRAs under employer plans is effective for plan years beginning after December 31, 2002. The provision relating to tax-free IRA withdrawals for charitable purposes is effective for taxable years beginning after December 31, 2009.

CONFERENCE AGREEMENT

Increase in annual contribution limits

The conference agreement increases the maximum annual dollar contribution limit for IRA contributions from \$2,000 to \$3,000 for 2002 through 2004, \$4,000 for 2005 through 2007, and \$5,000 for 2008. After 2008, the limit is adjusted annually for inflation in \$500 increments.

Additional catch-up contributions

The conference agreement provides that individuals who have attained age 50 may make additional catch-up IRA contributions. The otherwise maximum contribution limit (before application of the AGI phase-out limits) for an individual who has attained age 50 before the end of the taxable year is increased by \$500 for 2002 through 2005, and \$1,000 for 2006 and thereafter.

⁵⁸ It is intended that, in the case of transfer to a trust, fund, or annuity, the full amount distributed from an IRA will meet the definition of a qualified charitable distribution if the charitable organization's interest in the distribution would qualify as a charitable contribution under section 170.

⁵⁶ Early distribution of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the four-year rule applicable to 1998 conversions.

⁵⁷ The Senate amendment does not specify the treatment of deemed IRAs for purposes other than the Code and ERISA.

Deemed IRAs under employer plans

The conference agreement follows the Senate amendment.

Tax-free IRA withdrawals for charitable purposes

The conference agreement does not include the Senate amendment.

Effective date

The conference agreement is generally effective for taxable years beginning after December 31, 2001. The provision relating to deemed IRAs under employer plans is effective for plan years beginning after December 31, 2002.

B. PENSION PROVISIONS

1. Expanding Coverage

- (a) Increase in benefit and contribution limits (secs. 201 and 209 of the House bill, sec. 611 of the Senate amendment, and secs. 401(a)(17), 401(c)(2), 402(g), 408(p), 415 and 457 of the Code)

PRESENT LAW

In general

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

Limitations on contributions and benefits

Under present law, the limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined contribution plan, the qualification rules limit the annual additions to the plan with respect to each plan participant to the lesser of (1) 25 percent of compensation or (2) \$35,000 (for 2001). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The \$35,000 limit is indexed for cost-of-living adjustments in \$5,000 increments.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) \$140,000 (for 2001). The dollar limit is adjusted for cost-of-living increases in \$5,000 increments.

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

Compensation limitation

Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to \$170,000 (for 2001). The compensation limit is indexed for cost-of-living adjustments in \$10,000 increments.

In general, contributions to qualified plans and IRAs are based on compensation. For a self-employed individual, compensation generally means net earnings subject to self-employment taxes ("SECA taxes"). Members of certain religious faiths may elect to be exempt from SECA taxes on religious grounds. Because the net earnings of such individuals are not subject to SECA taxes, these individuals are considered to have no compensation on which to base contributions to a retirement plan. Under an exception to this rule, net earnings of such individuals are treated

as compensation for purposes of making contributions to an IRA.

Elective deferral limitations

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

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is \$10,500 (for 2001). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is \$6,500 (for 2001). These limits are indexed for inflation in \$500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) \$8,500 (for 2001) or (2) 33⅓ percent of compensation. The \$8,500 dollar limit is increased for inflation in \$500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last three years before retirement, the otherwise applicable limit is increased to the lesser of (1) \$15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

HOUSE BILL

Limits on contributions and benefits

The House bill increases the \$35,000 limit on annual additions to a defined contribution plan to \$40,000. This amount is indexed in \$1,000 increments.⁵⁹

The House bill increases the \$140,000 annual benefit limit under a defined benefit plan to \$160,000. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.⁶⁰ In adopting rules regarding the application of the increase in the defined benefit plan limits under the House bill, it is intended that the Secretary will apply rules similar to those adopted in Notice 99-44 regarding benefit increases due to the repeal of the combined plan limit under former section 415(e). Thus, for example, a defined benefit plan could provide for benefit increases to reflect the provisions of the House bill for a current or former employee who has commenced benefits under the plan prior to the effective date of the bill if the employee or former employee has an accrued benefit under the plan (other than an accrued benefit resulting from a benefit increase solely as a result of the increases in the section 415 limits under the bill). As under the notice, the maximum amount of permitted increase is generally the amount that could have been provided had the provisions of the House bill been in effect at the time of the commencement of benefit. In no case may benefits reflect increases that could not be paid prior to the effective date because of the limits in effect under present law. In addition, in no case may plan amendments providing increased benefits under the relevant provision

of the House bill be effective prior to the effective date of the House bill.

Compensation limitation

The House bill increases the limit on compensation that may be taken into account under a plan to \$200,000. This amount is indexed in \$5,000 increments. The House bill also amends the definition of compensation for purposes of all qualified plans and IRAs (including SIMPLE arrangements) to include an individual's net earnings that would be subject to SECA taxes but for the fact that the individual is covered by a religious exemption.

Elective deferral limitations

The House bill increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs to \$11,000 in 2002. In 2003 and thereafter, the limits are increased in \$1,000 annual increments until the limits reach \$15,000 in 2006, with indexing in \$500 increments thereafter. The House bill increases the maximum annual elective deferrals that may be made to a SIMPLE plan to \$7,000 in 2002. In 2003 and thereafter, the SIMPLE plan deferral limit is increased in \$1,000 annual increments until the limit reaches \$10,000 in 2005. Beginning after 2005, the \$10,000 dollar limit is indexed in \$500 increments.

Section 457 plans

The House bill increases the dollar limit on deferrals under a section 457 plan to conform to the elective deferral limitation. Thus, the limit is \$11,000 in 2002, and is increased in \$1,000 annual increments thereafter until the limit reaches \$15,000 in 2006. The limit is indexed thereafter in \$500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.⁶¹

Effective date

The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

Limits on contributions and benefits

The Senate amendment provides faster annual adjusting for inflation of the \$35,000 limit on annual additions to a defined contribution plan. Under the Senate amendment this limit amount is adjusted annually for inflation in \$1,000 increments.⁶²

The Senate amendment increases the \$140,000 annual benefit limit under a defined benefit plan to \$150,000 for 2002 through 2004 and to \$160,000 for 2005 and thereafter. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.

Compensation limitation

The Senate amendment increases the limit on compensation that may be taken into account under a plan to \$180,000 for 2002, \$190,000 for 2003, and \$200,000 for 2004 and 2005. After 2005, this amount is adjusted annually for inflation in \$5,000 increments.

Elective deferral limitations

In 2002, the Senate amendment increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities, and salary reduction SEPs to \$11,000. In 2003 and thereafter, the limits increase in \$500 annual increments until the limits reach \$15,000 in 2010, with annual adjustments for inflation in \$500 increments thereafter. The Senate amendment increases the maximum annual elective deferrals that may be made to a SIMPLE plan to \$7,000 for 2002 and 2003,

⁵⁹The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the House bill.

⁶⁰Another provision of the House bill modifies the defined benefit pension plan limits for multiemployer plans.

⁶¹Another provision of the House bill increases the 33⅓ percent of compensation limit to 100 percent.

⁶²The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the Senate amendment.

\$8,000 for 2004 and 2005, \$9,000 for 2006 and 2007, and \$10,000 for 2008. After 2008, the \$10,000 dollar limit is adjusted annually for inflation in \$500 increments.

Section 457 plans

The dollar limit on deferrals under a section 457 plan is increased to \$9,000 in 2002, and is increased in \$500 annual increments thereafter until the limit reaches \$11,000 in 2006. Beginning in 2007, the limit is increased in \$1,000 annual increments until it reaches \$15,000 in 2010. After 2010, the limit is adjusted annually for inflation thereafter in \$500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.⁶³

EFFECTIVE DATE

The Senate amendment is effective for years beginning after December 31, 2001.

CONFERENCE AGREEMENT

Limits on contributions and benefits

The conference agreement follows the House bill.

Compensation limitation

The conference agreement follows the House bill.

Elective deferral limitations

The conference agreement follows the House bill.

Section 457 plans

The conference agreement follows the House bill.

Effective date

The conference agreement generally is effective for years beginning after December 31, 2001. The provisions relating to defined benefit plans are effective for years ending after December 31, 2001.

- (b) Plan loans for S corporation shareholders, partners, and sole proprietors (sec. 202 of the House bill, sec. 612 of the Senate amendment, and sec. 4975 of the Code)

PRESENT LAW

The Internal Revenue Code prohibits certain transactions ("prohibited transactions") between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries.⁶⁴ Certain types of transactions are exempted from the prohibited transaction rules, including loans from the plan to plan participants, if certain requirements are satisfied. In addition, the Secretary of Labor can grant an administrative exemption from the prohibited transaction rules if the Secretary finds the exemption is administratively feasible, in the interest of the plan and plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. Pursuant to this exemption process, the Secretary of Labor grants exemptions both with respect to specific transactions and classes of transactions.

The statutory exemptions to the prohibited transaction rules do not apply to certain transactions in which the plan makes a loan to an owner-employee.⁶⁵ Loans to participants other than owner-employees are permitted if loans are available to all participants on a reasonably equivalent basis, are

not made available to highly compensated employees in an amount greater than made available to other employees, are made in accordance with specific provisions in the plan, bear a reasonable rate of interest, and are adequately secured. In addition, the Code places limits on the amount of loans and repayment terms.

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

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

HOUSE BILL

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

Effective date.—The House bill is effective with respect to years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment. The conferees intend that the Secretary of the Treasury and the Secretary of Labor will waive any penalty or excise tax in situations where a loan made prior to the effective date of the provision was exempt when initially made (treating any refinancing as a new loan) and the loan would have been exempt throughout the period of the loan if the provision had been in effect during the period of the loan.

- (c) Modification of top-heavy rules (sec. 203 of the House bill, sec. 613 of the Senate amendment, and sec. 416 of the Code)

PRESENT LAW

In general

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

Definition of top-heavy plan

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

For purposes of determining whether a plan is a top-heavy plan, benefits derived

both from employer and employee contributions, including employee elective contributions, are taken into account. In addition, the accrued benefit of a participant in a defined benefit plan and the account balance of a participant in a defined contribution plan includes any amount distributed within the five-year period ending on the determination date.

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

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

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

Definition of key employee

A key employee is an employee who, during the plan year that ends on the determination date or any of the four preceding plan years, is (1) an officer earning over one-half of the defined benefit plan dollar limitation of section 415 (\$70,000 for 2001), (2) a five-percent owner of the employer, (3) a one-percent owner of the employer earning over \$150,000, or (4) one of the 10 employees earning more than the defined contribution plan dollar limit (\$35,000 for 2001) with the largest ownership interests in the employer. A family ownership attribution rule applies to the determination of one-percent owner status, five-percent owner status, and largest ownership interest. Under this attribution rule, an individual is treated as owning stock owned by the individual's spouse, children, grandchildren, or parents.

Minimum benefit for non-key employees

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

For purposes of the minimum benefit rules, only benefits derived from employer contributions (other than amounts employees have elected to defer) to the plan are taken into account, and an employee's social security benefits are disregarded (i.e., the minimum benefit is nonintegrated). Employer matching contributions may be used to satisfy the minimum contribution requirement; however, in such a case the contributions are not treated as matching contributions for purposes of applying the special nondiscrimination requirements applicable to employee elective contributions and matching contributions under sections 401(k) and (m). Thus, such contributions would have to meet the general nondiscrimination test of section 401(a)(4).⁶⁶

⁶³Another provision increases the 33½ percentage of compensation limit to 100 percent.

⁶⁴Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), also contains prohibited transaction rules. The Code and ERISA provisions are substantially similar, although not identical.

⁶⁵Certain transactions involving a plan and S corporation shareholders are permitted.

⁶⁶Treas. Reg. sec. 1.416-1 Q&A M-19.

Top-heavy vesting

Benefits under a top-heavy plan must vest at least as rapidly as under one of the following schedules: (1) three-year cliff vesting, which provides for 100 percent vesting after three years of service; and (2) two-six year graduated vesting, which provides for 20 percent vesting after two years of service, and 20 percent more each year thereafter so that a participant is fully vested after six years of service.⁶⁷

Qualified cash or deferred arrangements

Under a qualified cash or deferred arrangement (a "section 401(k) plan"), an employee may elect to have the employer make payments as contributions to a qualified plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. A special nondiscrimination test applies to elective deferrals under cash or deferred arrangements, which compares the elective deferrals of highly compensated employees with elective deferrals of nonhighly compensated employees. (This test is called the actual deferral percentage test or the "ADP" test). Employer matching contributions under qualified defined contribution plans are also subject to a similar nondiscrimination test. (This test is called the actual contribution percentage test or the "ACP" test.)

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

HOUSE BILL

Definition of top-heavy plan

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

tion requirements applicable to top-heavy plans.⁶⁸

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

Definition of key employee

The House bill (1) provides that an employee is not considered a key employee by reason of officer status unless the employee earns more than \$150,000 and (2) repeals the top-10 owner key employee category. The House bill repeals the four-year lookback rule for determining key employee status and provides that an employee is a key employee only if he or she is a key employee during the preceding plan year.

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

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

Minimum benefit for nonkey employees

Under the House bill, matching contributions are taken into account in determining whether the minimum benefit requirement has been satisfied.⁶⁹

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

Effective date

The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications.

Under the Senate amendment, an employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of \$85,000 (for 2001), (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of \$150,000. The present-law limits on the number of officers treated as key employees under (1) continue to apply. An employee who was not an employee in the preceding plan year, or who was an employee only for part of the year, is treated as a key employee if it can be reasonably anticipated

that the employee will meet the definition of a key employee for the current plan year.

Under the Senate amendment, the family ownership attribution rule continues to apply in determining whether an individual is a five-percent owner of the employer for purposes of the top-heavy rules. In addition, the Senate amendment does not provide that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan.

Effective date.—The Senate amendment is effective for years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modifications.

Under the conference agreement, an employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of \$130,000 (adjusted for inflation in \$5,000 increments), (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of \$150,000. The present-law limits on the number of officers treated as key employees under (1) continue to apply.

Under the conference agreement, the family ownership attribution rule continues to apply in determining whether an individual is a five-percent owner of the employer for purposes of the top-heavy rules.

Effective date.—The conference agreement is effective for years beginning after December 31, 2001.

(d) Elective deferrals not taken into account for purposes of deduction limits (sec. 204 of the House bill, sec. 614 of the Senate amendment, and sec. 404 of the Code)

PRESENT LAW

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

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

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

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

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

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

HOUSE BILL

Under the House bill, elective deferral contributions are not subject to the deduction

⁶⁷Benefits under a plan that is not top heavy must vest at least as rapidly as under one of the following schedules: (1) five-year cliff vesting; and (2) three-seven year graded vesting, which provides for 20 percent vesting after three years and 20 percent more each year thereafter so that a participant is fully vested after seven years of service.

⁶⁸This provision is not intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

⁶⁹Thus, this provision overrides the provision in Treasury regulations that, if matching contributions are used to satisfy the minimum benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

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

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification.

Under the Senate amendment, the applicable percentage of elective deferral contributions is not subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan does not take into account the applicable percentage of elective deferral contributions. The applicable percentage is 25 percent for 2002 through 2010, and 100 percent for 2011 and thereafter.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

- (e) Repeal of coordination requirements for deferred compensation plans of state and local governments and tax-exempt organizations (sec. 205 of the House bill, sec. 615 of the Senate amendment, and sec. 457 of the Code)

PRESENT LAW

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local government employer (a “section 457 plan”) is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) \$8,500 (in 2001) or (2) 33½ percent of compensation. The \$8,500 limit is increased for inflation in \$500 increments. Under a special catch-up rule, a section 457 plan may provide that, for one or more of the participant’s last three years before retirement, the otherwise applicable limit is increased to the lesser of (1) \$15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

The \$8,500 limit (as modified under the catch-up rule), applies to all deferrals under all section 457 plans in which the individual participates. In addition, in applying the \$8,500 limit, contributions under a tax-sheltered annuity (“section 403(b) annuity”), elective deferrals under a qualified cash or deferred arrangement (“section 401(k) plan”), salary reduction contributions under a simplified employee pension plan (“SEP”), and contributions under a SIMPLE plan are taken into account. Further, the amount deferred under a section 457 plan is taken into account in applying a special catch-up rule for section 403(b) annuities.

