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NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT

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

R E P O R T

[To accompany S. 1953]

The Committee on Finance, having considered an original bill (S. 1953) to amend the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 to protect the retirement security of American workers by ensuring that pension benefits are funded and that pension assets are adequately diversified and by providing workers with adequate access to, and information about, their pension plans, and for other purposes, reports favorably thereon and recommends that the bill do pass.

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I. LEGISLATIVE BACKGROUND

Overview

The Senate Committee on Finance marked up an original bill, the "National Employee Savings and Trust Equity Guarantee Act of 2005" on July 26, 2005, and ordered the bill favorably reported by a voice vote.

Hearings

During the 109th Congress, the Committee held hearings on various topics relating to the provisions of the bill, as follows.

The Committee held a hearing on June 30, 2005, on encouraging savings and investment.

The Committee held a hearing on June 7, 2005, titled "Preventing the Next Pension Collapse: Lessons from the United Airlines Case."

On March 1, 2005, the Committee held a hearing on the financial status of the Pension Benefit Guaranty Corporation ("PBGC") and the President's defined benefit plan funding proposal. On February 8, 2005, the Committee held a hearing on the revenue proposals in the President's Fiscal Year 2006 Budget Proposal.

In addition, on June 23, 2005, Senator Grassley, Chairman, and Senator Baucus, ranking member, sent letters to 36 companies requesting detailed information regarding their pension plans as part of an ongoing effort to understand the scope of pension underfunding and to assist in the crafting of comprehensive pension reform legislation that will help prevent dramatic underfunding in the future.

Prior activity

In general

Many provisions of the bill are substantially similar or build on proposals previously considered by the Committee.

Activity during the 108th Congress

During the 108th Congress, the Committee reported S. 2424, the "National Employee Savings and Trust Equity Guarantee Act" on May 14, 2004.[1] The Committee held hearings on various topics relating to the provisions of the S. 2424 (108th Cong).

The Committee held a hearing on April 8, 2003, on compensation-related issues addressed in the Joint Committee on Taxation staff investigation and report relating to Enron Corporation conducted at the request of Senators Baucus and Grassley. The Committee also held a hearing on March 11, 2003, on issues relating to the funding of defined benefit plans.

The Committee held a hearing on company-owned life insurance on October 23, 2003.

Activity during the 107th Congress

During the 107th Congress, the Committee reported S. 1971, the "National Employee Savings and Trust Equity Guarantee Act," and held hearings on various topics relating to the provisions of S. 1971 (107th Cong.). The Committee held a hearing on February 27, 2002, regarding retirement security. The Committee held a hearing on April 18, 2002, regarding corporate governance and executive compensation.

[1] S. Rep. No. 108–266. The "National Employee Savings and Trust Equity Guarantee Act," an original bill, was initially marked up by the Committee, and ordered favorably reported by voice vote, on September 17, 2003. On October 1, 2003, the Committee by unanimous consent recalled the bill and amended it to make the provision relating to company-owned life insurance ("COLI") effective on the date of enactment and agreed to a further markup of the COLI and related provisions of the bill. On February 2, 2004, the Committee marked up a modification to the bill and ordered the bill favorably reported by voice vote.

II. EXPLANATION OF THE BILL

TITLE I—DIVERSIFICATION RIGHTS AND OTHER DEFINED CONTRIBUTION PARTICIPANT PROTECTIONS

A. DEFINED CONTRIBUTION PLANS REQUIRED TO PROVIDE EMPLOYEES WITH FREEDOM TO INVEST THEIR PLAN ASSETS

(Sec. 101 of the bill, new sec. 401(a)(35) of the Code, and new sec. 204(j) of ERISA)

PRESENT LAW

In general

Defined contribution plans may permit both employees and employers to make contributions to the plan. Under a qualified cash or deferred arrangement (commonly referred to as a "section 401(k) plan"), employees may elect to make pretax contributions to a plan, referred to as elective deferrals. Employees may also be permitted to make after-tax contributions to a plan. In addition, a plan may provide for employer nonelective contributions or matching contributions. Nonelective contributions are employer contributions that are made without regard to whether the employee makes elective deferrals or after-tax contributions. Matching contributions are employer contributions that are made only if the employee makes elective deferrals or after-tax contributions.

Under the Internal Revenue Code (the "Code"),[2] elective deferrals, after-tax employee contributions, and employer matching contributions are subject to special nondiscrimination tests. Certain employer nonelective contributions may be used to satisfy these special nondiscrimination tests. In addition, plans may satisfy the special nondiscrimination tests by meeting certain safe harbor contribution requirements.

The Code requires employee stock ownership plans ("ESOPs") to offer certain plan participants the right to diversify investments in employer securities. The Employee Retirement Income Security Act of 1974 ("ERISA") limits the amount of employer securities and employer real property that can be acquired or held by certain employer-sponsored retirement plans. The extent to which the ERISA limits apply depends on the type of plan and the type of contribution involved.

Diversification requirements applicable to ESOPs under the Code

An ESOP is a defined contribution plan that is designated as an ESOP and is designed to invest primarily in qualifying employer securities and that meets certain other requirements under the Code. For purposes of ESOP investments, a "qualifying employer security" is defined as: (1) publicly traded common stock of the employer or a member of the same controlled group; (2) if there is no such publicly traded common stock, common stock of the employer (or member of the same controlled group) that has both voting power and dividend rights at least as great as any other class of common stock; or (3) noncallable preferred stock that is convertible into common stock described in (1) or (2) and that meets certain

[2] All references to the "Code" are to the Internal Revenue Code. All section references and descriptions of present law refer to the Code unless otherwise indicated.

requirements. In some cases, an employer may design a class of preferred stock that meets these requirements and that is held only by the ESOP.

An ESOP can be an entire plan or it can be a component of a larger defined contribution plan. An ESOP may provide for different types of contributions. For example, an ESOP may include a qualified cash or deferred arrangement that permits employees to make elective deferrals.[3]

Under the Code, ESOPs are subject to a requirement that a participant who has attained age 55 and who has at least 10 years of participation in the plan must be permitted to diversify the investment of the participant's account in assets other than employer securities.[4] The diversification requirement applies to a participant for six years, starting with the year in which the individual first meets the eligibility requirements (i.e., age 55 and 10 years of participation). The participant must be allowed to elect to diversify up to 25 percent of the participant's account (50 percent in the sixth year), reduced by the portion of the account diversified in prior years.

The participant must be given 90 days after the end of each plan year in the election period to make the election to diversify. In the case of participants who elect to diversify, the plan satisfies the diversification requirement if: (1) the plan distributes the applicable amount to the participant within 90 days after the election period; (2) the plan offers at least three investment options (not inconsistent with Treasury regulations) and, within 90 days of the election period, invests the applicable amount in accordance with the participant's election; or (3) the applicable amount is transferred within 90 days of the election period to another qualified defined contribution plan of the employer providing investment options in accordance with (2).[5]

ERISA limits on investments in employer securities and real property

ERISA imposes restrictions on the investment of retirement plan assets in employer securities or employer real property.[6] A retirement plan may hold only a "qualifying" employer security and only "qualifying" employer real property.

Under ERISA, any stock issued by the employer or an affiliate of the employer is a qualifying employer security.[7] Qualifying employer securities also include certain publicly traded partnership interests and certain marketable obligations (i.e., a bond, debenture, note, certificate or other evidence of indebtedness). Qualifying employer real property means parcels of employer real property: (1) if a substantial number of the parcels are dispersed geographically; (2) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use; (3) even if all of the real property is leased to one lessee (which

[3] Such an ESOP design is sometimes referred to as a "KSOP."
[4] Sec. 401(a)(28). The present-law diversification requirements do not apply to employer securities held by an ESOP that were acquired before January 1, 1987.
[5] IRS Notice 88–56, 1988–1 C.B. 540, Q&A–16.
[6] ERISA sec. 407.
[7] Certain additional requirements apply to employer stock held by a defined benefit pension plan or a money purchase pension plan (other than certain plans in existence before the enactment of ERISA).

may be an employer, or an affiliate of an employer); and (4) if the acquisition and retention of such property generally comply with the fiduciary rules of ERISA (with certain specified exceptions).

ERISA also prohibits defined benefit pension plans and money purchase pension plans (other than certain plans in existence before the enactment of ERISA) from acquiring employer securities or employer real property if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer securities and real property. Except as discussed below with respect to elective deferrals, this 10-percent limitation generally does not apply to defined contribution plans other than money purchase pension plans.[8] In addition, a fiduciary generally is deemed not to violate the requirement that plan assets be diversified with respect to the acquisition or holding of employer securities or employer real property in a defined contribution plan.[9]

The 10-percent limitation on the acquisition of employer securities and real property applies separately to the portion of a plan consisting of elective deferrals (and earnings thereon) if any portion of an individual's elective deferrals (or earnings thereon) are required to be invested in employer securities or real property pursuant to plan terms or the direction of a person other than the participant. This restriction does not apply if: (1) the amount of elective deferrals required to be invested in employer securities and real property does not exceed more than one percent of any employee's compensation; (2) the fair market value of all defined contribution plans maintained by the employer is no more than 10 percent of the fair market value of all retirement plans of the employer; or (3) the plan is an ESOP.

REASONS FOR CHANGE

Recent events have focused public attention on the investment of retirement plan assets in employer securities. The bankruptcies of several large publicly-traded companies, such as the Enron Corporation, have been accompanied by the loss of employees' pension benefits because defined contribution plan assets were heavily invested in employer securities. In many cases, employees lost not only their jobs, but also their retirement savings, upsetting their plans for retirement.

The Committee understands that employer securities are one possible investment for defined contribution plans. In some cases, the plan may offer employer securities as one of several investment options made available to plan participants. In other cases, the plan may provide that certain contributions are invested in employer securities. For example, many plans provide that employer matching contributions with respect to employee elective deferrals under a qualified cash or deferred arrangement are to be invested in employer securities.

Present law has facilitated and encouraged the acquisition of employer securities by defined contribution plans, particularly in the

[8] The 10-percent limitation also applies to a defined contribution plan that is part of an arrangement under which benefits payable to a participant under a defined benefit pension plan are reduced by benefits under the defined contribution plan (i.e., a "floor-offset" arrangement).

[9] Under ERISA, a defined contribution plan is generally referred to as an individual account plan. Plans that are not subject to the 10-percent limitation on the acquisition of employer securities and employer real property are referred to as "eligible individual account plans."

case of ESOPs. Thus, for example, present law provides that the dividends paid on employer securities held by an ESOP are deductible under certain circumstances and also allows an ESOP to borrow to acquire the employer securities. Present law recognizes that employer securities can be a profitable investment for employees as well as a corporate financing tool for employers. Employees who hold employer securities through a defined contribution plan often feel that they have a stake in the business, leading to increased profitability.

On the other hand, the Committee recognizes that diversification of assets is a basic principle of sound investment policy and that requiring certain contributions to be invested in employer securities may create tension with the objectives of diversification. Failure to adequately diversify defined contribution plan investments may jeopardize retirement security. The Committee believes that participants should be provided with a greater opportunity to diversify plan investments in employer securities.

In addition, at the request of the Committee, the staff of the Joint Committee on Taxation ("Joint Committee staff") undertook an investigation relating to Enron Corporation and related entities, including a review of the compensation arrangements of Enron employees, e.g., qualified retirement plans, nonqualified deferred compensation arrangements, and other arrangements. The Joint Committee staff issued an official report of its investigation, including findings and recommendations resulting from its review of Enron's pension plans and compensation arrangements.[10] The Joint Committee staff's findings support the Committee's views regarding the need for greater diversification in the investment of defined contribution plan assets. The Joint Committee staff found that participants in Enron's Savings Plan lost considerable amounts of retirement savings due to the high level of investment in Enron stock and that Enron's plan is not alone in its high concentration of investment in employer stock.[11] The Joint Committee staff recommended legislative changes to allow participants greater opportunities to invest their accounts in diversified investments, rather than in employer securities.[12]

The Committee believes that allowing participants greater opportunity to diversify plan investments in employer securities will help participants achieve their retirement security goals, while continuing to allow employers and employees the freedom to choose their own investments. The Committee bill therefore requires certain defined contribution plans that hold employer securities that are publicly traded to permit plan participants to direct the plan to reinvest employer securities in other assets. The Committee bill generally requires diversification in accordance with the present-law rules regarding vesting.

Recent issues relating to investments in employer securities have arisen in the context of publicly-traded companies. Although similar issues may arise with respect to investments in employer securities by retirement plans of privately-held companies, the Com-

[10] Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS–3–03), February 2003.
[11] Id. at Vol. I, 12–13, 39–40, 515–540.
[12] Id. at Vol. I, 19, 39–40, 538–540.

mittee understands that such investments often play a different role than in the case of publicly-traded companies. For example, it is more common for an ESOP of a privately-held company to hold a controlling interest in the employer. In addition, because of the lack of a public market for the securities, diversification could put an undue financial strain on the employer. Thus, the diversification requirements in the bill apply only to defined contribution plans holding employer securities of publicly traded companies.

The Committee believes that the current role of ESOPs should be preserved in order to encourage this form of ownership. Thus, the bill does not apply additional diversification requirements to "stand alone" ESOPs, meaning ESOPs that do not hold elective deferrals and related contributions. Again, the Committee believes this strikes an appropriate balance between the principle of diversification and the goals served by ESOPs.

Investment of defined contribution plan assets in employer real property may present similar issues as to adequate diversification, particularly if plan assets are also invested in employer securities. Accordingly, the diversification requirements apply to both employer securities and employer real property in the case of a plan that holds publicly traded employer securities.

EXPLANATION OF PROVISION

In general

Under the provision, in order to satisfy the plan qualification requirements of the Code and the vesting requirements of ERISA, certain defined contribution plans are required to provide diversification rights with respect to amounts invested in employer securities or employer real property. Such a plan is required to permit applicable individuals to direct that the portion of the individual's account held in employer securities or employer real property be invested in alternative investments. Under the provision, an applicable individual includes: (1) any plan participant; and (2) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant. The time when the diversification requirements apply depends on the type of contributions invested in employer securities or employer real property.

Plans subject to requirements

The diversification requirements generally apply to an "applicable defined contribution plan,"[13] which means a defined contribution plan holding publicly-traded employer securities (i.e., securities issued by the employer or a member of the employer's controlled group of corporations[14] that are readily tradable on an established securities market).

For this purpose, a plan holding employer securities that are not publicly traded is generally treated as holding publicly-traded employer securities if the employer (or any member of the employer's controlled group of corporations) has issued a class of stock that is

[13] Under ERISA, the diversification requirements apply to an "applicable individual account plan."

[14] For this purpose, "controlled group of corporations" has the same meaning as under section 1563(a), except that, in applying that section, 50 percent is substituted for 80 percent.

a publicly-traded employer security. This treatment does not apply if neither the employer nor any parent corporation[15] of the employer has issued any publicly-traded security or any special class of stock that grants particular rights to, or bears particular risks for, the holder or the issuer with respect to any member of the employer's controlled group that has issued any publicly-traded employer security. For example, a controlled group that generally consists of corporations that have not issued publicly-traded securities, may include a member that has issued publicly-traded stock (the "publicly-traded member"). In the case of a plan maintained by an employer that is another member of the controlled group, the diversification requirements do not apply to the plan, provided that neither the employer nor a parent corporation of the employer has issued any publicly-traded security or any special class of stock that grants particular rights to, or bears particular risks for, the holder or issuer with respect to the member that has issued publicly-traded stock. The Secretary of the Treasury has the authority to provide other exceptions in regulations. For example, an exception may be appropriate if no stock of the employer maintaining the plan (including stock held in the plan) is publicly traded, but a member of the employer's controlled group has issued a small amount of publicly-traded stock.

The diversification requirements do not apply to an ESOP that: (1) does not hold contributions (or earnings thereon) that are subject to the special nondiscrimination tests that apply to elective deferrals, employee after-tax contributions, and matching contributions; and (2) is a separate plan from any other qualified retirement plan of the employer. Accordingly, an ESOP that holds elective deferrals, employee contributions, employer matching contributions, or nonelective employer contributions used to satisfy the special nondiscrimination tests (including the safe harbor methods of satisfying the tests) is subject to the diversification requirements under the provision. The diversification rights applicable under the provision are broader than those applicable under the Code's present-law ESOP diversification rules. Thus, an ESOP that is subject to the new requirements is excepted from the present-law rules.[16]

The diversification requirements under the provision also do not apply to a one-participant retirement plan. A one-participant retirement plan is a plan that: (1) on the first day of the plan year, covers only one individual (or the individual and his or her spouse) and the individual owns 100 percent of the plan sponsor (i.e., the employer maintaining the plan), whether or not incorporated, or covered only one or more partners (or partners and their spouses) in the plan sponsor; (2) meets the minimum coverage requirements without being combined with any other plan that covers employees of the business; (3) does not provide benefits to anyone except the individuals (and spouses) described in (1); (4) does not cover a busi-

[15] For this purpose, "parent corporation" has the same meaning as under section 424(e), i.e., any corporation (other than the employer) in an unbroken chain of corporations ending with the employer if each corporation other than the employer owns stock possessing at least 50 percent of the total combined voting power of all classes of stock with voting rights or at least 50 percent of the total value of shares of all classes of stock in one of the other corporations in the chain.

[16] An ESOP will not be treated as failing to be designed to invest primarily in qualifying employer securities merely because the plan provides diversification rights as required under the provision or greater diversification rights than required under the provision.

ness that is a member of an affiliated service group, a controlled group of corporations, or a group of corporations under common control; and (5) does not cover a business that uses leased employees. It is intended that, for this purpose, a "partner" includes an owner of a business that is treated as a partnership for tax purposes. In addition, it includes a two-percent shareholder of an S corporation.[17]

Elective deferrals and after-tax employee contributions

In the case of amounts attributable to elective deferrals under a qualified cash or deferred arrangement and employee after-tax contributions that are invested in employer securities or employer real property, any applicable individual must be permitted to direct that such amounts be invested in alternative investments.

Other contributions

In the case of amounts attributable to contributions other than elective deferrals and after-tax employees contributions (i.e., nonelective employer contributions and employer matching contributions) that are invested in employer securities or employer real property, an applicable individual who is a participant with three years of service,[18] a beneficiary of such a participant, or a beneficiary of a deceased participant must be permitted to direct that such amounts be invested in alternative investments.

The provision provides a transition rule for amounts attributable to these other contributions that are invested in employer securities or employer real property acquired before the first plan year for which the new diversification requirements apply. Under the transition rule, for the first three years for which the new diversification requirements apply to the plan, the applicable percentage of such amounts is subject to diversification as shown in Table 1, below.

The applicable percentage applies separately to each class of employer security and to employer real property in an applicable individual's account. The transition rule does not apply to plan participants who have three years of service and who have attained age 55 by the beginning of the first plan year beginning after December 31, 2005.

TABLE 1.—APPLICABLE PERCENTAGE FOR EMPLOYER SECURITIES OR EMPLOYER REAL PROPERTY HELD ON EFFECTIVE DATE

Plan year for which diversification applies	*Applicable percentage*
First year	33
Second year	66
Third year	100

The application of the transition rule is illustrated by the following example. Suppose that the account of a participant with at least three years of service held 120 shares of employer common stock contributed as matching contributions before the diversification requirements became effective. In the first year for which diversification applies, 33 percent (i.e., 40 shares) of that stock is subject to the diversification requirements. In the second year for which diversification applies, a total of 66 percent of 120 shares of

[17] Under section 1372, a two-percent shareholder of an S corporation is treated as a partner for fringe benefit purposes.

[18] Years of service is defined as under the rules relating to vesting (sec. 411(a)).

stock (i.e., 79 shares, or an additional 39 shares) is subject to the diversification requirements. In the third year for which diversification applies, 100 percent of the stock, or all 120 shares, is subject to the diversification requirements. In addition, in each year, employer stock in the account attributable to elective deferrals and employee after-tax contributions is fully subject to the diversification requirements, as is any new stock contributed to the account.

Rules relating to the election of investment alternatives

A plan subject to the diversification requirements is required to give applicable individuals a choice of at least three investment options, other than employer securities or employer real property, each of which is diversified and has materially different risk and return characteristics. It is intended that other investment options generally offered by the plan also must be available to applicable individuals.

A plan does not fail to meet the diversification requirements merely because the plan limits the times when divestment and reinvestment can be made to periodic, reasonable opportunities that occur at least quarterly. It is intended that applicable individuals generally be given the opportunity to make investment changes with respect to employer securities or employer real property on the same basis as the opportunity to make other investment changes, except in unusual circumstances. Thus, in general, applicable individuals must be given the opportunity to request changes with respect to investments in employer securities or employer real property with the same frequency as the opportunity to make other investment changes and that such changes are implemented in the same timeframe as other investment changes, unless circumstances require different treatment. For example, in the case of a plan that provides diversification rights with respect to investments in employer real property, if the property must be sold in order to implement an applicable individual's request to divest his or her account of employer real property, a longer period may be needed to implement the individual's request than the time needed to implement other investment changes. Providing a longer period is permissible in those circumstances.

Except as provided in regulations, a plan may not impose restrictions or conditions with respect to the investment of employer securities or employer real property that are not imposed on the investment of other plan assets (other than restrictions or conditions imposed by reason of the application of securities laws). For example, such a restriction or condition includes a provision under which a participant who divests his or her account of employer securities or employer real property receives less favorable treatment (such as a lower rate of employer contributions) than a participant whose account remains invested in employer securities or employer real property. On the other hand, such a restriction does not include the imposition of fees with respect to other investment options under the plan, merely because fees are not imposed with respect to investments in employer securities.

