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DESCRIPTION OF S. 1784 (RETIREMENT INCOME POLICY ACT OF 1985)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

SENATE COMMITTEE ON FINANCE

ON JANUARY 28, 1986

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled a public hearing on January 28, 1986, on S. 1784 (introduced by Senators Heinz and Chafee). The bill would set forth a national retirement income policy and would revise the rules of the Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974 (ERISA) relating to coverage, vesting, integration, and portability under pension plans.

This pamphlet [1] is prepared by the staff of the Joint Committee on Taxation in connection with the Subcommittee's January 28 hearing. The first part of the pamphlet is a summary of the bill. The second part is a description of the provisions of the bill, including the relevant provisions of present law.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of S. 1784 (Retirement Income Policy Act of 1985)* (JCS-1-86), January 27, 1986.

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I. SUMMARY OF THE BILL

Participation requirements

Retirement plans and nonretirement savings plans

The bill would establish two types of deferred compensation plans, retirement plans and nonretirement savings plans, which could be maintained by employers. Under the bill, an employer could provide a nonretirement savings plan for an employee only if that employee is also a participant in a retirement plan that provides a specified minimum benefit. In addition, a retirement plan would be required to meet certain retirement income requirements, which provide restrictions on the timing and form of distributions from retirement plans.

Under the bill, a deferred compensation plan would be a nonretirement savings plan if it is not a retirement plan. The provisions with respect to retirement plans and nonretirement savings plans would be added to the Code and to ERISA.

Coverage requirements

The bill would revise the coverage requirements applicable to qualified plans under the Code and would extend those requirements to all pension plans subject to ERISA.

Under the bill, an employer would be considered to meet the coverage requirements if each employee in the employer's relevant workforce whose compensation is less than the social security contribution and benefit base (i.e., the wage base) is eligible to participate in a retirement plan maintained by the employer. Special rules would apply to permit coverage to be tested separately if the relevant workforce of the employer consists of two or more allowable subdivisions.

In addition, the bill would provide a special coverage test in the case of a retirement plan of an employer that provides for mandatory employee contributions if the retirement plan is used to qualify a nonretirement savings plan of the employer.

Limitations on deductions, contributions, and benefits

The bill would restrict the deduction for qualified voluntary employee contributions to contributions made to a retirement plan.

The bill would revise the rules of the Code relating to qualified cash or deferred arrangements (401(k) plans) and would add corresponding rules to ERISA. Under the bill, a cash or deferred arrangement could be provided only by a retirement plan that meets specified requirements relating to the coverage of employees. The bill would coordinate the exclusion provided for elective deferrals under a 401(k) plan with the deduction allowed to an employee for contributions to an individual retirement arrangement by reducing the deduction limit for contributions to an individual retirement

arrangement by the amount of elective deferrals under a 401(k) plan.

Under the bill, the overall limits on contributions and benefits under qualified plans would be revised and the combined plan limit would be repealed if no plan in which the employee participates is top heavy.

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The bill would relate the overall limits on benefits and contributions under qualified plans to the benefit and contribution base under the Social Security Act (i.e., the wage base ($42,000 for 1986)). Under a retirement plan, the dollar limit would be (1) 200 percent of the wage base in the case of a defined benefit plan, and (2) 50 percent of the wage base in the case of a defined contribution plan. The bill would provide further reductions for contributions and benefits under nonretirement plans and 401(k) plans. In addition, the bill would limit the amount of compensation that may be taken into account under a plan for purposes of the nondiscrimination provisions relating to qualified plans and the overall limits on benefits and contributions under a qualified plan. A corresponding limit on compensation taken into account would be provided by the bill under ERISA.

Vesting standards

The bill would amend ERISA and the Code to require that, in the case of a retirement plan, a participant who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions. In the case of a nonretirement savings plan, a participant would have a nonforfeitable right to 100 percent of employer contributions without regard to the participant's years of service. A special rule would apply for multiemployer retirement plans.

Pension integration

The bill would revise the integration rules under the Code for qualified plans and would add to the labor law a prohibition against discrimination by a pension plan in favor of specified employees similar to the rules of present law for qualified plans. Under the bill, a pension plan would not be considered to violate the nondiscrimination rules of the labor law or the tax law merely because the plan is integrated.

Distributions

The bill would repeal the 10-year forward income averaging and capital gains treatment of lump-sum distributions under qualified plans. In addition, under the bill, the 10-percent additional income tax on withdrawals from an IRA by the owner prior to the attainment of age 59½, death, or disability would be increased to 20 percent.

Coverage and portability

Early distributions of benefits

Under the bill, an accrued benefit would not be treated as nonforfeitable unless, in the case of any lump-sum distribution made before a participant attains age 59½, dies, or becomes disabled, the

distribution is made in a direct transfer to an IRA of the participant.

Special rules for simplified employee pensions (SEPs)

The bill would revise the qualification requirements relating to SEPs to permit employees to elect to have SEP contributions made on their behalf or to receive the contribution in cash. This salary reduction feature would only be available to employers who have 25 or fewer employees. In addition, the bill would repeal the provision permitting SEP contributions to be integrated with social security and would apply a limitation on annual SEP contributions that is tied to the contribution and benefit base under the Social Security Act.

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Effective dates

The bill generally would be effective with respect to any plan for plan years ending after the later of 2 years after the date of enactment of the bill or the earlier of (1) the effective date of the first plan amendment adopted after the date of enactment or (2) December 31, 1990. The provisions relating to individual retirement arrangements would be effective for taxable years ending after December 31, 1990.

A special effective date would be provided for collectively bargained plans. In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before the date of enactment, the bill would be effective for plan years ending after the later of 2 years after the date of enactment or the earliest of (1) the date on which the last of the collective bargaining agreements relating to the plan terminated (determined without regard to any extension ratified after the date of enactment), (2) the effective date of the first plan amendment adopted after the date of enactment, or (3) December 31, 1990.

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II. DESCRIPTION OF THE BILL

A. Overview of Tax-Favored Pension and Deferred Compensation Arrangements

In general

Under the Federal income tax system, individuals generally are taxed on income as it is earned. This principle has been applied to tax income that is made available (constructively received) in addition to income actually received. Under the economic benefit doctrine, if there is a transfer of property in exchange for services, the individual performing the services is required to include the value of the property in gross income when the property is not subject to a substantial risk of forfeiture. In addition, the gross income of a taxpayer generally includes noncash items that are equivalent to cash. An employer's deduction for compensation paid to an employee is postponed if the employer's income inclusion is postponed.

Historically, exceptions to the economic benefit doctrine have been adopted by Congress to encourage certain retirement savings by taxpayers. In particular, taxpayers have been encouraged by the tax law to set a part of their compensation aside under current programs that generally are designed to replace compensation upon retirement. Present law provides incentives by permitting taxpayers to postpone income tax on current compensation for retirement, and on investment earnings on those savings, under special plans of deferred compensation. Under these plans, income tax is generally postponed until the time benefits are paid, even though the benefits (if funded and nonforfeitable) would otherwise be currently taxable. Also, employers are allowed deductions (within limits) when contributions are made to these plans.

Since 1921, the Internal Revenue Code has specifically provided that certain employee trusts are exempt from Federal income tax. The 1921 Code provided an exemption for a trust forming part of a qualified profit-sharing or stock bonus plan.[2] The 1926 Code provided a similar exemption for qualified pension trusts and established deduction limits designed to set appropriate limits on the extent to which tax-favored treatment would be available under qualified plans.[3]

The standards for plan qualification have been revised and expanded since 1921 to reflect Congressional interest in the expansion of pension, profit-sharing, and stock bonus plans and concern over tax abuses. The rules relating to qualified plans were substantially revised by the Employee Retirement Income Security Act of 1974 (ERISA), which added (1) minimum coverage, vesting, benefit

[2] Sec. 219(f) of the Revenue Act of 1921.
[3] Sec. 219(f), sec. 23(p) of the Revenue Act of 1926.

accrual, and funding requirements, and (2) overall limits on contributions and benefits. That Act also provided for protection of pension benefits under the labor laws and for insurance of some benefits under defined benefit pension plans by the Pension Benefit Guaranty Corporation (PBGC).

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In addition to the deferral of income tax on amounts contributed to a qualified plan, present law provides an exclusion from exployment taxes (FICA and FUTA) for the amounts deferred under and the benefits paid from a qualified plan. This employment tax exclusion does not apply to elective deferrals under a qualified cash or deferred arrangement. Present law also provides relief from the effect of graduated tax rates by providing special income averaging rules for certain lump sum distributions and special treatment for net unrealized appreciation on employer securities.

Types of tax-favored retirement arrangements

Qualified plans

Under a plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan), an employer is allowed a deduction for contributions (within limits) to a trust to provide employee benefits. Similar rules apply to plans funded with annuity contracts. A qualified plan may be a pension, profit-sharing, or stock bonus plan.

A qualified pension plan may be either a defined benefit pension plan or a money purchase pension plan. Under a defined benefit pension plan, benefit levels are specified under a plan formula and are not solely dependent on the balance of an account for the employee. For example, a defined benefit pension plan might provide a monthly benefit of $10 for each year of service completed by an employee. Benefits under a defined benefit pension plan may also be specified as a flat or step-rate percentage of the employee's average compensation or career compensation. Benefits under a defined benefit pension plan are guaranteed (within limits) by the Pension Benefit Guaranty Corporation (a Federal corporation within the Department of Labor).

Under a money purchase pension plan, the amount of employer contributions allocated to the account of an employee must be fixed or determinable. A money purchase pension plan is a type of defined contribution plan; therefore, the amount an employee is entitled to receive is based solely on the balance in the employee's account. Benefits may be paid under a defined benefit pension plan or a money purchase pension plan only in the event of death, disability, separation from service, or attainment of normal retirement age.