HOUSE BILL

The House bill repeals the rules coordinating the section 457 dollar limit with contributions under other types of plans.⁷⁰

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

⁷⁰The limits on deferrals under a section 457 plan are modified under other provisions of the House bill.

- (f) Eliminate IRS user fees for certain determination letter requests regarding employer plans (sec. 206 of the House bill and sec. 621 of the Senate amendment)

PRESENT LAW

An employer that maintains a retirement plan for the benefit of its employees may request from the IRS a determination as to whether the form of the plan satisfies the requirements applicable to tax-qualified plans (sec. 401(a)). In order to obtain from the IRS a determination letter on the qualified status of the plan, the employer must pay a user fee. The Secretary determines the user fee applicable for various types of requests, subject to statutory minimum requirements for average fees based on the category of the request. The user fee may range from \$125 to \$1,250, depending upon the scope of the request and the type and format of the plan.⁷¹

Present law provides that plans that do not meet the qualification requirements will be treated as meeting such requirements if appropriate retroactive plan amendments are made during the remedial amendment period. In general, the remedial amendment period ends on the due date for the employer’s tax return (including extensions) for the taxable year in which the event giving rise to the disqualifying provision occurred (e.g., a plan amendment or a change in the law). The Secretary may provide for general extensions of the remedial amendment period or for extensions in certain cases. For example, the remedial amendment period with respect to amendments relating to the qualification requirements affected by the General Agreements on Tariffs and Trade, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, and the Internal Revenue Service Restructuring and Reform Act of 1998 generally ends the last day of the first plan year beginning on or after January 1, 2001.⁷²

HOUSE BILL

A small employer (100 or fewer employees) is not required to pay a user fee for a determination letter request with respect to the qualified status of a retirement plan that the employer maintains if the request is made before the later of (1) the last day of the fifth plan year of the plan or (2) the end of any applicable remedial amendment period with respect to the plan that begins before the end of the fifth plan year of the plan. In addition, determination letter requests for which user fees are not required under the House bill are not taken into account in determining average user fees. The House bill applies only to requests by employers for determination letters concerning the qualified retirement plans they maintain. Therefore, a sponsor of a prototype plan is required to pay a user fee for a request for a notification letter, opinion letter, or similar ruling. A small employer that adopts a prototype plan, however, is not required to pay a user fee for a determination letter request with respect to the employer’s plan.

Effective date.—The House bill is effective for determination letter requests made after December 31, 2001.

⁷¹Authorization for the user fees was originally enacted in section 10511 of the Revenue Act of 1987 (Pub. L. No. 100-203, December 22, 1987). The authorization was extended through September 30, 2003, by Public Law Number 104-117 (An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996)).

⁷²Rev. Proc. 2000-27, 2000-26 I.R.B. 1272.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications. An eligible employer is not required to pay a user fee for a ruling letter, opinion letter, determination letter, or similar request with respect to the qualified status of a new retirement plan that the employer maintains and with respect to which the employer has not previously made a request. An employer is eligible under the Senate amendment if (1) the employer has no more than 100 employees, (2) the employer has at least one nonhighly compensated employee who is participating in the plan, and (3) during the three-taxable year period immediately preceding the taxable year in which the request is made, neither the employer nor a related employer established or maintained a qualified plan with respect to which contributions were made or benefits were accrued for substantially the same employees covered under the plan with respect to which the request is made.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modification. An employer is eligible under the conference agreement if the employer has no more than 100 employees and has at least one nonhighly compensated employee who is participating in the plan.

- (g) Deduction limits (sec. 207 of the House bill, sec. 616 of the Senate amendment, and sec. 404 of the Code)

PRESENT LAW

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

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

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

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

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

For purposes of the deduction limits, employee elective deferral contributions to a qualified cash or deferred arrangement (“section 401(k) plan”) are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.⁷³

⁷³Another provision of the House bill provides that elective deferrals are not subject to the deduction limits.

For purposes of the deduction limits, compensation means the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plan, and the beneficiaries under a profit-sharing or stock bonus plan are the employees who benefit under the plan with respect to the employer's contribution.⁷⁴ An employee who is eligible to make elective deferrals under a section 401(k) plan is treated as benefitting under the arrangement even if the employee elects not to defer.⁷⁵

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

HOUSE BILL

Under the House bill, the definition of compensation for purposes of the deduction rules includes salary reduction amounts treated as compensation under section 415. In addition, the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan is increased from 15 percent to 20 percent of compensation of the employees covered by the plan for the year.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

Under the Senate amendment, the definition of compensation for purposes of the deduction rules includes salary reduction amounts treated as compensation under section 415. In addition, the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan is increased from 15 percent to 25 percent of compensation of the employees covered by the plan for the year. Also, except to the extent provided in regulations, a money purchase pension plan is treated like a profit-sharing or stock bonus plan for purposes of the deduction rules.

Effective date.—The Senate amendment is effective for years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

- (h) Option to treat elective deferrals as after-tax contributions (sec. 208 of the bill, sec. 617 of the Senate amendment, and new sec. 402A of the Code)

PRESENT LAW

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

Elective deferrals for a taxable year that exceed the annual dollar limitation ("excess deferrals") are includible in gross income for the taxable year. If an employee makes elective deferrals under a plan (or plans) of a single employer that exceed the annual dollar limitation ("excess deferrals"), then the plan may provide for the distribution of the excess deferrals, with earnings thereon. If the excess deferrals are made to more than one plan of unrelated employers, then the plan may permit the individual to allocate excess deferrals among the various plans, no later than the March 1 (April 15 under the applicable regulations) following the end of the taxable year. If excess deferrals are distributed not later than April 15 following the end of the taxable year, along with earnings attributable to the excess deferrals, then the excess deferrals are not again includible in income when distributed. The earnings are includible in income in the year distributed. If excess deferrals (and income thereon) are not distributed by the applicable April 15, then the excess deferrals (and income thereon) are includible in income when received by the participant. Thus, excess deferrals that are not distributed by the applicable April 15th are taxable both in the taxable year when the deferral was made and in the year the participant receives a distribution of the excess deferral.

Individuals with adjusted gross income below certain levels generally may make nondeductible contributions to a Roth IRA and may convert a deductible or nondeductible IRA into a Roth IRA. Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, is made on account of death or disability, or is a qualified special purpose distribution (i.e., for first-time homebuyer expenses of up to \$10,000). A distribution from a Roth IRA that is not a qualified distribution is includible in income to the extent attributable to earnings, and is subject to the 10-percent tax on early withdrawals (unless an exception applies).⁷⁶

HOUSE BILL

A section 401(k) plan or a section 403(b) annuity is permitted to include a "qualified plus contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as designated plus contributions. Designated plus contributions are elective deferrals that the participant designates (at such time and in such manner as the Secretary may prescribe)⁷⁷ as not excludable from the participant's gross income.

The annual dollar limitation on a participant's designated plus contributions is the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated plus contributions. Designated plus contributions are treated as any other elective deferral for purposes of nonforfeitable requirements and distribution restrictions.⁷⁸ Under a section 401(k)

plan, designated plus contributions also are treated as any other elective deferral for purposes of the special nondiscrimination requirements.⁷⁹

The plan is required to establish a separate account, and maintain separate record-keeping, for a participant's designated plus contributions (and earnings allocable thereto). A qualified distribution from a participant's designated plus contributions account is not includible in the participant's gross income. A qualified distribution is a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled.⁸⁰ The nonexclusion period is the five-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated plus contribution to any designated plus contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated plus contribution account that is the source of the distribution from a designated plus contribution account established for the participant under another plan, the first taxable year for which the participant made a designated plus contribution to the previously established account.

A distribution from a designated plus contributions account that is a corrective distribution of an elective deferral (and income allocable thereto) that exceeds the section 402(g) annual limit on elective deferrals or a corrective distribution of an excess contribution under the special nondiscrimination rules (pursuant to sec. 401(k)(8) (and income allocable thereto) is not a qualified distribution. In addition, the treatment of excess designated plus contributions is similar to the treatment of excess deferrals attributable to non-designated plus contributions. If excess designated plus contributions (including earnings thereon) are distributed no later than the April 15th following the taxable year, then the designated plus contributions is not includible in gross income as a result of the distribution, because such contributions are includible in gross income when made. Earnings on such excess designated plus contributions are treated the same as earnings on excess deferrals distributed no later than April 15th, i.e., they are includible in income when distributed. If excess designated plus contributions are not distributed no later than the applicable April 15th, then such contributions (and earnings thereon) are taxable when distributed. Thus, as is the case with excess elective deferrals that are not distributed by the applicable April 15th, the contributions are includible in income in the year when made and again when distributed from the plan. Earnings on such contributions are taxable when received.

salary reduction contributions to the annuity (except that designated plus contributions are includible in income).

⁷⁹It is intended that the Secretary provide ordering rules regarding the return of excess contributions under the special nondiscrimination rules (pursuant to sec. 401(k)(8)) in the event a participant makes both regular elective deferrals and designated plus contributions. It is intended that such rules will generally permit a plan to allow participants to designate which contributions are returned first or to permit the plan to specify which contributions are returned first. It is also intended that the Secretary will provide ordering rules to determine the extent to which a distribution consists of excess Roth contributions.

⁸⁰A qualified special purpose distribution, as defined under the rules relating to Roth IRAs, does not qualify as a tax-free distribution from a designated plus contributions account.

⁷⁴Rev. Rul. 65-295, 1965-2 C.B. 148.

⁷⁵Treas. Reg. sec. 1.410(b)-3.

⁷⁶Early distributions of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the four-year rule applicable to 1998 conversions.

⁷⁷It is intended that the Secretary will generally not permit retroactive designations of elective deferrals as designated plus contributions.

⁷⁸Similarly, designated plus contributions to a section 403(b) annuity are treated the same as other

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

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

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except that the Senate amendment refers to designated plus contributions as “Roth contributions.”

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2003.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with a modification of the effective date.

Effective date.—The conference agreement is effective for taxable years beginning after December 31, 2005.

- (i) Certain nonresident aliens excluded in applying minimum coverage requirements (sec. 210 of the House bill, sec. 622 of the Senate amendment, and secs. 410(b)(3) and 861(a)(3) of the Code)

PRESENT LAW

Under the minimum coverage requirements (sec. 410(b)), a qualified plan must benefit a minimum number of the employer's nonhighly compensated employees. In applying the minimum coverage requirements, employees who are nonresident aliens are disregarded if they have no earned income from sources within the United States (“U.S. source income”).

Generally, compensation for services performed in the United States is treated as U.S. source income. Under a special rule, compensation is not treated as U.S. source income if the compensation is paid for labor or services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States. However, this special rule does not apply for purposes of qualified retirement plans (including the minimum coverage and nondiscrimination requirements applicable to such plans), employer-provided group-term life insurance, or employer-provided accident and health plans. As a result, such compensation is treated as U.S. source income for purposes of such plans, including the application of the qualified retirement plan minimum coverage and nondiscrimination requirements. As a result, such nonresident aliens must be taken into account in determining whether the plan satisfies the minimum coverage requirements.

HOUSE BILL

For purposes of the application of the minimum coverage requirements (sec. 410(b)), compensation is not treated as U.S. source income if the compensation is paid for labor or services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a pos-

session of the United States. As a result, such nonresident aliens are excluded from consideration in the application of the minimum coverage requirements.

Effective date.—The House bill is effective with respect to plan years beginning after December 31, 2001.

SENATE AMENDMENT

Under the Senate amendment, the special rule relating to compensation paid for labor or services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States compensation is extended in order to apply for purposes of qualified retirement plans, employer-provided group-term life insurance, and employer-provided accident and health plans. Therefore, such compensation is not treated as U.S. source income for any purpose under such plans, including the application of the qualified retirement plan minimum coverage and nondiscrimination requirements.

Effective date.—The Senate amendment is effective with respect to plan years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

- (j) Nonrefundable credit to certain individuals for elective deferrals and IRA contributions (sec. 618 of the Senate amendment and new sec. 25B of the Code)

PRESENT LAW

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

Several different types of tax-favored employer-sponsored retirement plans exist, such as section 401(a) qualified plans (including plans with a section 401(k) qualified cash-or-deferred arrangement), section 403(a) qualified annuity plans, section 403(b) annuities, section 408(k) simplified employee pensions (“SEPs”), section 408(p) SIMPLE retirement accounts, and section 457(b) eligible deferred compensation plans. In general, an employer and, in certain cases, employees, contribute to the plan. Taxation of the contributions and earnings thereon is generally deferred until benefits are distributed from the plan to participants or their beneficiaries.⁸¹ Contributions and benefits under tax-favored employer-sponsored retirement plans are subject to specific limitations.

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

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

IRA are not deductible from gross income, regardless of adjusted gross income. A distribution from a traditional IRA is includable in the individual's gross income except to the extent of individual contributions made on a nondeductible basis. A qualified distribution from a Roth IRA is excludable from gross income.

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

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a temporary nonrefundable tax credit for contributions made by eligible taxpayers to a qualified plan. The maximum annual contribution eligible for the credit is \$2,000. The credit rate depends on the adjusted gross income (“AGI”) of the taxpayer. Only joint returns with AGI of \$50,000 or less, head of household returns of \$37,500 or less, and single returns of \$25,000 or less are eligible for the credit. The AGI limits applicable to single taxpayers apply to married taxpayers filing separate returns. The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 or over, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

The credit is available with respect to elective contributions to a section 401(k) plan, section 403(b) annuity, or eligible deferred compensation arrangement of a State or local government (a “sec. 457 plan”), SIMPLE, or SEP, contributions to a traditional or Roth IRA, and voluntary after-tax employee contributions to a qualified retirement plan. The present-law rules governing such contributions continue to apply.

The amount of any contribution eligible for the credit is reduced by taxable distributions received by the taxpayer and his or her spouse from any savings arrangement described above or any other qualified retirement plan during the taxable year for which the credit is claimed, the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year and prior to the due date for filing the taxpayer's return for the year. In the case of a distribution from a Roth IRA, this rule applies to any such distributions, whether or not taxable.

The credit rates based on AGI are as follows.

Joint filers	Heads of households	All other filers	Credit rate
\$0-\$30,000	\$0-\$22,500	\$0-\$15,000	50 percent
\$30,000-\$32,500	\$22,500-\$24,375	\$15,000-\$16,250	20 percent
\$32,500-\$50,000	\$24,375-\$37,500	\$16,250-\$25,000	10 percent
Over \$50,000	Over \$37,500	Over \$25,000	0 percent

The Senate amendment directs the Secretary of the Treasury to report annually to the Senate Finance Committee and the House Committee on Ways and Means regarding the number of individuals who claim the credit.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001, and before January 1, 2007.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

⁸¹ In the case of after-tax employee contributions, only earnings are taxed upon withdrawal.

(k) Small business tax credit for qualified retirement plan contributions (sec. 619 of the Senate amendment and new sec. 45E of the Code)

PRESENT LAW

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

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a non-refundable income tax credit for small employers equal to 50 percent of certain qualifying employer contributions made to qualified retirement plans on behalf of nonhighly compensated employees. The credit is not available with respect to contributions to a SIMPLE IRA or SEP. For purposes of the Senate amendment, a small employer means an employer with no more than 20 employees who received at least \$5,000 of earnings in the preceding year. A nonhighly compensated employee is defined as an employee who neither (1) was a five-percent owner of the employer at any time during the current year or the preceding year, or (2) for the preceding year, had compensation in excess of \$80,000 (adjusted annually for inflation, this amount is \$85,000 for 2001).⁸² The credit is available for the first three plan years of the plan.⁸³

The Senate amendment requires a small employer to make nonelective contributions equal to at least one percent of compensation to qualify for the credit. The credit applies to both qualifying nonelective employer contributions and qualifying employer matching contributions, but only up to a total of three percent of the nonhighly compensated employee's compensation. The credit is available for 50 percent of qualifying benefit accruals under a nonintegrated defined benefit plan if the benefits are equivalent, as defined in regulations, to a three-percent nonelective contribution to a defined contribution plan.