EFFECTIVE DATE

The provision is generally effective for plan years beginning after December 31, 2005. In the case of a plan maintained pursuant to

one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2006, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2007.

A special effective date applies with respect to employer matching and nonelective contributions (and earnings thereon) that are invested in employer securities that, as of September 17, 2003: (1) consist of preferred stock; and (2) are held within an ESOP, under the terms of which the value of the preferred stock is subject to a guaranteed minimum. Under the special rule, the diversification requirements apply to such preferred stock for plan years beginning after the earlier of (1) December 31, 2006; or (2) the first date as of which the actual value of the preferred stock equals or exceeds the guaranteed minimum. When the new diversification requirements become effective for the plan under the special rule, the applicable percentage of employer securities or employer real property held on the effective date that is subject to diversification is determined without regard to the special rule. For example, if, under the general effective date, the diversification requirements would first apply to the plan for the first plan year beginning after December 31, 2005, and, under the special rule, the diversification requirements first apply to the plan for the first plan year beginning after December 31, 2008, the applicable percentage for that year is 100 percent.

B. Notice of Freedom To Divest Employer Securities or Real Property

(Secs. 102 and 205 of the bill, new sec. 4980H of the Code, and new sec. 101(j) of ERISA)

PRESENT LAW

Under ERISA, a plan administrator is required to furnish participants with certain notices and information about the plan. This information includes, for example, a summary plan description that includes certain information, including administrative information about the plan, the plan's requirements as to eligibility for participation and benefits, the plan's vesting provisions, and the procedures for claiming benefits under the plan. Under ERISA, if a plan administrator fails or refuses to furnish to a participant information required to be provided to the participant within 30 days of the participant's written request, the participant generally may bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or other relief that the court deems proper.

The Code contains a variety of notice requirements with respect to qualified plans. Such requirements are generally enforced by an excise tax. For example, in case of a failure to provide notice of a significant reduction in benefit accruals, an excise tax of $100 a day is generally imposed on the employer. If the employer exercised reasonable diligence in meeting the requirements, the excise tax with respect to a taxable year is limited to no more than $500,000.

REASONS FOR CHANGE

The bill provides participants with new rights to diversify the investment of their defined contribution plan accounts. After the new diversification requirements become effective, information about these rights will be provided to participants in accordance with present law, for example, as part of the summary plan description. However, under present law, such information is not required to be provided at the time the new diversification requirements become effective. Moreover, with respect to future participants, such information may be provided when an employee first becomes a participant in the plan, generally after one year of service, whereas, in some cases, a participant becomes eligible for diversification after three years of service. The Committee believes that participants should receive a specific notice of their diversification rights shortly before they first become eligible to exercise such rights. Such notice will better enable participants to exercise and benefit from the new diversification rights.

EXPLANATION OF PROVISION

In general

The provision requires a new notice under the Code and ERISA in connection with the right of an applicable individual to divest his or her account under an applicable defined contribution plan of employer securities or employer real property, as required under the provision relating to diversification rights with respect to amounts invested in employer securities or employer real property. Not later than 30 days before the first date on which an applicable individual is eligible to exercise such right with respect to any type of contribution, the administrator of the plan must provide the individual with a notice setting forth such right and describing the importance of diversifying the investment of retirement account assets. Under the diversification provision, an applicable individual's right to divest his or her account of employer securities or employer real property attributable to elective deferrals and employee after-tax contributions and the right to divest his or her account of employer securities or employer real property attributable to other contributions (i.e., nonelective employer contributions and employer matching contributions) may become exercisable at different times. Thus, to the extent the applicable individual is first eligible to exercise such rights at different times, separate notices are required.

The notice must be written in a manner calculated to be understood by the average plan participant and may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the applicable individual. The Secretary of the Treasury has regulatory authority over the notice required under the Code and ERISA and is directed to prescribe a model notice to be used for this purpose within 180 days of enactment of the provision. It is expected that the Secretary of the Treasury will consult with the Secretary of Labor on the description of the importance of diversifying the investment of retirement account assets. In addition, it is intended that the Secretary of the Treasury will prescribe rules to enable the notice to be provided at reduced administrative expense, such as allowing the notice to be provided with the summary plan description, with a reminder of

these rights within a reasonable period before they become exercisable.

Sanctions for failure to provide notice

Excise tax

Under the provision, an excise tax generally applies in the case of a failure to provide notice of diversification rights as required under the Code. The excise tax is generally imposed on the employer if notice is not provided.[19] The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until notice is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the notice requirement, the total excise tax imposed during a taxable year will not exceed $500,000.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the notice requirement. In addition, no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required notice within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

ERISA civil penalty

In the case of a failure to provide notice of diversification rights as required under ERISA, the Secretary of Labor may assess a civil penalty against the plan administrator of up to $100 a day from the date of the failure. For this purpose, each violation with respect to any single applicable individual is treated as a separate violation.

EFFECTIVE DATE

The provision generally applies to plan years beginning after December 31, 2005. Under a transition rule, if notice under the provision would otherwise be required before 90 days after the date of enactment, notice is not required until 90 days after the date of enactment.

C. Periodic Pension Benefit Statements for Defined Contribution Plans

(Secs. 103 and 205 of the bill, new sec. 4980I of the Code, and sec. 105(a) of ERISA)

PRESENT LAW

In general

Under ERISA, a plan administrator is required to furnish participants with certain notices and information about the plan.[20] If a plan administrator fails or refuses to furnish to a participant in-

[19] In the case of a multiemployer plan, the excise tax is imposed on the plan.

[20] Governmental plans and church plans are exempt from ERISA, including requirements to provide notices or information to participants.

formation required to be provided to the participant within 30 days of the participant's written request, the participant generally may bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or other relief that the court deems proper.

The Code contains a variety of notice requirements with respect to qualified plans. Such requirements are generally enforced by an excise tax. For example, in case of a failure to provide notice of a significant reduction in benefit accruals, an excise tax of $100 a day is generally imposed on the employer. If the employer exercised reasonable diligence in meeting the requirements, the excise tax with respect to a taxable year is limited to no more than $500,000.

Pension benefit statements

ERISA provides that a plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. The benefit statement must indicate, on the basis of the latest available information: (1) the participant's or beneficiary's total accrued benefit; and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than one benefit statement during any 12-month period.

Statements to participants on separation from service

A plan administrator must furnish a statement to each participant who: (1) separates from service during the year; (2) is entitled to a deferred vested benefit under the plan as of the end of the plan year; and (3) whose benefits were not paid during the year. The statement must set forth the nature, amount, and form of the deferred vested benefit to which the participant is entitled. The plan administrator generally must provide the statement no later than 180 days after the end of the plan year in which the separation from service occurs.

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

Requirements for benefit statements

Under the provision, the administrator of a defined contribution plan is required under the Code and ERISA to provide a benefit statement (1) to a participant or beneficiary who has the right to direct the investment of the assets in his or her account, at least quarterly, (2) to any other participant or other beneficiary who has his or her own account under the plan, at least annually, and (3)

to other beneficiaries, upon written request, but limited to one request during any 12-month period.[21]

The benefit statement is required to indicate, on the basis of the latest available information: (1) the total benefits accrued; (2) the vested accrued benefit or the earliest date on which the accrued benefit will become vested; and (3) an explanation of any offset that may be applied in determining accrued benefits under a plan that provides for permitted disparity or that is part of a floor-offset arrangement (i.e., an arrangement under which benefits payable to a participant under a defined benefit pension plan are reduced by benefits under a defined contribution plan). With respect to information on vested benefits, the Secretary of Labor is required to provide that the requirements of the provision are met if, at least annually, the plan: (1) updates the information on vested benefits that is provided in the benefit statement; or (2) provides in a separate statement information as is necessary to enable participants and beneficiaries to determine their vested benefits.

The benefit statement must also include the value of each investment to which assets in the individual's account are allocated (determined as of the plan's most recent valuation date), including the value of any assets held in the form of employer securities or employer real property (without regard to whether the securities or real property were contributed by the employer or acquired at the direction of the individual). A quarterly benefit statement provided to a participant or beneficiary who has the right to direct investments must also provide: (1) an explanation of any limitations or restrictions on any right of the individual to direct an investment; and (2) a notice that investments in any individual account may not be adequately diversified if the value of any investment in the account exceeds 20 percent of the fair market value of all investments in the account.

The benefit statement must be written in a manner calculated to be understood by the average plan participant. It may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the recipient. For example, regulations could permit current benefit statements to be provided on a continuous basis through a secure plan website for a participant or beneficiary who has access to the website.

The Secretary of Labor has regulatory authority over the benefits statements required under ERISA and the Code and the authority to issue interim final rules as the Secretary determines appropriate to carry out the provision. The Secretary of Labor is directed, within 180 days after the date of enactment of the provision, to develop one or more model benefit statements, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the requirements of ERISA and the Code. The use of the model statement is optional. It is intended that the model statement include items such as the amount of nonforfeitable accrued benefits as of the statement date that are payable at normal retirement age under the plan, the

[21] In the case of a tax-sheltered annuity (sec. 403(b)) that is not a plan established or maintained by the employer, the benefit statement generally must be provided by the issuer of the annuity contract. The benefit statement requirements do not apply to a one-participant retirement plan The term "one-participant retirement plan" is defined as under the provision requiring plans to provide diversification rights with respect to employer securities and employer real property.

amount of accrued benefits that are forfeitable but that may become nonforfeitable under the terms of the plan, information on how to contact the Social Security Administration to obtain a participant's personal earnings and benefit estimate statement, and other information that may be important to understanding benefits earned under the plan.

Sanctions for failure to provide information

Excise tax

Under the provision, an excise tax generally applies in the case of a failure to provide a benefit statement as required under the Code. The excise tax is generally imposed on the employer if a required benefit statement or model form is not provided.[22] The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the benefit statement or model form is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the benefit statement, the total excise tax imposed during a taxable year will not exceed $500,000.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the benefit statement requirement. In addition, no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required benefit statement within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

ERISA enforcement

The ERISA remedies that apply in the case of a failure or refusal to provide a participant with information under present law apply if the plan administrator fails to furnish a benefit statement required under the provision. That is, the participant or beneficiary is entitled to bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or such other relief that the court deems proper.

Exception for governmental and church plans

The provision contains an exception from the benefit statement under the Code for a governmental plan or a church plan. In addition, such plans are generally exempt from ERISA. Accordingly, the benefit statement and investment notice requirements do not apply to a governmental plan or a church plan.

EFFECTIVE DATE

The provision is generally effective for plan years beginning after December 31, 2006. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of De-

[22] In the case of a multiemployer plan, the excise tax is imposed on the plan. In the case of a tax-sheltered annuity (sec. 403(b)) that is not a plan established or maintained by the employer, the tax is generally imposed on the issuer of the annuity contract.

cember 31, 2007, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2008.

D. Periodic Pension Benefit Statements for Defined Benefit Pension Plans

(Sec. 103 of the bill, new sec. 4980I of the Code, and secs. 105(a) and 502(c)(1) of ERISA)

PRESENT LAW

In general

Under ERISA, a plan administrator is required to furnish participants with certain notices and information about the plan.[23] If a plan administrator fails or refuses to furnish to a participant information required to be provided to the participant within 30 days of the participant's written request, the participant generally may bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or other relief that the court deems proper.

The Code contains a variety of notice requirements with respect to qualified plans. Such requirements are generally enforced by an excise tax. For example, in case of a failure to provide notice of a significant reduction in benefit accruals, an excise tax of $100 a day is generally imposed on the employer. If the employer exercised reasonable diligence in meeting the requirements, the excise tax with respect to a taxable year is limited to no more than $500,000.

Pension benefit statements

ERISA provides that a plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. The benefit statement must indicate, on the basis of the latest available information: (1) the participant's or beneficiary's total accrued benefit; and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than one benefit statement during any 12-month period.

Statements to participants on separation from service

A plan administrator must furnish a statement to each participant who: (1) separates from service during the year; (2) is entitled to a deferred vested benefit under the plan as of the end of the plan year; and (3) whose benefits were not paid during the year. The statement must set forth the nature, amount, and form of the deferred vested benefit to which the participant is entitled. The plan administrator generally must provide the statement no later than 180 days after the end of the plan year in which the separation from service occurs.

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[23] Governmental plans and church plans are exempt from ERISA, including requirements to provide notices or information to participants.

REASONS FOR CHANGE

The Committee recognizes that benefits provided under a defined benefit pension plan are an important element in participants' retirement income planning. The Committee believes that providing participants with regular information concerning their benefits is necessary to increase participant awareness and appreciation of the importance of retirement savings.

EXPLANATION OF PROVISION

Requirements for benefit statements

Under the provision, the administrator of a defined benefit pension plan is required under the Code and ERISA either: (1) to furnish a benefit statement at least once every three years to each participant who has a vested accrued benefit and who is employed by the employer at the time the benefit statements are furnished to participants; or (2) to furnish at least annually to each such participant notice of the availability of a benefit statement and the manner in which the participant can obtain it. The Secretary of Labor is authorized to provide that years in which no employee or former employee benefits under the plan need not be taken into account in determining the three-year period. It is intended that the annual notice of the availability of a benefit statement may be included with other communications to the participant if done in a manner reasonably designed to attract the attention of the participant.

The administrator of a defined benefit pension plan is also required to furnish a benefit statement to a participant or beneficiary upon written request, limited to one request during any 12-month period.

The benefit statement is required to indicate, on the basis of the latest available information: (1) the total benefits accrued; (2) the vested accrued benefit or the earliest date on which the accrued benefit will become vested; and (3) an explanation of any offset that may be applied in determining accrued benefits under a plan that provides for permitted disparity or that is part of a floor-offset arrangement (i.e., an arrangement under which benefits payable to a participant under a defined benefit pension plan are reduced by benefits under a defined contribution plan). In the case of a statement provided to a participant (other than at the participant's request), information may be based on reasonable estimates determined under regulations prescribed by the Secretary of Labor in consultation with the Pension Benefit Guaranty Corporation.

Form of benefit statement

The benefit statement must be written in a manner calculated to be understood by the average plan participant. It may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the recipient. For example, regulations could permit current benefit statements to be provided on a continuous basis through a secure plan website for a participant or beneficiary who has access to the website.

The Secretary of Labor has regulatory authority over the benefits statements required under ERISA and the Code and the authority to issue interim final rules as the Secretary determines appropriate

to carry out the provision. The Secretary of Labor is directed, within 180 days after the date of enactment of the provision, to develop one or more model benefit statements, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the requirements of ERISA and the Code. The use of the model statement is optional. It is intended that the model statement include items such as the amount of nonforfeitable accrued benefits as of the statement date that are payable at normal retirement age under the plan, the amount of accrued benefits that are forfeitable but that may become nonforfeitable under the terms of the plan, information on how to contact the Social Security Administration to obtain a participant's personal earnings and benefit estimate statement, and other information that may be important to understanding benefits earned under the plan.

Sanctions for failure to provide information

Excise tax

Under the provision, an excise tax generally applies in the case of a failure to provide a benefit statement as required under the Code. The excise tax is generally imposed on the employer if a required benefit statement or model form is not provided.[24] The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the benefit statement or model form is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the benefit statement, the total excise tax imposed during a taxable year will not exceed $500,000.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the benefit statement requirement. In addition, no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required benefit statement within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

ERISA enforcement

The ERISA remedies that apply in the case of a failure or refusal to provide a participant with information under present law apply if the plan administrator fails to furnish a benefit statement required under the provision. That is, the participant or beneficiary is entitled to bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or such other relief that the court deems proper.

Exception for governmental and church plans

The provision contains an exception from the benefit statement under the Code for a governmental plan or a church plan. In addition, such plans are generally exempt from ERISA. Accordingly, the

[24] In the case of a multiemployer plan, the excise tax is imposed on the plan.

benefit statement and investment notice requirements do not apply to a governmental plan or a church plan.

EFFECTIVE DATE

The provision is generally effective for plan years beginning after December 31, 2006. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2007, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2008.

E. Notice to Participants and Beneficiaries of Blackout Periods

(Secs. 104 and 205 of the bill, new sec. 4980J of the Code, and sec. 101(i) of ERISA)

PRESENT LAW

In general

The Sarbanes-Oxley Act of 2002[25] amended ERISA to require that the plan administrator of an individual account plan[26] provide advance notice of a blackout period (a "blackout notice") to plan participants and beneficiaries to whom the blackout period applies.[27] Generally, notice must be provided at least 30 days before the beginning of the blackout period. In the case of a blackout period that applies with respect to employer securities, the plan administrator must also provide timely notice of the blackout period to the employer (or the affiliate of the employer that issued the securities, if applicable).

The blackout notice requirement does not apply to a one-participant retirement plan, which is defined as a plan that (1) on the first day of the plan year, covered only the employer (and the employer's spouse) and the employer owns the entire business (whether or not incorporated) or covers only one or more partners (and their spouses) in a business partnership (including partners in an S or C corporation as defined in section 1361(a) of the Code), (2) meets the minimum coverage requirements without being combined with any other plan that covers employees of the business, (3) does not provide benefits to anyone except the employer (and the employer's spouse) or the partners (and their spouses), (4) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of corporations under common control, and (5) does not cover a business that leases employees.[28]

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[25] Pub. L. No. 107–204 (2002).

[26] An "individual account plan" is the term generally used under ERISA for a defined contribution plan.

[27] ERISA sec. 101(i), as enacted by section 306(b) of the Sarbanes-Oxley Act of 2002. Under section 306(a), a director or executive officer of a publicly-traded corporation is prohibited from trading in employer stock during blackout periods in certain circumstances. Section 306 is effective 180 days after enactment.

[28] Governmental plans and church plans are exempt from ERISA. Accordingly, the blackout notice requirement does not apply to these plans.

Definition of blackout period

A blackout period is any period during which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of the plan, to direct or diversify assets credited to their accounts, or to obtain loans or distributions from the plan, is temporarily suspended, limited, or restricted if the suspension, limitation, or restriction is for any period of more than three consecutive business days. However, a blackout period does not include a suspension, limitation, or restriction that (1) occurs by reason of the application of securities laws, (2) is a change to the plan providing for a regularly scheduled suspension, limitation, or restriction that is disclosed through a summary of material modifications to the plan or materials describing specific investment options under the plan, or changes thereto, or (3) applies only to one or more individuals, each of whom is a participant, alternate payee, or other beneficiary under a qualified domestic relations order.

Timing of notice

Notice of a blackout period is generally required at least 30 days before the beginning of the period. The 30-day notice requirement does not apply if (1) deferral of the blackout period would violate the fiduciary duty requirements of ERISA and a plan fiduciary so determines in writing, or (2) the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the reasonable control of the plan administrator and a plan fiduciary so determines in writing. In those cases, notice must be provided as soon as reasonably practicable under the circumstances unless notice in advance of the termination of the blackout period is impracticable.

Another exception to the 30-day period applies in the case of a blackout period that applies only to one or more participants or beneficiaries in connection with a merger, acquisition, divestiture, or similar transaction involving the plan or the employer and that occurs solely in connection with becoming or ceasing to be a participant or beneficiary under the plan by reason of the merger, acquisition, divestiture, or similar transaction. Under the exception, the blackout notice requirement is treated as met if notice is provided to the participants or beneficiaries to whom the blackout period applies as soon as reasonably practicable.

The Secretary of Labor may provide additional exceptions to the notice requirement that the Secretary determines are in the interests of participants and beneficiaries.

Form and content of notice

A blackout notice must be written in a manner calculated to be understood by the average plan participant and must include (1) the reasons for the blackout period, (2) an identification of the investments and other rights affected, (3) the expected beginning date and length of the blackout period, and (4) in the case of a blackout period affecting investments, a statement that the participant or beneficiary should evaluate the appropriateness of current investment decisions in light of the inability to direct or diversify assets during the blackout period, and (5) other matters as required by regulations. If the expected beginning date or length of the blackout period changes after notice has been provided, the

plan administrator must provide notice of the change (and specify any material change in other matters related to the blackout) to affected participants and beneficiaries as soon as reasonably practicable.

Notices provided in connection with a blackout period (or changes thereto) must be provided in writing and may be delivered in electronic or other form to the extent that the form is reasonably accessible to the recipient. The Secretary of Labor is required to issue guidance regarding the notice requirement and a model blackout notice.

Penalty for failure to provide notice

In the case of a failure to provide notice of a blackout period, the Secretary of Labor may assess a civil penalty against a plan administrator of up to $100 per day for each failure to provide a blackout notice. For this purpose, each violation with respect to a single participant or beneficiary is treated as a separate violation.

Code requirements

The Code does not contain a notice requirement with respect to blackouts. However, the Code contains a variety of other notice requirements with respect to qualified plans. Such requirements are generally enforced by an excise tax. For example, in case of a failure to provide notice of a significant reduction in benefit accruals, an excise tax of $100 a day is generally imposed on the employer. If the employer exercised reasonable diligence in meeting the requirements, the excise tax with respect to a taxable year is limited to no more than $500,000.