Profit-sharing and stock bonus plans are also types of defined contribution plans. Under a profit-sharing plan, employer contributions are provided out of current or accumulated profits of the employer. Under a stock bonus plan, contributions may be made under a fixed formula or they may be related to profits of the employer. The rules for stock bonus plans generally require that benefits be distributed in the form of employer stock. Under a profit-sharing or stock bonus plan, benefits can be distributed to an employee who has not separated from service.

An employer's deductions and an employee's benefits under a qualified plan may be limited by reference to the employee's compensation. The Code also imposes overall limits on benefits or contributions that may be provided under qualified plans. In addition, subject to limits similar to the rules for individual retirement accounts (IRAs), certain employee contributions may be deductible when made. Investment earnings on the assets of a qualified plan are generally exempt from income tax until distributed.

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Under a qualified plan, employees do not include benefits in gross income until the benefits are distributed even though the plan is funded and the benefits are nonforfeitable. Tax deferral is provided under qualified plans from the time contributions are made until the time benefits are received. The employer is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee's income inclusion is deferred.

Benefits or contributions under a qualified plan are subject to standards designed to prohibit discrimination in favor of employees who are officers, shareholders, or highly compensated. In addition, qualified plans are required to meet minimum standards relating to coverage (what employees participate in the plan), vesting (the time at which an employee's benefit becomes nonforfeitable), and benefit accrual (the rate at which an employee earns a benefit). Also, minimum funding standards apply to the rate at which employer contributions are required to be made to ensure the solvency of pension plans.

Coverage under employer pension plans in the United States increased from approximately 15 percent of the nonagricultural workforce in 1940 to 41 percent in 1960. Since 1960, it has increased at a much slower rate so that, by 1983, 48.5 percent of the nonagricultural workforce (or 44.3 million workers) was covered by a plan. Table 1, below, shows the distribution of coverage under pension plans by compensation levels for 1983.

Table 1.—Distribution of Total Nonagricultural Wage and Salary Workers With Employer Pension Plans, 1983

Wage and salary class	Total wage and salary workers (thousands)	Workers with employer-provided pension plan	
		Number (thousands)	Percent of workers
Less than $5,000	17,766	1,568	8.8
$5,000–$10,000	16,961	4,908	28.9
$10,000–$20,000	29,926	17,405	58.2
$20,000–$30,000	16,103	12,216	75.9
$30,000–$50,000	8,544	6,672	78.1
Over $50,000	2,088	1,529	73.2
Total	91,388	44,298	48.5

Source: Office of Tax Analysis, U.S. Treasury and 1984 Current Population Survey (reported data at 1983 levels).

Little or no data are available concerning the extent to which individuals who are participating in employer-provided plans actually receive benefits from the plans. Some participants will terminate employment with their employers before vesting in any accrued benefits. Other participants will remain with an employer long enough to obtain vested rights, but their benefits will be partially or fully offset by social security benefits (through social security integration) considered to be provided by their employers.

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Tax-sheltered annuities

Tax-sheltered annuity programs may be established by public educational institutions and certain tax-exempt organizations (including churches and other organizations described in Code sec. 501(c)(3)) to provide retirement benefits to employees. Approximately 3 million persons are presently covered by these annuities.

Amounts paid by such an employer to purchase a tax-sheltered annuity (which may consist of shares of a regulated investment company (a mutual fund or a closed-end investment company)) are excluded (within limits) from the gross income of an employee even though the employee has a nonforfeitable right to benefits. Tax is also deferred on the investment earnings under a tax-sheltered annuity program. Over $3 billion in contributions were made to tax-sheltered annuities in 1983.

Tax-sheltered annuities may provide for nonexcludable employee contributions. Also, subject to rules similar to those provided for IRAs, certain employee contributions may be deducted by an employee. The limits on exclusions under tax-sheltered annuity programs may be higher than those for qualified plans.

Unlike qualified plans, tax-sheltered annuity programs are not subject to standards that prohibit discrimination in favor of employees who are officers, shareholders, or highly compensated.

Individual retirement arrangements (IRAs)

An individual is allowed a deduction for contributions (within limits) to provide retirement benefits under an individual retirement account or an individual retirement annuity (an IRA). Deductions are limited by reference to the individual's compensation. An individual is generally not taxed on amounts held by an IRA, including investment earnings, until benefits are distributed. Tax deferral is provided during the period between the contribution of compensation and the receipt of benefits. Amounts held by an IRA are subject to restrictions designed to restrain nonretirement use of the funds.

For tax year 1983, contributions to IRAs exceeded $32 billion. This total includes deductible contributions and tax-free rollovers.

B. Statement of National Retirement Income Policy Goals

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Present Law

Although policy goals have been stated in the legislative history of the provisions of present law with respect to retirement income programs, that policy has not been provided by statutory provisions.

Explanation of Provision

In general

The bill states findings of the Congress with respect to retirement income policy and would declare national retirement income policy goals.

Findings

According to the bill, the Congress finds that:

(1) The growth in the size, scope, and number of employee pension benefit plans has been substantial over the past quarter of a century;

(2) Since the enactment of the Employee Retirement Income Security Act of 1974, the number of workers and their families receiving benefits under these plans has steadily increased;

(3) For most workers and their families, the benefits paid by employee pension benefit plans are a necessary supplement to benefits received through the old-age, survivors, and disability insurance program under title II of the Social Security Act;

(4) Although the number of participants covered under these plans has increased, nearly half of current workers are not covered under any plan, and that percentage has remained relatively constant for the past decade;

(5) Even among workers covered by employee pension benefit plans, only 50 percent of those covered are currently entitled to receive benefits from those plans;

(6) The current rules regarding coverage, vesting, and integration of employee pension benefit plans with benefits under the old-age, survivors, and disability insurance program under title II of the Social Security Act tend to impede the policy goals of broadening of coverage and improving benefit delivery, particularly for mobile workers;

(7) Current incentives for plan formation have been inadequate and special incentives are needed to encourage small businesses to establish employee pension benefit plans;

(8) The lack of consistency and coordination of the rules governing various types of employee pension benefit plans has led to an erosion of the fundamental concept that retirement plans should provide retirement benefits;

(9) The frequency with which legislative changes affecting employee pension benefit plans have been enacted over the past decade have led to both uncertainty as to what the law requires and substantial additional administrative expenses for such plans which, in turn, has discouraged the growth and development of employee pension benefit plans; and

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(10) The lack of an articulated national retirement income policy has encouraged frequent and piecemeal changes.

Declaration of policy

The bill declares that its policy is to articulate certain basic national retirement income policy goals and to make certain changes to ERISA and the Code in pursuance of those goals.

The bill provides that it is the sense of the Congress that the following national retirement income policy goals should be pursued:

(1) The old-age, survivors, and disability insurance program under title II of the Social Security Act should be the universal and fundamental source of retirement income security for each American.

(2) Retirement benefits provided by title II of the Social Security Act should be supplemented with benefits provided from employer-financed retirement plans.

(3) Retirement benefits provided by title II of the Social Security Act and employer-financed pensions should be supplemented by individual savings for retirement.

(4) The current voluntary system of employer-sponsored retirement plans should be retained; and the growth and development of such plans should be encouraged.

(5) Although the age of retirement should be an individual decision, workers should be encouraged by public policy to remain in the work force throughout their productive years.

(6) Employer-sponsored retirement plans should be sufficiently flexible to deliver adequate retirement benefits to workers with a variety of career patterns.

(7) Benefits which are accumulated for retirement should be retained for that purpose.

(8) Although elective approaches to retirement savings may be useful in supplementing employer-financed retirement benefits, public policy should be developed with the recognition that employer-financed retirement programs can be more effective in delivering benefits to a broad cross-section of the population.

(9) Employer-sponsored savings for purposes other than retirement should be encouraged for employees participating in a meaningful retirement program.

(10) To the extent possible, retirement income should be provided from a variety of sources and should be sufficient to maintain an employee's preretirement standard of living throughout retirement.

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C. Participation Requirements

1. Retirement plans and nonretirement savings plans (sec. 101, 102, 104, 201, 202, and 204 of the bill, secs. 3, 211, and 213 of ERISA, and secs. 401, 409A, and 414 of the Code)[4]

Present Law

Distribution restrictions

Under a qualified pension plan, benefits may be withdrawn on account of plan termination or an employee's separation from service, disability, death, or attainment of normal retirement age. Withdrawals from qualified profit-sharing or stock bonus plans are subject to fewer restrictions than withdrawals under qualified pension plans. Qualified profit-sharing or stock bonus plans generally may permit the withdrawal of employer contributions after the expiration of a stated period of time (2 years or longer) or after the occurrence of a stated event (e.g., hardship). Hardship distributions may also be permitted under a tax-sheltered annuity investing in a mutual fund. Plans to which the less restrictive withdrawal rules apply have been sometimes referred to as capital accumulation or savings plans.

Special restrictions apply to benefits under a qualified cash or deferred arrangement (a plan that is part of a profit-sharing, stock bonus, or pre-ERISA money purchase pension plan and that meets the requirements of sec. 401(k)). Generally, except for hardship, these benefits may not be withdrawn before an employee attains age 59½, separates from service, dies, or becomes disabled.

The Code does not provide restrictions on benefit distributions under most private nonqualified plans of deferred compensation. However, benefits under unfunded deferred compensation plans of State or local governments and of certain tax-exempt organizations are not permitted to be made available earlier than when the employee separates from service or is faced with an unforeseeable emergency.

The labor law provisions of ERISA contain no restrictions on benefit distributions.