To qualify for the credit, the nonelective and matching contributions to a defined contribution plan and the benefit accruals under a defined benefit plan are required to vest at least as rapidly as under either a three-year cliff vesting schedule or a graded schedule that provides 20-percent vesting per year for the first five years. In order to qualify for the credit, contributions to plans other than pension plans must be subject to the same distribution restrictions that apply to qualified nonelective employer contributions to a

section 401(k) plan, i.e., distribution only upon separation from service, death, disability, attainment of age 59½, plan termination without a successor plan, or acquisition of a subsidiary or substantially all the assets of a trade or business that employs the participant.⁸⁴ Qualifying contributions to pension plans are subject to the distribution restrictions applicable to such plans.

A defined contribution plan to which the small employer makes the qualifying contributions (and any plan aggregated with that plan for nondiscrimination testing purposes) is required to allocate any nonelective employer contributions proportionally to participants' compensation from the employer (or on a flat-dollar basis) and, accordingly, without the use of permitted disparity or cross-testing. An equivalent requirement must be met with respect to a defined benefit plan.

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

The credit is a general business credit.⁸⁵ The 50 percent of qualifying contributions that are effectively offset by the tax credit are not deductible; the other 50 percent of the qualifying contributions (and other contributions) are deductible to the extent permitted under present law.

Effective date.—The Senate amendment is effective with respect to contributions paid or incurred in taxable years beginning after December 31, 2002.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment.

- (1) Small business tax credit for new retirement plan expenses (sec. 620 of the Senate amendment and new sec. 45E of the Code)

PRESENT LAW

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

HOUSE BILL

No provision.

SENATE AMENDMENT

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

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

least one nonhighly compensated employee. In addition, if the credit is for the cost of a payroll deduction IRA arrangement, the arrangement must be made available to all employees of the employer who have worked with the employer for at least three months.

The credit is a general business credit.⁸⁶ The 50 percent of qualifying expenses that are effectively offset by the tax credit are not deductible; the other 50 percent of the qualifying expenses (and other expenses) are deductible to the extent permitted under present law.

Effective date.—The Senate amendment is effective with respect to costs paid or incurred in taxable years beginning after December 31, 2001, with respect to plans established after such date.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

2. Enhancing Fairness for Women

- (a) Additional salary reduction catch-up contributions (sec. 301 of the House bill, sec. 631 of the Senate amendment, and sec. 414 of the Code)

PRESENT LAW

Elective deferral limitations

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

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is \$10,500 (for 2001). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is \$6,500 (for 2001). These limits are indexed for inflation in \$500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) \$8,500 (for 2001) or (2) 33-1/3 percent of compensation. The \$8,500 dollar limit is increased for inflation in \$500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last three years before retirement, the otherwise applicable limit is increased to the lesser of (1) \$15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

HOUSE BILL

The House bill provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan are increased for individuals who have attained age 50 by the end of the year.⁸⁷ Additional contributions are permitted by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the House bill, the additional amount of elective

⁸²The top paid group election, which under present law permits an employer to classify an employee as a nonhighly compensated employee if the employee had compensation in excess of \$80,000 (adjusted annually for inflation) during the preceding year but was not among the top 20 percent of employees of the employer when ranked on the basis of compensation paid to employees during the preceding year, is not taken into account in determining nonhighly compensated employees for purposes of the Senate amendment.

⁸³The credit only applies if the employer has not had another qualified retirement plan in the prior three taxable years with respect to which contributions or accruals were made for substantially the same employees. It is intended that a plan will be for substantially the same employees if half or more of the employees for whom contributions or accruals are made under the new plan are employees for whom contributions or accruals were made under a prior plan.

⁸⁴The rules relating to distribution upon separation from service are modified under another provision of the Senate amendment.

⁸⁵The credit cannot be carried back to years before the effective date.

⁸⁶The credit cannot be carried back to years before the effective date.

⁸⁷Another provision of the House bill increases the dollar limit on elective deferrals under such arrangements.

contributions that are permitted to be made by an eligible individual participating in such a plan is the lesser of (1) \$5,000, or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year. This \$5,000 amount is indexed for inflation in \$500 increments in 2007 and thereafter.⁸⁸

Catch-up contributions made under the House bill are not subject to any other contribution limits and are not taken into account in applying other contribution limits. Such contributions are subject to applicable nondiscrimination rules. Although catch-up contributions are subject to applicable nondiscrimination rules, a plan does not fail to meet the applicable nondiscrimination requirements under section 401(a)(4) with respect to benefits, rights, and features if the plan allows all eligible individuals participating in the plan to make the same election with respect to catch-up contributions. For purposes of this rule, all plans of related employers are treated as a single plan.

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

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan is increased for individuals who have attained age 50 by the end of the year.⁸⁹ Additional contributions could be made by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the Senate amendment, the additional amount of elective contributions that could be made by an eligible individual participating in such a plan is the lesser of (1) the applicable dollar amount or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.⁹⁰ The applicable dollar amount is \$500 for 2002 through 2004, \$1,000 for 2005 and 2006, \$2,000 for 2007, \$3,000 for 2008, \$4,000 for 2009, and \$7,500 for 2010 and thereafter.

Catch-up contributions made under the Senate amendment are not subject to any other contribution limits and are not taken into account in applying other contribution limits. In addition, such contributions are not subject to applicable nondiscrimination rules.⁹¹

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

The following examples illustrate the application of the Senate amendment, after the catch-up is fully phased-in.

Example 1: Employee A is a highly compensated employee who is over 50 and who participates in a section 401(k) plan sponsored by A's employer. The maximum annual deferral limit (without regard to the provision) is \$15,000. After application of the special nondiscrimination rules applicable to section 401(k) plans, the maximum elective deferral A may make for the year is \$8,000. Under the provision, A is able to make additional catch-up salary reduction contributions of \$7,500.

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

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan is increased for individuals who have attained age 50 by the end of the year.⁹² The catch-up contribution provision does not apply to after-tax employee contributions. Additional contributions may be made by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the conference agreement, the additional amount of elective contributions that may be made by an eligible individual participating in such a plan is the lesser of (1) the applicable dollar amount or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.⁹³ The applicable dollar amount under a section 401(k) plan, section 403(b) annuity, SEP, or section 457 plan is \$1,000 for 2002, \$2,000 for 2003, \$3,000 for 2004, \$4,000 for 2005, and \$5,000 for 2006 and thereafter. The applicable dollar amount under a SIMPLE is \$500 for 2002, \$1,000 for 2003, \$1,500 for 2004, \$2,000 for 2005, and \$2,500 for 2006 and thereafter. The \$5,000 and \$2,500 amounts are adjusted for inflation in \$500 increments in 2007 and thereafter.⁹⁴

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

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

The following examples illustrate the application of the conference agreement, after the catch-up is fully phased-in.

Example 1: Employee A is a highly compensated employee who is over 50 and who participates in a section 401(k) plan sponsored by A's employer. The maximum annual deferral limit (without regard to the provision) is \$15,000. After application of the special nondiscrimination rules applicable to section 401(k) plans, the maximum elective deferral A may make for the year is \$8,000. Under the provision, A is able to make additional catch-up salary reduction contributions of \$5,000.

Example 2: Employee B, who is over 50, is a participant in a section 401(k) plan. B's compensation for the year is \$30,000. The maximum annual deferral limit (without regard to the provision) is \$15,000. Under the terms of the plan, the maximum permitted deferral is 10 percent of compensation or, in B's case, \$3,000. Under the provision, B can contribute up to \$8,000 for the year (\$3,000 under the normal operation of the plan, and an additional \$5,000 under the provision).

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001.

- (b) Equitable treatment for contributions of employees to defined contribution plans (sec. 302 of the House bill, sec. 632 of the Senate amendment, and secs. 403(b), 415, and 457 of the Code)

PRESENT LAW

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

Defined contribution plans

In the case of a tax-qualified defined contribution plan, the limit on annual additions that can be made to the plan on behalf of an employee is the lesser of \$35,000 (for 2001) or 25 percent of the employee's compensation (sec. 415(c)). Annual additions include employer contributions, including contributions made at the election of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee. For this purpose, compensation means taxable compensation of the employee, plus elective deferrals, and similar salary reduction contributions. A separate limit applies to benefits under a defined benefit plan.

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

Tax-sheltered annuities

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

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

⁸⁸In the case of a section 457 plans, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

⁸⁹Another provision of the Senate amendment increases the dollar limit on elective deferrals under such arrangements.

⁹⁰In the case of a section 457 plan, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

⁹¹Another provision increases the dollar limit on elective deferrals under such arrangements.

⁹²Another provision of the conference agreement increases the dollar limit on elective deferrals under such arrangements.

⁹³In the case of a section 457 plan, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

⁹⁴In the case of a section 457 plans, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

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

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

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

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

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

Section 457 plans

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local governmental employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) \$8,500 (in 2001) or (2) 33-1/3 percent of compensation. The \$8,500 limit is increased for inflation in \$500 increments.

HOUSE BILL

Increase in defined contribution plan limit

The House bill increases the 25 percent of compensation limitation on annual additions under a defined contribution plan⁹⁵ to 100 percent.⁹⁶

Conforming limits on tax-sheltered annuities

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

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

Section 457 plans

The House bill increases the 33-1/3 percent of compensation limitation on deferrals

under a section 457 plan to 100 percent of compensation.

Effective date

The House bill generally is effective for years beginning after December 31, 2001. The provision regarding the regulations under section 403(b)(2) is effective on the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications.

The Senate amendment increases the 25 percent of compensation limitation on annual additions under a defined contribution plan to 50 percent for 2002 through 2010, and 100 percent for 2011 and thereafter.⁹⁷ The Senate amendment increases the 33-1/3 percent of compensation limitation on deferrals under a section 457 plan to 50 percent for 2002 through 2010, and 100 percent for 2011 and thereafter.

With respect to the direction to the Secretary of the Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance, the regulatory provisions regarding the exclusion allowance are to be applied as if the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance were void for taxable years beginning after December 31, 2000.

Effective date.—The Senate amendment generally is effective for years beginning after December 31, 2001. The provision regarding the regulations under section 403(b)(2) is effective on the date of enactment. The provision regarding the repeal of the exclusion allowance applicable to tax-sheltered annuities is effective for years beginning after December 31, 2010.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modifications.

With respect to the increase in the defined contribution plan limit, the conferees intend that the Secretary of the Treasury will use the Secretary's existing authority to address situations where qualified nonelective contributions are targeted to certain participants with lower compensation in order to increase the average deferral percentage of nonhighly compensated employees.

For taxable years beginning after December 31, 1999, a plan may disregard the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance.

- (c) Faster vesting of employer matching contributions (sec. 303 of the House bill, sec. 633 of the Senate amendment, and sec. 411 of the Code)

PRESENT LAW

Under present law, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of five years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after three years of service, 40 percent after four years of service, 60 percent

after five years of service, 80 percent after six years of service, and 100 percent after seven years of service.⁹⁸

HOUSE BILL

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

Effective date.—The House bill is effective for contributions for plan years beginning after December 31, 2001, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The House bill does not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date is taken into account.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (d) Modifications to minimum distribution rules (sec. 304 of the House bill, sec. 634 of the Senate amendment, and sec. 401(a)(9) of the Code)

PRESENT LAW

In general

Minimum distribution rules apply to all types of tax-favored retirement vehicles, including qualified plans, individual retirement arrangements ("IRAs"), tax-sheltered annuities ("section 403(b) annuities"), and eligible deferred compensation plans of tax-exempt and State and local government employers ("section 457 plans"). In general, under these rules, distribution of minimum benefits must begin no later than the required beginning date. Minimum distribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the individual plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax may be waived if the individual establishes to the satisfaction of the Commissioner that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall. Under certain circumstances following the death of a participant, the excise tax is automatically waived under proposed Treasury regulations.

Distributions prior to the death of the individual

In the case of distributions prior to the death of the plan participant, the minimum distribution rules are satisfied if either (1) the participant's entire interest in the plan is distributed by the required beginning date, or (2) the participant's interest in the plan is to be distributed (in accordance with regulations), beginning not later than the required beginning date, over a permissible period. The permissible periods are (1) the life of the

⁹⁵ Another provision of the House bill increases the defined contribution plan dollar limit.

⁹⁶ The House bill preserves the present-law deduction rules for money purchase pension plans. Thus, for purposes of such rules, the limitation on the amount the employer generally may deduct is an amount equal to 25 percent of compensation of the employees covered by the plan for the year.

⁹⁷ Another provision of the Senate amendment increases the defined contribution plan dollar limit.

⁹⁸ The minimum vesting requirements are also contained in Title I of ERISA.

participant, (2) the lives of the participant and a designated beneficiary, (3) the life expectancy of the participant, or (4) the joint life and last survivor expectancy of the participant and a designated beneficiary. In calculating minimum required distributions, life expectancies of the participant and the participant's spouse may be recomputed annually.

In the case of qualified plans, tax-sheltered annuities, and section 457 plans, the required beginning date is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, in the case of a five-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the five-percent owner attains age 70½. If commencement of benefits is delayed beyond age 70½ from a defined benefit plan, then the accrued benefit of the employee must be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan.⁹⁹ In the case of distributions from an IRA other than a Roth IRA, the required beginning date is the April 1 of the calendar year following the calendar year in which the IRA owner attains age 70½. The pre-death minimum distribution rules do not apply to Roth IRAs.

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

Distributions after the death of the plan participant

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

HOUSE BILL

Modification of post-death distribution rules

The House bill applies the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. Thus, in general, if the employee dies before his or her entire interest has been distributed, distribution of the remaining interest is required to be made within five years of the date of

death, or begin within one year of the date of death and paid over the life or life expectancy of a designated beneficiary. In the case of a surviving spouse, distributions are not required to begin until April 1 of the calendar year following the calendar year in which the surviving spouse attains age 70½. The House bill includes a transition rule with respect to the provision providing that the required beginning date in the case of a surviving spouse is no earlier than the April 1 of the calendar year following the calendar year in which the surviving spouse attains age 70½. In the case of an individual who died before the date of enactment and prior to his or her required beginning date and whose beneficiary is the surviving spouse, minimum distributions to the surviving spouse are not required to begin earlier than the date distributions would have been required to begin under present law.

Reduction in excise tax

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

Treasury regulations

The Treasury is directed to revise the life expectancy tables under the applicable regulations to reflect current life expectancy.

Effective date

In general, the House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment does not modify the excise tax on failures to satisfy the minimum distribution rules.

CONFERENCE AGREEMENT

The conference agreement directs the Treasury to revise the life expectancy tables under the applicable regulations to reflect current life expectancy.

Effective date.—The conference agreement is effective on the date of enactment.

- (e) Clarification of tax treatment of division of section 457 plan benefits upon divorce (sec. 305 of the House bill, sec. 635 of the Senate amendment, and secs. 414(p) and 457 of the Code)

PRESENT LAW

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

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

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

former spouse) are taxable to the plan participant.

Section 457 of the Internal Revenue Code provides rules for deferral of compensation by an individual participating in an eligible deferred compensation plan ("section 457 plan") of a tax-exempt or State and local government employer. The QDRO rules do not apply to section 457 plans.

HOUSE BILL

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

Effective date.—The House bill is effective for transfers, distributions, and payments made after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with a modification of the effective date.

Effective date.—The provision of the Senate amendment relating to tax treatment of distributions made pursuant to a domestic relations order from a section 457 plan is effective for transfers, distributions, and payments made after December 31, 2001. The provisions of the Senate amendment relating to the waiver of restrictions on distributions and the application of the special rule for determining whether a distribution is pursuant to a QDRO are effective on January 1, 2002, except that in the case of a domestic relations order entered before January 1, 2002, the plan administrator (1) is required to treat such order as a QDRO if the administrator is paying benefits pursuant to such order on January 1, 2002, and (2) is permitted to treat any other such order entered before January 1, 2002, as a QDRO even if such order does not meet the relevant requirements of the provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

- (f) Provisions relating to hardship withdrawals (sec. 306 of the House bill, sec. 636 of the Senate amendment, and sec. 401(k) and 402 of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement (a "section 401(k) plan") may not be distributable prior to the occurrence of one or more specified events. One event upon which distribution is permitted is the financial hardship of the employee. Applicable Treasury regulations¹⁰⁰ provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.