REASONS FOR CHANGE

In the course of normal plan operation, periods may occur during which a plan participant's ability to direct the investment of his or her account or obtain loans or distributions from the plan is restricted (a so-called "blackout" period). These periods usually occur in connection with administrative changes, such as a change in recordkeepers or in the investment options offered under a plan. Such a period may result also from changes in the plan in connection with a corporate transaction, such as a sale or merger. Present law requires advance notice of a blackout period to plan participants and beneficiaries to whom the blackout period applies. The Committee believes that such blackout notices serve an important purpose by allowing plan participants to prepare for any restrictions that will occur during a blackout period. The Committee believes that enhancing enforcement of the blackout notice requirement will ensure that all participants receive blackout notices, and thus, have the opportunity to prepare for any restrictions that will occur during a blackout period.

At the request of the Committee, the Joint Committee staff undertook an investigation relating to Enron Corporation and related entities, including a review of the compensation arrangements of Enron employees, e.g., qualified retirement plans, nonqualified de-

ferred compensation arrangements, and other arrangements.[29] The Joint Committee staff issued an official report of its investigation, including findings and recommendations resulting from its review of Enron's pension plans and compensation arrangements. The Joint Committee staff found that Enron provided a variety of advance notices to plan participants explaining the proposed blackout; however, the Joint Committee staff determined that not all participants received the same notices. In particular, certain active employees received additional reminders of the blackout that were not sent to other participants.[30] The Joint Committee staff's findings support the Committee's views regarding the need for plan participants to receive notice of blackouts sufficient to allow them to make appropriate decisions in anticipation of a blackout.

EXPLANATION OF PROVISION

In general

The provision amends the Code to include a blackout notice requirement similar to the present-law ERISA requirement.[31] The blackout notice requirement under the Code does not apply to a one-participant retirement plan, a governmental plan, or a church plan. The Secretary of Labor has regulatory authority over the notice required under ERISA and the Code.

Definition of one-participant retirement plan

The provision clarifies the definition of a one-participant retirement plan not subject to the blackout notice requirement. Under the provision, for purposes of the blackout notice requirements under the Code and ERISA, the definition is conformed to the definition that applies under the provision relating to diversification, thus clarifying that such a plan covers only an individual (or the individual and his or her spouse) who owns 100 percent of the plan sponsor (i.e., the employer maintaining the plan), whether or not incorporated, or covers only one or more partners (or partners and their spouses) in the plan sponsor. For this purpose, a partner includes an owner of a business that is treated as a partnership for tax purposes and a two-percent shareholder of an S corporation.[32]

Excise tax for failure to provide notice

Under the provision, an excise tax is generally imposed on the employer if a blackout notice is not provided as required under the Code.[33] The excise tax is $100 per day for each applicable individual with respect to whom the failure occurred, until notice is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the notice requirements, the total excise tax imposed during a taxable year will not exceed

[29] Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS–3–03), February 2003.

[30] Id. at Vol. I, 12–13, 38, 493–515.

[31] In the case of a tax-sheltered annuity (sec. 403(b)) that is not a plan established or maintained by the employer, the blackout notice required under the Code generally must be provided by the issuer of the annuity contract.

[32] This is the same definition that applies for purposes of the provision relating to required diversification rights with respect to amounts invested in employer securities or real property.

[33] In the case of a multiemployer plan, the excise tax is imposed on the plan. In the case of a tax-sheltered annuity (sec. 403(b)) that is not a plan established or maintained by the employer, the excise tax generally is imposed on the issuer of the annuity contract.

$500,000. No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the notice requirement. In addition, no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required notice as soon as reasonably practicable after learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

EFFECTIVE DATE

The amendments to the Code apply to failures to provide the required notice after the date of enactment. The amendments to ERISA made by the provision are effective as if included in section 306 of the Sarbanes-Oxley Act of 2002.

F. ADDITIONAL IRA CONTRIBUTIONS FOR CERTAIN EMPLOYEES

(Sec. 105 of the bill and secs. 25B and 219 of the Code)

PRESENT LAW

Under present law, favored tax treatment applies to qualified retirement plans maintained by employers and to individual retirement arrangements ("IRAs").

Qualified defined contribution plans may permit both employees and employers to make contributions to the plan. Under a qualified cash or deferred arrangement (commonly referred to as a "section 401(k) plan"), employees may elect to make pretax contributions to a plan, referred to as elective deferrals. Employees may also be permitted to make after-tax contributions to a plan. In addition, a plan may provide for employer nonelective contributions or matching contributions. Nonelective contributions are employer contributions that are made without regard to whether the employee makes elective deferrals or after-tax contributions. Matching contributions are employer contributions that are made only if the employee makes elective deferrals or after-tax contributions. Matching contributions are sometimes made in the form of employer stock.

Under present law, an individual may generally make contributions to an IRA for a taxable year up to the lesser of a certain dollar amount or the individual's compensation. The maximum annual dollar limit on IRA contributions to IRAs is $4,000 for 2005–2007 and $5,000 for 2008, with indexing thereafter. Individuals who have attained age 50 may make additional "catch-up" contributions to an IRA for a taxable year of up to $500 in 2005 and $1,000 in 2006 and thereafter.

Present law provides a temporary nonrefundable tax credit for eligible taxpayers for qualified retirement savings contributions ("saver's" credit). The maximum annual contribution eligible for the credit is $2,000. The credit rate depends on the adjusted gross income ("AGI") of the taxpayer. Taxpayers filing joint returns with AGI of $50,000 or less, head of household returns of $37,500 or less, and single returns of $25,000 or less are eligible for the credit. The AGI limits applicable to single taxpayers apply to married taxpayers filing separate returns. The credit is in addition to any de-

duction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 or over, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return. The credit is available with respect to contributions to various types of retirement savings arrangements, including contributions to a traditional or Roth IRA.

REASONS FOR CHANGE

The Committee recognizes that, if employer matching contributions are made in the form of employer stock, the employer's bankruptcy may cause employees to lose a substantial portion of their retirement savings. The Committee believes that employees should be permitted to make up for such losses by making additional IRA contributions.

EXPLANATION OF PROVISION

Under the provision, an eligible individual would be permitted to make additional contributions to an IRA up to $1,500 per year in 2005, and $3,000 per year in 2006–2009. To be eligible to make these additional contributions, an individual must have been a participant in a section 401(k) plan under which the employer matched at least 50 percent of the employee's contribution to the plan with stock of the employer. In addition, (1) the employer must have filed for bankruptcy, (2) the employer or any other person must have been subject to an indictment or conviction resulting from business transactions related to the bankruptcy, and (3) the individual was a participant in the section 401(k) plan on the date six months before the employer filed for bankruptcy. An individual eligible to make these additional contributions is not permitted to make IRA catch-up contributions that apply to individuals age 50 and older.

Under the provision, the saver's credit applies, with modifications, to an additional IRA contribution made by an eligible individual in a taxable year beginning before January 1, 2008. The modified credit is equal to 50 percent of the additional IRA contribution and is available without regard to the individual's adjusted gross income.

EFFECTIVE DATE

The ability to make additional IRA contributions is effective for taxable years beginning after December 31, 2004, and before January 1, 2010. The modified saver's credit applies with respect to additional IRA contributions made for taxable years beginning after December 31, 2004, and before January 1, 2008.

TITLE II—PROVIDING INVESTMENT ADVICE AND INVESTMENT EDUCATION TO PLAN PARTICIPANTS

A. Investment Education Requirements for Defined Contribution Plan Participants

(Secs. 201 and 205 of the bill, new sec. 4980I of the Code, and secs. 104 and 502 of ERISA)

PRESENT LAW

In general

Under ERISA, a plan administrator is required to furnish participants with certain notices and information about the plan.[34] If a plan administrator fails or refuses to furnish to a participant information required to be provided to the participant within 30 days of the participant's written request, the participant generally may bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or other relief that the court deems proper.

The Code contains a variety of notice requirements with respect to qualified plans. Such requirements are generally enforced by an excise tax. For example, in case of a failure to provide notice of a significant reduction in benefit accruals, an excise tax of $100 a day is generally imposed on the employer. If the employer exercised reasonable diligence in meeting the requirements, the excise tax with respect to a taxable year is limited to no more than $500,000.

Pension benefit statements

ERISA provides that a plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. The benefit statement must indicate, on the basis of the latest available information: (1) the participant's or beneficiary's total accrued benefit; and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than one benefit statement during any 12-month period.

Statements to participants on separation from service

A plan administrator must furnish a statement to each participant who: (1) separates from service during the year; (2) is entitled to a deferred vested benefit under the plan as of the end of the plan year; and (3) whose benefits were not paid during the year. The statement must set forth the nature, amount, and form of the deferred vested benefit to which the participant is entitled. The plan administrator generally must provide the statement no later than 180 days after the end of the plan year in which the separation from service occurs.

Investment guidelines

Present law does not require that participants be given investment guidelines relating to retirement savings.

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[34] Governmental plans and church plans are exempt from ERISA, including requirements to provide notices or information to participants.

REASONS FOR CHANGE

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

Under some employer-sponsored retirement plans, participants are responsible for directing the investment of the assets in their accounts under the plan. Awareness of investment principles, including the need for diversification, is fundamental to making investment decisions consistent with long-term retirement income security. The Committee believes participants should be provided with investment guidelines and information for calculating retirement income to enable them to make sound investment and retirement savings decisions.

At the request of the Committee, the Joint Committee staff undertook an investigation relating to Enron Corporation and related entities, including a review of the compensation arrangements of Enron employees, e.g., qualified retirement plans, nonqualified deferred compensation arrangements, and other arrangements.[35] The Joint Committee staff issued an official report of its investigation, including findings and recommendations resulting from its review of Enron's pension plans and compensation arrangements. The Joint Committee staff's findings support the Committee's views regarding participants' need for investment education. The Joint Committee staff found that significant amounts of plan assets were invested in Enron stock even though the plan offered approximately 20 other investment options.[36] The Joint Committee staff recommended legislative changes to require plans to provide participants with notices regarding investment principles and investment education.[37]

EXPLANATION OF PROVISION

In general

Under the provision, the administrator of a defined contribution plan (other than a one-participant retirement plan) is required under the Code and ERISA to provide at least once a year a model form relating to basic investment guidelines to each participant or beneficiary who has the right to direct the investment of the assets in his or her account under the plan.[38] The Secretary of Labor has regulatory authority over the model form required to be provided under ERISA and the Code.

Model form

Under the provision, the Secretary of Labor is directed, in consultation with the Secretary of the Treasury, to develop and make available a model form containing basic guidelines for investing for

[35] Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS–3–03), February 2003.

[36] Id. at Vol. I, 12, 522–523, 526–535, 536.

[37] Id. at Vol. I, 19, 39, 538.

[38] In the case of a tax-sheltered annuity (sec. 403(b)) that is not a plan established or maintained by the employer, the model form generally must be provided by the issuer of the annuity contract.

retirement. The guidelines in the model form are to include: (1) information on the benefits of diversification of investments; (2) information on the essential differences, in terms of risk and return, of pension plan investments, including stocks, bonds, mutual funds and money market investments; (3) information on how an individual's investment allocations under the plan may differ depending on the individual's age and years to retirement, as well as other factors determined by the Secretary; (4) sources of information where individuals may learn more about pension rights, individual investing, and investment advice; and (5) such other information related to individual investing as the Secretary determines appropriate. For example, information on how investment fees may affect the return on an investment is appropriate and other information that the Secretary may determine must be included in the investment guidelines.

The model form must also include addresses for Internet sites, and a worksheet, that a participant or beneficiary may use to calculate: (1) the retirement age value of the individual's vested benefits under the plan (expressed as an annuity amount and determined by reference to varied historical annual rates of return and annuity interest rates); and (2) other important amounts relating to retirement savings, including the amount that an individual must save annually in order to provide a retirement income equal to various percentages of his or her current salary (adjusted for expected growth prior to retirement). The Secretary of Labor is directed to provide at least 90 days for public comment before publishing final notice of the model form and to update the model form at least annually. In addition, the Secretary of Labor is also required to develop an Internet site to be used by an individual in making these calculations, the address of which will be included in the model form.

The model form must be written in a manner calculated to be understood by the average plan participant and may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the recipient.

Sanctions for failure to provide information

Excise tax

Under the provision, an excise tax generally applies in the case of a failure to provide an investment guideline model form as required under the Code. The excise tax is generally imposed on the employer if a required benefit statement or model form is not provided.[39] The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the model form is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the model form requirement, the total excise tax imposed during a taxable year will not exceed $500,000.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the model form requirement. In addition,

[39] In the case of a multiemployer plan, the excise tax is imposed on the plan. In the case of a tax-sheltered annuity (sec. 403(b)) that is not a plan established or maintained by the employer, the tax is generally imposed on the issuer of the annuity contract.

no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required model form within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

ERISA enforcement

The Secretary of Labor may assess a civil penalty against the plan administrator of up to $100 a day from the date of the failure. For this purpose, each violation with respect to any single participant or beneficiary is treated as a separate violation.

Exception for governmental and church plans

The provision contains an exception from the investment notice requirements under the Code for a governmental plan or a church plan. In addition, such plans are generally exempt from ERISA. Accordingly, the benefit statement and investment notice requirements do not apply to a governmental plan or a church plan.

EFFECTIVE DATE

The provision is generally effective for plan years beginning after December 31, 2006. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2007, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2008.

B. Information Relating to Investment in Employer Securities

(Secs. 202 and 205 of the bill, new sec. 4980H of the Code, and secs. 101 and 502 of ERISA)

PRESENT LAW

The Code and ERISA require that certain information be provided to participants and beneficiaries under employer-sponsored retirement plans. Present law does not specifically require that participants in defined contribution plans which permit participants to direct the investment of the assets in their accounts in employer securities be provided with the reports, statements, and communications which are required to be provided to investors in connection with investing in securities under applicable securities laws.

The Code contains a variety of notice requirements with respect to qualified plans. Such requirements are generally enforced by an excise tax. For example, in case of a failure to provide notice of a significant reduction in benefit accruals, an excise tax of $100 a day is generally imposed on the employer. If the employer exercised reasonable diligence in meeting the requirements, the excise tax with respect to a taxable year is limited to no more than $500,000.

Under ERISA, if a plan administrator fails or refuses to furnish to a participant information required to be provided to the participant within 30 days of the participant's written request, the participant generally may bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or other relief that the court deems proper.

REASONS FOR CHANGE

The Committee believes that, in the case of a defined contribution plan that allows participants and beneficiaries to exercise control over the assets in their individual accounts, the same material investment information that the plan sponsor is required to disclose to investors under securities laws should be provided to participants and beneficiaries whose accounts are invested in employer stock. The Committee believes that plan administrators should be required to provide this information.

EXPLANATION OF PROVISION

In general

The provision creates a new requirement in connection with defined contribution plans which permit participants to direct the investment of the assets in their accounts in employer securities. The provision amends the Code and ERISA to require administrators of such plans to provide participants with all reports, proxy statements, and other communications regarding investment of such assets in employer securities to the extent that such reports, statements, and communications are required to be provided by the plan sponsor to investors in connection with investment employer securities under applicable securities laws. Any such information which is maintained by the plan sponsor must be provided to the plan administrator.

The reports, statements, and communications may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to participants. The Secretary of Labor has regulatory authority over the ERISA and Code requirement to provide this information.

Sanctions for failure to provide information

Excise tax

Under the provision, an excise tax generally applies in the case of a failure to provide the information as required under the Code. The excise tax is generally imposed on the employer if notice is not provided.[40] The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the information is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the requirement, the total excise tax imposed during a taxable year will not exceed $500,000.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the requirement. In addition, no tax is imposed if the employer exercises reasonable diligence to comply and

[40] In the case of a multiemployer plan, the excise tax is imposed on the plan.

provides the required information within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

ERISA civil penalty

In the case of a failure or refusal to provide the information as required under the provision, the Secretary of Labor may assess a civil penalty against the plan administrator of up to $1,000 a day from the date of the failure or refusal until it is corrected.

EFFECTIVE DATE

The provision is generally effective for plan years beginning after December 31, 2005. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2006, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2007.

C. Safe Harbor for Independent Investment Advice Provided to Plan Participants

(Sec. 203 of the bill and new sec. 404(e) of ERISA)

PRESENT LAW

ERISA requires an employee benefit plan to provide for one or more named fiduciaries who jointly or severally have the authority to control and manage the operation and administration of the plan. In addition to fiduciaries named in the plan, or identified pursuant to a procedure specified in the plan, a person is a plan fiduciary under ERISA to the extent the fiduciary exercises any discretionary authority or control over management of the plan or exercises authority or control over management or disposition of its assets, renders investment advice for a fee or other compensation, or has any discretionary authority or responsibility in the administration of the plan. In certain circumstances, a fiduciary under ERISA may be liable for a breach of responsibility by a co-fiduciary.

REASONS FOR CHANGE

The Committee believes that providing specific rules under which a fiduciary may arrange for independent investment advice to be provided to participants who are responsible for directing the investment of their retirement assets will facilitate the provision of such investment advice without undercutting the fiduciary requirements of ERISA. The provision of independent investment advice will better enable participants to make sound investment decisions.

EXPLANATION OF PROVISION

In general

The provision amends ERISA by adding specific rules dealing with the provision of investment advice to plan participants by a

qualified investment adviser. The provision applies to an individual account plan[41] that permits a participant or beneficiary to direct the investment of the assets in his or her account. Under the provision, if certain requirements are met, an employer or other plan fiduciary will not be liable for investment advice provided by a qualified investment adviser.

Qualified investment adviser

Under the provision, a "qualified investment adviser" is defined as a person who is a plan fiduciary by reason of providing investment advice and who is also (1) a registered investment adviser under the Investment Advisers Act of 1940 or registered as an investment adviser under the laws of the State (consistent with section 203A of the Investment Advisers Act[42]) in which the adviser maintains its principal office, (2) a bank or similar financial institution, (3) an insurance company qualified to do business under State law, or (4) a comparably qualified entity under criteria to be established by the Secretary of Labor. In addition, any individual who provides investment advice to participants on behalf of the investment adviser (such as an employee thereof) is required to be (1) a registered investment adviser under Federal or State law as described above,[43] (2) a registered broker or dealer under the Securities Exchange Act, (3) a registered representative under the Securities Exchange Act or the Investment Advisers Act, or (4) any comparably qualified individual under criteria to be established by the Secretary of Labor.

A qualified investment adviser is required to provide the following documents to the employer or plan fiduciary: (1) the contract for investment advice services, (2) a disclosure of any fees or other compensation to be received by the investment adviser for the provision of investment advice and any fees or other compensation to be received as a result of a participant's investment choices, and (3) its registration with the Securities and Exchange Commission or other documentation of its status as a qualified investment adviser. A qualified investment adviser that acknowledges its fiduciary status will be a fiduciary under ERISA with respect to investment advice provided to a participant or beneficiary.

Requirements for employer or other fiduciary

Before designating the investment adviser and at least annually thereafter, the employer or other fiduciary is required to obtain written verification that the investment adviser (1) is a qualified investment adviser, (2) acknowledges its status as a plan fiduciary that is solely responsible for the investment advice it provides, (3) has reviewed the plan document (including investment options) and determined that its relationship with the plan and the investment advice provided to any participant or beneficiary, including the receipt of fees or compensation, will not violate the prohibited trans-

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[41] An "individual account plan" is the term generally used under ERISA for a defined contribution plan.

[42] See 15 U.S.C. 80b–3a. Nothing in the provision is intended to restrict the authority under present law of any State to assert jurisdiction over investment advisers and investment adviser representatives based on their presence in the State or the fact that they have clients in the State.

[43] An individual who is registered as an investment adviser under the laws of a State is a qualified investment adviser only if the State has an examination requirement to qualify for such registration.

action rules, (4) will consider any employer securities or employer real property allocated to the participant's or beneficiary's account in providing investment advice, and (5) has the necessary insurance coverage (as determined by the Secretary of Labor) for any claim by a participant or beneficiary.

In designating an investment adviser, the employer or other fiduciary is required to review the documents provided by the qualified investment adviser. The employer or other fiduciary is also required to make a determination that there is no material reason not to engage the investment adviser.

In the case of (1) information that the investment adviser is no longer qualified or (2) concerns about the investment adviser's services raised by a substantial number of participants or beneficiaries, the employer or other fiduciary is required within 30 days to investigate and to determine whether to continue the investment adviser's services.

An employer or other fiduciary that complies with the requirements for designating and monitoring an investment adviser will be deemed to have satisfied its fiduciary duty in the prudent selection and periodic review of an investment adviser and does not bear liability as a fiduciary or co-fiduciary for any loss or breach resulting from the investment advice.

EFFECTIVE DATE

The provision applies to investment advisers designated after the date of enactment of the provision.

D. Treatment of Employer-Provided Qualified Retirement Planning Services

(Sec. 204 of the bill and sec. 132 of the Code)

PRESENT LAW

Under present law, certain employer-provided fringe benefits are excludable from gross income and wages for employment tax purposes.[44] These excludable fringe benefits include qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified employer plan. A qualified employer plan includes a qualified retirement plan or annuity, a tax-sheltered annuity, a simplified employee pension, a SIMPLE retirement account, or a governmental plan, including an eligible deferred compensation plan maintained by a governmental employer.

Qualified retirement planning services are retirement planning advice and information. The exclusion is not limited to information regarding the qualified employer plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

[44] Secs. 132 and 3121(a)(20).

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

REASONS FOR CHANGE

The Committee believes that it is important for all employees to have access to retirement planning advice and information. In order to plan adequately for retirement, individuals must anticipate retirement income needs and understand how their retirement income goals can be achieved. The Committee believes that allowing employees to purchase qualified retirement planning services on a salary-reduction basis will help many more employees obtain advice and assistance when making retirement decisions.