Prerequisite for nonretirement plan

Present law does not specify a distinction (other than withdrawal restrictions) between retirement plans and nonretirement savings plans and does not prevent an employer from establishing one type of plan for employees because the employer does not also provide another type of plan.

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[4] References to ERISA mean the Employee Retirement Income Security Act of 1974, and references to the Code mean the Internal Revenue Code of 1954.

Explanation of Provisions

ɔerview

The bill would establish two types of deferred compensation ans, retirement plans and nonretirement savings plans, which uld be maintained by employers. Under the bill, an employer uld provide a nonretirement savings plan for an employee only if at employee was also a participant in a retirement plan that prodes a specified minimum benefit. In addition, a retirement plan ould be required to meet certain retirement income requirements, hich provide restrictions on in-service distributions from retireent plans and would provide restrictions on the form in which nefits could be paid under those plans.

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Under the bill, a deferred compensation plan would be a nonreement savings plan if it is not a retirement plan. The provisions th respect to retirement plans and nonretirement savings plans ould be added to the Code and to the labor law.

In addition, under the bill, a retirement plan could not be conrted by a plan amendment into a nonretirement savings plan.

etirement income plans

Restrictions on time of distribution.—Generally, a plan would eet the restrictions of the bill relating to the time of benefit disibutions (the retirement income requirements) only if the plan ovides for distribution of the accrued benefits with respect to ich participant commencing not earlier than specified times. nder the bill, accrued benefits generally could not be distributed der a retirement plan until (i) the participant's disability, (ii) the articipant's death, or (iii) the later of the participant's attainment age 59½, or separation from service. The retirement income reuirements could also be met by a plan if the plan provides for cerin direct transfers.

Under the bill, in the case of a participant who has separated om service and who has not attained age 59½, died or become sabled, a distribution may be made upon separation from service the distribution meets certain requirements. The bill provides at the distribution could be made upon separation from service if is in a retirement income form and if the benefits will be paid no ter than the time permitted by the bill.

The bill would require that the payment of benefits commence ot later than the later of (1) the end of the plan year in which the nployee attains age 70½, or (2) in the case of an employee other ian an owner-employee (sec. 401(c)(3) of the Code), the end of the lan year in which the employee retires.

Restrictions on benefit forms.—The bill specifies three forms of enefit distribution (retirement income forms) that would satisfy ie restrictions on the form in which benefits may be distributed pon separation from service to a participant who has not attained ge 59½, died, or become disabled. Under the bill, the distribution iay be made (1) in the form of an annuity for the life of the particpant, (2) in the form of a qualified joint and survivor annuity (as efined in sec. 205(d) of ERISA or sec. 417(b) of the Code), or (3) in ie form of a level distribution over life expectancy (which may be djusted not more frequently than annually to account for changes

in life expectancy and reasonable assumptions based on previous investment performance under the plan).

Under the bill, a distribution would not fail to be in a retirement income form merely because the distribution is adjusted to allow for periodic supplements that terminate upon commencement of entitlement to benefits under the Social Security Act (e.g., a social security supplement), and after adding benefits otherwise paid under the plan for periods for which such supplements are paid, do not exceed the amount of those projected benefits under the Social Security Act and the plan upon the commencement of entitlement.

The bill would also permit the distribution of certain sickness, accident, or disability benefits (sec. 3(1) of ERISA).

Direct transfers.—The bill provides that a plan would not be treated as failing to meet the retirement income requirements solely because the plan provides for a direct transfer, to an IRA or to another retirement plan that accepts such direct transfers, of the accrued benefit with respect to the participant upon the participant's separation from service under the plan. See, also, part H.1., which describes provisions of the bill permitting certain direct transfers to an IRA without the participant's consent.

Nonretirement savings plans

Under the bill, a defined contribution plan that does not meet the requirements for status as a retirement plan would be a nonretirement savings plan. The bill would prohibit an employer from maintaining a nonretirement savings plan for an employee unless the employee participates in at least one retirement plan (a prerequisite plan) that meets specified requirements.

If the prerequisite plan is a defined benefit pension plan, then the bill would require that the defined benefit pension plan provide the participant with an accrued benefit equivalent to a specified amount. The bill provides that the specified amount would be determined by multiplying one-half of one percent by the product of (1) the amount of the participant's compensation (sec. 415 of the Code), and (2) the number of the participant's years of plan participation (sec. 411 of the Code).

The bill provides that if the prerequisite plan is a defined contribution plan, then the employer contribution with respect to each participant for each plan year must not be less than 3 percent of the participant's compensation (sec. 415 of the Code) for the plan year.

2. Coverage requirements (secs. 103 and 203 of the bill, secs. 202 and 212 of ERISA, and secs. 401, 409B, and 410 of the Code)

Present Law

The coverage requirements applicable to qualified plans (Code sec. 410(b)) require that a plan cover employees in general rather than merely the employer's top-ranking employees. A plan generally satisfies the present-law coverage rule if (1) it benefits a significant percentage of the employer's workforce (percentage test), or (2) it benefits a classification of employees determined by the Secretary of the Treasury not to discriminate in favor of employees who

e officers, shareholders, or highly compensated (fair cross-section st). Present law does not require that an employer cover all em- ɔyees (other than excludable employees).

Under present law, the coverage requirements do not apply ıder ERISA.

ˑrcentage test

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A plan meets the percentage test if (1) it benefits at least 70 per- nt of all employees, or (2) it benefits at least 80 percent of the ıployees eligible to benefit under the plan and at least 70 percent all employees are eligible (i.e., the plan benefits at least 56 per- nt of all employees).

ıir cross-section test

A plan meets the fair cross-section test if the Secretary of the easury determines that it covers a classification of employees at is found not to discriminate in favor of employees who are offi- rs, shareholders, or highly compensated. In making that determi- ıtion, the Secretary is required to consider all the surrounding cts and circumstances, allowing for a reasonable difference be- een the ratio of highly compensated employees who are benefited the plan to all such employees and the corresponding ratio cal- ılated for employees who are not highly compensated.

ggregation rules

Controlled groups.—In applying the qualification rules (including oth the percentage and fair cross-section coverage tests), all em- oyees of corporations that are members of a controlled group of ɪrporations, or all employees of trades and businesses (whether or ɔt incorporated) that are under common control, are aggregated ıd treated as if employed by a single employer (Code sec. 414(b) ıd (c)).

Affiliated service groups.—All employees of employers that are embers of an affiliated service group of employers are treated as nployed by a single employer for purposes of the qualification re- ıirements (Code sec. 414(m)). An affiliated service group consists a service organization (the "first organization") and (1) each her service organization that is related to the first organization ıd (2) each other service organization that is related to either the rst organization, or to a service organization that is related to the rst organization. In determining whether a group of employers ɔnstitutes an affiliated service group, certain attribution rules ɔply.

Employee leasing arrangements.—For purposes of certain of the ıx-law rules for qualified plans and SEPs, an individual (a leased nployee) who performs services for another person (the recipient) treated as the recipient's employee if the services are performed ursuant to an agreement between the recipient and a third person he leasing organization) who has contracted with the recipient for ıe individual's service (Code sec. 414(n)). The individual is treated s the recipient's employee only if the individual has performed ɜrvices for the recipient (or for the recipient and persons related) the recipient) on a substantially full-time basis for a period of at

least 12 months, and if the services are of a type historically per formed by employees in the recipient's business field.

However, under a safe-harbor provision, an individual who other wise would be treated as a recipient's employee pursuant to these rules is not treated as such an employee if certain requirement are met with respect to contributions provided for the individua under a qualified money purchase pension plan maintained by the leasing organization. The safe-harbor rule is inapplicable to a leased employee who is otherwise a common-law employee of the recipient.

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Other aggregation.—The Secretary of the Treasury also has the regulatory authority to develop any rules as may be necessary to prevent the avoidance of any employee benefit requirement to which the employee leasing or affiliated service group provision apply through the use of employee leasing or other arrangement (Code sec. 414(o)).

Excludable employees

In applying the percentage test, certain employees who have no yet completed minimum periods of service (generally one year [5] and employees who have not yet attained age 21 may be disregard ed if they are excluded pursuant to a plan provision. In addition, in applying both the percentage and the fair cross-section test, em ployees included in a unit of employees covered by an agreemen that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives [6] and one or more employees are disregarded if they are excluded pursuant to a plan provision and there is evidence that retirement benefits were the subject of good faith bargaining between such employee representa tives and the employer or employers (Code sec. 410(b)(3)(A)). Cer tain nonresident aliens and certain airline employees must be ex cluded from consideration (Code sec. 410(b)(3) (B) and (C)).

Tax-sheltered annuities

Under present law, no coverage or nondiscrimination rules apply to prohibit an employer's tax-sheltered annuity program from fa voring highly compensated employees.

Explanation of Provisions

In general

The bill would revise the coverage requirements applicable to qualified plans under the Code and would extend those require ments to apply to all pension plans subject to ERISA.

Under the bill, an employer would be considered to meet the cov erage requirements if each employee in the employer's relevan workforce whose compensation is less than the social security con tribution and benefit base (i.e., the wage base) is eligible to partici pate in a retirement plan maintained by the employer.

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[5] Under a special rule, an employee may be excluded from participation for up to three year provided the employee is, after three years, fully and immediately vested.

[6] An organization is not considered to be an employee representative if more than one-half o its members participating in the plan are employees who are also owners, officers, or executive of the employer.

The bill provides that the coverage requirements would not limit ıe application of the general nondiscrimination rules applicable to ıalified plans (sec. 401(a)(4) of the Code).

pecial rules for subdivisions

Under the bill, if the relevant workforce of the employer consists ' two or more allowable subdivisions, the coverage requirements ould be considered to be met if two tests are met.