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

Under present law, hardship withdrawals of elective deferrals from a qualified cash or deferred arrangement (or 403(b) annuity) are

⁹⁹State and local government plans and church plans are not required to actuarially increase benefits that begin after age 70½.

¹⁰⁰Treas. Reg. sec. 1.401(k)-1.

not eligible rollover distributions. Other types of hardship distributions, e.g., employer matching contributions distributed on account of hardship, are eligible rollover distributions. Different withholding rules apply to distributions that are eligible rollover distributions and to distributions that are not eligible rollover distributions. Eligible rollover distributions that are not directly rolled over are subject to withholding at a flat rate of 20-percent. Distributions that are not eligible rollover distributions are subject to elective withholding. Periodic distributions are subject to withholding as if the distribution were wages; nonperiodic distributions are subject to withholding at a rate of 10 percent. In either case, the individual may elect not to have withholding apply.

HOUSE BILL

The Secretary of the Treasury is directed to revise the applicable regulations to reduce from 12 months to six months the period during which an employee must be prohibited from making elective contributions and employee contributions in order for a distribution to be deemed necessary to satisfy an immediate and heavy financial need. The revised regulations are to be effective for years beginning after December 31, 2001.

In addition, any distribution made upon hardship of an employee is not an eligible rollover distribution. Thus, such distributions may not be rolled over, and are subject to the withholding rules applicable to distributions that are not eligible rollover distributions. The House bill does not modify the rules under which hardship distributions may be made. For example, as under present law, hardship distributions of qualified employer matching contributions are only permitted under the rules applicable to elective deferrals.

The House bill is intended to clarify that all assets distributed as a hardship withdrawal, including assets attributable to employee elective deferrals and those attributable to employer matching or nonelective contributions, are ineligible for rollover. This rule is intended to apply to all hardship distributions from any tax qualified plan, including those made pursuant to standards set forth in section 401(k)(2)(B)(i)(IV) (which are applicable to section 401(k) plans and section 403(b) annuities) and to those treated as hardship distributions under any profit-sharing plan (whether or not in accordance with the standards set forth in section 401(k)(2)(B)(i)(IV)). For this purpose, a distribution that could be made either under the hardship provisions of a plan or under other provisions of the plan (such as provisions permitting in-service withdrawal of assets attributable to employer matching or nonelective contributions after a fixed period of years) could be treated as made upon hardship of the employee if the plan treats it that way. For example, if a plan makes an in-service distribution that consists of assets attributable to both elective deferrals (in circumstances where those assets could be distributed only upon hardship) and employer matching or nonelective contributions (which could be distributed in nonhardship circumstances under the plan), the plan is permitted to treat the distribution in its entirety as made upon hardship of the employee.

Effective date.—The provision of the House bill directing the Secretary to revise the rules relating to safe harbor hardship distributions is effective on the date of enactment. The provision that hardship distributions are not eligible rollover distributions is effective for distributions made after December 31, 2001. The Secretary has the authority to issue transitional guidance with

respect to the provision that hardship distributions are not eligible rollover distributions to provide sufficient time for plans to implement the new rule.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (g) Pension coverage for domestic and similar workers (sec. 307 of the House bill, sec. 637 of the Senate amendment, and sec. 4972(c)(6) of the Code)

PRESENT LAW

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

Employers of household workers may establish a pension plan for their employees. Contributions to such plans are not deductible because they are not made in connection with a trade or business of the employer.

HOUSE BILL

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

No inference is intended with respect to the application of the excise tax under present law to contributions that are not deductible because they are not made in connection with a trade or business of the employer.

As under present law, a plan covering domestic workers is not qualified unless the coverage rules are satisfied by aggregating all employees of family members taken into account under the attribution rules in section 414(c), but disregarding employees employed by a controlled group of corporations or a trade or business.

It is intended that the House bill is restricted to contributions made by employers of household workers with respect to whom all applicable employment taxes have been and are being paid.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The legislative history of the Senate amendment does not include a statement of intention that the Senate amendment is restricted to contributions made by employers of household workers with respect to whom all applicable employment taxes have been and are being paid.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

3. Increasing Portability for Participants

- (a) Rollovers of retirement plan and IRA distributions (secs. 401-403 and 409 of the House bill, secs. 641-643 and 649 of the Senate amendment, and secs. 401, 402, 403(b), 408, 457, and 3405 of the Code)

PRESENT LAW

In general

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

Distributions from qualified plans

Under present law, an "eligible rollover distribution" from a tax-qualified employer-sponsored retirement plan may be rolled over tax free to a traditional individual retirement arrangement ("IRA")¹⁰¹ or another qualified plan.¹⁰² An "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan, except the term does not include (1) any distribution which is one of a series of substantially equal periodic payments made (a) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (b) for a specified period of 10 years or more, (2) any distribution to the extent such distribution is required under the minimum distribution rules, and (3) certain hardship distributions. The maximum amount that can be rolled over is the amount of the distribution includible in income, i.e., after-tax employee contributions cannot be rolled over. Qualified plans are not required to accept rollovers.

Distributions from tax-sheltered annuities

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

IRA distributions

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

Distributions from section 457 plans

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. In some cases, different rules apply under section 457 to governmental plans and plans of tax-exempt employers. For example, governmental section

¹⁰¹ A "traditional" IRA refers to IRAs other than Roth IRAs or SIMPLE IRAs. All references to IRAs refer only to traditional IRAs.

¹⁰² An eligible rollover distribution may either be rolled over by the distributee within 60 days of the date of the distribution or, as described below, directly rolled over by the distributing plan.

457 plans are like qualified plans in that plan assets are required to be held in a trust for the exclusive benefit of plan participants and beneficiaries. In contrast, benefits under a section 457 plan of a tax-exempt employer are unfunded, like nonqualified deferred compensation plans of private employers.

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

Rollovers by surviving spouses

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

Direct rollovers and withholding requirements

Qualified plans and section 403(b) annuities are required to provide that a plan participant has the right to elect that an eligible rollover distribution be directly rolled over to another eligible retirement plan. If the plan participant does not elect the direct rollover option, then withholding is required on the distribution at a 20-percent rate.¹⁰³

Notice of eligible rollover distribution

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

Taxation of distributions

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

HOUSE BILL

In general

The House bill provides that eligible rollover distributions from qualified retirement

¹⁰³ Distributions from qualified plans and section 403(b) annuities that are not eligible rollover distributions are subject to elective withholding. Periodic distributions are subject to withholding as if the distribution were wages; nonperiodic distributions are subject to withholding at a rate of 10 percent. In either case, the individual may elect not to have withholding apply.

plans, section 403(b) annuities, and governmental section 457 plans generally could be rolled over to any of such plans or arrangements.¹⁰⁴ Similarly, distributions from an IRA generally are permitted to be rolled over into a qualified plan, section 403(b) annuity, or governmental section 457 plan. The direct rollover and withholding rules are extended to distributions from a governmental section 457 plan, and such plans are required to provide the written notification regarding eligible rollover distributions.¹⁰⁵ The rollover notice (with respect to all plans) is required to include a description of the provisions under which distributions from the plan to which the distribution is rolled over may be subject to restrictions and tax consequences different than those applicable to distributions from the distributing plan. Qualified plans, section 403(b) annuities, and section 457 plans would not be required to accept rollovers.

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

Rollover of after-tax contributions

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

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

Expansion of spousal rollovers

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

Treasury regulations

The Secretary is directed to prescribe rules necessary to carry out the House bill. Such rules may include, for example, reporting requirements and mechanisms to address mistakes relating to rollovers. It is anticipated

¹⁰⁴ Hardship distributions from governmental section 457 plans would be considered eligible rollover distributions.

¹⁰⁵ The elective withholding rules applicable to distributions from qualified plans and section 403(b) annuities that are not eligible rollover distributions are also extended to distributions from governmental section 457 plans. Thus, periodic distributions from governmental section 457 plans that are not eligible rollover distributions are subject to withholding as if the distribution were wages and nonperiodic distributions from such plans that are not eligible rollover distributions are subject to withholding at a 10-percent rate. In either case, the individual may elect not to have withholding apply.

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

Effective date

The House bill is effective for distributions made after December 31, 2001. It is intended that the Secretary will revise the safe harbor rollover notice that plans may use to satisfy the rollover requirements. No penalty is imposed on a plan for a failure to provide the information required under the House bill with respect to any distribution made before the date that is 90 days after the date the Secretary issues a new safe harbor rollover notice, if the plan administrator makes a reasonable attempt to comply with such notice requirement. For example, the House bill requires that the rollover notice include a description of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making the distribution. A plan is treated as making a reasonable good faith effort to comply with this requirement if the notice states that distributions from the plan to which the rollover is made may be subject to different restrictions and tax consequences than those that apply to distributions from the plan from which the rollover is made.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment does not include a provision for relief from the imposition of a penalty for failure to provide the information required under the Senate amendment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modification. Hardship distributions from governmental section 457 plans are not considered eligible rollover distributions.

(b) Waiver of 60-day rule (sec. 404 of the House bill, sec. 644 of the Senate amendment, and secs. 402 and 408 of the Code)

PRESENT LAW

Under present law, amounts received from an IRA or qualified plan may be rolled over tax free if the rollover is made within 60 days of the date of the distribution. The Secretary does not have the authority to waive the 60-day requirement, except during military service in a combat zone or by reason of a Presidentially declared disaster. The Secretary has issued regulations postponing the 60-day rule in such cases.

HOUSE BILL

The House bill provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. For example, the Secretary may issue guidance that includes objective standards for a waiver of the 60-day rollover period, such as waiving the rule due to military service in a combat zone or during a Presidentially declared disaster (both of which are provided for under present law), or for a period during which the participant has received payment in the form of a check, but has not cashed the check, or for errors committed by a financial institution.

Effective date.—The House bill applies to distributions made after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. For example, the Secretary may issue guidance that includes objective standards for a waiver of the 60-day rollover period, such as waiving the rule due to military service in a combat zone or during a Presidentially declared disaster (both of which are provided for under present law), or for a period during which the participant has received payment in the form of a check, but has not cashed the check, or for errors committed by a financial institution, or in cases of inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error.

Effective date.—The conference agreement applies to distributions made after December 31, 2001.

(c) Treatment of forms of distribution (sec. 405 of the House bill, sec. 645 of the Senate amendment, and sec. 411(d)(6) of the Code)

PRESENT LAW

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant. An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit (sec. 411(d)(6)).¹⁰⁶

Under regulations recently issued by the Secretary,¹⁰⁷ this prohibition against the elimination of an optional form of benefit does not apply in the case of (1) a defined contribution plan that offers a lump sum at the same time as the form being eliminated if the participant receives at least 90 days' advance notice of the elimination, or (2) a voluntary transfer between defined contribution plans, subject to the requirements that a transfer from a money purchase pension plan, an ESOP, or a section 401(k) plan must be to a plan of the same type and that the transfer be made in connection with certain corporate mergers, acquisitions, or similar transactions or changes in employment status.

HOUSE BILL

A defined contribution plan to which benefits are transferred will not be treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, and (4) the transferee plan allows the participant or beneficiary to receive distribution of his or

her benefit under the transferee plan in the form of a single sum distribution. The House bill does not modify the rules relating to survivor annuities under section 417. Thus, as under present law, a plan that is a transferee of a plan subject to the joint and survivor rules is also subject to those rules.

Except to the extent provided by the Secretary of the Treasury in regulations, a defined contribution plan is not treated as reducing a participant's accrued benefit if (1) a plan amendment eliminates a form of distribution previously available under the plan, (2) a single sum distribution is available to the participant at the same time or times as the form of distribution eliminated by the amendment, and (3) the single sum distribution is based on the same or greater portion of the participant's accrued benefit as the form of distribution eliminated by the amendment.

Furthermore, the House bill directs the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit do not apply to plan amendments that eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants, but only if such an amendment does not adversely affect the rights of any participant in more than a de minimis manner.

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

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

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

Assume that A's plan has an early retirement subsidy for individuals who have at-

tained age 50 with a specified number of years of service, but the subsidy is not the same as under B's plan. Under A's plan, the present value of E2's early retirement subsidy is \$9,850. Maintenance of both subsidies after the plan merger would create burdens for the plan and complexities for the plan and its participants.

Treasury regulations could permit E1's early retirement subsidy under B's plan to be eliminated entirely (i.e., even if A's plan did not have an early retirement subsidy). Taking into account all relevant factors, including the value of the benefit, E1's compensation, and the number of years until E1 would be eligible to receive the subsidy, the subsidy is de minimis. Treasury regulations could permit E2's early retirement subsidy under B's plan to be eliminated as to be replaced by the subsidy under A's plan, because the difference in the subsidies is de minimis. However, A's subsidy could not be entirely eliminated.

The Secretary is directed to issue, not later than December 31, 2003, final regulations under section 411(d)(6), including regulations required under the House bill.

Effective date.—The House bill is effective for years beginning after December 31, 2001, except that the direction to the Secretary is effective on the date of enactment.

SENATE AMENDMENT

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

Furthermore, the Senate amendment directs the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit do not apply to plan amendments that eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants, but only if such an amendment does not adversely affect the rights of any participant in more than a de minimis manner.

It is intended that the factors to be considered in determining whether an amendment has more than a de minimis adverse effect on any participant will include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age

¹⁰⁶ A similar provision is contained in Title I of ERISA.

¹⁰⁷ Treas. Reg. sec. 1.411(d)-4, Q&A-2(e) and Q&A-3(b).

under the plan (or early retirement age, as applicable), (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation, and (5) the number of years before the plan amendment is effective.

The Secretary is directed to issue, not later than December 31, 2002, final regulations under section 411(d)(6), including regulations required under the Senate amendment.

Effective date.—The provision is effective for years beginning after December 31, 2001, except that the direction to the Secretary is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

- (d) Rationalization of restrictions on distributions (sec. 406 of the House bill, sec. 646 of the Senate amendment, and secs. 401(k), 403(b), and 457 of the Code)

PRESENT LAW

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

A separation from service occurs only upon a participant's death, retirement, resignation or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, consolidation or other similar corporate transaction. A severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan. Under a so-called "same desk rule," a participant's severance from employment does not necessarily result in a separation from service.¹⁰⁸

In addition to separation from service and other events, a section 401(k) plan that is maintained by a corporation may permit distributions to certain employees who experience a severance from employment with the corporation that maintains the plan but do not experience a separation from service because the employees continue on the same job for a different employer as a result of a corporate transaction. If the corporation disposes of substantially all of the assets used by the corporation in a trade or business, a distributable event occurs with respect to the accounts of the employees who continue employment with the corporation that acquires the assets. If the corporation disposes of its interest in a subsidiary, a distributable event occurs with respect to the accounts of the employees who continue employment with the subsidiary. Under a recent IRS ruling, a person is generally deemed to have separated from service if that person is transferred to another employer in connection with a sale of less than substantially all the assets of a trade or business.¹⁰⁹

HOUSE BILL

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

Effective date.—The House bill is effective for distributions after December 31, 2001, regardless of when the severance of employment occurred.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

The conferees intend that a plan may provide that certain specified types of severance from employment do not constitute distributable events. For example, a plan could provide that a severance from employment is not a distributable event if it would not have constituted a "separation from service" under the law in effect prior to a specified date. Also, if a plan describes distributable events by reference to section 401(k)(2), the plan may be amended to restrict distributable events to fewer than all events that constitute a severance from employment. Thus, for example, if a plan sponsor had employees who experienced a severance from employment in the past that the "same desk rule" prevented from being treated as a distributable event, the plan sponsor would have the option of providing in the plan that such severance from employment would, or would not, be treated as a distributable event under the plan.

The conferees intend that, as under current law, if there is a transfer of plan assets and liabilities relating to any portion of an employee's benefit under a plan of the employee's former employer to a plan being maintained or created by the employee's new employer (other than a rollover or elective transfer), then that employee has not experienced a severance from employment with the employer maintaining the plan that covers the employee.