EXPLANATION OF PROVISION

The provision permits employers to offer employees a choice between cash compensation and eligible qualified retirement planning services. The maximum amount for which such a choice can be provided is limited to $1,000 per individual, per year. The provision only applies to qualified retirement planning services provided by an eligible investment adviser.

Under the provision, an "eligible investment adviser" is defined as a person who is (1) a registered investment adviser under the Investment Advisers Act of 1940 or registered as an investment adviser under the laws of the State (consistent with section 203A of the Investment Advisers Act[45]) in which the adviser maintains its principal office, (2) a bank or similar financial institution, (3) an insurance company qualified to do business under State law, or (4) a comparably qualified entity under criteria to be established by the Secretary of the Treasury. In addition, any individual who provides investment advice to participants on behalf of the investment adviser (such as an employee thereof) is required to be (1) a registered investment adviser under Federal or State law as described above,[46] (2) a registered broker or dealer under the Securities Exchange Act, (3) a registered representative under the Securities Exchange Act or the Investment Advisers Act, or (4) any comparably qualified individual under criteria to be established by the Secretary of the Treasury.

As under present law, the provision applies only to amounts for retirement planning advice and information and does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

Under the provision, no amount is includible in gross income or wages merely because the employee is offered the choice of cash in lieu of eligible qualified retirement planning services. Also, no amount is includible in income or wages merely because the employee is offered a choice among eligible qualified retirement planning services. The amount of cash offered is includible in income and wages only to the extent the employee elects cash. The exclu-

[45] See 15 U.S.C. 80b–3a.

[46] An individual who is registered as an investment adviser under the laws of a State is an eligible investment adviser only if the State has an examination requirement to qualify for such registration.

sion does not apply to highly compensated employees unless the salary reduction option is available on substantially the same terms to all employees normally provided education and information about the plan.

Under the provision, salary reduction amounts used to provide eligible qualified retirement planning services are generally treated for pension plan purposes the same as other salary reduction contributions. Thus, such amounts are included in compensation for purposes of applying the limits on contributions and benefits, and an employer is able to elect whether or not to include such amounts in compensation for nondiscrimination testing.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2005, and before January 1, 2011.

TITLE III—IMPROVEMENTS IN FUNDING RULES FOR SINGLE-EMPLOYER DEFINED BENEFIT PENSION PLANS

A. Minimum Funding Rules for Single-Employer Defined Benefit Pension Plans

(Secs. 301–302, 305, 311–312, 314, and 321 of the bill, sec. 412 of the Code, new secs. 430 and 431 of the Code, secs. 302–308 of ERISA)

PRESENT LAW

In general

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code").[47] The amount of contributions required for a plan year under the minimum funding rules is generally the amount needed to fund benefits earned during that year plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit. The amount of required annual contributions is determined under one of a number of acceptable actuarial cost methods. Additional contributions are required under the deficit reduction contribution rules in the case of certain underfunded plans. No contribution is required under the minimum funding rules in excess of the full funding limit (described below).

General minimum funding rules

Funding standard account

As an administrative aid in the application of the funding requirements, a defined benefit pension plan is required to maintain a special account called a "funding standard account" to which

[47] Code sec. 412. The minimum funding rules also apply to multiemployer plans, but the rules for multiemployer plans differ in various respects from the rules applicable to single-employer plans. The minimum funding rules do not apply to governmental plans or to church plans, except church plans with respect to which an election has been made to have various ERISA and Code requirements, including the funding requirements, apply to the plan. In addition, special rules apply to certain plans funded exclusively by the purchase of individual insurance contracts (referred to as "insurance contract" plans).

specified charges and credits are made for each plan year, including a charge for normal cost and credits for contributions to the plan. Other credits or charges may apply as a result of decreases or increases in past service liability as a result of plan amendments, experience gains or losses, gains or losses resulting from a change in actuarial assumptions, or a waiver of minimum required contributions.

In determining plan funding under an actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan. These assumptions typically involve rates of interest, mortality, disability, salary increases, and other factors affecting the value of assets and liabilities. If the plan's actual unfunded liabilities are less than those anticipated by the actuary on the basis of these assumptions, then the excess is an experience gain. If the actual unfunded liabilities are greater than those anticipated, then the difference is an experience loss. Experience gains and losses for a year are generally amortized as credits or charges to the funding standard account over five years.

If the actuarial assumptions used for funding a plan are revised and, under the new assumptions, the accrued liability of a plan is less than the accrued liability computed under the previous assumptions, the decrease is a gain from changes in actuarial assumptions. If the new assumptions result in an increase in the accrued liability, the plan has a loss from changes in actuarial assumptions. The accrued liability of a plan is the actuarial present value of projected pension benefits under the plan that will not be funded by future contributions to meet normal cost or future employee contributions. The gain or loss for a year from changes in actuarial assumptions is amortized as credits or charges to the funding standard account over ten years.

If minimum required contributions are waived (as discussed below), the waived amount (referred to as a "waived funding deficiency") is credited to the funding standard account. The waived funding deficiency is then amortized over a period of five years, beginning with the year following the year in which the waiver is granted. Each year, the funding standard account is charged with the amortization amount for that year unless the plan becomes fully funded.

If, as of the close of a plan year, the funding standard account reflects credits at least equal to charges, the plan is generally treated as meeting the minimum funding standard for the year. If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, then the excess is referred to as an "accumulated funding deficiency." Thus, as a general rule, the minimum contribution for a plan year is determined as the amount by which the charges to the funding standard account would exceed credits to the account if no contribution were made to the plan. For example, if the balance of charges to the funding standard account of a plan for a year would be $200,000 without any contributions, then a minimum contribution equal to that amount would be required to meet the minimum funding standard for the year to prevent an accumulated funding deficiency.

Credit balances

If credits to the funding standard account exceed charges, a "credit balance" results. A credit balance results, for example, if contributions in excess of minimum required contributions are made. Similarly, a credit balance may result from large net experience gains. The amount of the credit balance, increased with interest at the rate used under the plan to determine costs, can be used to reduce future required contributions.

Funding methods and general concepts

A defined benefit pension plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an actuarial cost method breaks up the cost of benefits under the plan into annual charges consisting of two elements for each plan year. These elements are referred to as: (1) normal cost; and (2) supplemental cost.

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions as to interest, mortality, time of payment, etc., had been fulfilled. The normal cost will be funded by future contributions to the plan: (1) in level dollar amounts; (2) as a uniform percentage of payroll; (3) as a uniform amount per unit of service (e.g., $1 per hour); or (4) on the basis of the actuarial present values of benefits considered accruing in particular plan years.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses, changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs must be amortized (i.e., recognized for funding purposes) over a specified number of years, depending on the source. For example, the cost attributable to a past service liability is generally amortized over 30 years.

Normal costs and supplemental costs under a plan are computed on the basis of an actuarial valuation of the assets and liabilities of a plan. An actuarial valuation is generally required annually and is made as of a date within the plan year or within one month before the beginning of the plan year. However, a valuation date within the preceding plan year may be used if, as of that date, the value of the plan's assets is at least 100 percent of the plan's current liability (i.e., the present value of benefit liabilities under the plan, as described below).

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan as-

sets is the value determined under a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of the plan assets, values may be used for a stated period not to exceed the five most recent plan years, including the current year.[48]

In applying the funding rules, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would be obtained if each assumption and method were reasonable. In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan.[49]

Additional contributions for underfunded plans

In general

Under special funding rules (referred to as the "deficit reduction contribution" rules),[50] an additional charge to a plan's funding standard account is generally required for a plan year if the plan's funded current liability percentage for the plan year is less than 90 percent.[51] A plan's "funded current liability percentage" is generally the actuarial value of plan assets as a percentage of the plan's current liability.[52] In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan, determined on a present-value basis.

The amount of the additional charge required under the deficit reduction contribution rules is the sum of two amounts: (1) the excess, if any, of (a) the deficit reduction contribution (as described below), over (b) the contribution required under the normal funding rules; and (2) the amount (if any) required with respect to unpredictable contingent event benefits. The amount of the additional charge cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent (taking into account any expected increase in current liability due to benefits accruing during the plan year).

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[48] Treas. Reg. sec. 1.412(c)(2)–1(b)(7)(ii).

[49] Under present law, certain changes in actuarial assumptions that decrease the liabilities of an underfunded single-employer plan must be approved by the Secretary of the Treasury.

[50] The deficit reduction contribution rules apply to single-employer plans, other than single-employer plans with no more than 100 participants on any day in the preceding plan year. Single-employer plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under these rules.

[51] Under an alternative test, a plan is not subject to the deficit reduction contribution rules for a plan year if (1) the plan's funded current liability percentage for the plan year is at least 80 percent, and (2) the plan's funded current liability percentage was at least 90 percent for each of the two immediately preceding plan years or each of the second and third immediately preceding plan years.

[52] In determining a plan's funded current liability percentage for a plan year, the value of the plan's assets is generally reduced by the amount of any credit balance under the plan's funding standard account. However, this reduction does not apply in determining the plan's funded current liability percentage for purposes of whether an additional charge is required under the deficit reduction contribution rules.

The deficit reduction contribution is the sum of (1) the "unfunded old liability amount," (2) the "unfunded new liability amount," and (3) the expected increase in current liability due to benefits accruing during the plan year.[53] The "unfunded old liability amount" is the amount needed to amortize certain unfunded liabilities under 1987 and 1994 transition rules. The "unfunded new liability amount" is the applicable percentage of the plan's unfunded new liability. Unfunded new liability generally means the unfunded current liability of the plan (i.e., the amount by which the plan's current liability exceeds the actuarial value of plan assets), but determined without regard to certain liabilities (such as the plan's unfunded old liability and unpredictable contingent event benefits). The applicable percentage is generally 30 percent, but decreases by .40 of one percentage point for each percentage point by which the plan's funded current liability percentage exceeds 60 percent. For example, if a plan's funded current liability percentage is 85 percent (i.e., it exceeds 60 percent by 25 percentage points), the applicable percentage is 20 percent (30 percent minus 10 percentage points (25 multiplied by .4)).[54]

A plan may provide for unpredictable contingent event benefits, which are benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce. The value of any unpredictable contingent event benefit is not considered in determining additional contributions until the event has occurred. The event on which an unpredictable contingent event benefit is contingent is generally not considered to have occurred until all events on which the benefit is contingent have occurred.

Required interest rate and mortality table

Specific interest rate and mortality assumptions must be used in determining a plan's current liability for purposes of the special funding rule. For plans years beginning before January 1, 2004, the interest rate used to determine a plan's current liability must be within a permissible range of the weighted average[55] of the interest rates on 30-year Treasury securities for the four-year period ending on the last day before the plan year begins. The permissible range is generally from 90 percent to 105 percent (120 percent for plan years beginning in 2002 or 2003).[56] The interest rate used under the plan generally must be consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan.[57]

Under the Pension Funding Equity Act of 2004 ("PFEA 2004"),[58] a special interest rate applies in determining current liability for

[53] If the Secretary of the Treasury prescribes a new mortality table to be used in determining current liability, as described below, the deficit reduction contribution may include an additional amount.

[54] In making these computations, the value of the plan's assets is reduced by the amount of any credit balance under the plan's funding standard account.

[55] The weighting used for this purpose is 40 percent, 30 percent, 20 percent and 10 percent, starting with the most recent year in the four-year period. Notice 88–73, 1988–2 C.B. 383.

[56] If the Secretary of the Treasury determines that the lowest permissible interest rate in this range is unreasonably high, the Secretary may prescribe a lower rate, but not less than 80 percent of the weighted average of the 30-year Treasury rate.

[57] Code sec. 412(b)(5)(B)(iii)(II). Under Notice 90–11, 1990–1 C.B. 319, the interest rates in the permissible range are deemed to be consistent with the assumptions reflecting the purchase rates that would be used by insurance companies to satisfy the liabilities under the plan.

[58] Pub. L. No. 108–218 (2004).

plan years beginning in 2004 or 2005.[59] For these years, the interest rate used must be within a permissible range of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins. The permissible range for these years is from 90 percent to 100 percent. The interest rate is to be determined by the Secretary of the Treasury on the basis of two or more indices that are selected periodically by the Secretary and are in the top three quality levels available.

The Secretary of the Treasury is required to prescribe mortality tables and to periodically review (at least every five years) and update such tables to reflect the actuarial experience of pension plans and projected trends in such experience.[60] The Secretary of the Treasury requires the use of the 1983 Group Annuity Mortality Table.[61]

Other rules

Full funding limitation

No contributions are required under the minimum funding rules in excess of the full funding limitation. The full funding limitation is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets.[62] However, the full funding limitation may not be less than the excess, if any, of 90 percent of the plan's current liability (including the current liability normal cost) over the actuarial value of plan assets. In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability under the full funding limitation may be based on projected future benefits, including future salary increases.

Timing of plan contributions

In general, plan contributions required to satisfy the funding rules must be made within 8½ months after the end of the plan year. If the contribution is made by such due date, the contribution is treated as if it were made on the last day of the plan year.

In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, contributions for the current plan year must be made in quarterly installments

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[59] In addition, under PFEA 2004, if certain requirements are met, reduced contributions under the deficit reduction contribution rules apply for plan years beginning after December 27, 2003, and before December 28, 2005, in the case of plans maintained by commercial passenger airlines, employers primarily engaged in the production or manufacture of a steel mill product or in the processing of iron ore pellets, or a certain labor organization.

[60] Code sec. 412(l)(7)(C)(ii).

[61] Rev. Rul. 95–28, 1995–1 C.B. 74. The IRS and the Treasury Department have announced that they are undertaking a review of the applicable mortality table and have requested comments on related issues, such as how mortality trends should be reflected. Notice 2003–62, 2003–38 I.R.B. 576; Announcement 2000–7, 2000–1 C.B. 586.

[62] For plan years beginning before 2004, the full funding limitation was generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) a percentage (170 percent for 2003) of the plan's current liability (including the current liability normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets, but in no case less than the excess, if any, of 90 percent of the plan's current liability over the actuarial value of plan assets. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the full funding limitation based on 170 percent of current liability is repealed for plan years beginning in 2004 and thereafter. The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

with any remaining amount due 8½ months after the end of the plan year.[63] The amount of each required installment is 25 percent of the lesser of (1) 90 percent of the amount required to be contributed for the current plan year or (2) 100 percent of the amount required to be contributed for the preceding plan year.[64]

Funding waivers

Within limits, the Secretary of the Treasury is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year (a "waived funding deficiency").[65] A waiver may be granted if the employer (or employers) responsible for the contribution could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than three waivers may be granted within any period of 15 consecutive plan years.

The IRS is authorized to require security to be granted as a condition of granting a waiver of the minimum funding standard if the sum of the plan's accumulated funding deficiency and the balance of any outstanding waived funding deficiencies exceeds $1 million.

Failure to make required contributions

An employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS.[66] The excise tax is 10 percent of the amount of the funding deficiency. In addition, a tax of 100 percent may be imposed if the funding deficiency is not corrected within a certain period.

If the total of the contributions the employer fails to make (plus interest) exceeds $1 million and the plan's funded current liability percentage is less than 100 percent, a lien arises in favor of the plan with respect to all property of the employer and the members of the employer's controlled group. The amount of the lien is the total amount of the missed contributions (plus interest).

REASONS FOR CHANGE

The Committee believes that fundamental reform of the single-employer defined benefit pension plan funding rules is necessary. The present-law single-employer defined benefit plan funding rules are overly complex and do not operate to ensure that pension plans become and remain adequately funded. The Committee believes that the present-law funding rules provide an inaccurate measure of a plan's true financial status. The present-law rules have resulted in plan underfunding which has led to a loss of pension benefits for plan participants and record deficits for the PBGC. In recent years, plans which had complied with present-law requirements have nonetheless terminated on severely underfunded bases.

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[63] Code sec. 412(m).

[64] If quarterly contributions are required with respect to a plan, the amount of a quarterly installment must also be sufficient to cover any shortfall in the plan's liquid assets (a "liquidity shortfall").

[65] Code sec. 412(d). Under similar rules, the amortization period applicable to an unfunded past service liability or loss may also be extended.

[66] Code sec. 4971. An excise tax applies also if a quarterly installment is less than the amount required to cover the plan's liquidity shortfall.

The Committee believes that liabilities should be measured more precisely than required under present law. The Committee believes that it is necessary to provide a more accurate interest rate for pension purposes and that a more accurate calculation would result from matching interest rates to the timing of expected payments rather than using a single long-term interest rate. Accordingly, the Committee believes that a yield curve that reflects the rates of interest on corporate bonds of varying maturities should be used for pension purposes. Such rates take into account the timing of when benefit payments will be due under the plan.

Present-law rules for the valuation of plan assets allow value to be based on average value over a period of up to five years. The Committee believes that the use of such value can disguise the true value of plan assets and the funded status of the plan. The Committee believes that fair market value (or average value for a recent period) should be used to determine a plan's funded status.

The Committee recognizes that accurate measurement is necessary, but also recognizes that accurate measurement can result in large fluctuations in required pension plan contributions from one year to the next. Thus, the Committee believes that it is appropriate to impose a limit on the amount of fluctuation of required contributions from one year to the next.

The Committee is also concerned about seriously underfunded plans maintained by employers experiencing ongoing financial weakness or uncertainty. Such plans present a risk to employees, as well as to the PBGC insurance program and to other PBGC premium payors. The Committee believes that such employers should be required to use certain additional assumptions that will require funding to a target that more closely reflects the cost of terminating the plan.

EXPLANATION OF PROVISION

Interest rate required for plan years beginning in 2006

For plan years beginning after December 31, 2005, and before January 1, 2007, the provision generally applies the present-law funding rules.[67] For such years, the provision extends the use of the rate of interest on amounts invested conservatively in long-term investment-grade corporate bonds in determining current liability for funding purposes. As under present law, the interest rate used must be within the permissible range of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins.

General funding rules for plan years beginning after 2006

For plan years beginning after December 31, 2006, in the case of single-employer defined benefit pension plans, the provision repeals the present-law funding rules (including the requirement that a funding standard account be maintained) and provides a new set of rules for determining minimum required contributions.[68]

[67] The interest rate used under the provision for PBGC premiums, and other provisions relating to such premiums, is discussed under Title VI., below.

[68] The provision does not change the funding rules applicable to insurance contract plans. Governmental plans and church plans continue to be exempt from the funding rules to the extent

Continued

Under the provision, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's target liability.

The minimum required contribution for a plan year is the sum of (1) the target normal cost of the plan for the plan year; (2) the aggregate amortization payment for the plan year; and (3) the waiver amortization payment for the plan year. The sum of the amortization payments for the plan year cannot exceed the unfunded target liability for the plan year. For plan years beginning after 2007, a limit applies on the amount that required contributions can increase or decrease from the contribution required for the prior year.

A plan's target normal cost for a plan year is the present value of benefits that accrue or are earned during the plan year. A plan's unfunded target liability is the excess of the target liability for the plan year, over the value of the assets of the plan as of the valuation date. Under the provision, a plan's target liability is the present value of all benefits accrued or earned under the plan as of the beginning of the plan year. As discussed below, if a plan sponsor is a financially-weak employer, the target normal cost is the at-risk normal cost and the target liability is the at-risk target liability.

The provision specifies the interest rates and mortality table that must be used in determining a plan's target normal cost and target liability, as well as certain other actuarial assumptions that must be used.

As described in more detail below, under the provision, credit balances generated under present law are carried over to a new "prefunding balance." In addition, as described more fully below, contributions in excess of the minimum contributions required under the provision generally increase the prefunding balance. Prefunding balances may be credited against the minimum required contribution. In determining the required contribution for a plan year, the value of plan assets is reduced by any prefunding balance.

Target normal cost

Under the provision, the minimum required contribution for a plan year generally includes the plan's target normal cost for the plan year. A plan's target normal cost is the present value of all benefits which accrue or are earned under the plan during the plan year (the "current" year).[69] For this purpose, an increase in any benefit attributable to services performed in a preceding year by reason of a compensation increase during the current year is treated as accruing in the current year.

As discussed below, if a plan sponsor is a financially-weak employer, the plan's target normal cost is the at-risk target normal cost (subject to a phase-in rule discussed below).

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provided under present law. The provision generally does not change the funding rules for multiemployer plans, except to repeal the alternative minimum funding standard account rules and extend controlled-group liability for required contributions to multiemployer plans.

[69] It is intended that Treasury will provide guidance addressing normal cost issues, It is expected that such guidance will address issues such as the treatment of administrative expenses and determining accruals for the year in the case of a plan using a valuation date other than the first day of the plan year.

Aggregate amortization payment

In general

The minimum required contribution includes the aggregate amortization payment (if any) for the plan.

Target liability

A plan's target liability is the present value of all benefits accrued or earned under the plan as of the beginning of the plan year.

As discussed below, if a plan sponsor is financially weak, the target liability is the at-risk target liability (subject to a phase-in rule discussed below).

Unfunded target liability

A plan's unfunded target liability with respect to a plan year is the excess of the target liability for the plan year over the value of the assets of the plan as of the valuation date (reduced by any prefunding balance for purposes of determining the minimum required contribution).

A transition rule generally applies in determining a plan's unfunded target liability for plan years beginning in 2007 and 2008. In the case of plan years beginning in 2007, the unfunded target liability is the excess of 93 percent of the target liability for the plan year over the assets of the plan as of the valuation date (reduced by any prefunding balance). For plan years beginning in 2008, the percentage is 96 percent.