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Under the first test, all employees in each allowable subdivision ho earn less than the social security wage base would be required ı be eligible to participate in a retirement plan maintained by the nployer. This first test would not apply to an allowable subdivi- on if no employee in the allowable subdivision is eligible to par- cipate in a retirement plan maintained by the employer.

The second test would apply to all employees of the employer ıot merely to employees within an allowable subdivision). This ·st would be met if the percentage of the relevant workforce (the ›verage percentage) of employees who (1) earn less than the social ·curity wage base ($42,000 for 1986), and (2) are eligible to partici- ate in a retirement plan maintained by the employer is at least 80 ercent as of the end of the last fiscal year of the employer. Alter- atively, the second test would be satisfied if the average of the ›verage percentages as of the end of each of the last 5 fiscal years f the employer (or all preceding fiscal years of the employer, if ·ss than 5) is at least 80 percent.

Iultiple plans of an employer

Under the bill, the coverage requirements (to the extent that hey require an employer to maintain a retirement plan) would be ıet if the employer maintained more than one plan and if each mployee is eligible to participate in at least one retirement plan of he employer.

Rules for contributory plans

In the case of a plan that provides for mandatory employee con- ributions, the coverage requirements would be met only if, in addi- ion to meeting the general coverage requirements, at least 60 per- ent of the employees who are eligible to participate actually bene- it under the plan. Under the bill, the 60 percent test would be in- reased to 70 percent in the case of a retirement plan that is main- ained as a prerequisite for a nonretirement savings plan.

Under the bill, the term "mandatory contributions" would mean .mounts contributed to the plan by a participant that are required ıs a condition of employment, as a condition of participation in the ›lan, or as a condition of obtaining benefits under the plan attrib- ıtable to employer contributions.

Iodification of minimum participation standards

The bill would repeal the present-law rule under which an em- ›loyee may be required to complete three years of service before ›ecoming eligible to participate in a plan maintained by an em- ›loyer as long as the plan provides for full and immediate vesting ıpon plan participation.

Definitions

Relevant workforce.—Under the bill (as under present law), the term relevant workforce would mean all employees of an employer other than certain excludable employees. An excludable employee would include the following employees:

(1) Employees who have not met the minimum age or service requirements, if any, for participation in any pension, profit-sharing, or stock bonus plan established or maintained by the employer;

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(2) Employees who do not participate in any pension, profit-sharing, or stock bonus plan established or maintained by an employer and who are included in a unit of employees covered by an agreement that the Secretary finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers;

(3) Employees who are included in a unit of employees covered by an agreement pursuant to which a pension, profit-sharing, or stock bonus plan is maintained by the employer and that the Secretary finds to be a collective-bargaining agreement between airline pilots and one or more employers (unless the principal duties of such employee are not customarily performed aboard aircraft in flight); or

(4) Employees who are nonresident aliens and who receive no earned income from the employer that constitutes U.S. earned income.

Allowable subdivision.—The bill would define the term allowable subdivision to mean the portion of the relevant workforce of the employer that serves in a separate business unit as defined in Treasury regulations distinguishing such business unit solely on the basis of its distinct locality or its separate product line. Further, the bill would define an allowable subdivision to include the portion of the relevant workforce of the employer that does not serve in the workforce of any such separate business unit.

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'. Limitations on Deductions, Contributions, and Benefits (secs. 111, 112, 211, 212, 213, 214, and 215 of the bill, secs. 214 and 306 of ERISA, and secs. 72, 219, 401, 402, and 415 of the Code

Present Law

ndividual retirement accounts and annuities

The individual retirement savings provisions of the Code were riginally enacted in ERISA to provide a tax-favored retirement avings arrangement to individuals who were not covered under a ualified plan or a governmental plan maintained by the employer. hose who were active participants in employer plans were not ermitted to make deductible IRA contributions.

In the Economic Recovery Tax Act of 1981 (ERTA), Congress liminated the provision restricting IRA eligibility to individuals 'ho were not active participants and increased both the dollar and ercentage of compensation limitations, from the lesser of 25 perent of compensation or $1,500, to the lesser of 100 percent of comensation or $2,000. In addition, ERTA provided rules permitting eductible employee contributions (or qualified voluntary employee ontributions) to be made to a qualified plan.

Under present law (Code sec. 219), an individual generally is enitled to deduct from gross income the amount contributed to an RA (within limits). The limit on the deduction for a taxable year enerally is the lesser of $2,000 or 100 percent of compensation earned income, in the case of income from self-employment). Simiar rules apply with respect to qualified voluntary employee contriutions made by an employee under a qualified plan. To the extent hat a deduction is allowed to an individual for a year with respect o a qualified voluntary employee contribution, the limit for the 'ear on deductions for a contribution to an IRA is reduced.

'ash or deferred arrangements (401(k) plans)

In general

Before the enactment of ERISA, some employers permitted emloyees to decide whether to accept compensation in cash or defer he compensation by having the employer contribute it to a profitharing plan. The Internal Revenue Service raised questions as to vhether, under the usual tax principles of constructive receipt, emloyees who could have received cash, but chose to defer compensaion, should be taxed as though they had received the cash. ERISA rovided a limited moratorium on the issuance of Treasury regulaions and IRS rulings relating to the application of the constructive eceipt rule to employee deferrals under qualified plans. The moraorium was extended through 1978, when Congress enacted special ules relating to qualified cash or deferred arrangements (also reerred to as CODAs or sec. 401(k) plans). Under those rules, if the

requirements of the Code are met, an employee can choose deferral of compensation (within limits) without being taxed as though the compensation had been received.

If a tax-qualified profit-sharing or stock bonus plan (or certain pre-ERISA money purchase pension plans) meets certain requirements described below (a "qualified cash or deferred arrangement"), then an employee is not required to include in income any employer contributions to the plan merely because the employee could have elected to receive the amount contributed in cash.

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Nondiscrimination requirements

The amount a highly paid employee can elect to defer, tax free, under a qualified cash or deferred arrangement depends (in part) on the level of elective deferrals by other employees. Special nondiscrimination tests apply a limit on elective deferrals by the group of highly paid employees that is determined by reference to deferrals by other employees. An employee is considered highly paid, for this purpose, if the employee is more highly compensated than ⅔ of all of the eligible employees. These nondiscrimination tests provide that the special treatment of elective deferrals is not available unless the cash or deferred arrangement does not disproportionately benefit highly paid employees.

The tests are based on the relationship of the actual deferral percentage for the group of highly paid employees to the actual deferral percentage for the group of other eligible employees. The deferral percentage for an employee for a year is the percentage of that employee's compensation that has been electively deferred for the year. The actual deferral percentage for a group of employees is the sum of the deferral percentages for the employees divided by the number of employees in the group eligible to defer.

A cash or deferred arrangement meets these special nondiscrimination requirements for a plan year if (1) the actual deferral percentage for the highly paid employees does not exceed the actual deferral percentage of the other eligible employees by more than 150 percent, or (2) the actual deferral percentage for the highly paid employees does not exceed the actual deferral percentage of the other eligible employees by more than three percentage points. If the three percent test is used, the actual deferral percentage for the highly paid employees also cannot exceed the actual deferral percentage of all other eligible employees by more than 250 percent. In calculating these deferral percentages, contributions by the employer that (1) are nonforfeitable when made and (2) satisfy the withdrawal restrictions applicable to elective deferrals may be taken into account as elective deferrals by employees.

The special nondiscrimination tests applicable to cash or deferred arrangements apply in lieu of the usual nondiscrimination rules for qualified plans, which permit employer contributions to social security to be taken into account. These special nondiscrimination rules do not replace, however, the usual rules requiring that a qualified plan cover either a specified percentage of employees or a fair cross-section of employees.

Withdrawal restrictions

Under present law, a participant in a qualified cash or deferred arrangement is not permitted to withdraw elective deferrals (and earnings thereon) prior to age 59½, death, disability, separation from service, retirement, or the occurrence of a hardship. What constitutes the occurrence of a hardship under present law has not been defined except in proposed regulations.

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Limit on elective deferrals

Elective deferrals under a qualified cash or deferred arrangement are subject to the overall limits on contributions to a defined contribution plan. Thus, under present law, the elective deferrals made by a participant, together with all other annual additions made to any plan of the employer on behalf of the participant, generally cannot exceed the lesser of $30,000 or 25 percent of the participant's nondeferred compensation.

Limits on contributions and benefits under qualified plans

In general

ERISA added overall limits on contributions and benefits under qualified plans and tax-sheltered annuities (Code sec. 415). The overall limits apply to contributions and benefits provided to an individual under all qualified plans, tax-sheltered annuities, and simplified employee plans (SEPs) maintained by any private or public employer or by certain related employers. The limits provided by ERISA were automatically adjusted for inflation. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced the limits and suspended cost-of-living increases. The Deficit Reduction Act of 1984 further suspended cost-of-living increases through 1987.

Defined contribution plans

Under a defined contribution plan, an overall limit applies to the annual addition with respect to each plan participant (Code sec. 415(c)). As originally enacted, the annual addition (consisting of employer contributions, certain employee contributions, and forfeitures allocated from the accounts of other participants) generally was limited to the lesser of (1) 25 percent of compensation for the year, or (2) $25,000, adjusted for cost-of-living increases, as measured by the changes in the consumer price index (CPI) since 1974. By 1982, the dollar limit, as increased to reflect cost-of-living adjustments, was $45,475. In 1982, TEFRA reduced the dollar limit from $45,475 to $30,000.