- (e) Purchase of service credit under governmental pension plans (sec. 407 of the House bill, sec. 647 of the Senate amendment, and secs. 403(b) and 457 of the Code)

PRESENT LAW

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

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

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

HOUSE BILL

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

Effective date.—The House bill is effective for transfers after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (f) Employers may disregard rollovers for purposes of cash-out rules (sec. 408 of the House bill, sec. 648 of the Senate amendment, and sec. 411(a)(11) of the Code)

PRESENT LAW

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed \$5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.¹¹⁰

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan.¹¹¹

HOUSE BILL

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

Effective date.—The House bill is effective for distributions after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (g) Minimum distribution and inclusion requirements for section 457 plans (sec. 409 of the House bill, sec. 649 of the Senate amendment, and sec. 457 of the Code)

PRESENT LAW

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, amounts deferred under a section 457 plan cannot exceed certain limits. Amounts deferred under a section 457 plan are generally includable in income when paid or made available.

¹¹⁰A similar provision is contained in Title I of ERISA.

¹¹¹Other provisions expand the kinds of plans to which benefits may be rolled over.

¹⁰⁸Rev. Rul. 79-336, 1979-2 C.B. 187.

¹⁰⁹Rev. Rul. 2000-27, 2000-21 I.R.B. 1016.

Amounts deferred under a plan of deferred compensation of a State or local government or tax-exempt employer that does not meet the requirements of section 457 are includible in income when the amounts are not subject to a substantial risk of forfeiture, regardless of whether the amounts have been paid or made available.¹¹²

Section 457 plans are subject to the minimum distribution rules applicable to tax-qualified pension plans. In addition, such plans are subject to additional minimum distribution rules (sec. 457(d)(2)(B)).

HOUSE BILL

The House bill provides that amounts deferred under a section 457 plan of a State or local government are includible in income when paid. The House bill also repeals the special minimum distribution rules applicable to section 457 plans. Thus, such plans are subject to the minimum distribution rules applicable to qualified plans.

Effective date.—The House bill is effective for distributions after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification.

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

Effective date.—The Senate amendment is generally effective for distributions after December 31, 2001. The provision relating to plans of tax-exempt organizations is effective for taxable years ending after the date of enactment for cost-of-living increases after September 1993.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

4. Strengthening Pension Security and Enforcement

- (a) Phase in repeal of 160 percent of current liability funding limit; deduction for contributions to fund termination liability (secs. 501–502 of the House bill, secs. 651–652 of the Senate amendment, and secs. 404(a)(1), 412(c)(7), and 4972(c) of the Code)

PRESENT LAW

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

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 160 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)).¹¹³ In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the ac-

crued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.¹¹⁴ In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

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

HOUSE BILL

Current liability full funding limit

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

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the House bill applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.¹¹⁵

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

General Accounting Office study

In connection with the Committee's desire to strengthen pension security, the Committee directs the General Accounting Office to conduct a study examining the extent to which certain present-law rules create obstacles or disincentives for taxpayers experiencing financial hardships to make current and future contributions to underfunded defined benefit pension plans. The Committee is concerned that, as a result of not obtaining a current or carryback deduction for pension contributions, taxpayers experiencing financial hardships will be subject to higher after-tax costs of maintaining pension funding levels. In the study, the General Accounting Office is to consider whether pension funding would be enhanced if section

172(f), which since 1998 has permitted only listed items to be carried back, were modified to list deductions for payments to defined benefit pension plans as an item for which 10-year specified loss carrybacks may be available. This study is to be submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate not later than one year after the date of enactment.

Effective date

The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

Current liability full funding limit

The Senate amendment gradually increases and then repeals the current liability full funding limit. Under the Senate amendment, the current liability full funding limit is 160 percent of current liability for plan years beginning in 2002, 165 percent for plan years beginning in 2003, and 170 percent for plan years beginning in 2004. The current liability full funding limit is repealed for plan years beginning in 2005 and thereafter. Thus, in 2005 and thereafter, the full funding limit is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the value of the plan's assets.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the Senate amendment applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.¹¹⁶

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

Effective date

The Senate amendment is effective for plan years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications.

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

With respect to the special rule allowing a deduction for unfunded current liability, the modification of the rule to provide that the deduction is for up to 100 percent of unfunded termination liability is applicable only for a plan that terminates within the plan year.

¹¹⁶The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

¹¹²This rule of inclusion does not apply to amounts deferred under a tax-qualified retirement plan or similar plans.

¹¹³The minimum funding requirements, including the full funding limit, are also contained in title I of ERISA.

¹¹⁴As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, 160 percent in 2001 and 2002, and adopted the scheduled increases described in the text.

¹¹⁵The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

(b) Excise tax relief for sound pension funding (sec. 503 of the House bill, sec. 653 of the Senate amendment, and sec. 4972 of the Code)

PRESENT LAW

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

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 160 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)). In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.¹¹⁷ In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

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

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

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

HOUSE BILL

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

Effective date.—The House bill is effective for years beginning after December 31, 2001.

¹¹⁷As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, 160 percent in 2001 and 2002, and adopted the scheduled increases described in the text. Another provision would gradually increase and then repeal the current liability full funding limit.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(c) Notice of significant reduction in plan benefit accruals (sec. 504 of the House bill, sec. 659 of the Senate amendment, and new sec. 4980f of the Code)

PRESENT LAW

Section 204(h) of Title I of ERISA provides that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice ("section 204(h) notice"), setting forth the plan amendment (or a summary of the amendment written in a manner calculated to be understood by the average plan participant) and its effective date. The plan administrator must provide the section 204(h) notice to each plan participant, each alternate payee under an applicable qualified domestic relations order ("QDRO"), and each employee organization representing participants in the plan. The applicable Treasury regulations¹¹⁸ provide, however, that a plan administrator need not provide the section 204(h) notice to any participant or alternate payee whose rate of future benefit accrual is reasonably expected not to be reduced by the amendment, nor to an employee organization that does not represent a participant to whom the section 204(h) notice must be provided. In addition, the regulations provide that the rate of future benefit accrual is determined without regard to optional forms of benefit, early retirement benefits, retirement-type subsidiaries, ancillary benefits, and certain other rights and features.

A covered amendment generally will not become effective with respect to any participants and alternate payees whose rate of future benefit accrual is reasonably expected to be reduced by the amendment but who do not receive a section 204(h) notice. An amendment will become effective with respect to all participants and alternate payees to whom the section 204(h) notice was required to be provided if the plan administrator (1) has made a good faith effort to comply with the section 204(h) notice requirements, (2) has provided a section 204(h) notice to each employee organization that represents any participant to whom a section 204(h) notice was required to be provided, (3) has failed to provide a section 204(h) notice to no more than a de minimis percentage of participants and alternate payees to whom a section 204(h) notice was required to be provided, and (4) promptly upon discovering the oversight, provides a section 204(h) notice to each omitted participant and alternate payee.

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

HOUSE BILL

The House bill adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan or a money purchase pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy.

¹¹⁸Treas. Reg. sec. 1.411(d)-6.

The plan administrator is required to provide in this notice, in a manner calculated to be understood by the average plan participant, sufficient information (as defined in Treasury regulations) to allow participants to understand the effect of the amendment.

The notice requirement does not apply to governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)). The House bill authorizes the Secretary of the Treasury to provide a simplified notice requirement or an exemption from the notice requirement for plans with less than 100 participants and to allow any notice required under the House bill to be provided by using new technologies. The House bill also authorizes the Secretary to provide a simplified notice requirement or an exemption from the notice requirement if participants are given the option to choose between benefits under the new plan formula and the old plan formula. In such cases, the House bill will have no effect on the fiduciary rules applicable to pension plans that may require appropriate disclosure to participants, even if no disclosure is required under the House bill.

The plan administrator is required to provide this notice to each affected participant, each affected alternate payee, and each employee organization representing affected participants. For purposes of the House bill, an affected participant or alternate payee is a participant or alternate payee whose rate of future benefit accrual may reasonably be expected to be significantly reduced by the plan amendment.

Except to the extent provided by Treasury regulations, the plan administrator is required to provide the notice within a reasonable time before the effective date of the plan amendment. The House bill permits a plan administrator to provide any notice required under the House bill to a person designated in writing by the individual to whom it would otherwise be provided.

The House bill imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to \$100 per day per omitted participant and alternate payee. No excise tax is imposed during any period during which any person subject to liability for the tax did not know that the failure existed and exercised reasonable diligence to meet the notice requirement. In addition, no excise tax is imposed on any failure if any person subject to liability for the tax exercised reasonable diligence to meet the notice requirement and such person provides the required notice during the 30-day period beginning on the first date such person knew, or exercising reasonable diligence would have known, that the failure existed. Also, if the person subject to liability for the excise tax exercised reasonable diligence to meet the notice requirement, the total excise tax imposed during a taxable year of the employer will not exceed \$500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved.

It is intended under the House bill that the Secretary issue the necessary regulations with respect to disclosure within 90 days of enactment. It is also intended that such guidance may be relatively detailed because of the need to provide for alternative disclosures rather than a single disclosure methodology that may not fit all situations, and the need to consider the complex actuarial calculations and assumptions involved in providing necessary disclosures.

In addition, the House bill directs the Secretary of the Treasury to prepare a report on

the effects of conversions of traditional defined benefit plans to cash balance or hybrid formula plans. Such study is to examine the effect of such conversions on longer service participants, including the incidence and effects of "wear away" provisions under which participants earn no additional benefits for a period of time after the conversion. The Secretary is directed to submit such report, together with recommendations thereon, to the Committee on Ways and Means and the Committee on Education and the Workforce of the House of Representatives and the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate as soon as practicable, but not later than 60 days after the date of enactment.

Effective date.—The House bill is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the House bill will not end before the last day of the three-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan is treated as meeting the requirements of the House bill if the plan makes a good faith effort to comply with such requirements. The notice requirement under the House bill does not apply to any plan amendment taking effect on or after the date of enactment if, before April 25, 2001, notice is provided to participants and beneficiaries adversely affected by the plan amendment (or their representatives) that is reasonably expected to notify them of the nature and effective date of the plan amendment.

SENATE AMENDMENT

The Senate amendment adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy.¹¹⁹ The notice is required to set forth: (1) a summary of the plan amendment and the effective date of the amendment; (2) a statement that the amendment is expected to significantly reduce the rate of future benefit accrual; (3) a description of the classes of employees reasonably expected to be affected by the reduction in the rate of future benefit accrual; (4) examples illustrating the plan changes for these classes of employees; (5) in the event of an amendment that results in the significant restructuring of the plan benefit formula, as determined under regulations prescribed by the Secretary (a "significant restructuring amendment"), a notice that the plan administrator will provide, generally no later than 15 days prior to the effective date of the amendment, a "benefit estimation tool kit" (described below) that will enable employees who have completed at least one year of participation to personalize the illustrative examples; and (6) notice of each affected participant's right to request, and of the procedures for requesting, an annual benefit statement as provided under present law. The plan administrator is required to provide the

notice not less than 45 days before the effective date of the plan amendment.

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

The plan administrator is required to provide this generalized notice to each affected participant and each affected alternate payee. For purposes of the Senate amendment, an affected participant or alternate payee is a participant or alternate payee to whom the significant reduction in the rate of future benefit accrual is reasonably expected to apply.

As noted above, the Senate amendment requires the plan administrator to provide a benefit estimation tool kit, no later than 15 days prior to the amendment effective date, to a participant for whom the amendment may reasonably be expected to produce a significant reduction in the rate of future benefit accrual if the amendment is a significant restructuring amendment. The plan administrator is not required to provide this benefit estimation tool kit to any participant who has less than one year of participation in the plan.

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

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

In the case of a significant restructuring amendment that occurs in connection with a business disposition or acquisition transaction and within one year following the date of the transaction, the Senate amendment requires the plan administrator to provide the benefit estimation tool kit prior to the date that is 12 months after the date on which the generalized notice of the amendment is given to the affected participants.

The Senate amendment permits a plan administrator to provide any notice required under the Senate amendment to a person designated in writing by the individual to whom it would otherwise be provided. In addition, the Senate amendment authorizes the Secretary of the Treasury to allow any notice required under the Senate amendment to be provided by using new technologies, provided that at least one option for providing notice is not dependent upon new technologies.

The Senate amendment imposes on a plan administrator that fails to comply with the

notice requirement an excise tax equal to \$100 per day per omitted participant and alternate payee. No excise tax is imposed during any period during which any person subject to liability for the tax did not know that the failure existed and exercised reasonable diligence to meet the notice requirement. In addition, no excise tax is imposed on any failure if any person subject to liability for the tax exercised reasonable diligence to meet the notice requirement and such person provides the required notice during the 30-day period beginning on the first date such person knew, or exercising reasonable diligence would have known, that the failure existed. Also, if the person subject to liability for the excise tax exercised reasonable diligence to meet the notice requirement, the total excise tax imposed during a taxable year of the employer will not exceed \$500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax is excessive relative to the failure involved.

The Senate amendment directs the Secretary of the Treasury to issue, not later than one year after the date of enactment, regulations with respect to early retirement benefits or retirement-type subsidies, the determination of a significant restructuring amendment, and the examples that are required under the generalized notice and the benefit estimation tool kit.

In addition, the Senate amendment directs the Secretary of the Treasury to prepare a report on the effects of significant restructurings of plan benefit formulas of traditional defined benefit plans. Such study is to examine the effect of such restructurings on longer service participants, including the incidence and effects of "wear away" provisions under which participants earn no additional benefits for a period of time after the restructuring. The Secretary is directed to submit such report, together with recommendations thereon, to the Committee on Ways and Means and the Committee on Education and the Workforce of the House of Representatives and the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate as soon as practicable, but not later than one year after the date of enactment.

Effective date.—The Senate amendment is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the Senate amendment will not end before the last day of the three-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan is treated as meeting the requirements of the Senate amendment if the plan makes a good faith effort to comply with such requirements.

CONFERENCE AGREEMENT

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

¹¹⁹The provision also modifies the present-law notice requirement contained in section 204(h) of Title I of ERISA to provide that an applicable pension plan may not be amended to provide for a significant reduction in the rate of future benefit accrual in the event of a failure by the plan administrator to exercise due diligence in meeting a notice requirement similar to the notice requirement that the provision adds to the Internal Revenue Code. In addition, the provision expands the current ERISA notice requirement regarding significant reductions in normal retirement benefit accrual rates to early retirement benefits and retirement-type subsidies.

(d) Modifications to section 415 limits for multiemployer plans (sec. 505 of the House bill, sec. 654 of the Senate amendment, and sec. 415 of the Code)

PRESENT LAW

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

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation for the highest three years, or (2) \$140,000 (for 2001). The dollar limit is adjusted for cost-of-living increases in \$5,000 increments. The dollar limit is reduced in the case of retirement before the social security retirement age and increases in the case of retirement after the social security retirement age.

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

In the case of a defined contribution plan, the limit on annual additions is the lesser of (1) 25 percent of compensation¹²⁰ or (2) \$35,000 (for 2001).

In applying the limits on contributions and benefits, plans of the same employer are aggregated. That is, all defined benefit plans of the same employer are treated as a single plan, and all defined contribution plans of the same employer are treated as a single plan. Under Treasury regulations, multiemployer plans are not aggregated with other multiemployer plans. However, if an employer maintains both a plan that is not a multiemployer plan and a multiemployer plan, the plan that is not a multiemployer plan is aggregated with the multiemployer plan to the extent that benefits provided under the multiemployer plan are provided with respect to a common participant.¹²¹

HOUSE BILL

Under the House bill, the 100 percent of compensation defined benefit plan limit does not apply to multiemployer plans. With respect to aggregation of multiemployer plans with other plans, the House bill provides that multiemployer plans are not aggregated with single-employer defined benefit plans maintained by an employer contributing to the multiemployer plan for purposes of applying the 100 percent of compensation limit to such single-employer plan.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill with respect to the waiver of the 100 percent of compensation limit.

With respect to aggregation of multiemployer plans with other plans, multiemployer plans are not aggregated with any other plan maintained by the same employer, except for purposes of applying the dollar limitation on defined plans and the limits on annual additions to a plan that is not a multiemployer plan.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

(e) Investment of employee contributions in 401(k) plans (sec. 506 of the House bill, sec. 655 of the Senate amendment, and sec. 1524(b) of the Taxpayer Relief Act of 1997)

PRESENT LAW

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

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

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

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

HOUSE BILL

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

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

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(f) Periodic pension benefit statements (sec. 507 of the House bill and sec. 105(a) of ERISA)

PRESENT LAW

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

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

HOUSE BILL

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

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

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

The Secretary of Labor is authorized to provide that years in which no employee or former employee benefits under a plan need not be taken into account in determining the applicable three-year period.