A five-year transition rule applies in the case of plans with 100 or fewer participants. Under such rule, for plan years beginning in 2007, the unfunded target liability is the excess of 92 percent of the target liability for the plan year over the assets of the plan as of the valuation date (reduced by any prefunding balance). The percentage is 94 percent for 2008, 96 percent for 2009, and 98 percent for 2010.

Aggregate amortization payment

The aggregate amortization payment for a plan year is the aggregate amount of the target liability amortization installments determined for the plan year with respect to amortizable target liability for the plan year and each of the six preceding plan years.

Amortizable target liability is the amount by which (1) the unfunded target liability for the plan year is more or less than (2) the present value of all target liability amortization installments and waiver amortization installments which were determined for the current year or any succeeding plan year with respect to any amortizable target liability or waived funding deficiency for any plan year preceding the current plan year.

If the plan has an amortizable target liability, the liability must be amortized over the seven year period beginning with the current plan year. Each amortization installment is a fixed amount equal to the amount necessary to amortize the liability in seven level amortization payments. If the present value of already scheduled amortization payments is greater than the plan's unfunded target liability, the excess is amortized over seven years. Each annual amortization amount can offset any annual amortization amounts re-

quired with respect to shortfalls (i.e., negative amortization installments may offset positive amortization installments).

In determining the present value of any amortization installment or the amount of any amortization installment, the plan must assume that each amortization installment will be paid on the valuation date for the plan year for which the installment is determined. The plan must also use the interest rates determined under the yield curve method (discussed below) for the current plan year.[70]

Waiver amortization payment

The provision retains the present-law rules under which the Secretary of the Treasury may waive all or a portion of the contributions required under the minimum funding standard for a plan year (referred to as a "waived funding deficiency").[71] If a plan has a waived funding deficiency for a plan year or any of the five preceding plan years, the minimum required contribution for the plan year includes the waiver amortization payment for the plan year.

The waiver amortization payment for a plan year is the aggregate amount of the waiver amortization installments determined for the plan year with respect to any amortizable waived funding deficiency for the five preceding plan years. The waiver amortization installments with respect to an amortizable waived funding deficiency for a plan year are annual installments determined as the amount needed to amortize the waiver amortization base in level annual installments over the five-year period beginning with the following plan year. The waiver amortization installments for a plan year are determined by assuming each amortization installment will be paid on the valuation date for which the installment is determined and using the interest rates determined under the yield curve method for the plan year in which the waived funding deficiency to which the installment relates arose.

Limitation on annual increases and decreases

For plan years beginning after 2007, the provision includes a limitation on the amount that required contributions can increase or decrease from one plan year to the next. The limit is the greater of (1) 30 percent of the plan's target normal cost for the preceding plan year or (2) two percent of the plan's target liability for the preceding plan year. The minimum required contribution for the current plan year cannot be greater than the minimum required contribution for the preceding plan year plus the limit and cannot be less than the minimum required contribution for the preceding plan year minus the limit.

For purposes of this rule, the minimum required contribution for the preceding year is determined (1) before interest is determined in the case of contributions made after the valuation date (as discussed below) and (2) after the application of the limit on the annual increase or decrease in minimum required contributions for that year. In addition, for purposes of this rule, the minimum required contribution for the preceding year is reduced by any amor-

[70] The phase-in yield curve method does not apply for this purpose.

[71] In the case of single-employer plans, the provision repeals the present-law rules under which the amoritization period applicable to an unfunded past service liability or loss may be extended.

tization installment (i.e., any target liability amortization installment or waiver amortization installment) attributable to any amortizable target liability or any waived funding deficiency that was fully amortized as of the close of the preceding plan year.

The limit does not apply to costs attributable to benefit improvements for the current year (i.e., the minimum required contribution taking into account the limit would be determined and then costs attributable to benefit improvements would be taken into account). A similar rule applies in the case of benefit decreases.

Special rule for plans that reach funding target

If the value of the plan's assets (reduced by any prefunding balance) equals or exceeds the target liability for the plan year (1) the minimum required contribution otherwise determined is equal to target normal cost, reduced (but not below zero) by the amount of such excess, and (2) amortization installments determined with respect to unfunded target liability and waived funding deficiencies allocable to the current plan year or any succeeding plan year are not required to be made, or taken into account for any other purpose, in any succeeding plan year.[72]

Actuarial assumptions used in determining a plan's target normal cost and target liability

Interest rates

The provision requires that the determination of present value or other computation requiring any interest rate assumption be made using the yield curve method. For plan years beginning in 2007 and 2008, a phase-in yield curve method applies.

The yield curve method is a method under which present value or other amounts requiring interest rate assumptions are determined: (1) using interest rates drawn from a yield curve prescribed by the Secretary of the Treasury that reflects interest rates on high-quality corporate bonds of varying maturities; and (2) by matching the timing of the expected benefit payments under the plan to the interest rates on the yield curve (i.e., for bonds with maturity dates comparable to the times when benefits are expected to be paid). Each month, the Secretary of the Treasury is required to publish any yield curve which shall apply to plan years beginning in such month and such yield curve must be based on average interest rates for business days occurring during the three preceding months.

Under the phase-in yield curve method applicable for plan years beginning in 2007 and 2008, present value or any other amount requiring the use of interest rate assumptions is equal to the sum of two amounts: (1) the applicable percentage of such amount determined under the yield curve method; and (2) such amount determined using the interest rate rules in effect for plan years beginning in 2005 under present law and 2006 under the provision (i.e., an interest rate in the permissible range of the weighted four-year average of conservative long-term corporate bond rates), multiplied by a percentage equal to 100 percent minus the applicable percent-

[72] If the rule applies for a plan year, the plan's normal cost is treated as the minimum required contribution for the year for purposes of applying the limitation on annual increases or decreases for the following year.

age for the plan year. For this purpose, the applicable percentage is 33 percent for plan years beginning in 2007 and 67 percent for plan years beginning in 2008.

Under the provision, certain amounts (e.g., contributions made after the valuation date) are determined using the plan's "applicable effective interest rate" for a plan year. The applicable effective interest rate with respect to a plan for a plan year is the single rate of interest which, if used to determine the present value of benefits accrued or earned under the plan as of the beginning of the plan year, would result in an amount equal to the plan's target liability for the plan year.

Mortality table

As under present law, the provision requires that the Secretary of the Treasury prescribe by regulation mortality tables to be used in calculating funding requirements. Such tables must be based on the actual experience of pension plans and projected trends in such experience. It is expected that the Secretary will take into account projections of future improvements in mortality. In prescribing the mortality tables, the Secretary is required to take into account results of available independent studies of mortality of individuals covered by pension plans.

As under present law, the provision requires the Secretary of the Treasury to issue separate mortality tables that may be used for individuals who are entitled to benefits under the plan on account of disability.

As under present law, the provision requires that the Secretary periodically (at least every five years) review the mortality tables and, to the extent determined necessary, update the tables to reflect the actual experience in pension plans and projected trends in such experience. It is intended that the mortality currently used under present law will continue to apply until the Secretary issues an updated table, which is expected shortly.

Value of plan assets

The provision provides that the value of plan assets is to be determined on the basis of fair market value. The provision allows the value of plan assets to be determined by averaging fair market values over not more than the period beginning on the last day of the fourth month preceding the valuation date and ending on the valuation date in accordance with regulations prescribed by the Secretary.[73]

Other assumptions

Under the provision, in determining present value or other computations, the probability that future benefits will be paid in optional forms of benefit provided under the plan must be taken into account (including lump-sum distributions). In addition, there must be taken into account any difference in the present value of such optional form of benefit and the present value of the future payments used in computing target normal costs and target liability.

The provision generally does not require other specified assumptions to be used in determining the plan's target normal cost and

[73] The 80 to 120 percent corridor under present law does not apply.

funding target except in the case of plans maintained by financially-weak plan sponsors (discussed below). However, similar to present law, the determination of present value or other computation must be made on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), and which, in combination, offer the actuary's best estimate of anticipated experience under the plan.[74]

Special rules for plans maintained by financially-weak employers

The provision applies special rules in determining the target liability and target normal cost in the case of plans maintained by financially-weak employers. If, as of the valuation date, a plan sponsor is a financially-weak employer, the plan's target liability is the at-risk target liability and the plan's target normal cost is the at-risk target normal cost.

In general, a plan sponsor is a financially-weak employer if, as of the valuation date for each of the three consecutive plan years ending with the current plan year, the plan sponsor is rated as below investment grade.[75] A sponsor is rated as below investment grade if (1) it has an outstanding senior unsecured debt instrument which is rated lower than investment grade by each of the nationally recognized statistical rating organizations for corporate bonds that has issued a credit rating for such instrument, or (2) if no outstanding senior unsecured debt instrument has been rated by such an organization, but one or more organizations has made an issuer credit rating for the employer, all such organizations that have so rated the employer have rated the employer lower than investment grade.[76]

In determining if a plan sponsor is a financially-weak employer, a special rule applies in the case of a plan sponsor that, as of the current year valuation date, continues to be rated as below investment grade, but receives a higher credit rating by any rating organization than that received by such organization as of the valuation date for the preceding plan year (an "improvement year").[77] Under such rule, the improvement year is not taken into account in determining if the plan sponsor is financially weak and plan years immediately before and after the improvement year are treated as consecutive plan years. The rule applies even if the credit rating by another rating organization is lowered for such period. For example, suppose that as of the valuation date for 2007, the employer is rated by all of the nationally recognized statistical rating organizations as below investment grade, including a rating by Moody's of Ca. Suppose that the ratings for the employer remain the same as of the valuation date for 2008. If, as of the valuation date for 2009, the rating by Moody's is improved to B, plan year 2009 is an

[74] The provision retains the present-law rule under which certain changes in actuarial assumptions that decrease the liabilities of an underfunded single-employer plan must be approved by the Secretary of the Treasury.

[75] Plan years beginning on or before the date of enactment are not taken into account in determining whether an employer is financially weak.

[76] In the case of a multiple employer plan, which covers employees of more than one employer, each employer's financial status is determined separately, based on the employer's controlled group.

[77] If a plan sponsor receives a rating of investment grade or higher from any of the nationally recognized statistical rating organizations for any plan year, the plan sponsor is not treated as below investment grade for such year. Thus, the earliest that the plan sponsor could be determined to be a financially-weak employer is the third year following such year.

improvement period and such year is disregarded in determining if the employer is financially weak. This result applies even if the rating from another rating agency is lowered as of the valuation date for 2009. If, as of the valuation date for 2010, there is no additional improvement (i.e., ratings by all of the rating organizations are either lowered or remain the same as those for 2009), the employer is treated as below investment grade for three consecutive plan years (2007, 2008 and 2010) and is financially-weak beginning in 2010.

A phase-in rule applies in the case of plan sponsors that are financially weak for less than five consecutive years. If a plan sponsor was not financially weak on the valuation date of the four immediately preceding plan years, the at-risk target liability or at-risk target normal cost is equal to the sum of (1) the applicable percentage of the at-risk target liability or the at-risk target normal cost (whichever is applicable, determined without regard to the phase-in), and (2) a percentage equal to 100 percent minus the applicable percentage of the target liability or target normal cost (whichever is applicable, determined without regard to the rules for financially-weak employers). The applicable percentage of at-risk target liability or at-risk normal cost that is used is based on the number of years that the plan sponsor is financially weak. The applicable percentage is 20 percent for the first year that the plan sponsor is financially weak and increases by 20 percent per year until the fifth year when 100 percent of the at-risk target liability or at-risk normal cost is used.

An improvement year is disregarded in applying the 20-percent per year phase-in. In the case of an improvement year, the applicable percentage is the applicable percentage in effect for the preceding plan year. The rule applies even if the credit rating by another rating organization is lowered for such period. If, as of the valuation date for any succeeding plan year, the credit rating has not been raised, the applicable percentage is increased by 20 percent for such succeeding plan year.

If an employer is a member of a controlled group, the employer is not treated as financially weak if a significant member (as determined under regulations prescribed by the Secretary) of such group has an outstanding senior unsecured debt instrument that is rated as being investment grade by one of the nationally recognized statistical rating organizations. In the case of plans with fewer than 500 participants, the employer is not treated as financially weak. In the case of a plan which on any day during the preceding plan year had at least 500 participants, if an employer has no outstanding senior unsecured debt instrument which is rated by a nationally recognized statistical rating organization and no such organization has made an issuer credit rating for the employer, the employer is treated as financially weak only to the extent provided in regulations prescribed by the Secretary. It is expected that the Treasury regulations will determine whether the plan sponsor is financially weak based on financial measures, e.g., whether the long-term debt to equity ratio of the controlled group is 1.5 or more (with debt to include the unfunded pension liability and equity to be based on fair market value for a privately-held company or market capitalization for a company whose stock is publicly-traded).

A plan is not subject to the special rules for plans maintained by financially-weak employers for any plan year in which the plan has no unfunded target liability, i.e., the value of plan assets is at least equal to the plan's target liability (determined without regard to the at-risk assumptions). For this purpose, the value of plan assets is not reduced by any prefunding balance.

The rules for plans of financially-weak employers do not apply to a multiple employer plan if at least 85 percent of the employers participating in the plan are (1) certain rural cooperatives[78] or (2) certain cooperative organizations which are owned more than 50 percent by producers of agricultural products or by certain cooperatives of agricultural producers.

A plan's at-risk target liability and at-risk normal cost are determined in the same manner as target liability and target normal cost, except that certain additional actuarial assumptions are required to be used. Under those assumptions, it must be assumed that all employees who are not otherwise assumed to retire as of the valuation date will retire at the earliest retirement age under the plan,[79] but not before the end of the plan year for which the at-risk target liability and at-risk target normal cost are being determined. It is also required to be assumed that all employees will elect the retirement benefit available under the plan at the assumed age that would result in the highest present value of liabilities.[80] In no event, however, can at-risk target liability or at-risk normal cost be less than target liability or target normal cost determined without regard to the at-risk rules.

Use of prefunding balance to satisfy minimum required contributions

The provision allows a plan sponsor to use any amount of a plan's prefunding balance to satisfy all or a portion of the minimum required contribution for the plan year. The prefunding balance consists of a beginning balance, increased and decreased (as described below) and adjusted to reflect the rate of net gain or loss on plan assets.

In the case of a single-employer plan that was in effect for a plan year beginning in 2006 and, as of the end of the 2006 plan year, had a positive balance in the funding standard account maintained under the funding rules as in effect for 2006, the beginning balance for the prefunding balance is such positive balance. In other cases, the beginning balance of the prefunding balance is zero.

As of the first day of each plan year beginning after 2007, the prefunding balance of a plan is increased by the amount of the excess (if any) of (1) the aggregate total employer contributions for the preceding plan year, over (2) the minimum required contribution for the preceding plan year. The excess contribution must be

[78] This is as defined in Code section 401(k)(7)(B) without regard to (iv) thereof and includes (1) organizations engaged primarily in providing electric service on a mutual or cooperative basis, or engaged primarily in providing electric service to the public and which is exempt from tax or which is a State or local government, other than a municipality; (2) certain civic leagues and business leagues exempt from tax 80 percent of the members of which are described in (1); (3) certain cooperative telephone companies; and (4) any organization that is a national association of organizations described above.

[79] It is intended that the determination of earliest retirement age will be addressed in Treasury guidance.

[80] It is intended that Treasury guidance will specify that the form that is actuarially expected to result in the highest target liability must be assumed. The determination is not required to be made on an individual basis as long as no material difference in the plan's liabilities results.

properly adjusted for interest accruing for the periods between the first day of the current plan year and the dates on which the excess contributions were made, determined by using the applicable effective interest rate for the preceding plan year and by treating contributions as being first used to satisfy the minimum required contribution. Additional contributions required to be made under the limitation on benefits provision do not increase the prefunding balance.

As of the first day of each plan year beginning after 2007, the prefunding balance of a plan is decreased (but not below zero) by the amount credited against the minimum required contribution for the preceding plan year.

In determining the prefunding balance as of the first day of the plan year, the plan sponsor must adjust the balance in accordance with regulations prescribed by the Secretary of the Treasury, to reflect the rate of net gain or loss on plan assets. The rate of net gain or loss is determined on the basis of the fair market value of the plan assets and the gain or loss experienced with respect to plan assets for the preceding plan year, properly taking into account, in accordance with regulations, all contributions, distributions, and other plan payments made during the period.

The value of assets must be reduced by the prefunding balance in determining the plan's minimum required contribution.

Other rules and definitions

Valuation date

Under the provision, all determinations made with respect to minimum required contributions for a plan year (such as the value of plan assets and liabilities) must be made as of the plan's valuation date for the plan year. In general, the valuation date for a plan year must be the first day of the plan year. However, any day in the plan year may be designated as the plan's valuation date for the plan year and succeeding plan years if, on each day during the preceding plan year, the plan had 100 or fewer participants.[81] For this purpose, all defined benefit pension plans (other than multiemployer plans) maintained by the same employer (or a predecessor employer), or by any member of such employer's controlled group, are treated as a single plan, but, in the case of multiple employer plans, only participants with respect to such employer or controlled group member are taken into account.

Treatment of contributions after valuation date

If an employer makes any contribution to the plan after the valuation date for the plan year in which the contribution is made and the contribution is for a preceding plan year, the contribution is taken into account as an asset of the plan as of the valuation date. In the case of any plan year beginning after 2007, only the present value of such contribution is to be taken into account. The present

[81] In the case of a plan's first plan year, the ability to use a valuation date other than the first day of the plan year is determined by taking into account the number of participants the plan is reasonably expected to have on each day during the first plan year. As under present law, a change in valuation date is a change in funding method requiring IRS approval. Thus, IRS approval is required to change the valuation date used by a smaller plan. However, the valuation date is automatically changed to the first day of the plan year if a plan is no longer eligible for the special rule.

value is determined using the applicable effective interest rate for the preceding plan year to which the contribution is properly allocable. If contributions for the plan year are made during the plan year, but before the valuation date for the plan year, such contributions and interest on such contributions between the date of the contributions and the valuation date (determined by using the applicable effective interest rate for the plan year) are not included in the plan assets.

Timing rules for contributions

As under present law, the due date for the payment of a minimum required contribution for a plan year is 8½ months after the end of the plan year. Any payment made on a date other than the valuation date for the plan year must be adjusted by interest at the plan's applicable effective rate of interest for the plan year for the period between the valuation date and the payment date. Such interest is included in the minimum required contribution.

The provision retains the present-law rules requiring quarterly contributions with some modifications. Except in the case of plans covering 100 or fewer participants during the preceding year and plans that had an unfunded target liability[82] of $1 million or less for the preceding year, quarterly contributions must be made during a plan year if the plan had a funded target liability percentage of less than 100 percent for the preceding plan year.[83] If an employer fails to pay the full amount of a required installment for the plan year, the amount of interest charged on the underpayments is determined using a rate of interest equal to the applicable effective rate of interest for the plan, plus five percentage points.

Excise tax on failure to make minimum required contributions

The provision retains the present-law rules under which an employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS.[84] The excise tax is 10 percent of the aggregate unpaid minimum required contributions for all plan years remaining unpaid as of the end of any plan year. In addition, a tax of 100 percent may be imposed if any unpaid minimum required contributions remain unpaid after a certain period.

Regulations

Under the provision, the Secretary of the Treasury is to prescribe such regulations as are necessary to carry out the provision, including regulations (1) for the proper treatment of increases in liabilities of any plan pursuant to plan amendments that are adopted, or which take effect, on a date during the plan year other than the valuation date; (2) for the application of any small plan exception under the provision in the case of mergers and acquisitions; and (3) for the application of the funding rules for multiple employer plans. In general, it is intended that for purposes of the minimum funding

[82] Plan assets are not reduced by the plan's prefunding balance for this purpose.

[83] The provision also retains the present-law rules under which the amount of any quarterly installment must be sufficient to cover any liquidity shortfall.

[84] The provision retains the present-law rules under which a lien in favor of the plan with respect to property of the employer (and members of the employer's controlled group) arises in certain circumstances in which the employer fails to make required contributions.

requirements, multiple employer plans will be treated as separate plans.

Conforming changes

The provision makes various technical and conforming changes to reflect the new funding requirements.

EFFECTIVE DATE

The extension of the present-law interest rate is effective for plan years beginning after December 31, 2005, and before January 1, 2007. The modifications to the single-employer plan funding rules are generally effective for plan years beginning after December 31, 2006.

B. Limitations on Benefit Improvements and Distributions by Single-Employer Plans That Are Underfunded or Maintained by Financially Weak Employers

(Secs. 303, 313, and 402 of the bill, new sec. 436 of the Code, and new sec. 305 of ERISA)

PRESENT LAW

In general

Under present law, various restrictions may apply to benefit increases and distributions from a defined benefit pension plan, depending on the funding status of the plan.

Limitation on certain benefit increases while funding waivers in effect

Within limits, the IRS is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year.[85] A waiver may be granted if the employer responsible for the contribution could not make the required contribution without temporary substantial business hardship for the employer (and members of the employer's controlled group) and if requiring the contribution would be adverse to the interests of plan participants in the aggregate.