Defined benefit pension plans

Under a defined benefit pension plan, the limit on the annual benefit derived from employer contributions adopted in ERISA was the lesser of (1) 100 percent of average compensation, or (2) $75,000, adjusted for cost-of-living increases, as measured by the CPI since 1974. By 1982, the dollar limit on annual benefits, as increased to reflect cost-of-living adjustments, was $136,425. In 1982, TEFRA reduced that dollar limit from $136,425 to $90,000.

Prior to TEFRA, the annual benefit generally was the equivalent of an annuity for the life of the participant, beginning at age 55 or

later, and determined without regard to certain survivor and non-retirement benefits. If retirement benefits commenced before age 55, the dollar limit was actuarially reduced. TEFRA provided that the new $90,000 limit (but not the 100 percent of compensation limit) is reduced if benefits commence before age 62 (rather than age 55). Thus, for benefits commencing before age 62, the $90,000 limit generally is reduced so that it is the actuarial equivalent of an annual benefit of $90,000 commencing at age 62. In no event, however, is the dollar limit applicable to benefits commencing at or after age 55 less than $75,000. If retirement benefits commence before age 55, the dollar limit is actuarially reduced so that it is the actuarial equivalent of a $75,000 annual benefit commencing at age 55.

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The Code provides that reduced limits apply to participants with fewer than ten years of service. The limits are reduced by ten percent per year for each year of service less than ten. For example, benefits commencing at or after age 62 with respect to a participant who had only three years of service could not exceed 3/10 of $90,000 ($27,000).

Employee contributions

Under the Code, only a portion of nondeductible employee contributions to a qualified plan is taken into account in applying the overall limits. The amount taken into account is the lesser of one-half of the employee contributions or total employee contributions in excess of six percent of compensation. Therefore, if total employee contributions do not exceed six percent of compensation, no employee contributions are counted as annual additions.

Combined plan limit

The Code also provides an aggregate limit applicable to employees who participate in more than one type of plan maintained by the same employer.

If an employee participates in a defined contribution plan and a defined benefit pension plan maintained by the same employer, the fraction of the separate limit used for the employee by each plan is computed and the sum of the fractions is subject to an overall limit (Code sec. 415(e)). As originally enacted, the sum of the fractions was limited to 1.4. In 1982, TEFRA redefined the fractions and limited the sum of the two fractions to 1.0. Although the sum of the fractions is 1.0, adjustments made to the denominators of the revised fractions effectively provide an aggregate limit of the lesser of 1.25 (as applied to the dollar limits) or 1.4 (as applied to the percentage of compensation limits).

Aggregate limit on contributions and benefits for key employees in a top-heavy plan

Under present law, the combined plan limit may be reduced for an employee who participates in both a defined benefit pension plan and a defined contribution plan one of which is top heavy. Unless certain requirements are met, for any year for which one of the plans is top heavy, the new fractions are modified, effectvely providing the employee with an aggregate limit equal to the lesser

of 1.0 (as applied to the dollar limits) or 1.4 (as applied to the percentage of compensation limits).

These modifications do not apply if the plans of the employer in which the employee participates (1) are not super top heavy (i.e., do not provide more than 90 percent of the benefits for key employees), and (2) provide either an extra minimum benefit (in the case of the defined benefit pension plan) or an extra minimum contribution (in the case of the defined contribution plan) for non-key employees participating in the plans.

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Tax-sheltered annuities

The amount paid by an employer under a tax-sheltered annuity is excluded from the employee's income for the taxable year to the extent that the payment does not exceed the employee's exclusion allowance for the taxable year. The exclusion allowance is generally equal to 20 percent of the employee's includible compensation from the employer multiplied by the number of the employee's years of service with that employer, reduced by amounts already paid by the employer to purchase the annuity.

Employer payments to purchase a tax-sheltered annuity contract for an employee are also subject to the overall limits on contributions and benefits under qualified plans (Code sec. 415). Tax-sheltered annuities are generally defined contribution arrangements.[7] Under the overall limits, annual additions to tax-sheltered annuities and other defined contribution arrangements for the employee may not exceed the lesser of $30,000 or 25 percent of the employee's compensation from the employer for the year. Under a special rule (Code sec. 415(c)(4)(C)), an employee of an educational institution, hospital, home health service agency, or church may elect to compute the annual exclusion allowance for payments under a tax-sheltered annuity solely by reference to the maximum annual employer payment that could be made under the overall limit.

In addition, to allow certain lower-paid employees catch-up payments (i.e., payments permitted under the exclusion allowance on account of prior years of service, but denied under the overall annual limit that takes into account only the current year), alternative special elections are provided to increase the overall limit for the year of the election. An individual is allowed only one of the special election under section 415.[8]

In addition, a church employee may make an additional election pursuant to which the church may make payments for the year in excess of the otherwise applicable overall annual limit.[9] The elec-

[7] The Economic Recovery Tax Act of 1981 (ERTA) provided that a church-maintained retirement income program in existence on September 3, 1982, will not be considered as failing to satisfy the requirements for a tax-sheltered annuity (Code sec. 403(b)) merely because the program is a defined benefit pension plan (Code sec. 414(j)).

[8] The first alternative catch-up election (Code sec. 415(c)(4)(A)) may be made only for the year of an employee's separation from the service of the contributing employer (the separation year catch-up election). The second alternative catch-up election (Code sec. 415(c)(4)(B)) generally may be made for any year, but is subject to additional limitations. Neither election increases the amount excludable from the employee's income for the year under the exclusion allowance.

[9] The employee's election increases the overall annual limits (subject to the employee's exclusion allowance) to the lesser of (1) the amount paid by the church for the year, or (2) $10,000. Employer payments permitted for a church employee under this provision (i.e., payments in excess of the otherwise applicable annual limits) may not exceed $40,000 for the employee's lifetime.

tion may not be made for the same year in which a catch-up election is effective.

Explanation of Provisions

In general

The bill would www.libtool.com.cn restrict the deduction for qualified voluntary employee contributions made by plan participants. Under the bill, the deduction would be allowed only for a contribution to a retirement plan.

The bill would revise the rules of the Code providing for qualified cash or deferred arrangements (401(k) plans) and would provide corresponding labor law rules. Under the bill, a cash or deferred arrangement could be provided only by a retirement plan that meets specified requirements relating to the coverage of employees. The bill would coordinate the exclusion provided for elective deferrals under a 401(k) plan with the deduction allowed to an employee for contributions to an IRA. Under the bill, the deduction limit for contributions to an IRA would be reduced by the amount of elective deferrals under a 401(k) plan.

Under the bill, the overall limits on contributions and benefits under qualified plans would be revised. The bill would provide further reductions for contributions and benefits under nonretirement plans. In addition, the bill would limit the amount of compensation that may be taken into account under a qualified plan for purposes of determining whether benefits and contributions under a plan meet the requirements of the Code. A corresponding limit on compensation taken into account would be provided by the bill under labor law.

Finally, the bill would repeal the combined limit that applies if an employee participates in more than one plan of the employer unless one of the plans in which the employee participates is top heavy.

Qualified voluntary employee contributions

Under the bill, a voluntary employee contribution to a plan would not be deductible unless it is made to a retirement plan. For rules defining retirement plans under the bill, see part C., above.

Cash or deferred arrangements (401(k) plans)

In general

The bill would restrict cash or deferred arrangements to retirement plans. Accordingly, under the bill, a pension, profit-sharing, or stock bonus plan could not provide a cash or deferred arrangement unless the plan meets the requirements for status as a retirement plan (see part C., above).

The bill defines a cash or deferred arrangement as any arrangement that is part of a plan and under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash. Accordingly, under the bill, a cash or deferred arrangement could be maintained under a pension plan (including a defined benefit pension plan) that is a retirement plan. The bill

would continue present law under which an employee's right to the accrued benefit derived from employer contributions with respect to employee deferrals under a cash or deferred arrangement is required to be nonforfeitable.

The changes made under the bill with respect to cash or deferred arrangements would also apply for labor law purposes.

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Relationship of deferral percentages

The bill would continue present law under which a cash or deferred arrangement would not be treated as meeting the requirements of the Code unless the actual deferral percentage for highly compensated employees for a plan year bears a specified relationship to the actual deferral percentage for all other eligible employees for that year. Under the bill, as under present law, an arrangement may meet a 1.5 multiplier test or a 2.5 multiplier test. The bill would continue the rules of present law with respect to employers who maintain 2 or more plans that include cash or deferred arrangements and for employees who participate in more than one cash or deferred arrangement of an employer.

The bill would provide for application of the nondiscrimination tests for cash or deferred arrangements on the basis of allowable subdivisions of an employer's employees (see part C., above, for a definition of allowable subdivisions). Under the bill, in the case of any plan that would not meet the retirement income requirements without the application of the provisions of the bill relating to allowable subdivisions, the tests for cash or deferred arrangements would be applied on the basis of each separate allowable subdivision.

Coordination with individual retirement accounts and annuities

The bill would provide rules coordinating the level of deductible contributions to individual retirement accounts and individual retirement annuities (IRAs) with elective deferrals under qualified cash or deferred arangements. The bill would continue the rules of present law under which the limit on deductible contributions to IRAs are coordinated with qualified voluntary employee contributions.

Under the bill, if an individual makes elective deferrals under a cash or deferred arrangement that is a retirement plan, then the amount of the IRA contributions which are paid for the taxable year and which are allowable as a deduction is to be reduced by the amount of the individual's elective deferrals under the cash or deferred arrangement.

Wage-based limits on contributions and benefits

In general

The bill would limit the amount of compensation taken into account for purposes of applying the nondiscrimination and integration rules applicable under the Code and under ERISA and for purposes of computing the overall limits on contributions and benefits. The bill would also modify the separate limits with respect to defined benefit pension plans and defined contribution plans. Re-

duced limits would apply to a nonretirement savings plan. The combined limit applicable to an employee who participates both in a defined benefit pension plan and a defined contribution plan of the same employer would be applied only if at least one of the plans in which the employee participates is top heavy. These limits would also apply to tax-sheltered annuities.