In addition, the Secretary of Labor is directed to develop a model benefit statement, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the requirements of section 105 of ERISA. The use of the model statement is

¹²⁰ Another provision of the House bill increases this limit to 100 percent of compensation.

¹²¹ Treas. Reg. sec. 1.415-8(e).

optional. It is intended that the model statement include items such as the amount of nonforfeitable accrued benefits as of the statement date that are payable at normal retirement age under the plan, the amount of accrued benefits that are forfeitable but that may become nonforfeitable under the terms of the plan, information on how to contact the Social Security Administration to obtain a participant's personal earnings and benefit estimate statement, and other information that may be important to understanding benefits earned under the plan. Statements provided by electronic forms of communications shall be provided consistent with Department of Labor and Department of Treasury regulations.

Effective date.—The provision is effective for plan years beginning after December 31, 2002.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(g) Prohibited allocations of stock in an S corporation ESOP (sec. 508 of the House bill, sec. 656 of the Senate amendment, and secs. 409 and 4979a of the Code)

PRESENT LAW

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

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

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

HOUSE BILL

In general

Under the House bill, if there is a non-allocation year with respect to an ESOP maintained by an S corporation: (1) the amount allocated in a prohibited allocation to an individual who is a disqualified person is treated as distributed to such individual (i.e., the value of the prohibited allocation is includible in the gross income of the individual receiving the prohibited allocation); (2) an excise tax is imposed on the S corporation equal to 50 percent of the amount involved in a prohibited allocation; and (3) an excise tax is imposed on the S corporation with respect to any synthetic equity owned by a disqualified person.¹²²

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

Definition of nonallocation year

A nonallocation year means any plan year of an ESOP holding shares in an S corporation if, at any time during the plan year, dis-

qualified persons own at least 50 percent of the number of outstanding shares of the S corporation.

A person is a disqualified person if the person is either (1) a member of a "deemed 20-percent shareholder group" or (2) a "deemed 10-percent shareholder." A person is a member of a "deemed 20-percent shareholder group" if the aggregate number of deemed-owned shares of the person and his or her family members is at least 20 percent of the number of deemed-owned shares of stock in the S corporation.¹²³ A person is a deemed 10-percent shareholder if the person is not a member of a deemed 20-percent shareholder group and the number of the person's deemed-owned shares is at least 10 percent of the number of deemed-owned shares of stock of the corporation.

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

For purposes of determining whether there is a nonallocation year, ownership of stock generally is attributed under the rules of section 318,¹²⁴ except that: (1) the family attribution rules are modified to include certain other family members, as described below, (2) option attribution does not apply (but instead special rules relating to synthetic equity described below apply), and (3) "deemed-owned shares" held by the ESOP are treated as held by the individual with respect to whom they are deemed owned.

Under the House bill, family members of an individual include (1) the spouse¹²⁵ of the individual, (2) an ancestor or lineal descendant of the individual or his or her spouse, (3) a sibling of the individual (or the individual's spouse) and any lineal descendant of the brother or sister, and (4) the spouse of any person described in (2) or (3).

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

"Synthetic equity" means any stock option, warrant, restricted stock, deferred issuance stock right, or similar interest that gives the holder the right to acquire or receive stock of the S corporation in the future. Except to the extent provided in regulations, synthetic equity also includes a stock appreciation right, phantom stock unit, or similar right to a future cash payment based on the value of such stock or appreciation in such value.¹²⁶

¹²³A family member of a member of a "deemed 20-percent shareholder group" with deemed owned shares is also treated as a disqualified person.

¹²⁴These attribution rules also apply to stock treated as owned by reason of the ownership of synthetic equity.

¹²⁵As under section 318, an individual's spouse is not treated as a member of the individual's family if the spouses are legally separated.

¹²⁶The provisions relating to synthetic equity do not modify the rules relating to S corporations, e.g., the circumstances in which options or similar interests are treated as creating a second class of stock.

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

Definition of prohibited allocation

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

Application of excise tax

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

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

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

Treasury regulations

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

Effective date

The House bill generally is effective with respect to plan years beginning after December 31, 2004. In the case of an ESOP established after March 14, 2001, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the House bill is effective with respect to plan years ending after March 14, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with a modification of the effective date.

Effective date.—The Senate amendment generally is effective with respect to plan years beginning after December 31, 2002. In the case of an ESOP established after July 11, 2000, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the Senate amendment is effective with respect to plan years ending after July 11, 2000.

CONFERENCE AGREEMENT

The conference agreement follows the House bill. The conference agreement authorizes the Secretary to determine, by regulation or other guidance of general applicability, that a nonallocation year occurs in any case in which the principal purpose of the ownership structure of an S corporation constitutes, in substance, an avoidance or evasion of the prohibited allocation rules. For example, this might apply if more than 10 independent businesses are combined in an S corporation owned by an ESOP in order to take advantage of the income tax treatment of S corporations owned by an ESOP.

¹²²The plan is not disqualified merely because an excise tax is imposed under the provision.

(h) Automatic rollovers of certain mandatory distributions (sec. 657 of the Senate amendment and secs. 401(a)(31) and 402(f)(1) of the Code and sec. 404(c) of ERISA)

PRESENT LAW

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

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

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment makes a direct rollover the default option for involuntary distributions that exceed \$1,000 and that are eligible rollover distributions from qualified retirement plans. The distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly.

The written explanation provided by the plan administrator is required to explain that an automatic direct rollover will be made unless the participant elects otherwise. The plan administrator is also required to notify the participant in writing (as part of the general written explanation or separately) that the distribution may be transferred without cost to another IRA.

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

The Senate amendment directs the Secretary of Labor to issue safe harbors under which the designation of an institution and investment of funds in accordance with the Senate amendment are deemed to satisfy the requirements of section 404(a) of ERISA. In addition, the Senate amendment authorizes and directs the Secretary of the Treasury and the Secretary of Labor to give consideration to providing special relief with respect to the use of low-cost individual retirement plans for purposes of the provision and for other uses that promote the preservation of tax-qualified retirement assets for retirement income purposes.

Effective date.—The Senate amendment applies to distributions that occur after the Department of Labor has adopted final regulations implementing the Senate amendment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications. The conference agreement directs the Secretary

of Labor to adopt final regulations implementing the conference agreement not later than three years after the date of enactment.

(i) Clarification of treatment of contributions to a multiemployer plan (sec. 658 of the bill)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, contributions are deductible for the taxable year of the employer in which the contributions are made. Under a special rule, an employer may be deemed to have made a contribution on the last day of the preceding taxable year if the contribution is on account of the preceding taxable year and is made not later than the time prescribed by law for filing the employer's income tax return for that taxable year (including extensions).¹²⁷

A change in method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. A material item is any item that involves the proper time for the inclusion of the item in income or taking of a deduction.¹²⁸ A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability. Also, a change in method of accounting does not include adjustment of any item of income or deduction that does not involve the proper time for the inclusion of the item of income or the taking of a deduction. A change in method of accounting also does not include a change in treatment resulting from a change in underlying facts.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment clarifies that a determination of whether contributions to multiemployer pension plans are on account of a prior year under section 404(a)(6) is not a method of accounting. Thus, any taxpayer that begins to deduct contributions to multiemployer plans as provided in section 404(a)(6) has not changed its method of accounting and is not subject to an adjustment under section 481. The Senate amendment is intended to respect, not disturb, the effect of the statute of limitations. The Senate amendment is not intended to permit, as of the end of the taxable year, aggregate deductions for contributions to a qualified plan in excess of the amounts actually contributed or deemed contributed to the plan by the taxpayer. The Secretary of the Treasury is authorized to promulgate regulations to clarify that, in the aggregate, no taxpayer will be permitted deductions in excess of amounts actually contributed to multiemployer plans, taking into account the provisions of section 404(a)(6).

No inference is intended regarding whether the determination of whether a contribution to a multiemployer pension plan on account of a prior year under section 404(a)(6) is a method of accounting prior to the effective date of the provision.

Effective date.—The Senate amendment is effective after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

5. Reducing regulatory burdens

(a) Modification of timing of plan valuations (sec. 601 of the House bill, sec. 661 of the Senate amendment, and sec. 412 of the Code)

PRESENT LAW

Under present law, plan valuations are generally required annually for plans subject to the minimum funding rules. Under proposed Treasury regulations, except as provided by the Commissioner, the valuation must be as of a date within the plan year to which the valuation refers or within the month prior to the beginning of that year.¹²⁹

HOUSE BILL

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

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement incorporates into the statute the proposed regulation regarding the date of valuations. The conference agreement also provides, as an exception to this general rule, that the valuation date with respect to a plan year may be any date within the immediately preceding plan year if, as of such date, plan assets are not less than 100 percent of the plan's current liability. Information determined as of such date is required to be adjusted actuarially, in accordance with Treasury regulations, to reflect significant differences in plan participants. A change in funding method to take advantage of the exception to the general rule may not be made unless, as of such date, plan assets are not less than 125 percent of the plan's current liability. The Secretary is directed to automatically approve changes in funding method to use a prior year valuation date if the change is within the first three years that the plan is eligible to make the change.

(b) ESOP dividends may be reinvested without loss of dividend deduction (sec. 602 of the House bill, sec. 662 of the Senate amendment, and sec. 404 of the Code)

PRESENT LAW

An employer is entitled to deduct certain dividends paid in cash during the employer's taxable year with respect to stock of the employer that is held by an employee stock ownership plan ("ESOP"). The deduction is allowed with respect to dividends that, in accordance with plan provisions, are (1) paid in cash directly to the plan participants or their beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) used to make payments on loans (including payments of interest as well as principal) that

¹²⁷ Section 404(a)(6).

¹²⁸ Treas. Reg. sec. 1.446-1(e)(2)(ii)(a).

¹²⁹ Prop. Treas. Reg. sec. 1.412(c)(9)-1(b)(1).

were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

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

HOUSE BILL

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

The House bill permits the Secretary to disallow the deduction for any ESOP dividend if the Secretary determines that the dividend constitutes, in substance, the avoidance or evasion of taxation.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct the applicable percentage of dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities. The applicable percentage is 25 percent for 2002 through 2004, 50 percent for 2005 through 2007, 75 percent for 2008 through 2010 and 100 percent for 2011 and thereafter.

CONFERENCE AGREEMENT

The conference agreement follows the House bill. The provision of the conference agreement that authorizes the Secretary to disallow the deduction for any ESOP dividend if the Secretary determines that the dividend constitutes, in substance, the avoidance or evasion of taxation includes authority to disallow a deduction of unreasonable dividends. For purposes of the section 404(k)(2)(A)(iii) reinvested dividends, a dividend paid on common stock that is primarily and regularly traded on an established securities market, the reasonableness of a dividend is determined by comparing the dividend rate on stock held by the ESOP with the dividend rate for common stock of comparable corporations whose stock is primarily and regularly traded on an established securities market. Whether a corporation is comparable is determined by comparing relevant corporate characteristics such as industry, corporate size, earnings, debt-equity structure and dividend history.

- (c) Repeal transition rule relating to certain highly compensated employees (sec. 603 of the House bill, sec. 663 of the Senate amendment, and sec. 1114(c)(4) of the Tax Reform Act of 1986)

PRESENT LAW

Under present law, for purposes of the rules relating to qualified plans, a highly

compensated employee is generally defined as an employee¹³⁰ who (1) was a five-percent owner of the employer at any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of \$85,000 (for 2001) or (b) at the election of the employer, had compensation in excess of \$85,000 for the preceding year and was in the top 20 percent of employees by compensation for such year.

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

HOUSE BILL

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

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (d) Employees of tax-exempt entities (sec. 604 of the House bill and sec. 664 of the Senate amendment)

PRESENT LAW

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

Treasury regulations provide that, in applying the nondiscrimination rules to a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan), the employer may treat as excludable those employees of a tax-exempt entity who could not participate in the arrangement due to the prohibition on maintenance of a section 401(k) plan by such entities. Such employees may be disregarded only if more than 95 percent of the employees who could participate in the section 401(k) plan benefit under the plan for the plan year.¹³¹

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

HOUSE BILL

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

¹³⁰An employee includes a self-employed individual.

¹³¹Treas. Reg. sec. 1.410(b)-6(g).

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

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (e) Treatment of employer-provided retirement advice (sec. 605 of the House bill, sec. 665 of the Senate amendment, and sec. 132 of the Code)

PRESENT LAW

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

In addition, if certain requirements are satisfied, up to \$5,250 annually of employer-provided educational assistance is excludable from gross income (sec. 127) and wages. This exclusion expires with respect to courses beginning after December 31, 2001.¹³² Education not excludable under section 127 may be excludable as a working condition fringe.

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

HOUSE BILL

Qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan are excludable from income and wages. The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan. "Qualified retirement planning services" are retirement planning advice and information. The exclusion is not limited to information regarding the qualified plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

It is intended that the House bill will clarify the treatment of retirement advice provided in a nondiscriminatory manner. It is intended that the Secretary, in determining the application of the exclusion to highly compensated employees, may permit employers to take into consideration employee circumstances other than compensation and position in providing advice to classifications of employees. Thus, for example, the Secretary may permit employers to limit certain advice to individuals nearing retirement age under the plan.

¹³²The exclusion does not apply with respect to graduate-level courses.

Effective date.—The House bill is effective with respect to years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (f) Reporting simplification (sec. 606 of the House bill and sec. 666 of the Senate amendment)

PRESENT LAW

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.¹³³ The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Department of Labor, which forwards the form to the Internal Revenue Service and the PBGC.

The Form 5500 series consists of two different forms: Form 5500 and Form 5500-EZ. Form 5500 is the more comprehensive of the forms and requires the most detailed financial information. A plan administrator generally may file Form 5500-EZ, which consists of only one page, if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500-EZ and the total value of the plan assets as of the end of the plan year and all prior plan years beginning on or after January 1, 1994, does not exceed \$100,000, the plan administrator is not required to file a return.

With respect to a plan that does not satisfy the eligibility requirements for Form 5500-EZ, the characteristics and the size of the plan determine the amount of detailed financial information that the plan administrator must provide on Form 5500. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must provide more information.

HOUSE BILL

The Secretary of the Treasury is directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500-EZ to provide that if the total value of the plan assets of such a plan as of the end of the plan year and all prior plan years beginning on or after January 1, 1994, does not exceed \$250,000, the plan administrator is not required to file a return. In addition, the House bill directs the Secretary of the Treasury and the Secretary of Labor to provide sim-

plified reporting requirements for certain plans with fewer than 25 employees.

Effective date.—The House bill is effective on January 1, 2002.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment does not include the direction to the Secretary of the Treasury and the Secretary of Labor to provide simplified reporting requirements for certain plans with fewer than 25 employees.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (g) Improvement to Employee Plans Compliance Resolution System (sec. 607 of the House bill and sec. 667 of the Senate amendment)

PRESENT LAW

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), or section 403(b), as applicable.¹³⁴ EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

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

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

HOUSE BILL

The Secretary of the Treasury is directed to continue to update and improve EPCRS,

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

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (h) Repeal of the multiple use test (sec. 608 of the House bill, sec. 668 of the Senate amendment, and sec. 401(m) of the Code)

PRESENT LAW

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

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

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

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

¹³³Treas. Reg. sec. 301.6058-1(a).

¹³⁴Rev. Proc. 2001-17, 2001-7 I.R.B. 589.

compensated employee group for the prior plan year and not more than two percentage points greater than the ACP of the non-highly compensated employee group for the prior plan year.

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

HOUSE BILL

The House bill repeals the multiple use test.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

- (i) Flexibility in nondiscrimination, coverage, and line of business rules (sec. 609 of the House bill, sec. 669 of the Senate amendment, and secs. 401(a)(4), 410(b), and 414(r) of the Code)

PRESENT LAW

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

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

each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

HOUSE BILL

The Secretary of the Treasury is directed to modify, on or before December 31, 2003, the existing regulations issued under section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

The Secretary of the Treasury is directed to provide by regulation applicable to years beginning after December 31, 2003, that a plan is deemed to satisfy the nondiscrimination requirements of section 401(a)(4) if the plan satisfies the pre-1994 facts and circumstances test, satisfies the conditions prescribed by the Secretary to appropriately limit the availability of such test, and is submitted to the Secretary for a determination of whether it satisfies such test (to the extent provided by the Secretary).