If a funding waiver is in effect for a plan, subject to certain exceptions, no plan amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan.[86]

Security for certain plan amendments

In the case of a single-employer defined benefit pension plan, if a plan amendment increasing current liability is adopted and the plan's funded current liability percentage is less than 60 percent (taking into account the effect of the amendment, but disregarding any unamortized unfunded old liability), the employer and members of the employer's controlled group must provide security in favor of the plan.[87] The amount of security required is the excess of: (1) the lesser of (a) the amount by which the plan's assets are

[85] Code sec. 412(d).
[86] Code sec. 412(f).
[87] Code sec. 401(a)(29).

less than 60 percent of current liability, taking into account the benefit increase, or (b) the amount of the benefit increase and prior benefit increases after December 22, 1987, over (2) $10 million. The amendment is not effective until the security is provided.

The security must be in the form of a bond, cash, certain U.S. government obligations, or such other form as is satisfactory to the Secretary of the Treasury and the parties involved. The security is released after the funded liability of the plan reaches 60 percent.

Prohibition on benefit increases during bankruptcy

Subject to certain exceptions, if an employer maintaining a single-employer defined benefit pension plan is involved in bankruptcy proceedings, no plan amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan.[88]

Restrictions on benefit payments due to liquidity shortfalls

In the case of a single-employer plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year. If quarterly contributions are required with respect to a plan, the amount of a quarterly installment must also be sufficient to cover any shortfall in the plan's liquid assets (a "liquidity shortfall"). In general, a plan has a liquidity shortfall for a quarter if the plan's liquid assets (such as cash and marketable securities) are less than a certain amount (generally determined by reference to disbursements from the plan in the preceding 12 months).

If a quarterly installment is less than the amount required to cover the plan's liquidity shortfall, limits apply to the benefits that can be paid from a plan during the period of underpayment. During that period, the plan may not make: (1) any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplement provided under the plan) in the case of a participant or beneficiary whose annuity starting date occurs during the period; (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits (e.g., an annuity contract); or (3) any other payment specified by the Secretary of the Treasury by regulations.[89]

Prohibition on reductions in accrued benefits

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant.[90] This restriction is sometimes referred to as the "anticutback" rule and applies to benefits that have already accrued. In general, an amendment may reduce the amount of future benefit accruals, provided that, in the case of a significant reduction in the rate of future benefit accrual, certain notice requirements are met.

For purposes of the anticutback rule, an amendment is also treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the

[88] Code sec. 401(a)(33).
[89] Code sec. 401(a)(32).
[90] Code sec. 411(d)(6).

effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit.

REASONS FOR CHANGE

Under present law, sponsors of underfunded plans can continue to provide for additional accruals and, in some cases, may make benefit increases, pushing the cost of paying for such benefits off into the future. Companies should be more responsible with respect to pension benefits and should not continue to promise increased benefits when current promises are unfulfilled. Lump sums and other accelerated distributions from a severely underfunded plan allow certain participants to receive the full value of their benefits while depleting plan assets for those who remain in the plan. The Committee believes that appropriate restrictions should apply to underfunded plans to reduce the risk that underfunding will increase.

EXPLANATION OF PROVISION

In general

Under the provision, in the case of an underfunded single-employer defined benefit pension plan or a plan of an employer in bankruptcy, limitations may apply with respect to: (1) benefit increases; (2) certain forms of distribution; and (3) benefit accruals.

Limitations on benefit increases for plans less than 80 percent funded and plans of employers in bankruptcy

Restrictions on plans less than 80 percent funded

If a plan's adjusted funded target liability percentage as of the valuation date for the preceding plan year is less than 80 percent, then no applicable benefit increase may take effect in the current plan year until an additional funding requirement is satisfied. The additional funding requirement is satisfied if the plan sponsor, in addition to normal cost and the aggregate amortization payment and the waiver amortization payment for the year (if any), makes contributions sufficient so that the plan's adjusted funded target liability percentage (determined by assuming that the applicable benefit increase had taken effect as of the beginning of the year) is at least 80 percent. If a contribution required under the provision is made after the first day of the plan year, the contribution is adjusted for interest as under the minimum funding rules.

An applicable benefit increase generally is any increase in liabilities of the plan by plan amendment (or otherwise as specified by the Secretary) which would occur by reason of: (1) any increase in benefits; (2) any change in the accrual of benefits; or (3) any change in the rate at which benefits become nonforfeitable under the plan. It is intended that the Secretary will treat phased benefit increases as an applicable benefit increase pursuant to a plan amendment. For example, if a plan provides for a benefit of 1 percent for each year of service and the percentage increases to 1.5 percent after a certain date, and then increases to 2 percent at a later date, the increase in liabilities due to the increase to 1.5 percent is to be treated as an applicable benefit increase and the increase from 1.5 percent to 2 percent is treated as a separate applicable benefit in-

crease. It is intended that increases in benefits due to increases in final average pay are not an applicable benefit increase. Rather, such increases are part of normal cost for that year. An applicable benefit increase does not include any increase in liabilities under a plan: (1) by reason of a plan amendment if such amendment is required as a condition of qualification of the plan; or (2) which is specified in Treasury regulations.

Two additional exceptions apply in the case of a plan maintained pursuant to a collective bargaining agreement.[91] In the case of such a plan, an applicable benefit increase does not include an increase in liabilities of the plan by reason of any increase in benefits under a formula which is not based on a participant's compensation, if the rate of increase is not in excess of the contemporaneous rate of increase in average wages of participants covered by the amendment. In addition, in the case of increases in liabilities by reason of a plan provision pursuant to a collective bargaining agreement ratified when the plan had an adjusted funded target liability percentage of at least 80 percent and which takes effect in any plan year beginning after the year in which the agreement was ratified, the restriction does not apply for years beginning before the earlier of: (1) the date on which such collective bargaining agreement terminates (determined without regard to any extensions); and (2) the date which is three years after the date the limitation would otherwise apply.

The limitation does not apply to a plan for the first five years the plan (or a predecessor plan) is in effect.

Restrictions on plans of employers in bankruptcy

In the case of any period during which the plan sponsor is in bankruptcy, the provision is applied by substituting "100 percent" for "80 percent." In addition, the exceptions for collectively bargained plans and the exception for the first five years the plan is in effect do not apply.

Limitation on certain forms of distribution for plans less than 60 percent funded and plans of employers in bankruptcy

In general

Under the provision, restrictions on distributions apply if (1) a plan is less than 60 percent funded or (2) the employer is in bankruptcy and the plan is less than 100 percent funded.[92]

Restrictions on plans less than 60 percent funded

If a plan's adjusted funded target liability percentage is less than 60 percent for the prior plan year, then no prohibited payments may be made in the current plan year until the plan actuary certifies that the plan has an adjusted funded target liability percentage of at least 60 percent or the employer makes sufficient contributions in addition to any other required contributions (or provides security as provided below) so that the plan's adjusted funded

[91] The special rules for plans maintained pursuant to a collective bargaining agreement apply with respect to individuals covered by such agreement.

[92] The present-law restrictions on distributions during a period of liquidity shortfall continue to apply under the provision.

target liability percentage for the current year is at least 60 percent.

If the plan's funded target liability percentage is not at least 60 percent by the end of the plan year (or there is no actuarial certification), the freeze on prohibited payments continues until the plan's funded target liability percentage has been at least 60 percent for two consecutive plan years. If contributions (or security) are required in order for the adjusted funded target liability percentage to be 60 percent by the end of the current plan year, and the employer fails to make the contributions (or provide security), such failure is treated as the failure to make a minimum required contribution for purposes of the quarterly contribution rules, the excise tax on failure to make required contributions, and the lien with respect to failures to make certain required contributions.

If, before the close of the current plan year, the plan sponsor makes the contribution required under the provision or the plan's enrolled actuary certifies that, as of the valuation date for the plan year, the adjusted funded target liability percentage is at least 60 percent, then there is no freeze on prohibited payments and, under rules prescribed by the Secretary, the plan is to restore any payments not made during the plan year before such certification or contributions were made.

The timing of the provision is illustrated by the following example. Suppose that the valuation date for a plan (and the beginning of the plan year) is January 1 and that the plan's adjusted funded target liability percentage is less than 60 percent as of January 1, 2008. If the plan's adjusted funded target liability percentage is less than 60 percent as of January 1, 2009, then no prohibited payments can be made until the plan actuary certifies that such percentage is at least 60 percent or the employer makes sufficient contributions to the plan (or provides security) so that such percentage is at least 60 by the end of the plan year. If no such contributions or certification is made, then a prohibited period continues in effect until the plans' adjusted funded target liability percentage is at least 60 percent for two consecutive plan years beginning after January 1, 2009.

As described above, the requirement to make contributions under the provision may be satisfied by providing security in lieu of contributions.[93] The security must meet the present-law requirements applicable to security required for certain plan amendments and must be provided no later than the due date of the contribution to which it relates (or such earlier date as the Secretary prescribes). The security is released at the end of the prohibited period for the failure to which the security relates. The security may be perfected and enforced at any time after the earlier of: (1) the date the employer fails to meet any minimum funding requirement (other than the requirement for which the security was provided), (2) the plan's adjusted funded target liability percentage is less than 60 percent for seven years, or (3) the date on which the plan terminates.

The prohibited payments for a plan that is less than 60-percent funded are generally the same as those that are prohibited under present law during a period of a liquidity shortfall. Thus, during

[93] The security may not be used to offset minimum required contributions and is not taken into account in determining the value of plan assets for purposes of the funding rules.

a prohibited period, a plan generally may not make: (1) any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplement provided under the plan) in the case of a participant or beneficiary whose annuity starting date occurs during the period; (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits (e.g., an annuity contract); or (3) any other payment specified by the Secretary of the Treasury by regulations. However, an otherwise prohibited payment may be made if the payment does not exceed the lesser of: (1) 50 percent of the amount of the payment that would be made in the absence of the prohibition; and (2) the present value (as determined under guidance prescribed by the PBGC using the interest and mortality assumptions under section 417(e)) of the maximum PBGC guaranteed benefit. The PBGC is directed to publish such present value.

Restrictions on plans in bankruptcy

Under the provision, no prohibited payments (regardless of amount) may be made during any period the plan sponsor is in bankruptcy. This prohibition does not apply to any portion of a plan year which occurs on or after the date the plan's actuary certifies that, as of the valuation date for the plan year, the plan's funded target liability percentage is at least 100 percent.

Additional limitation on benefit accruals for plans less than 60-percent funded

If a plan is less than 60 percent funded, then accruals are frozen and certain benefits are eliminated. These limitations do not apply for the first five plan years a plan (or a predecessor plan) is in effect.

If a plan's adjusted funded target liability percentage is less than 60 percent for the prior plan year, then benefit accruals are suspended in the current plan year until the plan actuary certifies that the plan has an adjusted funded target liability percentage of at least 60 percent or the employer makes sufficient contributions (or provides security as provided below) so that the plan's adjusted funded target liability percentage for the current year is at least 60 percent.

If the plan's funded target liability percentage is not at least 60 percent by the end of the plan year (or there is no actuarial certification), the freeze continues until the plan's funded target liability percentage has been at least 60 percent for two consecutive plan years. If contributions (or security) are required in order for the adjusted funded target liability percentage to be 60 percent by the end of the current plan year, and the employer fails to make the contributions (or provide security), such failure is treated as the failure to make a minimum required contribution for purposes of the quarterly contribution rules, the excise tax on failure to make required contributions, and the lien with respect to failures to make certain required contributions.

A special rule applies in the case of a plan maintained pursuant to a collective bargaining agreement ratified before the freeze period would otherwise apply and in a plan year with respect to which the plan had an adjusted funded target liability percentage of at least 60 percent. In the case of benefits pursuant to and indi-

viduals covered by such an agreement, the freeze does not apply for years beginning before the earlier of: (1) the date on which such collective bargaining agreement terminates (determined without regard to any extensions); and (2) the date which is three years after the date the freeze would otherwise apply.

During a freeze period, the accrued benefit, any death or disability benefit, and any social security supplement (as described in sec. 411(a)(9)) of each participant are frozen at the amount of such benefit or supplement immediately before the freeze period and all other benefits provided under the plan are eliminated to the extent that such freezing or elimination would be permitted under the anti-cutback rules (or other applicable Code or ERISA requirements) if they had been implemented by a plan amendment.

The same rules relating to providing security in lieu of contributions that apply with respect to restrictions on distributions apply with respect to a freeze period.

Determining funding levels and other rules

For purposes of the restrictions on benefits, accruals, and payments, the funded target liability percentage for any plan year is a percentage equal to a fraction, the numerator of which is the value of plan assets (determined as under the funding rules) and the denominator of which is the target liability for the plan year. In determining adjusted funded target liability percentage, certain distributions for the immediately preceding two plan years are added back in to the numerator and denominator of the fraction. The distributions added back in are the sum of purchases of annuities, payments of single sums, and such other disbursements as the Secretary provides in regulations. In determining the funded target liability percentage, plan assets are not reduced by any prefunding balance. Contributions required under the provisions relating to benefit limitations, prohibited payments and freeze periods do not give rise to a prefunding balance (and such contribution requirements cannot be satisfied with a prefunding balance).

Notice to participants

The provision amends the Code and ERISA to require that the plan administrator provide written notice to participants and beneficiaries of a limitation applicable to a plan within a reasonable period of time before the limitation takes effect. Similarly, the plan administrator is to provide written notice to participants and beneficiaries of the date a limitation will cease to apply to a plan within a reasonable period of time before such cessation. The Secretary of the Treasury may provide that a notice be provided at a later time if it is not practicable to provide the notice in advance.

Under the provision, an excise tax generally applies in the case of a failure to provide the information as required under the Code. The excise tax is generally imposed on the employer if notice is not provided. The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the information is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the requirement, the total excise tax imposed during a taxable year will not exceed $500,000. The $500,000 limit is applied separately with respect to each type of notice required.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the requirement. In addition, no tax is imposed if the employer uses reasonable diligence to comply and provides the required information within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

In addition to the excise tax, if the required notice is not provided, the Secretary of Labor may impose a civil penalty of up to $100 a day from the time of the failure. Each violation with respect to any single participant or beneficiary is treated as a separate violation.

Coordination with other requirements

Under the provision, a plan does not fail to meet the qualification requirements solely by reason of complying with the requirements of the provision.

Restoration of benefits

If limitations on distributions or accruals apply with respect to plan for a plan year, unless the plan provides otherwise, prohibited distributions or accruals resume as of the day following the prohibited or freeze period. This rule is not to be construed as affecting the plan's treatment of benefits prohibited, frozen, or eliminated during the prohibited or freeze period.

EFFECTIVE DATE

The provision generally applies with respect to plan years beginning after December 31, 2006.

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 of the provision, the provision does not apply to plan years beginning before the earlier of: (1) the later of (a) the date on which the last collective bargaining agreement relating to the plan terminates (determined without regard to any extension thereof agreed to after the date of enactment), or (b) the first day of the first plan year to which the provision would otherwise apply; or (2) January 1, 2009. For this purpose, any plan amendment made pursuant to a collective bargaining agreement relating to the plan that amends the plan solely to conform to any requirement under the provision is not to be treated as a termination of the collective bargaining agreement.

Only plan years after the effective date are taken into account in determining whether a limitation applies to a plan. Thus, in the case of a plan that is not maintained pursuant to a collective bargaining agreement, the first year that a limitation could apply to a plan based on its funding status is a plan year beginning in 2008.

C. Increase in Deduction Limits for Single-Employer Plans

(Secs. 304, 322, and 323 of the bill and secs. 404 and 4972 of the Code)

PRESENT LAW

Employer contributions to qualified retirement plans are deductible subject to certain limits.[94] In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan, the employer generally may deduct the greater of: (1) the amount necessary to satisfy the minimum funding requirement of the plan for the year; or (2) the amount of the plan's normal cost for the year plus the amount necessary to amortize certain unfunded liabilities over 10 years, but limited to the full funding limitation for the year.[95] The maximum amount otherwise deductible generally is not less than the plan's unfunded current liability.[96] In the case of a single-employer plan covered by the PBGC insurance program that terminates during the year, the maximum deductible amount is generally not less than the amount needed to make the plan assets sufficient to fund benefit liabilities as defined for purposes of plan termination under the PBGC insurance program.

In the case of a defined contribution plan, the employer generally may deduct contributions in an amount up to 25 percent of compensation paid or accrued during the employer's taxable year.

If an employer sponsors one or more defined benefit pension plans and one or more defined contribution plans that cover at least one of the same employees, an overall deduction limit applies to the total contributions to all plans for a plan year. The overall deduction limit generally is the greater of (1) 25 percent of compensation, or (2) the amount necessary to meet the minimum funding requirements of the defined benefit plan for the year, but not less than the amount of the plan's unfunded current liability.

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. Certain contributions to a defined contribution plan that are nondeductible solely because of the overall deduction limit are disregarded in determining the amount of nondeductible contributions for purposes of the excise tax. Contributions that are disregarded are the greater of (1) the amount of contributions not in excess of six percent of the compensation of the employees covered by the defined contribution plan, or (2) the amount of matching contributions.

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[94] Code sec. 404.

[95] The full funding limitation is the excess, if any, of (1) the accrued liability of the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets. However, the full funding limit is not less than the excess, if any, of 90 percent of the plan's current liability (including normal cost) over the actuarial value of plan assets.

[96] In the case of a plan with 100 or fewer participants, unfunded current liability for this purpose does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment that is made or becomes effective, whichever is later, within the last two years.

REASONS FOR CHANGE

The Committee is concerned that the present-law deduction limits play a role in the underfunding of defined benefit pension plans by restricting employers' ability to make contributions in addition to minimum required contributions. The Committee believes that employers should have greater flexibility to make additional contributions, particularly in good economic times when extra resources are available to fund the plan. Such additional contributions enable employers to improve the funded status of their plans and reduce the chance that the employer will be required to make larger contributions during an economic downturn. Such additional contributions also further benefit security for plan participants (and reduce risk to the PBGC) by increasing the assets available to pay promised plan benefits.

The Committee understands that the overall limit on deductible contributions has the effect of reducing, or even eliminating, employers' ability to make deductible contributions to their defined contribution plans in years in which substantial contributions must be made to their defined benefit pension plans. As a result, employees may receive little or no contributions to their defined contribution plan accounts in such years. The Committee believes that the overall deduction limit should allow for defined contribution plan contributions up to certain levels without regard to contributions made to defined benefit pension plans. The Committee is also concerned that the overall deduction limit may discourage employers from making defined benefit pension plan contributions in addition to minimum required contributions, which increases the risk that plan assets will not be sufficient to provide benefits in the case of plan termination. The Committee believes that the overall deduction limit should be applied without regard to contributions to defined benefit pension plans covered by the PBGC insurance program.

EXPLANATION OF PROVISION

Deduction limits for contributions to defined benefit pension plans

Under the provision, for 2006, the maximum amount deductible for contributions to a single-employer defined benefit pension plan is not less than the excess (if any) of (1) 180 percent of the plan's current liability, over (2) the value of plan assets.[97]

For years after 2006, the maximum deductible amount for a single-employer defined benefit pension plan is not less than the greater of: (1) the excess (if any) of the sum of the plan's target liability, the plan's target normal cost, and a cushion amount for a plan year, over the value of plan assets (as determined under the minimum funding rules); and (2) the minimum required contribution for the plan year. However, in the case of a plan to which at-risk target liability and at-risk target normal cost do not apply, the amount in (1) is not less than the excess (if any) of the sum of the

[97] Under the provision relating to funding requirements for single-employer plans, the interest rate used to determine current liability for plan years beginning in 2006 must be within the permissible range of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins. Current liability as determined for funding purposes in 2006 applies also in determining the deduction limits for 2006.

plan's at-risk target liability and at-risk target normal cost (determined as if they did apply), over the value of plan assets.

The cushion amount for a plan year is the sum of (1) 80 percent of the plan's target liability for the plan year; and (2) the amount by which the plan's target liability would increase if determined by taking into account increases in participants' compensation for future years or, if the plan does not base benefits attributable to past service on compensation, increases in benefits that are expected to occur in succeeding plans year (determined on the basis of average annual benefit increases over the previous six years).[98] For this purpose, the dollar limits on benefits and on compensation apply, but, in the case of a plan that is covered by the PBGC insurance program, increases in the limits that are expected to occur in succeeding plan years may be taken into account.

The provision retains the present-law rule under which, in the case of a single-employer plan covered by the PBGC insurance program that terminates during the year, the maximum deductible amount is generally not less than the amount needed to make the plan assets sufficient to fund benefit liabilities as defined for purposes of plan termination under the PBGC insurance program.

Overall deduction limit for combinations of plans

For 2006, in the case of single-employer plans, the overall limit on deductions for contributions to one or more defined benefit pension plans and one or more defined contribution plans applies to contributions to defined contribution plans only to the extent that such contributions exceed six percent of compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plans. For purposes of determining the excise tax on nondeductible contributions, matching contributions to a defined contribution plan that are nondeductible solely because of the overall deduction limit are disregarded.

Under the provision, for years after 2006, single-employer defined benefit plans that are covered by the PBGC insurance program are not taken into account in applying the overall limit on deductions for contributions to combinations of defined benefit and defined contribution plans. Thus, the deduction for contributions to a defined benefit pension plan or a defined contribution plan is not affected by the overall deduction limit merely because employees are covered by both plans if the defined benefit plan is covered by the PBGC insurance program (i.e., the separate deduction limits for contributions to defined contribution plans and defined benefit pension plans apply).