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Under the bill, the dollar limit for a defined benefit pension plan would be 200 percent of the contribution and benefit base under the Social Security Act. For a defined contribution plan that is a retirement plan, the bill would provide a dollar limit of 50 percent of the contribution and benefit base under the Social Security Act.

For a nonretirement savings plan, the bill would provide a limit of the lesser of 25 percent of the contribution and benefit base under the Social Security Act or 10 percent of the participant's compensation.

The limit on elective deferrals under a cash or deferred arrangement would be reduced to 25 percent of the contribution or benefit base under the Social Security Act.

Compensation taken into account

The bill would provide a limit on the level of compensation taken into account in applying the overall limits and for purposes of the nondiscrimination and integration rules under the Code and the labor law. Under the bill, the compensation taken into account would be limited to 500 percent of the contribution and benefit base under the Social Security Act (the compensation limit would be $210,000 if it applied in 1986).

Defined benefit pension plans

The bill would provide that the limit applicable to the annual benefit under a defined benefit pension plan is the lesser of 200 percent of the contribution and benefit base under the Social Security Act (the limit on the annual benefit would be $84,000 if the bill applied in 1986) or 100 percent of the participant's high 3-year average compensation. Because the limit on annual benefits would be linked directly to the contribution and benefit base under the Social Security Act, the limit for a year would be automatically adjusted for inflation when the contribution and benefit base under the Social Security Act is adjusted.

Defined contribution plans

For a defined contribution plan that is a retirement plan, the bill would generally limit the annual addition to the lesser of 50 percent of the contribution and benefit base under the Social Security Act ($21,000 if the bill applied in 1986) or 20 percent of compensation.

The bill would provide that the annual addition under a nonretirement savings plan is the lesser of 25 percent of the contribution and benefit base under the Social Security Act ($10,500 if the bill applied in 1986) or 10 percent of compensation.

The bill would modify the definition of the annual addition by eliminating the exclusion for employee contributions of less than 6 percent of compensation. Accordingly, under the bill, one-half of all

employee contributions would be taken into account in computing the annual addition.

Cash-or-deferred arrangements

Under the bill, an employee's elective deferral under a cash or deferred arrangement would be limited to the lesser of 25 percent of the contribution and benefit base under the Social Security Act ($10,500 if it applied in 1986) or 20 percent of compensation.

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Combined limits

Although the bill would continue to apply separate dollar and percentage limits to defined benefit pension plans and defined contribution plans, the special limit on combined plans would be repealed if no plan in which an employee participates is top heavy.

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E. Vesting Standards (secs. 121 and 221 of the bill, sec. 203 of ERISA, and sec. 411 of the Code)

Present Law

In general

Prior to the enactment of ERISA, a qualified plan was required to provide vested (i.e., nonforfeitable) rights to employees when they attained the normal or stated retirement age. Qualified plans were also required to vest employees upon plan termination or the discontinuance of employer contributions. However, no preretirement vesting was required unless the absence of such vesting caused discrimination in favor of officers, shareholders, supervisors, or highly compensated employees.

To ensure that employees with substantial periods of service with the employer do not lose plan benefits upon separation from employment, ERISA and the Code generally require that (1) a participant's benefits be fully vested upon attainment of normal retirement age under the plan; (2) a participant be fully vested at all times in the benefit derived from employee contributions; and (3) employer-provided benefits vest at least as rapidly as under one of 3 alternative minimum vesting schedules (Code sec. 411(a)). Under these schedules, an employee's right to benefits derived from employer contributions becomes nonforfeitable (vested) to varying degrees upon completion of specified periods of service with an employer.

Under one of the schedules, full vesting is required upon completion of 10 years of service (no vesting is required before the end of the 10th year). Under a second schedule, vesting begins at 25 percent after completion of 5 years of service and increases gradually to 100 percent after completion of 15 years of service. The third schedule takes both age and service into account, but, in any event, requires 50-percent vesting after 10 years of service, and an additional 10-percent vesting for each additional year of service until 100-percent vesting is attained after 15 years of service.

Patterns of discrimination

Prior to ERISA, preretirement vesting was sometimes required under a qualified plan to prevent discrimination. Although ERISA required all plans to meet certain minimum preretirement vesting standards, ERISA also provided that earlier vesting may still be required under a qualified plan to prevent discrimination if (1) there has been a pattern of abuse under the plan tending to discriminate in favor of employees who are officers, shareholders, or highly compensated; or (2) there has been, or there is reason to believe there will be, an accrual of benefits or forfeitures tending to discriminate

favor of employees who are officers, shareholders, or highly com-
ısated (Code sec. 411(d)(1)).

ı-heavy plans

'he Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)
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uired earlier preretirement vesting for certain top-heavy plans
improve the likelihood that covered participants would receive
ıefits.[10] For any plan year for which a qualified plan is top
ıvy, an employee's right to accrued benefits must become nonfor-
:able under one of 2 alternative schedules. Under the first top-
ıvy schedule, a participant who has completed at least 3 years of
vice with the employer maintaining the plan must have a non-
feitable right to 100 percent of the accrued benefit derived from
ployer contributions.

\ plan satisfies the second alternative (6-year, graded vesting) if
'articipant has a nonforfeitable right to at least 20 percent of the
'rued benefit derived from employer contributions at the end of
'ears of service, 40 percent at the end of 3 years of service, 60
·cent at the end of 4 years of service, 80 percent at the end of 5
ırs of services, and 100 percent at the end of 6 years of service
:h the employer.

ıss year plans

Special vesting rules also apply to "class year plans." A class
ar plan is a profit-sharing or stock bonus plan that provides for
ə separate vesting of employee rights to employer contributions
a year-by-year basis. The minimum vesting requirements are
:isfied if the plan provides that a participant's right to amounts
:ributable to employer contributions with respect to any plan
ar are nonforfeitable not later than the close of the fifth plan
ar following the plan year for which the contribution was made.

Explanation of Provision

The bill would amend ERISA and the Code to require that, in
ə case of a retirement plan, a participant who has completed at
ıst 5 years of service have a nonforfeitable right to 100 percent of
ə participant's accrued benefit derived from employer contribu-
ıns. As an exception to this rule, the bill requires that in the case
a multiemployer plan that is a retirement plan a participant in
e plan who has completed at least 10 years of service have a non-
·feitable right to 100 percent of the participant's accrued benefit
rived from employer contributions.

:planation of Provision

The bill would amend ERISA and the Code to require that, in
e case of a retirement plan, a participant who has completed at
ıst 5 years of service have a nonforfeitable rigfht to 100 percent
the participant's accrued benefit derived from employer contri-
.tions. As an exception to this rule, the bill requires that in the
se of a multiemployer plan that is a retirement plan.

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[10] A top-heavy plan is a qualified plan under which more than 60 percent of the benefits are
vided for key employees (Code sec. 416).

The bill would amend the Code and ERISA to require that in th case of a nonretirement savings plan, a participant who has com pleted at least one year of service has a nonforfeitable right t 100 percent of the participant's accrued benefit derived from em ployer contributions.

The provisions apply with respect to participants who have com pleted at least one hour of service on or after the date of enact ment.

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F. Pension Integration (secs. 131 and 231 of the bill, sec. 215 of ERISA, and sec. 401(l) of the Code)

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Present Law

general

The Code provides nondiscrimination standards for qualified pen-
n, profit-sharing, and stock bonus plans. These standards prohib-
discrimination in favor of employees who are officers, sharehold-
s, or highly compensated. Under these standards, coverage tests
e applied to determine whether the classification of employees
io participate in a plan is discriminatory. Additional tests are ap-
ed to determine whether contributions or benefits under the
an discriminate in favor of highly compensated employees.

The rules prohibiting discrimination under qualified plans were
opted by the Congress in 1942. The nondiscrimination standard
is adopted to "safeguard the public against the use of the pension
an as a tax-avoidance device by management groups seeking to
mpensate themselves without paying their appropriate taxes." [11]
ongress was concerned that the requirement of nondiscriminatory
verage by a plan was not sufficient. Although nondiscriminatory
verage could assure that rank-and-file employees were not un-
irly omitted from a plan, it could not assure that those employees
ould be provided with a fair share of benefits. Accordingly, the
42 Act included standards requiring that a qualified plan provide
ondiscriminatory benefits or contributions for plan participants. It
as noted that even ". . . extended coverage would not by itself
iarantee that the pension plan would be operated for the welfare
employees generally, because the scale of benefits could be ma-
pulated. Therefore, the scale of benefits must be nondiscrimina-
ry." [12] In determining whether benefits were discriminatory, the
ongress noted that plans designed in good faith to supplement
cial security should be permitted to qualify for favorable tax
eatment.[13] Thus, a plan that provides benefits which, when ag-
egated with employer-provided social security benefits, constitute
nondiscriminatory percentage of compensation is deemed to be
ondiscriminatory even though plan benefits standing alone would
ot meet the nondiscrimination standard.

ntegration of defined benefit pension plans

Generally, in applying the nondiscrimination test to benefits
nder a plan, the rate at which benefits are provided by the plan
r highly compensated participants (as a percentage of their pay)
compared with the rate at which the plan provides benefits for

[11] H. Rpt. 77-2333, 77th Cong., 2d. Sess. 51 (1942).
[12] *Ibid.*
[13] See, e.g., S. Rpt. 1631, 77th Cong., 2d. Sess. 139 (1942).

other participants. A similar test may be applied to employer con tributions under a plan. A plan fails the nondiscrimination stand ard if both benefits and contributions discriminate in favor o highly compensated employees.