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

Effective date.—The provision of the House bill relating to the line of business requirements under section 414(r) is effective on the date of enactment. The provision relating to the nondiscrimination requirements under section 401(a)(4) is effective on the date of enactment, except that any condition of availability prescribed by the Secretary is not effective before the first year beginning not less than 120 days after the date on which such condition is prescribed. The provision relating to the minimum coverage requirements under section 410(b) is effective for years beginning after December 31, 2003, except that any condition of availability prescribed by the Secretary by regulation does not apply before the first year beginning not less than 120 days after the date on which such condition is prescribed.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment provides that the regulations required with respect to the nondiscrimination requirements of section 401(a)(4) are to be applicable to plan years beginning after December 31, 2001, and that the regulations required with respect to the line of business requirements of section 414(r) are to be issued by December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (j) Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to state and local government plans (sec. 610 of the House bill, sec. 670 of the Senate amendment, sec. 1505 of the Taxpayer Relief Act of 1997, and secs. 401(a) and 401(k) of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec.

401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

HOUSE BILL

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

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (k) Notice and consent period regarding distributions (sec. 611 of the House bill and sec. 417 of the Code)

PRESENT LAW

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.¹³⁵

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

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

HOUSE BILL

A qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 180 days

¹³⁵ Similar provisions are contained in Title I of ERISA.

before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 180 days and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

- (1) Annual report dissemination (sec. 612 of the House bill and sec. 104(b)(3) of ERISA)

PRESENT LAW

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

HOUSE BILL

The requirement that a plan administrator furnish a summary annual report is satisfied if the report is made reasonably available through electronic means or other new technology. The interpretation of the House bill is to be consistent with the regulations of the Department of Labor and the Department of the Treasury.

Effective date.—The House bill is effective for reports for years beginning after December 31, 2000.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

- (m) Modifications to the SAVER Act (sec. 613 of the House bill and sec. 517 of ERISA)

PRESENT LAW

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

HOUSE BILL

The House bill clarifies that future National Summits on Retirement Savings are to be held in the month of September in 2001 and 2005, and adds an additional National Summit in 2009. To facilitate the administration of future National Summits, the Department of Labor is given authority to enter into cooperative agreements (pursuant to the Federal Grant and Cooperative Agreement Act of 1977) with its 1999 summit partner, the American Savings Education Council.

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

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

Effective date.—The provision is effective on the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

6. Other ERISA provisions

- (a) Extension of PBGC missing participants program (sec. 701 of the House bill, sec. 681 of the Senate amendment, and secs. 206(f) and 4050 of ERISA)

PRESENT LAW

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator of a single employer plan cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

HOUSE BILL

The PBGC is directed to prescribe for terminating multiemployer plans rules similar to the present-law missing participant rules applicable to terminating single-employer plans that are subject to Title IV of ERISA.

In addition, plan administrators of certain types of plans not subject to the PBGC termination insurance program under present law are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the House bill extends the missing par-

ticipants program to defined contribution plans, defined benefit plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

Effective date.—The House bill is effective for distributions from terminating plans that occur after the PBGC has adopted final regulations implementing the House bill.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (b) Reduce PBGC premiums for small and new plans (secs. 702-703 of the House bill, secs. 682-683 of the Senate amendment, and sec. 4006 of ERISA)

PRESENT LAW

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of \$19 per participant and an additional variable-rate premium based on a charge of \$9 per \$1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable-rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than five years, and with respect to benefit increases from a plan amendment that was in effect for less than five years before termination of the plan.

HOUSE BILL

Reduced flat-rate premiums for new plans of small employers

Under the House bill, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium is \$5 per plan participant.

A small employer is a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

A new plan means a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) has not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as are in the new plan.

Reduced variable-rate PBGC premium for new plans

The House bill provides that the variable-rate premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable-rate premium is a percentage of the variable premium otherwise due, as follows: zero percent of the otherwise applicable variable-rate premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan is defined as described above under the flat-rate premium provision of the House bill relating to new small employer plans.

Reduced variable-rate PBGC premium for small plans

In the case of a plan of a small employer, the variable-rate premium is no more than \$5 multiplied by the number of plan participants in the plan at the end of the preceding plan year. For purposes of the House bill, a small employer is a contributing sponsor that, on the first day of the plan year, has 25 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

Effective date

The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans is effective with respect to plans established after December 31, 2001. The reduction of the variable-rate premium for small plans is effective with respect to plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (c) Authorization for PBGC to pay interest on premium overpayment refunds (sec. 704 of the House bill, sec. 684 of the Senate amendment, and sec. 4007(b) of ERISA)

PRESENT LAW

The PBGC charges interest on underpayments of premiums, but is not authorized to pay interest on overpayments.

HOUSE BILL

The House bill allows the PBGC to pay interest on overpayments made by premium payors. Interest paid on overpayments is calculated at the same rate and in the same manner as interest is charged on premium underpayments.

Effective date.—The House bill is effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (d) Rules for substantial owner benefits in terminated plans (sec. 705 of the House bill, sec. 685 of the Senate amendment, and secs. 4021, 4022, 4043 and 4044 of ERISA)

PRESENT LAW

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

HOUSE BILL

The House bill provides that the 60-month phase-in of guaranteed benefits applies to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in occurs over a 10-year period and depends on the number of years the plan has been in effect. The majority owner's guaranteed benefit is limited so that it could not be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets applies to substantial owners, other than majority owners, in the same manner as other participants.

Effective date.—The House bill is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC, after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

- (e) Civil penalties for breach of fiduciary responsibility (sec. 706 of the House bill and sec. 502 of ERISA)

PRESENT LAW

Present law requires the Secretary of Labor to assess a civil penalty against (1) a fiduciary who breaches a fiduciary responsibility under, or commits a violation of, part 4 of Title I of ERISA, or (2) any other person who knowingly participates in such a breach or violation. The penalty is equal to 20 percent of the "applicable recovery amount" that is paid pursuant to a settlement agreement with the Secretary of Labor or that a court orders to be paid in a judicial proceeding brought by the Secretary of Labor to enforce ERISA's fiduciary responsibility provisions. The Secretary of Labor may waive or reduce the penalty only if the Secretary

finds in writing that either (1) the fiduciary or other person acted reasonably and in good faith, or (2) it is reasonable to expect that the fiduciary or other person cannot restore all the losses without severe financial hardship unless the waiver or reduction is granted.

HOUSE BILL

The House bill makes the assessment of the penalty discretionary with the Secretary of Labor, rather than mandatory. This change will allow the Secretary to refrain from imposing the penalty in certain cases as well as to assess a penalty of less than 20 percent of the applicable recovery amount. The requirement of a settlement agreement is also eliminated. The applicable recovery amount is any amount recovered by a plan or by a participant or beneficiary more than 30 days after the fiduciary's or other person's receipt of a written notice of the violation from the Department of Labor ("DOL"). Payments made after the 30-day grace period, whether they are made pursuant to a settlement agreement, or simply to discourage the DOL from bringing a legal action, are subject to the penalty, as are amounts recovered pursuant to a court order. ERISA section 502(l) is also amended to clarify that the term "applicable recovery amount" includes payments by third parties that are made on behalf of the relevant fiduciary or other persons liable for the amount that is recovered, including those who did not actually pay. These changes prevent avoidance of the penalty by having an unrelated third party pay the recovery amount.

Effective date.—The House bill applies to any breach of fiduciary responsibility or other violation of part 4 of Title I of ERISA occurring on or after the date of enactment. The change with respect to "applicable recovery amount" includes a transition rule whereby a breach or other violation occurring before the date of enactment which continues past the 180th day from enactment (and which may have been discontinued during that period) is treated as having occurred after the date of enactment (to avoid having to make a complex determination regarding how much of the applicable recovery amount for such continuing violations should be attributed to the post-enactment part of the violation).

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

- (f) Benefit suspension notice (sec. 707 of the House bill and sec. 203 of ERISA)

PRESENT LAW

Under present law (ERISA sec. 203(a)(3)(B)), a plan will not fail to satisfy the vesting requirements with respect to a participant by reason of suspending payment of the participant's benefits while such participant is employed. Under the applicable Department of Labor ("DOL") regulations, such a suspension is only permissible if the plan notifies the participant during the first calendar month or payroll period in which the plan withholds benefit payments. Such notice must provide certain information and must also include a copy of the plan's provisions relating to the suspension of payments.

In the case of a plan that does not pay benefits to active participants upon attainment of normal retirement age, the employer must monitor plan participants to determine when any participant who is still employed attains normal retirement age. In order to suspend payment of such a participant's benefits, generally a plan must, as noted above, promptly provide the participant with a suspension notice.

HOUSE BILL

The House bill directs the Secretary of Labor to revise the regulations relating to the benefit suspension notice to generally permit the information currently required to be set forth in a suspension notice to be included in the summary plan description. The House bill also directs the Secretary of Labor to eliminate the requirement that the notice include a copy of relevant plan provisions. However, individuals reentering the workforce to resume work with a former employer after they have begun to receive benefits will still receive the notification of the suspension of benefits (and a copy of the plan's provisions relating to suspension of payments). In addition, if a reduced rate of future benefit accruals will apply to a returning employee (as of his or her first date of participation in the plan after returning to work) who has begun to receive benefits, the notice must include a statement that the rate of future benefit accruals will be reduced.

Effective date.—The House bill applies to plan years beginning after December 31, 2001.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(g) Studies (sec. 708 of the House bill)

PRESENT LAW

No provision.

HOUSE BILL

Study on small employer group plans

The House bill directs the Secretary of Labor, in consultation with the Secretary of the Treasury, to conduct a study to determine (1) the most appropriate form(s) of pension plans that would be simple to create and easy to maintain by multiple small employers, while providing ready portability of benefits for all participants and beneficiaries, (2) how such arrangements could be established by employer or employee associations, (3) how such arrangements could provide for employees to contribute independent of employer sponsorship, and (4) appropriate methods and strategies for making such pension plan coverage more widely available to American workers.

The Secretary of Labor is to consider the adequacy and availability of existing pension plans and the extent to which existing models may be modified to be more accessible to both employees and employers. The Secretary of Labor is to issue a report within 18 months, including recommendations for one or more model plans or arrangements as described above which may serve as the basis for appropriate administrative or legislative action.

Study on pension coverage

The House bill also directs the Secretary of Labor to report to the Committee on Education and the Workforce of the House of Representatives and the Committee on Health, Education, Labor and Pensions of the Senate regarding the effect of the bill on pension coverage, including: the extent of pension plan coverage for low and middle-income workers, the levels of pension plan benefits generally, the quality of pension plan coverage generally, worker's access to and participation in pension plans, and retirement security. This report is required to be submitted no later than five years after the date of enactment.

Effective date

The House bill is effective on the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

7. Miscellaneous provisions

(a) Tax treatment of electing Alaska Native Settlement Trusts (section 691 of the Senate amendment and new sections 646 and 6039H of the Code, modifying Code sections including 1(e), 301, 641, 651, 661, and 6034A))

PRESENT LAW

An Alaska Native Corporation ("ANC") may establish a Settlement Trust ("Trust") under section 39 of the Alaska Native Claims Settlement Act ("ANCSA")¹³⁶ and transfer money or other property to such Trust for the benefit of beneficiaries who constitute all or a class of the shareholders of the ANC, to promote the health, education and welfare of the beneficiaries and preserve the heritage and culture of Alaska Natives.

With certain exceptions, once an ANC has made a conveyance to a Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgment, except with respect to the lawful debts and obligations of the Trust.

The Internal Revenue Service ("IRS") has indicated that contributions to a Trust constitute distributions to the beneficiary-shareholders at the time of the contribution and are treated as dividends to the extent of earnings and profits as provided under section 301 of the Code.¹³⁷ Also, a Trust and its beneficiaries are generally taxed subject to applicable trust rules.¹³⁸

Under general rules regarding the classification of entities, an entity that is taxed as a trust may not engage in business activity and must meet certain other requirements.¹³⁹ Under certain circumstances, a trust can be treated as a "grantor" trust rather than being taxed as a trust; and its income can be taxed directly to the person or persons considered the owner of the trust.¹⁴⁰

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment allows an election under which special rules will apply in determining the income tax treatment of an electing Trust and of its beneficiaries. An electing Trust will pay tax on its income at the lowest rate specified for ordinary income of an individual (or corresponding lower capital gains rate). The provision also specifies the treatment of distributions by an electing Trust to beneficiaries, the reporting requirements associated with such an election, and the consequences of disqualification for these benefits due to the allowance of certain impermissible dispositions of Trust interests, or of ANC stock.

Under the provision, a trust that is a Trust established by an Alaska Native Corporation under section 39 of ANCSA may make an election for its first taxable year ending after the date of enactment of the provision to be subject to the rules of the provision rather than otherwise applicable income tax rules. If the election is in effect, no amount will be included in the gross income of a beneficiary of such Trust by reason of a contribution to the Trust.¹⁴¹ In addition, ordi-

¹³⁶ 43 U.S.C. 1601 et seq. A settlement Trust is subject to certain limitations under ANCSA, including that it may not operate a business. 43 U.S.C. 1629e(b).

¹³⁷ See, e.g., P.L.R. 9824014; P.L.R. 9433021; P.L.R. 9329026 and P.L.R. 9326019.

¹³⁸ See Subchapter J of the Code (secs. 641 et. seq.); Treas. Reg. Sec. 301.7701-4.

¹³⁹ Treas. Reg. Sec. 301.7701-4.

¹⁴⁰ 140 Sec. 671 et. seq.

¹⁴¹ If the ANC transfers appreciated property to the Trust, section 311(b) of the Code will apply to the

nary income of the electing Trust, whether accumulated or distributed, will be taxed only to the Trust (and not to beneficiaries) at the lowest individual tax rate for ordinary income. Capital gains of the electing Trust will similarly be taxed to the Trust at the capital gains rate applicable to individuals subject to such lowest rate. These rates will apply, rather than the higher rates generally applicable to trusts or to higher tax bracket beneficiaries. The election is made on a one-time basis only. The benefits of the election will terminate, however, and other special rules will apply, if the electing Trust or the sponsoring ANC fail to satisfy the restrictions on transferability of Trust beneficial interests or of ANC stock.

The treatment to beneficiaries of amounts distributed by an electing Trust depends upon the amount of the distribution. Solely for purposes of determining what amount has been distributed and thus which treatment applies under these rules, the amount of any distribution of property is the fair market value of the property at the time of the distribution.¹⁴²

Amounts distributed by an electing Trust during any taxable year are excludable from the gross income of the recipient beneficiary to the extent of (1) the taxable income of the Trust for the taxable year and all prior taxable years for which an election was in effect (decreased by any income tax paid by the Trust with respect to the income) plus (2) any amounts excluded from gross income of the Trust under section 103 for those periods.¹⁴³

If distributions to beneficiaries exceed the excludable amounts described above, then such excess distributions are reported and taxed to beneficiaries as if distributed by the ANC in the year of the distribution by the electing Trust to the extent the ANC then has current or accumulated earnings and profits, and are treated as dividends to beneficiaries.¹⁴⁴ Additional distributions in excess of the current or accumulated earnings and profits of the ANC are treated by the beneficiaries as distributions by the Trust in excess of the distributable net income of the Trust for such year.¹⁴⁵

ANC, as under present law, so that the ANC will recognize gain as if it had sold the property for fair market value. The Trust takes the property with a fair market value basis, pursuant to section 301(d) of the Code.

¹⁴² Section 661 of the Code, which provides a deduction to the trust for certain distributions, does not apply to an electing Trust under the provision unless the election is terminated by disqualification. Similarly, the inclusion provisions of section 662 of the Code, relating to amounts to be included in income of beneficiaries, also do not apply to a qualified electing Trust.

¹⁴³ In the case of any such excludable distribution that involves a distribution of property other than cash, the basis of such property in the hands of the recipient beneficiary will generally be the adjusted basis of the property in the hands of the Trust, unless the Trust makes an election to pay tax, in which case the basis in the hands of the beneficiary would be the fair market value of the property. See Code sections 643(e) and 643(e)(3).