In addition, for years after 2006, in applying the overall deduction limit to contributions to one or more single-employer defined benefit pension plans that are not covered by the PBGC insurance program and one or more defined contribution plans, the overall limit applies to contributions to defined contribution plans only to the extent that such contributions exceed six percent of compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plans. For purposes of determining the excise

[98] In determining the cushion amount for a plan with 100 or fewer participants, target liability does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment that is made or becomes effective, whichever is later, within the last two years.

tax on nondeductible contributions, matching contributions to a defined contribution plan that are nondeductible solely because of the overall deduction limit are disregarded.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2005.

D. Replacement of 30-Year Treasury Rate for Calculating Lump-Sum Distributions

(Sec. 331 of the bill, sec. 417(e) of the Code, and sec. 205(g) of ERISA)

PRESENT LAW

Accrued benefits under a defined benefit pension plan generally must be paid in the form of an annuity for the life of the participant unless the participant consents to a distribution in another form. Defined benefit pension plans generally provide that a participant may choose among other forms of benefit offered under the plan, such as a lump-sum distribution. These optional forms of benefit generally must be actuarially equivalent to the life annuity benefit payable to the participant.

A defined benefit pension plan must specify the actuarial assumptions that will be used in determining optional forms of benefit under the plan in a manner that precludes employer discretion in the assumptions to be used. For example, a plan may specify that a variable interest rate will be used in determining actuarial equivalent forms of benefit, but may not give the employer discretion to choose the interest rate.

Statutory assumptions must be used in determining the minimum present value of certain optional forms of benefit, such as a lump sum.[99] That is, the lump sum payable under the plan may not be less than the amount of the lump sum that is actuarially equivalent to the life annuity payable to the participant, determined using the statutory assumptions. The statutory assumptions consist of an applicable mortality table (as published by the IRS) and an applicable interest rate.

The applicable interest rate is the annual interest rate on 30-year Treasury securities, determined as of the time that is permitted under regulations. The regulations provide various options for determining the interest rate to be used under the plan, such as the period for which the interest rate will remain constant ("stability period") and the use of averaging.

Under the anticutback rule, an amendment of a qualified retirement plan generally may not eliminate an optional form of benefit.[100] For this purpose, a change in the interest rate used to determine an optional form of benefit is generally treated as the elimination of one optional form of benefit and the addition of a new optional form of benefit.

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[99] Code sec. 417(e)(3).
[100] Code sec. 411(d)(6).

REASONS FOR CHANGE

Under present law, the interest rate on 30-year Treasury securities is used to determine present value in the case of certain forms of benefit, such as lump sums. The Committee considers interest rates on high-quality corporate bonds to be more appropriate for this purpose. In addition, the Committee believes that a more accurate present value will result from matching interest rates to the timing of the payments being valued, rather than using a single long-term interest rate. Accordingly, a yield curve that reflects the rates of interest on corporate bonds of varying maturities should be used for this purpose.

The Committee recognizes that an immediate change in the interest rate used to calculate lump-sum benefits will in some cases reduce the amount of these benefits, which may cause participants to terminate employment in order to avoid any possible reduction. The Committee believes that a deferred effective date followed by a phase-in period of the yield-curve rates will mitigate any potential effect on participants and will provide participants with time to evaluate the impact of the change in interest rates on their benefits.

EXPLANATION OF PROVISION

The provision replaces the applicable interest rate used in determining the minimum present value of certain optional forms of benefit, such as lump sums, with the phase-in yield curve method (for plan years beginning in 2007–2010) and the yield curve method (for plan years beginning after 2010), based on the methods used to determine target liability (i.e., the value of plan liabilities) under the provision relating to the funding requirements for single-employer defined benefit pension plans.

Under the yield curve method, present value is determined: (1) using interest rates drawn from a yield curve prescribed by the Secretary of the Treasury that reflects interest rates on high-quality corporate bonds with varying maturities (as used in determining target liability); and (2) by matching the timing of the expected benefit payments under the plan to the interest rates on the yield curve (i.e., for bonds with maturity dates comparable to the times when benefits are expected to be paid). The present-law rules relating to the use of a stability period and averaging continue to apply.

Under the phase-in yield curve method, present value is the sum of two amounts: (1) the applicable percentage of present value determined under the yield curve method; and (2) present value determined using the annual rate of interest on 30-year Treasury securities, multiplied by a percentage equal to 100 percent minus the applicable percentage for the plan year.[101] For this purpose, the applicable percentage for a plan year is determined in accordance with the following table.

[101] In applying the phase-in yield curve method for purposes of the provision relating to the funding requirements for single-employer defined benefit pension plans, an interest rate based on a weighted four-year average of conservative long term corporate bond rates applies, rather than the annual rate of interest on 30-year Treasury securities.

TABLE 2.—APPLICABLE PERCENTAGE FOR PLAN YEARS BEGINNING IN 2007–2010

Plan years beginning in	*Applicable percentage*
2007	20
2008	40
2009	60
2010	80

Thus, for example, for plan years beginning in 2008, a lump-sum benefit payable under a plan may not be less than the sum of: (1) 40 percent of the minimum lump-sum benefit determined under the yield curve method, and (2) 60 percent of the minimum lump-sum benefit determined using the annual rate of interest on 30-year Treasury securities.

Under the provision relating to plan amendments, a plan amendment made pursuant to the provision generally will not violate the anticutback rule if certain requirements are met (e.g., the plan amendment is made on or before the last day of the first plan year beginning on or after January 1, 2007). Thus, subject to those requirements, a plan amendment will not violate the anticutback rule merely because it provides for the use of the phase-in yield curve method and the yield curve method, rather than the interest rate on 30-year Treasury securities, in determining benefits subject to the minimum present value rules.

The provision provides a special rule that allows a plan amendment to change the interest rate used to determine certain optional forms of benefit. Under the special rule, a plan amendment will not violate the anticutback rule if: (1) for the last plan year beginning in 2003, the plan provides that the annual rate of interest on 30-year Treasury securities is used in determining the amount of a benefit (other than the accrued benefit) that is not subject to the minimum present value rules; (2) the plan is amended to provide that a different rate of interest is used in determining the amount of such benefit; and (3) the first plan year for which such amendment is effective begins no later than January 1, 2007. The provision relating to plan amendments applies to a plan amendment made pursuant to the special rule.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2006.

E. Interest Rate Assumption for Applying Benefit Limitations to Lump-Sum Distributions

(Sec. 332 of the bill and sec. 415 of the Code)

PRESENT LAW

Annual benefits payable under a defined benefit pension plan generally may not exceed the lesser of (1) 100 percent of average compensation, or (2) $170,000 (for 2005).[102] The dollar limit generally applies to a benefit payable in the form of a straight life annuity. If the benefit is not in the form of a straight life annuity (e.g., a lump sum), the benefit generally is adjusted to an equivalent straight life annuity. For purposes of adjusting a benefit in a

[102] Code sec. 415(b).

form that is subject to the minimum present value rules, such as a lump-sum benefit, the interest rate used generally must be not less than the greater of: (1) the rate applicable in determining minimum lump sums, i.e., the interest rate on 30-year Treasury securities; or (2) the interest rate specified in the plan. For 2004 and 2005, the interest rate used must be not less than the greater of: (1) 5.5 percent; or (2) the interest rate specified in the plan.

Under the anticutback rule, an amendment of a qualified retirement plan generally may not eliminate an optional form of benefit.[103] For this purpose, a change in the interest rate used to determine an optional form of benefit is generally treated as the elimination of one optional form of benefit and the addition of a new optional form of benefit.

REASONS FOR CHANGE

The Committee understands that, under some plans, in determining lump-sum benefits, a fixed interest rate is used rather than the variable rate that is required under the minimum present value rules (provided that the resulting lump sum cannot be less than the minimum present value). The use of a fixed rate rather than a variable rate makes the value of benefits more predictable for employees and also makes employers' required contributions more predictable. The Committee further understands that the present-law requirement to use a variable rate in applying the benefit limits to lump sums interferes with this predictability. The Committee therefore believes that it should be permissible to use a fixed rate in applying the benefit limits to lump sums.

EXPLANATION OF PROVISION

Under the provision, for purposes of adjusting a benefit in a form that is subject to the minimum present value rules, such as a lump-sum benefit, the interest rate used generally must be not less than the greater of: (1) 5.5 percent; or (2) the interest rate specified in the plan.[104] Thus, the rule that applies for 2004 and 2005 is made permanent.

Under the provision relating to plan amendments, a plan amendment made pursuant to the provision generally will not violate the anticutback rule if certain requirements are met (e.g., the plan amendment is made on or before the last day of the first plan year beginning on or after January 1, 2007). Thus, subject to those requirements, a plan amendment that changes made pursuant to the provision to change the interest rate used to apply the benefit limits to benefits that are subject to the minimum present value rules will not violate the anticutback rule.

EFFECTIVE DATE

The provision is effective for years beginning after 2005.

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[103] Code sec. 411(d)(6).

[104] In the case of a plan under which lump-sum benefits are determined solely as required under the minimum value rules (rather than using an interest rate that results in larger lump-sum benefits), the interest rate specified in the plan is the interest rate applicable under the minimum value rules. Thus, for purposes of applying the benefit limits to lump-sum benefits under the plan, the interest rate used must be not less than the greater of: (1) 5.5 percent; or (2) the interest rate applicable under the minimum value rules.

F. Restrictions on Funding of Nonqualified Deferred Compensation Plan When Employer's Defined Benefit Pension Plan Is Underfunded

(Sec. 333 of the bill, secs. 409A and 4980I of the Code, new sec. 306 of ERISA, and sec. 502(g) of ERISA)

PRESENT LAW

In general

Present law does not include any prohibition on the funding of nonqualified deferred compensation in connection with the funded status of a defined benefit pension plan of the same plan sponsor.

Income tax treatment of nonqualified deferred compensation

Amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied.[105] For example, distributions from a nonqualified deferred compensation plan may be allowed only upon certain times and events. Rules also apply for the timing of elections. If the requirements are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax.

In the case of assets set aside in a trust (or other arrangement) for purposes of paying nonqualified deferred compensation, such assets are treated as property transferred in connection with the performance of services under Code section 83 at the time set aside if such assets (or trust or other arrangement) are located outside of the United States or at the time transferred if such assets (or trust or other arrangement) are subsequently transferred outside of the United States. A transfer of property in connection with the performance of services under Code section 83 also occurs with respect to compensation deferred under a nonqualified deferred compensation plan if the plan provides that upon a change in the employer's financial health, assets will be restricted to the payment of nonqualified deferred compensation.

REASONS FOR CHANGE

The Committee believes that it is inappropriate for companies with underfunded defined benefit pension plans to fund nonqualified deferred compensation plans covering executives while the pension plan is not adequately funded. Executives of companies with underfunded defined benefit pension plans should not benefit from having their nonqualified deferred compensation arrangements funded, and thus, more secure, while the pension plan faces underfunding.

While rank-and-file employees have little control over a company's decision to fund its pension plans, executives often have con-

[105] Code section 409A.

trol in determining whether nonqualified deferred compensation plans will be funded. In addition, executives who are covered by a nonqualified deferred compensation plan may also be instrumental in deciding how much to contribute to the defined benefit pension plan, thus determining the funded status of the pension plan. The Committee believes that it is also appropriate to restrict funding of nonqualified deferred compensation during the period immediately preceding termination of the company's pension plan and when the plan sponsor is in bankruptcy.

The Committee believes that if a nonqualified deferred compensation plan covering executives is funded during certain periods of pension plan underfunding, when the plan sponsor is in bankruptcy, or immediately preceding termination of a pension plan, executives should be required to recognize current income inclusion upon the funding of their nonqualified deferred compensation plans and penalties should apply.

EXPLANATION OF PROVISION

ERISA prohibition on funding nonqualified deferred compensation

The provision provides that during any restricted period, a plan sponsor of a single-employer defined benefit pension plan (and any member of its controlled group) may not directly or indirectly transfer assets, and may not directly or indirectly otherwise reserve assets, in a trust (or other arrangement determined by the Secretary of Treasury) for purposes of paying deferred compensation of an applicable covered employee under a nonqualified deferred compensation plan of such plan sponsor or member.

With respect to any single-employer defined benefit pension plan, the restricted period is (1) if the plan's adjusted target liability percentage as of the valuation date for the preceding plan year and current plan year is less than 80 percent, the period beginning on the first day of the current plan year and ending on the first day for which the plan's adjusted funded target liability percentage is at least 80 percent; (2) any period that the plan sponsor is in bankruptcy; and (3) in the case of a plan that terminates, the 12-month period beginning on the date which is six months before the termination date of the plan if, as of the termination date, plan assets are not sufficient for benefit liabilities.

In general, covered employees include the chief executive officer (or individual acting in such capacity) and the four highest compensated officers for the taxable year (other than the chief executive officer). An applicable covered employee includes any (1) covered employee of a plan sponsor; (2) covered employee of a member of a controlled group which includes the plan sponsor; and (3) former employee who was a covered employee at the time of termination of employment with the plan sponsor or a member of a controlled group which includes the plan sponsor.

The provision requires that the plan administrator of a single-employer defined benefit pension plan notify the plan sponsor within a reasonable time after the occurrence of an event which results in a restricted period with respect to the plan. The notice must include the duration of the restricted period and the restrictions that apply during such period. Within 30 days of receipt of the notice, the plan sponsor must notify the plan administrator (of the single-

employer defined benefit pension plan) of nonqualified deferred compensation plans maintained by the plan sponsor (or members of the controlled group) and the amount of any assets transferred or otherwise reserved by the plan sponsor (or member) in violation of the prohibition on transfers during any portion of the restricted period occurring on or before the date the plan sponsor provided such notice. If, subsequent to this notice, and during any portion of the remaining restricted period, the plan sponsor (or member of controlled group) (1) transfers or reserves assets in violation of the prohibition, or (2) establishes a new nonqualified deferred compensation plan, the plan sponsor must notify the plan administrator (of the single-employer defined benefit pension plan) within three days of such action. An excise tax of $1,000 per day applies in the case of a failure to provide a notice as required by the provision.

The provision provides that any fiduciary of the plan may have access to the financial records of a plan sponsor (or member of the controlled group) to determine if assets were transferred or otherwise reserved in violation of the provision.

The provision also creates a civil right of action by a fiduciary of a single-employer defined benefit pension plan against (1) a plan sponsor, member of a controlled group which includes the plan sponsor, an applicable covered employee, or a person holding assets which are part of a nonqualified deferred compensation plan, to recover on behalf of the plan (A) assets which were set aside or transferred in violation of the provision (and earnings thereon), or (B) amounts equivalent to such assets and earnings; or (2) a plan sponsor, or member of a controlled group which includes the plan sponsor, to compel the production of records the fiduciary is entitled to under the provision. The provision also provides for the recovery of attorney's fees and costs of the action.

Tax consequences of funding nonqualified deferred compensation

Under the provision, if during any restricted period, a plan sponsor of a single-employer defined benefit pension plan (or any member of the controlled group) directly or indirectly transfers assets, or directly or indirectly otherwise reserves assets, in a trust (or other arrangement as determined by the Secretary of the Treasury) for purposes of paying deferred compensation of an applicable covered employee under a nonqualified deferred compensation plan, such assets are treated as property transferred in connection with the performance of services (whether or not such assets are available to satisfy the claims of general creditors) under Code section 83. Thus, the provision requires current income inclusion to the extent of assets transferred or otherwise reserved.

Any subsequent increases in the value of, or any earnings with respect to, transferred or restricted assets are treated as additional transfers of property. Interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the amounts been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to an additional 20-percent tax.

Definition of nonqualified deferred compensation plan

A nonqualified deferred compensation plan is any plan that provides for the deferral of compensation other than a qualified employer plan or any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan means a qualified retirement plan, tax-deferred annuity, simplified employee pension, and SIMPLE.[106] A qualified governmental excess benefit arrangement (sec. 415(m)) is a qualified employer plan. An eligible deferred compensation plan (sec. 457(b)) is also a qualified employer plan under the provision. The term plan includes any agreement or arrangement, including an agreement or arrangement that includes one person.

EFFECTIVE DATE

The provision is effective for transfers and other reservations of assets after December 31, 2006.

G. Special Funding Rules for Plans Maintained by Commercial Airlines That Are Amended To Cease Future Benefit Accruals

(Sec. 334 of the bill)

PRESENT LAW

In general

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code").[107] The amount of contributions required for a plan year under the minimum funding rules is generally the amount needed to fund benefits earned during that year plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit. The amount of required annual contributions is determined under one of a number of acceptable actuarial cost methods. Additional contributions are required under the deficit reduction contribution rules in the case of certain underfunded plans. No contribution is required under the minimum funding rules in excess of the full funding limit (described below).

General minimum funding rules

Funding standard account

As an administrative aid in the application of the funding requirements, a defined benefit pension plan is required to maintain a special account called a "funding standard account" to which specified charges and credits are made for each plan year, including a charge for normal cost and credits for contributions to the plan. Other credits or charges or credits may apply as a result of decreases or increases in past service liability as a result of plan amendments, experience gains or losses, gains or losses resulting

[106] A qualified employer plan also includes a section 501(c)(18) trust.

[107] Code sec. 412. The minimum funding rules also apply to multiemployer plans, but the rules for multiemployer plans differ in various respects from the rules applicable to single-employer plans.

from a change in actuarial assumptions, or a waiver of minimum required contributions.

If, as of the close of a plan year, the funding standard account reflects credits at least equal to charges, the plan is generally treated as meeting the minimum funding standard for the year. If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, then the excess is referred to as an "accumulated funding deficiency." Thus, as a general rule, the minimum contribution for a plan year is determined as the amount by which the charges to the funding standard account would exceed credits to the account if no contribution were made to the plan. For example, if the balance of charges to the funding standard account of a plan for a year would be $200,000 without any contributions, then a minimum contribution equal to that amount would be required to meet the minimum funding standard for the year to prevent an accumulated funding deficiency.

Credit balances

If credits to the funding standard account exceed charges, a "credit balance" results. A credit balance results, for example, if contributions in excess of minimum required contributions are made. Similarly, a credit balance may result from large net experience gains. The amount of the credit balance, increased with interest at the rate used under the plan to determine costs, can be used to reduce future required contributions.

Funding methods and general concepts

A defined benefit pension plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an actuarial cost method breaks up the cost of benefits under the plan into annual charges consisting of two elements for each plan year. These elements are referred to as: (1) normal cost; and (2) supplemental cost.

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions as to interest, mortality, time of payment, etc., had been fulfilled. The normal cost will be funded by future contributions to the plan: (1) in level dollar amounts; (2) as a uniform percentage of payroll; (3) as a uniform amount per unit of service (e.g., $1 per hour); or (4) on the basis of the actuarial present values of benefits considered accruing in particular plan years.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attrib-

utable to net experience losses, changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs must be amortized (i.e., recognized for funding purposes) over a specified number of years, depending on the source. For example, the cost attributable to a past service liability is generally amortized over 30 years.

Normal costs and supplemental costs under a plan are computed on the basis of an actuarial valuation of the assets and liabilities of a plan. An actuarial valuation is generally required annually and is made as of a date within the plan year or within one month before the beginning of the plan year. However, a valuation date within the preceding plan year may be used if, as of that date, the value of the plan's assets is at least 100 percent of the plan's current liability (i.e., the present value of benefit liabilities under the plan, as described below).

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan assets is the value determined under a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of the plan assets, values may be used for a stated period not to exceed the five most recent plan years, including the current year.

In applying the funding rules, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would be obtained if each assumption and method were reasonable. In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan.[108]

Additional contributions for underfunded plans

Under special funding rules (referred to as the "deficit reduction contribution" rules),[109] an additional charge to a plan's funding standard account is generally required for a plan year if the plan's funded current liability percentage for the plan year is less than 90 percent.[110] A plan's "funded current liability percentage" is generally the actuarial value of plan assets as a percentage of the plan's current liability. In general, a plan's current liability means

[108] Under present law, certain changes in actuarial assumptions that decrease the liabilities of an underfunded single-employer plan must be approved by the Secretary of the Treasury.

[109] The deficit reduction contribution rules apply to single-employer plans, other than single-employer plans with no more than 100 participants on any day in the preceding plan year. Single-employer plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under these rules.

[110] Under an alternative test, a plan is not subject to the deficit reduction contribution rules for a plan year if (1) the plan's funded current liability percentage for the plan year is at least 80 percent, and (2) the plan's funded current liability percentage was at least 90 percent for each of the two immediately preceding plan years or each of the second and third immediately preceding plan years.

all liabilities to employees and their beneficiaries under the plan, determined on a present-value basis.[111]

The amount of the additional charge required under the deficit reduction contribution rules is the sum of two amounts: (1) the excess, if any, of (a) the deficit reduction contribution (as described below), over (b) the contribution required under the normal funding rules; and (2) the amount (if any) required with respect to unpredictable contingent event benefits. The amount of the additional charge cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent (taking into account any expected increase in current liability due to benefits accruing during the plan year).