Under present law, in determining whether defined benefit pen sion plan benefits, as a percentage of nondeferred pay, discriminat in favor of employees who are highly compensated, the portion o each employee's social security benefits that are considered to b paid for by the employer may be taken into account. For this pur pose, social security benefits mean old age, survivors, and disabilit insurance (OASDI) benefits provided under the social securit system.

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A plan that meets the nondiscrimination standards of the Cod only if social security benefits are taken into account is referred t as an integrated plan. If these social security benefits and the em ployer-provided benefits under the plan, when added together, pro vide an aggregate benefit that is a higher percentage of pay fo highly compensated employees than for other employees, then th benefits under the plan are discriminatory and the plan does no qualify. Either benefits or contributions under a plan may be inte grated.

Two basic approaches to integration of defined benefit pensio plans have been developed—(1) the "offset" approach, and (2) th "excess" approach.[14]

Offset plans

A defined benefit pension plan that integrates under the offse approach is referred to as an offset plan. An offset plan initiall provides each employee with an annual pension benefit which (as percentage of pay) does not discriminate in favor of highly compen sated employees. For each employee, this initial benefit is then re duced, or offset, by the employer-provided portion of that employ ee's social security benefit to arrive at the actual pension benefi under the plan.

In 1971, the Internal Revenue Service determined that the valu of employer-provided social security benefits is equal to 83⅓ per cent of the annualized primary insurance amount (PIA) to whic an employee is entitled under the Social Security Act. This calcula tion forms the basis of the present-law rules for integrating offse plans. Consequently, an offset plan could integrate its benefits wit social security by providing each employee an annual benefit of, fo example, 50 percent of pay offset by 83⅓ percent of the employee' PIA.

Excess plans

A pension plan that integrates under the excess approach is re ferred to as an excess plan. The basic theory underlying the exces approach is that social security provides benefits based on only certain portion of an employee's earnings. An excess plan is de signed to provide benefits (or added benefits) based on the portio of an employee's earnings "in excess" of the earnings on whic

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[14] Rules for integrating under these two approaches are set forth in Rev. Rul. 71-446, 1971- C.B. 187.

:ial security benefits are provided (covered compensation). An :ess plan integrates if the benefits it provides with respect to npensation in excess of covered compensation are not greater, as percentage of pay, than the benefits provided by social security covered compensation.

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The Internal Revenue Service determined that the employer-pro- led portion of benefits under social security averages 37½ per- nt of the average maximum pay on which social security benefits e based. This calculation forms the basis of the present-law rules integrating excess plans. Consequently, for an employee retir- g at age 65 in 1986, an excess plan will integrate properly if it ovides benefits at a rate no greater than 37½ percent of pay in :ess of $15,000 (approximately the highest average annual wage on which social security benefits can be based for such an em- oyee), although it provides no benefits with respect to the first 5,000 of pay.

If an excess plan provides benefits on compensation up to cov- ed compensation, then it can provide benefits at a higher rate on y above the level of covered compensation. However, the rate at iich benefits are provided above covered compensation cannot ceed the rate at which benefits are provided on compensation up covered compensation by more than 37½ percent. For example, integrated excess plan could provide benefits at the rate of 12½ rcent for all compensation plus 50 percent (i.e., 37½ percent plus ½ percent) of compensation in excess of covered compensation.

tegration of defined contribution plans

Defined contribution plans do not provide specified benefit for- ulas. Defined contribution plans provide for contributions to be located to and accumulated in a separate account for each em- oyee. Accordingly, such plans are integrated by taking into ac- unt the employer-paid portion of social security taxes. Specifical- , a defined contribution plan is integrated by reducing contribu- ons to the plan with respect to the portion of an employee's pay bject to the social security tax (i.e., the taxable wage base).

Prior to 1984, the integration of a defined contribution plan was sed on the IRS-calculated cost of employer-provided social securi- benefits. For pre-1984 years, the Internal Revenue Service had termined that the employer's cost of providing social security nefits was seven percent of pay subject to the tax.

Effective for plan years beginning after 1983, TEFRA revised the tegration rules for profit-sharing and other defined contribution ans. TEFRA permits an employer to reduce plan contributions on half of an employee by no more than an amount equal to the em- oyee's taxable wage base multiplied by the actual OASDI tax te. Thus, a profit-sharing plan could provide contributions of 5.7 rcent (the OASDI tax rate) of 1986 pay in excess of $42,000 (the 86 taxable wage base) and no contributions for 1986 with respect the first $42,000 of pay. Similarly, if a plan provided for 1986 ntributions of 10 percent of pay in excess of $42,000, it would in- grate properly only if it provided for 1986 contributions of at ast 4.3 percent with respect to the first $42,000 of pay.

Top-heavy plans

A qualified plan that is top heavy must provide a minimum non integrated benefit or contribution derived from employer contribu tions for each employee who is a participant in the plan and who i not a key employee (sec. 416). The rule is designed to reflect th higher proportion of tax benefits focused on key employees in top-heavy plan.[15]

A defined benefit pension plan satisfies this minimum benefit re quirement if, on a cumulative basis, the accrued benefit of eacl participant who is not a key employee, when expressed as a annual retirement benefit, is not less than two percent of the em ployee's average annual compensation from the employer, multi plied by the employee's years of service with the employer. Howev er, an employee's minimum benefit is not required to exceed 2 percent of such average annual compensation. This required mini mum benefit may not be eliminated or reduced on account of th employee's social security benefits attributable to contributions b the employer (i.e., the minimum benefit is a "nonintegrated" bene fit).

For a plan year for which a defined contribution plan is a top heavy plan, the employer generally must contribute on behalf o each plan participant who is not a key employee an amount no less than three percent of the participant's compensation. The mir imum contribution must be made for each year in which the pla is top heavy. However, special rules provide that if the employer contribution rate for each participant who is a key employee fo the plan year is less than three percent, then the required mini mum contribution rate for each non-key employee generally is lin ited to the highest contribution rate for any key employee.

Amounts paid by the employer for the year to provide social se curity benefits for the employee are disregarded. Thus, the re quired minimum contribution for a non-key employee may not b eliminated or reduced on account of benefits attributable to socia security taxes paid by the employer (i.e., the minimum contributio is a "nonintegrated" contribution).

Explanation of Provisions

In general

The bill would revise the integration rules under the Code fo qualified plans and would add to labor law the prohibition applica ble to qualified plans under present law against discrimination b a plan in favor of specified employees. Under the bill, a pensio plan would not be considered to violate the nondiscrimination rule of the tax law or the labor law merely because the plan is integra ed.

Certain discrimination prohibited by ERISA

The bill would extend to all plans subject to ERISA the presen law nondiscrimination rule applicable to qualified plans. Unde

[15] Generally, a plan is top heavy if more than 60 percent of the benefits it provides are f key employees (sec. 416).

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.s rule, the contributions and benefits provided under a pension ın may not discriminate in favor of employees who are officers, ıreholders, or highly compensated. Employees in certain collec-e bargaining units and certain nonresident aliens may be ex-ıded from consideration in testing whether a plan meets the re-irements of the prohibition against discrimination.

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ndiscriminatory integration

The bill would provide that a plan would not violate the nondis-mination rules of labor law or of the Code merely because it is integrated plan. The bill defines an integrated plan as a plan ıt is discriminatory solely because it provides a contribution or ıefit that meets specified requirements. The bill provides re-irements for formulas under excess plans and under offset plans.

Excess plan requirements

Under the bill, the integration ratio of a plan is not to exceed the rmitted level. In the case of a defined contribution plan, the inte-ıtion ratio is a fraction (1) the numerator of which is the rate of ıployer contributions based on compensation up to the integra-n level, and (2) the denominator of which is the rate of employer ıtributions based on compensation in excess of that level. Under e bill, the minimum integration ratio of a plan is 50 percent. The l defines the integration level of a plan as an amount that does t exceed the contribution or benefit base under the Social Securi- Act as of the beginning of the plan year ($42,000 for plan years ginning in 1986). The bill provides corresponding rules for bene-s under defined benefit pension plans.

For example, a defined contribution plan would be considered to integrated properly under the bill if the rate of contributions to e plan based on compensation at or below the wage base is at ıst 50 percent of the rate of contributions based on compensation excess of the wage base. If a plan provided contributions to the ın at the rate of 10 percent for compensation in excess of $42,000 ıe wage base for 1986), then the plan would be considered nondis-iminatory if the rate of contributions to the plan is at least 5 per-nt for compensation at or below $42,000.

The bill would authorize the Secretary of the Treasury to pre-ribe regulations requiring an increase in the minimum integra-ɔn ratio under a defined benefit pension plan (or a class of de-ıed benefit pension plans) to the extent necessary to eliminate ıy additional discrimination otherwise forbidden by the bill at-ibutable solely to the value of the plan features (constituting the rm of benefit, any preretirement benefits, the vesting schedule, e normal retirement age, and any actuarial adjustment factors) ith respect to benefits attributable to compensation in excess of e specified integration level, taking into account the value of ıch features with respect to benefits attributable to compensation ɔt in excess of the specified integration level.

The bill would also authorize the Secretary of the Treasury to escribe regulations requiring increases in the minimum integra-ɔn ratio under a defined benefit pension plan (or a class of de-ıed benefit pension plans) that provides for mandatory employee ıntributions (sec. 411(c)(2)(C) of the Code and sec. 212(e)(4) of

ERISA) to the extent necessary to eliminate any additional dis-
crimination otherwise prohibited by the bill attributable solely to
the ratio which employee contribution rates applicable to compen-
sation which is not in excess of the integration level bears to em-
ployee contribution rates applicable to compensation which is in
excess of that level.