¹⁴⁴ The treatment of such amounts distributed by an electing Trust as a dividend applies even if all or any part of the contributions by an ANC to a Trust would not have been dividends at the time of the contribution under present law; for example, because the ANC had no current or accumulated earnings and profits, or because the contribution was made from Alaska Native Fund amounts that may not have been taxable. See 43 U.S.C. 1605.

¹⁴⁵ Such distributions would not be taxable to the beneficiaries. In the case of any such nontaxable distribution that involves a distribution of property other than cash, the basis of such property in the hands of the recipient beneficiary will generally be the adjusted basis of the property in the hands of the Trust, unless the Trust makes an election to pay tax, in which case the basis in the hands of the beneficiary will be the fair market value of the property. See Code sections 643(e) and 643(e)(3).

The fiduciary of an electing Trust must report to the IRS, with the Trust tax return, the amount of distributions to each beneficiary, and the tax treatment to the beneficiary of such distributions under the provision (either as exempt from tax to the beneficiary, or as a distribution deemed made by the ANC). The electing Trust must also furnish such information to the ANC. In the case of distributions that are treated as if made by the ANC, the ANC must then report such amounts to the beneficiaries and must indicate whether they are dividends or not, in accordance with the earnings and profits of the ANC. The reporting thus required by an electing Trust will be in lieu of, and will satisfy, the reporting requirements of section 6034A (and such other reporting requirements as the Secretary of the Treasury may deem appropriate).

The earnings and profits of an ANC will not be reduced by the amount of its contributions to an electing Trust at the time of the contributions. However, the ANC earnings and profits will be reduced as and when distributions are thereafter made by the electing Trust that are taxed to beneficiaries under the provision as dividends from the ANC to the Trust beneficiaries.

If in any taxable year the beneficial interests in the electing Trust may be disposed of to a person in a manner that would not be permitted under ANCSA if the interests were Settlement Common Stock (generally, to a person other than an Alaska Native),¹⁴⁶ then the special provisions applicable to electing Trusts, including the favorable ordinary income tax rate and corresponding lower capital gains tax rate, cease to apply as of the beginning of such taxable year. The distributable net income of the Trust is increased up to the amount of current and accumulated earnings and profits of the ANC as of the end of that year, but such increase shall not exceed the fair market value of the assets of the Trust as of the date the beneficial interests of the Trust became disposable.¹⁴⁷ Thereafter, the Trust and its beneficiaries are generally subject to the rules of subchapter J and to the generally applicable trust income tax rates. Thus, the increase in distributable net income will result in the Trust being taxed at regular trust rates to the extent the recomputed distributable net income is not distributed to beneficiaries; and beneficiaries will be taxed to the extent there are distributions. Normal reporting rules applicable to trusts and their beneficiaries will apply. The basis of any property distributed to beneficiaries will also be determined under normal trust rules. The same rules apply if any stock of the ANC may be disposed of to a person in a manner that would not be permitted under ANCSA if the stock were Settlement Common Stock and the ANC makes a transfer to the Trust.

The provision contains a special loss disallowance rule that reduces any loss that would otherwise be recognized by a shareholder upon the disposition of a share of stock of a sponsoring ANC by a "per share loss adjustment factor". This factor reflects the aggregate of all contributions to an electing Trust sponsored by such ANC made on or after the first day the trust is treated

as an electing Trust, expressed on a per share basis and determined as of the day of each such contribution.

The special loss disallowance rule is intended to prevent the allowance of non-economic losses if the ANC stock owned by beneficiaries ever becomes transferable in any type of transaction that could cause the recognition of taxable gain or loss, (including a redemption by the ANC) where the basis of the stock in the hands of the beneficiary (or in the hands of any transferee of a beneficiary) fails to reflect the allocable reduction in corporate value attributable to amounts transferred by the ANC into the Trust.

Effective date.—The provision is effective for taxable years of Trusts, their beneficiaries, and sponsoring Alaska Native Corporations ending after the date of enactment, and to contributions made to electing Trusts during such year and thereafter.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

The conferees wish to state certain technical clarifications of the description of the Senate amendment, which also apply under the conference agreement.

Under the Senate amendment and the conference agreement, a Trust that makes the election remains subject to the generally applicable requirements for classification and taxation as a trust, in order to obtain the benefits of the provision.

Under the Senate amendment and the conference agreement, the per share loss adjustment factor for stock of an ANC is the aggregate of all contributions to all electing Trusts sponsored by such ANC made on or after the first day each such Trust is treated as an electing Trust expressed on a per share basis and determined as of the day of each such contribution.

Under the Senate amendment and the conference agreement, the restrictions on transfer of stock or beneficial interests under the provision are those that would apply to Settlement Common Stock under section 7(h) of ANCSA¹⁴⁸ (whether or not the interest or stock in question is in fact Settlement Common Stock). To the extent section 7(h) of ANCSA permits certain transfers of Settlement Common stock on death or in other special circumstances, those are also permitted under the provision. Also, the mere transferability of ANC stock in manner that would not be permitted for Settlement Common Stock (but without such transferability of any Trust interests) will not destroy the beneficial treatment of an existing electing Trust unless and until the ANC thereafter makes a transfer to the Trust.

Under the Senate amendment and the conference agreement, the surrender of an interest in an ANC or an electing Trust in order to accomplish the whole or partial redemption of the interest of a shareholder or beneficiary in such ANC or Trust, or to accomplish the whole or partial liquidation of such ANC or Trust, is deemed to be a transfer permitted by section 7(h) of ANCSA for purposes of the provision.

The conferees also wish to clarify the effect of the general sunset rule of the legislation on this provision. The general sunset is effective for taxable years beginning after December 31, 2010. For such taxable years, the tax consequences of any election previously made under this provision, and any right to make a future election, shall be terminated. Thus, for taxable years beginning after December 31, 2010, any electing Trust then in existence, its beneficiaries, and the sponsoring ANC shall be taxed under the pro-

visions of law in effect immediately prior to the enactment of this provision.

8. Provisions relating to plan amendments (sec. 801 of the House bill)

PRESENT LAW

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

HOUSE BILL

The House bill permits certain plan amendments made pursuant to the changes made by the bill (or regulations issued under the provisions of the House bill) to be retroactively effective. If the plan amendment meets the requirements of the bill, then the plan is treated as being operated in accordance with its terms and the amendment does not violate the prohibition of reductions of accrued benefits. In order for this treatment to apply, the plan amendment must be made on or before the last day of the first plan year beginning on or after January 1, 2004 (January 1, 2006, in the case of a governmental plan). If the amendment is required to be made to retain qualified status as a result of the changes in the bill (or regulations) the amendment must be made retroactively effective as of the date on which the change became effective with respect to the plan and the plan must be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to the changes made by the bill (or applicable regulations) may be made retroactive as of the first day the plan was operated in accordance with the amendment.

A plan amendment is not considered to be pursuant to the bill (or applicable regulations) if it has an effective date before the effective date of the provision of the House bill (or regulations) to which it relates. Similarly, the House bill does not provide relief from section 411(d)(6) for periods prior to the effective date of the relevant provision of the House bill (or regulations) or the plan amendment.

The Secretary is authorized to provide exceptions to the relief from the prohibition on reductions in accrued benefits. It is intended that the Secretary will not permit inappropriate reductions in contributions or benefits that are not directly related to the provisions of the House bill. For example, it is intended that a plan that incorporates the section 415 limits by reference could be retroactively amended to impose the section 415 limits in effect before the bill. On the other hand, suppose a plan that incorporates the section 401(a)(17) limit on compensation by reference provides for an employer contribution of three percent of compensation. It is expected that the Secretary will provide that the plan could not be amended retroactively to reduce the contribution percentage for those participants not affected by the section 401(a)(17) limit, even though the reduction will result in the same dollar level of contributions for some participants because of the increase in compensation taken into account under the plan. As another example, suppose that under present law a plan is top-heavy and therefore a minimum benefit is required under the plan, and that under the provisions of the House bill, the plan would not be considered to be top heavy. It is expected that the Secretary will generally permit plans to be retroactively amended to reflect the new top-heavy provisions of the House bill.

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

No provision.

¹⁴⁶ Under ANCSA, Settlement Common Stock is subject to restrictions on transferability, generally limiting transfers. However, if changes are made to permit transfers of stock that would not be permitted for Settlement Common Stock, then the Settlement Common Stock is cancelled and Replacement Common Stock is issued. See 43 U.S.C. 1602(p), 1606(h) and 1629c.

¹⁴⁷ To the extent the earnings and profits of the ANC increase distributable net income of the Trust under this provision, the ANC will have a corresponding adjustment reducing its earnings and profits.

¹⁴⁸ 43 U.S.C. 1606(h).

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

VII. ALTERNATIVE MINIMUM TAX

A. INDIVIDUAL ALTERNATIVE MINIMUM TAX RELIEF (SEC. 3(C) OF H.R. 6, SEC. 701 OF THE SENATE AMENDMENT AND SEC. 55 OF THE CODE)

PRESENT LAW

Present law imposes an alternative minimum tax ("AMT") on individuals to the extent that the tentative minimum tax exceeds the regular tax. An individual's tentative minimum tax generally is an amount equal to the sum of (1) 26 percent of the first \$175,000 (\$87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of an exemption amount and (2) 28 percent of the remaining AMTI. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The AMT exemption amounts are: (1) \$45,000 in the case of married individuals filing a joint return and surviving spouses; (2) \$33,750 in the case of other unmarried individuals; and (3) \$22,500 in the case of married individuals filing a separate return, estates and trusts. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) \$150,000 in the case of married individuals filing a joint return and surviving spouses, (2) \$112,500 in the case of other unmarried individuals, and (3) \$75,000 in the case of married individuals filing separate returns or an estate or a trust. The exemption amounts, the threshold phase-out amounts, and rate brackets are not indexed for inflation.

HOUSE BILL

No provision.

However, H.R. 6, as passed by the House, increases the AMT exemption amount for married couples filing a joint return and surviving spouses by \$1,000 in 2005, by an additional \$500 in 2006, and by an additional \$500 every even-numbered year thereafter. The exemption amount for married individuals filing a separate return is one-half the exemption amount for a married couple filing a joint return.

Effective date.—The provision applies to taxable years beginning after December 31, 2004.

SENATE AMENDMENT

The Senate amendment increases the AMT exemption amount for married couples filing a joint return and surviving spouses by \$4,000. The AMT exemption amounts for other individuals (i.e., unmarried individuals and married individuals filing a separate return) are increased by \$2,000.

Effective date.—The provision applies to taxable years beginning after December 31, 2000, and before January 1, 2007.

CONFERENCE AGREEMENT

The conference agreement increases the AMT exemption amount for married couples filing a joint return and surviving spouses by \$4,000. The AMT exemption amounts for other individuals (i.e., unmarried individuals and married individuals filing a separate return) are increased by \$2,000.

Effective date.—The provision applies to taxable years beginning after December 31, 2000, and beginning before January 1, 2005.

VIII. OTHER PROVISIONS

A. MODIFICATION TO CORPORATE ESTIMATED TAX REQUIREMENTS (SECS. 801 AND 815 OF THE SENATE AMENDMENT)

PRESENT LAW

In general, corporations are required to make quarterly estimated tax payments of

their income tax liability (section 6655). For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

HOUSE BILL

No provision.

SENATE AMENDMENT

With respect to corporate estimated tax payments due on September 17, 2001,¹⁴⁹ 30 percent is required to be paid by September 17, 2001, and 70 percent is required to be paid by October 1, 2001. With respect to corporate estimated tax payments due on September 15, 2004, 80 percent is required to be paid by September 15, 2004, and 20 percent is required to be paid by October 1, 2004.

With respect to corporate estimated tax payments due in July, August, or September 2011, the payment must be 170 percent of the amount otherwise required to be paid under the corporate estimated tax rules.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with respect to corporate estimated tax payments due on September 15, 2004. With respect to corporate estimated tax payments due on September 17, 2001, 100 percent is not due until October 1, 2001. The conference agreement does not include the provision affecting corporate estimated tax payments due in 2011.

B. AUTHORITY TO POSTPONE CERTAIN TAX-RELATED DEADLINES BY REASON OF PRESIDENTIALLY DECLARED DISASTER (SEC. 802 OF THE SENATE AMENDMENT AND SEC. 7508A OF THE CODE)

PRESENT LAW

The Secretary of the Treasury may specify that certain deadlines are postponed for a period of up to 90 days in the case of a taxpayer determined to be affected by a Presidentially declared disaster.¹⁵⁰ The deadlines that may be postponed are the same as are postponed by reason of service in a combat zone. If the Secretary extends the period of time for filing income tax returns and for paying income tax, the Secretary must abate related interest for that same period of time.¹⁵¹

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment directs the Secretary to create in the IRS a Permanent Disaster Response Team, which, in coordination with the Federal Emergency Management Agency, is to assist taxpayers in clarifying and resolving tax matters associated with a Presidentially declared disaster. One of the duties of the Disaster Response Team is to postpone certain tax-related deadlines for up to 120 days in appropriate cases for taxpayers determined to be affected by a Presidentially declared disaster.

It is anticipated that the Disaster Response Team would be staffed by IRS employees with relevant knowledge and experience. It is anticipated that the Disaster Response Team would staff a toll-free number dedicated to responding to taxpayers affected by a Presidentially declared disaster and provide relevant information via the IRS website.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement expands the period of time with respect to which the Sec-

retary may postpone certain deadlines from 90 days to 120 days. The conference agreement does not include the provision of the Senate amendment that provides for a Permanent Disaster Response Team.

C. INCOME TAX TREATMENT OF CERTAIN RESTITUTION PAYMENTS TO HOLOCAUST VICTIMS (SEC. 803 OF THE SENATE AMENDMENT)

PRESENT LAW

Under the Code, gross income means "income from whatever source derived" except for certain items specifically exempt or excluded by statute (sec. 61). There is no explicit statutory exception from gross income provided for amounts received by Holocaust victims or their heirs.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that excludable restitution payments made to an eligible individual (or the individual's heirs or estate) are: (1) excluded from gross income; and (2) not taken into account for any provision of the Code which takes into account excludable gross income in computing adjusted gross income (e.g., taxation of Social Security benefits).

The basis of any property received by an eligible individual (or the individual's heirs or estate) that is excluded under this provision is the fair market value of such property at the time of receipt by the eligible individual (or the individual's heirs or estate).

The Senate amendment provides that any excludable restitution payment is disregarded in determining eligibility for, and the amount of benefits and services to be provided under, any Federal or federally assisted program which provides benefit or service based, in whole or in part, on need. Under the Senate amendment, no officer, agency, or instrumentality of any government may attempt to recover the value of excessive benefits or services provided under such a program before January 1, 2000, by reason of failure to take account of excludable restitution payments received before that date. Similarly, the Senate amendment requires a good faith effort to notify any eligible individual who may have been denied such benefits or services of their potential eligibility for such benefits or services. The Senate amendment also provides coordination between this bill and Public Law 103-286, which also disregarded certain restitution payments in determining eligibility for, and the amount of certain needs-based benefits and services.

Eligible restitution payments are any payment or distribution made to an eligible individual (or the individual's heirs or estate) which: (1) is payable by reason of the individual's status as an eligible individual (including any amount payable by any foreign country, the United States, or any foreign or domestic entity or fund established by any such country or entity, any amount payable as a result of a final resolution of legal action, and any amount payable under a law providing for payments or restitution of property); (2) constitutes the direct or indirect return of, or compensation or reparation for, assets stolen or hidden, or otherwise lost to, the individual before, during, or immediately after World War II by reason of the individual's status as an eligible individual (including any proceeds of insurance under policies issued on eligible individuals by European insurance companies immediately before and during World War II); or (3) interest payable as part of any payment or distribution described in (1) or (2), above. An eligible individual is a person who was persecuted for racial or religious reasons by Nazi Germany, or any other Axis regime, or any other Nazi-controlled or Nazi-allied country.

¹⁴⁹ September 15, 2001 will be a Saturday. Under present law, payments required to be made on a Saturday must be made no later than the next banking day.

¹⁵⁰ Section 7508A.

¹⁵¹ Section 6404(h).