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Offset plan requirements

Under the bill, the contribution or benefit formula of a plan
meets the offset plan requirements if, under that formula, to the
extent consistent with requirements of the bill relating to mini-
mum benefits, the normal retirement benefit with respect to each
participant is expressed in the form of a benefit which is a speci-
fied percentage of compensation, reduced by the permitted offset.
Under the bill, the permitted offset is a percentage specified by the
plan (not more than 100 percent) of the primary insurance amount
(sec. 215 of the Social Security Act) of the participant (or any other
individual on whose wages and self-employment income the partici-
pant's entitlement to monthly social security benefits is based), de-
termined as of the earlier of the date of the commencement of the
participant's entitlement to benefits under the Social Security Act
or the date of the participant's separation from service.

Under the bill, the benefit requirement for an offset plan is met
if the accrued benefit derived from employer contributions (sec.
411(a)(7) of the Code and sec. 204(c)(1) of ERISA) provided to each
participant is not less than 50 percent of the accrued benefit that
would be derived from employer contributions if the plan did not
take social security benefits into account.

The bill limits the authority of the Secretary to prescribe regula-
tions relating to the criteria for determining whether the require-
ments relating to the offset formula are satisfied. Under the bill, in
any regulations prescribed by the Secretary for purposes of deter-
mining whether the offset plan requirements have been met, the
form of benefit, preretirement benefits, or similar plan provisions
are not to be taken into account.

Treatment of multiple plans

The bill would provide that, for purposes of the integration rules,
if an employee is eligible to participate in 2 or more retirement
plans that are maintained by the same employer, the plans are to
be treated as a single plan with respect to the employee.

. Distributions (Secs. 241 and 242 of the bill and secs. 402, 403, and 408 of the Code)

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Present Law

np-sum distributions

Jnder present law, a lump-sum distribution from a qualified n may qualify for special 10-year forward income averaging. In lition, the portion of a lump sum attributable to contributions or to January 1, 1974, may qualify for capital gains treatment.

litional income tax on early withdrawals

Jenerally, under present law, a 10-percent additional income tax mposed on withdrawals from an IRA before the owner of the A attains age 59½, dies, or becomes disabled.

Explanation of Provisions

mp-sum distributions

The bill would repeal the 10-year averaging and capital gains atment for lump-sum distributions from qualified plans.

ditional income tax on early withdrawals

Jnder the bill, the 10-percent additional income tax on with- awals from an IRA by the owner prior to attainment of age 59½, ath, or disability would be increased to 20 percent.

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II. Coverage and Portability

1. Early distributions of benefits (secs. 141 and 251 of the bill, secs. 203 and 205 of ERISA, and secs. 411 and 417 of the Code)

Present Law

Under present law, in the case of an employee whose plan pa ticipation terminates, a pension plan may involuntarily "cash out the benefit (i.e., pay out the balance to the credit of a plan partic pant without the participant's consent) if the present value of th benefit does not exceed $3,500. If a benefit is cashed-out under th rule, and the participant subsequently returns to employment an is covered by the plan, then service taken into account in compu ing benefits payable under the plan after the return need not in clude service with respect to which benefits were cashed out unles the employee "buys back" the benefit.

In addition, present law provides that, if the present value of a accrued benefit exceeds $3,500, then the benefit may not be imme diately distributed without the consent of the participant (and, applicable, the participant's spouse).

Present law provides that the present value of a qualified join and survivor annuity may be immediately distributed if the valu does not exceed $3,500. In addition, if the present value of a qual fied joint and survivor annuity or a qualified preretirement surv vor annuity exceeds $3,500, the plan may immediately distribut all or part of the present value of the annuity only if the partic pant and the participant's spouse (or the surviving spouse, if th participant has died) consents in writing to the distribution.

Under present law, the interest rate to be used in determinin whether the present value of a benefit exceeds $3,500 may not b greater than the interest rate that would be used (as of the date o the distribution) by the Pension Benefit Guaranty Corporatio (PBGC) for purposes of determining the present value of a lum sum distribution upon termination of the plan. The PBGC rate i effect at the beginning of a plan year may be used with respect t distributions made at any time during the plan year if the plan s provides.

Generally, a cash-out distribution from a qualified plan (whethe voluntary or involuntary) may be rolled over, tax free, to an IRA o to another qualified plan if certain requirements are met.

Explanation of Provision

Under the bill, an accrued benefit would not be treated as non forefeitable unless, in the case of any lump-sum distribution mad before a participant attains age 59½, dies, or becomes disabled, th distribution is made in a direct transfer (after notice to the partic pant or the participant's beneficiary) to an individual retiremen

ount or annuity (an IRA). The participant or the participant's ıeficiary (if the participant has died) would be required to desig- :e the IRA and to demonstrate to the satisfaction of the plan ad- ıistrator that the account or annuity is willing to accept the nsfer.

'he bill provides that, if the participant or the participant's ben- :iary fails to designate an IRA for receipt of an involuntary cash within 60 days after the notice from the plan administrator, plan administrator would be permitted to make a direct trans- to an IRA selected by the plan administrator.

n addition, the bill provides that similar rules would apply to cash-out of benefits with respect to a qualified joint and survi- annuity and a qualified preretirement survivor annuity.

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Special rules for simplified employee pensions (secs. 252-254 of the bill and sec. 408(k) of the Code)

Present Law

general

Jnder present law, if an IRA qualifies as a simplified employee ısion (SEP), the annual IRA deduction limit is increased to the ser of $30,000 or 15 percent of compensation. The increased de- ction limit applies only to employer contributions.

An IRA qualifies as a SEP for a calendar year if certain require- nts relating to employee withdrawals and the employer contri- tion allocation formula are met. The allocation rules are de- ned to insure that employer contributions are made on a basis ıt does not discriminate in favor of employees who are officers, ıreholders, or highly compensated.

tegration of SEP benefits with social security

Under present law, a SEP is not qualified unless the employer ıtributions are nondiscriminatory without taking into account employer's contributions on behalf of employees to social secu- y. However, if the employer does not maintain any other inte- ıted plan, then the employer's contributions (OASDI contribu- ns) on behalf of an employee to social security may be taken into count as contributions by the employer to the SEP, but only if ch contributions are taken into account with respect to each em- ɔyee maintaining a SEP.

Present law provides that an integrated plan is a plan that uld not meet the qualification requirements if social security ntributions were not taken into account.

Explanation of Provisions

general

The bill would revise the qualification requirements relating to :Ps to permit employees to elect to have SEP contributions made their behalf or to receive the contribution in cash. In addition, e bill would repeal the provision permitting SEP contributions to integrated with social security and would apply a limitation on

annual SEP contributions that is tied to the contribution and bene fit base under the Social Security Act.

Salary reduction SEPs

Under the bill, employees who participate in a SEP would be per mitted to elect to have contributions made to the SEP or to receiv the contributions in cash. The election to have amounts contribut ed to a SEP or to receive the amounts in cash would be availabl only in a taxable year in which the employer maintaining the SEI has 25 or fewer employees as of the beginning of the taxable yea If an employee elects to have contributions made on the employee' behalf to the SEP, the contribution would not be treated as havin been distributed or made available to the employee. In addition the contribution would not be treated as an employee contributio merely because the SEP provides the employee with such an elec tion. Therefore, under the bill, an employee would not be require to include in income currently the amounts an employee elects t have contributed to the SEP.

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The bill provides that the election to have amounts contribute to a SEP or received in cash would be available only if at least 5 percent of the employees of the employer elect to have amount contributed to the SEP. In addition, under the bill, the amount el gible to be deferred as a percentage of an owner-employee's com pensation (i.e., the deferral percentage) would be limited by the av erage deferral percentage for all other employees who participat The deferral percentage for each owner-employee cannot excee the deferral percentage for all other participating employees b more than 150 percent.

For purposes of determining the deferral percentages, an employ ee's compensation would be the amount of the employee's compen sation taken into account under the SEP for purposes of calculat ing the contribution that may be made on the employee's behalf fo the year. Further, if an employee participates in more than on SEP of the employer, the employee's deferral percentage is the sur of the employee's deferral percentages under each of the SEPs.

In addition, the provision permitting employees to elect to defe compensation under a SEP would not apply unless the trustee c the SEP assumed the fiduciary duties imposed under ERISA.

Integration under SEPs

Under the bill, for purposes of testing whether the contribution or benefits under a SEP are nondiscriminatory, the contribution made by the employer on behalf of employees to Social Securit could not be taken into account.

Wage-based contribution limitation for SEPs

Under the bill, the limit on compensation taken into accoun under SEPs would be revised to equal 500 percent of the contribu tion and benefit base in effect for the year under the Social Secur ty Act, $210,000 in 1986.

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I. Effective Dates

he bill generally would be effective with respect to any plan for ı years ending after the later of 2 years after the date of enact- ıt of the bill or the earlier of (1) the effective date of the first ı amendment adopted after the date of enactment or (2) Decem- 31, 1990. The provisions relating to individual retirement ar- gements would be effective for taxable years ending after De- ıber 31, 1990.

. special effective date would be provided for collectively bar- ıed plans. In the case of a plan maintained pursuant to one or ·e collective bargaining agreements between employee repre- tatives and one or more employers ratified before the date of .ctment, the bill would be effective for plan years ending after later of 2 years after the date of enactment or the earliest of (1) date on which the last of the collective bargaining agreements ıting to the plan terminated (determined without regard to any ension ratified after the date of enactment), (2) the effective e of the first plan amendment adopted after the date of enact- nt, or (3) December 31, 1990.

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