The deficit reduction contribution is generally the sum of (1) the "unfunded old liability amount," (2) the "unfunded new liability amount," and (3) the expected increase in current liability due to benefits accruing during the plan year. The "unfunded old liability amount" is the amount needed to amortize certain unfunded liabilities under 1987 and 1994 transition rules. The "unfunded new liability amount" is the applicable percentage of the plan's unfunded new liability. Unfunded new liability generally means the unfunded current liability of the plan (i.e., the amount by which the plan's current liability exceeds the actuarial value of plan assets), but determined without regard to certain liabilities (such as the plan's unfunded old liability and unpredictable contingent event benefits). The applicable percentage is generally 30 percent, but decreases by .40 of one percentage point for each percentage point by which the plan's funded current liability percentage exceeds 60 percent. For example, if a plan's funded current liability percentage is 85 percent (i.e., it exceeds 60 percent by 25 percentage points), the applicable percentage is 20 percent (30 percent minus 10 percentage points (25 multiplied by .4)).

The Pension Funding Equity Act of 2004 allows certain employers, including a commercial passenger airline, to elect a reduced contribution under the deficit reduction contribution rules with respect to certain plans for plan years beginning after December 27, 2003, and before December 28, 2005. If an employer so elects, the additional contribution is the greater of: (1) 20 percent of the amount of the additional contribution that would otherwise be required; or (2) the additional contribution that would be required if the deficit reduction contribution for the plan year were determined as the expected increase in current liability due to benefits accruing during the plan year. An election of a reduced contribution may be made only with respect to a plan that was not subject to the deficit reduction contribution rules for the plan year beginning in 2000. In addition, certain notice and benefit restriction requirements must be met.

Other funding-related rules

Full funding limitation

No contributions are required under the minimum funding rules in excess of the full funding limitation. The full funding limitation is the excess, if any, of (1) the accrued liability under the plan (in-

[111] Specific interest rate and mortality assumptions must be used in determining a plan's current liability for purposes of the special funding rule.

cluding normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets. However, the full funding limitation may not be less than the excess, if any, of 90 percent of the plan's current liability (including the current liability normal cost) over the actuarial value of plan assets. In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability under the full funding limitation may be based on projected future benefits, including future salary increases.

Funding waivers

Within limits, the Secretary of the Treasury is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year (a "waived funding deficiency").[112] A waiver may be granted if the employer (or employers) responsible for the contribution could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than three waivers may be granted within any period of 15 consecutive plan years.

The IRS is authorized to require security to be granted as a condition of granting a waiver of the minimum funding standard if the sum of the plan's accumulated funding deficiency and the balance of any outstanding waived funding deficiencies exceeds $1 million.

Notice of certain plan amendments

A notice requirement must be met if an amendment to a defined benefit pension plan provides for a significant reduction in the rate of future benefit accrual. In that case, the plan administrator must furnish a written notice concerning the amendment. Notice may also be required if a plan amendment eliminates or reduces an early retirement benefit or retirement-type subsidy. The plan administrator is required to provide the notice to any participant or alternate payee whose rate of future benefit accrual may reasonably be expected to be significantly reduced by the plan amendment (and to any employee organization representing affected participants). The notice must be written in a manner calculated to be understood by the average plan participant and must provide sufficient information to allow recipients to understand the effect of the amendment. In the case of a single-employer plan, the plan administrator is generally required to provide the notice at least 45 days before the effective date of the plan amendment. In the case of a multiemployer plan, the notice is generally required to be provided 15 days before the effective date of the plan amendment.

REASONS FOR CHANGE

The Committee recognizes that the minimum funding rules play an important role in assuring that defined benefit pension plans are adequately funded. However, the Committee believes that special issues arise with respect to plans maintained by commercial airlines. The airline industry has faced significant economic challenges in recent years, forcing some airlines into bankruptcy pro-

[112] Code sec. 412(d). Under similar rules, the amortization period applicable to unfunded past service liability may also be extended.

ceedings. Recent economic conditions have also caused some plans maintained by airlines to be significantly underfunded. In some cases, underfunded plans have been terminated in bankruptcy proceedings, resulting in a loss of benefits by participants and an increase in PBGC liabilities.

Many airlines have taken measures to reduce costs, including in some cases freezing benefits (and thus liabilities) under their defined benefit pension plans. While the freezing of benefits is unfortunate, it is consistent with the Committee's view that employers should fund benefits that have already been promised to employees before promising additional benefits. The Committee is concerned that, even if benefits under plans maintained by such airlines are frozen, the amount of contributions required under the minimum funding rules may have the effect of diverting funds needed to assure the continued viability of the airlines' business, which could result in further terminations of underfunded plans. The Committee therefore believes that such airlines should be provided with additional time for funding their plans, subject to appropriate conditions.

EXPLANATION OF PROVISION

In general

Under the provision, if an election is made with respect to an eligible plan for a plan year (an "applicable" plan year), the minimum required contribution for the plan year is determined under a special method.[113] If minimum required contributions as determined under the provision are made: (1) for an applicable plan year beginning before January 1, 2007 (for which the present-law funding rules apply), the plan does not have an accumulated funding deficiency; and (2) for an applicable plan year beginning on or after January 1, 2007 (for which the changes to the funding rules made under the bill apply), the minimum required contribution is the contribution determined under the provision. For purposes of the provision, an eligible plan is a single-employer defined benefit pension plan sponsored by an employer that is a commercial passenger airline and with respect to which certain benefit accrual and benefit increase restrictions are met.

An election under the provision must be made at such time and in such manner as prescribed by the Secretary of the Treasury. The employer may select the first plan year to which the election applies from among plan years ending after the date of the election. The election applies to that plan year and subsequent plan years, unless the election is revoked with the approval of the Secretary. The employer may also change the plan year with respect to the plan by specifying a new plan year in the election. Such a change in plan year does not require approval of the Secretary.

Determination of required contribution

Under the provision, the minimum required contribution for any applicable plan year during the amortization period is the amount required to amortize the plan's unfunded liability, determined as of

[113] Any amortization bases, credit balance, or prefunding balance under the plan's funding standard account as of the end of the last year preceding the first applicable year is reduced to zero.

the first day of the plan year, in equal annual installments over the remaining amortization period. For this purpose, the amortization period is the 14-plan-year period beginning with the first applicable plan year. Thus, the annual amortization amount is redetermined each year, based on the plan's unfunded liability at that time and the remainder of the amortization period. For any plan years beginning after the end of the amortization period, the plan is subject to the generally applicable minimum funding rules (as modified under the provision of the bill relating to funding requirements for single-employer plans, including the limitations on benefit increases and distributions by underfunded plans). The plan's prefunding balance as of the first day of the first year beginning after the end of the amortization period is zero.[114]

For purposes of the provision, a plan's unfunded liability is the unfunded accrued liability under the plan, determined under the unit credit funding method. As under present law, minimum required contributions (including the annual amortization amount) under the provision must be determined using actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would be obtained if each assumption and method were reasonable. The assumptions are required also to offer the actuary's best estimate of anticipated experience under the plan. In addition, as under present law, the rate of interest used must be an appropriate rate consistent with the rate or rates used under the plan to determine costs, and the value of plan assets used must be the fair market value.

Benefit accrual and benefit increase restrictions

Under the provision, effective as of the first day of the first applicable plan year and at all times thereafter, an eligible plan must provide that, with respect to each participant: (1) the accrued benefit, any death or disability benefit, and any social security supplement are frozen at the amount of the benefit or supplement immediately before such first day; and (2) all other benefits under the plan are eliminated. However, the freezing or elimination of benefits or supplements is required only to the extent that it would be permitted under the anticutback rule if implemented by a plan amendment adopted immediately before such first day.

In addition, no applicable benefit increase under an eligible plan may take effect at any time during the period beginning on July 26, 2005, and ending on the day before the first day of the first applicable plan year. For this purpose, an applicable benefit increase generally is any increase in liabilities of the plan by plan amendment (or otherwise as specified by the Secretary) which would occur by reason of: (1) any increase in benefits; (2) any change in the accrual of benefits; or (3) any change in the rate at which benefits become nonforfeitable under the plan. An applicable benefit increase does not include any increase in liabilities under a plan: (1) by reason of a plan amendment if such amendment is required as

[114] If an election to use the special method is revoked before the end of the amortization period, the plan is subject to the generally applicable minimum funding rules beginning with the first plan year for which the election is revoked, and the plan's prefunding balance as of the beginning of that year is zero.

a condition of qualification of the plan; or (2) which is specified in Treasury regulations.[115]

Treatment of successors plans, PBGC benefit guarantee, and other rules

Under the provision, authority is granted to the Secretary of the Treasury to disqualify one or more single-employer defined benefit pension plans ("successor" plans) established by an employer maintaining an eligible plan to which the special method applies if the successor plan or plans provide benefit accruals to any substantial number of successor employees. For this purpose, a successor employee is any employee covered by the eligible plan or any employee performing substantially the same type of work with respect to the employer's business operations as an employee covered by the eligible plan. The Secretary of the Treasury may, in his or her discretion, disqualify a successor plan unless all benefit obligations under the eligible plan have been satisfied.

Under the provision, if an election to apply the special method is made with respect to a plan and the plan is terminated, certain aspects of the PBGC guarantee provisions are applied as if the plan terminated on the first day of the first applicable plan year. Specifically, the amount of guaranteed benefits payable by the PBGC is determined based on plan provisions, salary, service, and the guarantee in effect on the first day of the first applicable plan year. In addition, the priority among participants for purposes of allocating plan assets and employer recoveries to non-guaranteed benefits in the event of plan termination is determined as of the first day of the first applicable plan year.

Under the provision, the provision of the bill under which defined benefit plans that are covered by the PBGC insurance program are not taken into account in applying the overall limit on deductions for contributions to combinations of defined benefit and defined contribution plans, does not apply to an eligible plan to which the special method applies.

In the case of notice required with respect to an amendment that is made to an eligible plan maintained pursuant to one or more collective bargaining agreements in order to comply with the benefit accrual and benefit increase restrictions under the provision, the provision allows the notice to be provided 15 days before the effective date of the plan amendment.

EFFECTIVE DATE

The provision is effective for plan years ending after the date of enactment.

[115] Applicable benefit increase is generally defined as under the provision relating to benefit limitations under single-employer defined benefit pension plans. However, exceptions for certain benefit increases provided under a plan maintained pursuant to a collective bargaining agreement do not apply.

H. Modification of Pension Funding Requirements for Plans Subject to Current Transition Rule

(Sec. 335 of the bill and sec. 769 of the Retirement Protection Act of 1994, as amended by the Pension Funding Equity Act of 2004)

PRESENT LAW

Defined benefit pension plans are required to meet certain minimum funding rules. In some cases, additional contributions are required if a single-employer defined benefit pension plan is underfunded. Additional contributions generally are not required in the case of a plan with a funded current liability percentage of at least 90 percent. A plan's funded current liability percentage is the value of plan assets as a percentage of current liability. In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan. In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year.

The PBGC insures benefits under most single-employer defined benefit pension plans in the event the plan is terminated with insufficient assets to pay for plan benefits. The PBGC is funded in part by a flat-rate premium per plan participant, and a variable rate premium based on the amount of unfunded vested benefits under the plan. A specified interest rate and a specified mortality table apply in determining unfunded vested benefits for this purpose.

A special rule modifies the minimum funding requirements in the case of certain plans. The special rule applies in the case of plans that (1) were not required to pay a variable rate PBGC premium for the plan year beginning in 1996, (2) do not, in plan years beginning after 1995 and before 2009, merge with another plan (other than a plan sponsored by an employer that was a member of the controlled group of the employer in 1996), and (3) are sponsored by a company that is engaged primarily in interurban or interstate passenger bus service.

The special rule generally treats a plan to which it applies as having a funded current liability percentage of at least 90 percent for plan years beginning after 1996 and before 2004 if for such plan year the funded current liability percentage is at least 85 percent. If the funded current liability of the plan is less than 85 percent for any plan year beginning after 1996 and before 2004, the relief from the minimum funding requirements generally applies only if certain specified contributions are made.

For plan years beginning in 2004 and 2005, the funded current liability percentage of the plan is treated as at least 90 percent for purposes of determining the amount of required contributions (100 percent for purposes of determining whether quarterly contributions are required). As a result, for these years, additional contributions and quarterly contributions are not required with respect to the plan. In addition, for these years, the mortality table used under the plan is used in determining the amount of unfunded

vested benefits under the plan for purposes of calculating PBGC variable rate premiums.

For plan years beginning after 2005 and before 2010, the funded current liability percentage generally will be deemed to be at least 90 percent if the actual funded current liability percentage is at least at certain specified levels. The relief from the minimum funding requirements generally applies for a plan year beginning in 2006, 2007, or 2008 only if contributions to the plan for the plan year equal at least the expected increase in current liability due to benefits accruing during the plan year.

REASONS FOR CHANGE

The present-law funding rules for plans maintained by certain interstate bus companies were enacted because the generally applicable funding rules required greater contributions for such plans than were warranted given the special characteristics of such plans. In particular, these plans are closed to new participants and have demonstrated mortality significantly greater than that predicted under mortality tables that the plans would otherwise be required to use for minimum funding purposes. The Committee believes that it is appropriate to extend to 2006 the special rule that applies to such plans for 2004 and 2005 and, for years after 2006, to modify the special rule to reflect the changes made in the minimum funding rules.

EXPLANATION OF PROVISION

The provision revises the special rule for a plan that is sponsored by a company engaged primarily in interurban or interstate passenger bus service and that meets the other requirements for the special rule under present law. Under the provision, for the plan year beginning in 2006, the funded current liability percentage of such a plan is treated as at least 90 percent for purposes of determining the amount of required contributions (100 percent for purposes of determining whether quarterly contributions are required). As a result, for the 2006 plan year, additional contributions and quarterly contributions are not required with respect to the plan. In addition, the mortality table used under the plan is used in determining the amount of unfunded vested benefits under the plan for purposes of calculating PBGC variable rate premiums.

Under the provision, for plan years beginning after 2006, the mortality table used by the plan is used in: (1) determining any present value or making any computation under the minimum funding rules; and (2) determining unfunded target liability for PBGC variable premium rate purposes.[116] In addition, in determining the minimum required contribution for plan years after 2006, the value of plan assets is not reduced by the plan's prefunding balance if, pursuant to a written agreement with the PBGC entered into before January 1, 2006, the prefunding balance is not available to reduce the minimum required contribution for the plan year.

[116] The term "unfunded target liability" is defined under the provision relating to minimum funding rules for single-employer plans and generally means: (1) the excess (if any) of the plan's target liability for the plan year (i.e., the present value of liabilities under the plan), over (2) the value of the plan's assets (reduced by any prefunding balance).

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2005.

I. TREATMENT OF CASH BALANCE AND OTHER HYBRID DEFINED BENEFIT PENSION PLANS

(Sec. 341 of the bill, secs. 411 and 417 of the Code, and secs. 204 and 205 of ERISA)

PRESENT LAW

Cash balance and other hybrid plans

A cash balance plan is a defined benefit pension plan with benefits resembling the benefits associated with defined contribution plans. Cash balance plans are sometimes referred to as "hybrid" plans because they combine features of a defined benefit pension plan and a defined contribution plan. Other types of hybrid plans exist as well, such as so-called "pension equity" plans.

Under a cash balance plan, benefits are determined by reference to a hypothetical account balance. An employee's hypothetical account balance is determined by reference to hypothetical annual allocations to the account ("pay credits") (e.g., a certain percentage of the employee's compensation for the year) and hypothetical earnings on the account ("interest credits").

Cash balance plans are generally designed so that, when a participant receives a pay credit for a year of service, the participant also receives the right to future interest on the pay credit, regardless of whether the participant continues employment (referred to as "front-loaded" interest credits). That is, the participant's hypothetical account continues to be credited with interest after the participant stops working for the employer. As a result, if an employee terminates employment and defers distribution to a later date, interest credits will continue to be credited to that employee's hypothetical account.

Cash balance plans and other hybrid plans are subject to the qualification requirements applicable to defined benefit pension plans generally. However, because such plans have features of both defined benefit pension plans and defined contributions plans, questions arise as to the proper application of the qualification requirements to such plans.[117] Issues that commonly arise include: (1) the application of the age discrimination rules; (2) the proper method for determining lump-sum distributions; and (3) the treatment of a conversion to a cash balance plan or other hybrid plan formula.

Age discrimination

Present law prohibits any reduction in the rate of a participant's benefit accrual (or the cessation of accruals) under a defined benefit pension plan because of the attainment of any age. The age discrimination rules do not prohibit all benefit formulas under which

[117] There is little guidance under present law with respect to many of the issues raised by cash balance conversions. In 1999, the IRS imposed a moratorium on determination letters for cash balance conversions pending clarification of applicable legal requirements. Under the moratorium, all determination letter requests regarding converted cash balance plans are sent to the National Office for review; however, the National Office is not currently acting on these plans.

a reduction in accruals is correlated with participants' age in some manner. For example, a plan may limit the total amount of benefits, or may limit the years of service or participation considered in determining benefits.

An age discrimination issue has arisen as a result of front-loaded interest credits under cash balance plans because there is a longer time for interest credits to accrue on hypothetical contributions to the account of a younger participant. Several court cases have considered whether front-loaded interest credits under cash balance plans violate the age discrimination rules and have reached inconsistent conclusions.[118] A similar issue may arise with respect to other types of hybrid plans.

Determination of minimum lump-sum benefits

Defined benefit pension plans, including cash balance plans and other hybrid plans, are required to provide benefits in the form of a life annuity commencing at a participant's normal retirement age. If the plan permits benefits to be paid in certain other forms, such as a lump sum, minimum present value rules apply, under which the alternative form of benefit cannot be less than the present value of the life annuity payable at normal retirement age, determined using certain statutorily prescribed interest and mortality assumptions.

Most cash balance plans are designed to permit a lump-sum distribution of a participant's hypothetical account balance upon termination of employment. As is the case with defined benefit pension plans generally, such a lump-sum amount is required to be not less than the present value of the benefit payable at normal retirement age, determined using the statutory interest and mortality assumptions.[119] A participant's normal retirement benefit under a cash balance plan is generally determined by projecting the participant's hypothetical account balance to normal retirement age by crediting to the account future interest credits, the right to which has already accrued, and converting the projected account balance to an actuarially equivalent life annuity payable at normal retirement age, using the interest and mortality assumptions specified in the plan.

A difference in the rate of interest credits provided under the plan, which is used to project the account balance forward to normal retirement age, and the statutory rate used to determine the lump-sum value (i.e., present value) of the accrued benefit will cause a discrepancy between the value of the minimum lump-sum and the employee's hypothetical account balance. In particular, if

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[118] *Tootle* v. *ARINC Inc.,* 2004 U.S. Dist. LEXIS 10629 (June 10, 2004); *Cooper* v. *IBM Personal Pension Plan,* 274 F. Supp. 2d 1010 (S.D. Ill. 2003); *Eaton* v. *Onan,* 117 F. Supp. 2d 812 (S.D. Ind. 2000). In addition, proposed Treasury regulations issued in December 2002 provided rules under which cash balance plans could provide front-loaded interest credits without violating the age discrimination rules. However, the Treasury Department announced the withdrawal of the regulations in June 2004.

[119] *Berger* v. *Xerox Corp. Retirement Income Guarantee Plan,* 338 F.3d 755 (7th Cir. 2003); *Esden* v. *Bank of Boston,* 229 F.3d 154 (2d Cir. 2000), cert. dismissed, 531 U.S. 1061 (2001); *Lyons* v. *Georgia Pacific Salaried Employees Retirement Plan,* 221 F.3d 1235 (11th Cir. 2000), cert. denied, 532 U.S. 967 (2001); *West* v. *AK Steel Corp. Retirement Accumulation Plan,* 318 F. Supp.2d 579 (S.D. Ohio 2004); Notice 96–8, 1996–1996–1 C.B. 359. Additionally, under *Esden,* if participants accrue interest credits under a cash balance plan at an interest rate that is higher than the interest assumptions prescribed by the Code for determining the present value of the annuity, the interest credits must be reflected in the projection of the participant's hypothetical account balance to normal retirement age in order to avoid violating the Code's prohibition against forfeitures.

the plan's interest crediting rate is higher than the statutory interest rate, then the resulting lump-sum amount will generally be greater than the hypothetical account balance.[120]

Protection of accrued benefits when a plan is amended

In general, an amendment of a qualified retirement plan may not reduce benefits that have already accrued (the "anticutback rule"). For this purpose, an amendment is treated as reducing accrued benefits if it has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy or of eliminating an optional form of benefit. Several approaches may be used to comply with the anticutback rule, including wearaway and no-wearaway approaches.

Under a wearaway approach, a participant's accrued benefit after a plan amendment is determined as the greater of: (1) the participant's accrued benefit before the amendment ("preamendment" accrued benefit); and (2) the benefit determined by applying the new benefit formula to all the participant's years of service, both before and after the amendment. Under a wearaway approach, if a participant's preamendment accrued benefit is greater than the benefit provided under the new formula, the participant may have a period (a wearaway period) during which the participant does not accrue any additional benefits.

Under a no-wearaway approach, a participant's benefit after a plan amendment is determined as the sum of: (1) the participant's preamendment accrued benefit; and (2) the accrued benefit that results from applying the new formula with respect to years of service after the plan amendment. Under this approach, participants earn additional benefits under the new plan formula immediately.

In addition to wearaway and no-wearaway approaches, a plan amendment may include a grandfather provision under which the benefit formula that applied before the amendment continues to apply to the participants in the plan before the amendment if it provides a greater benefit than the new formula or under which such participants may choose between the old and new formulas. Alternatively, a plan amendment may provide a grandfather provision for older and longer-service participants.

A notice requirement must be met if an amendment to a defined benefit pension plan provides for a significant reduction in the rate of future benefit accrual.[121] In that case, the plan administrator must furnish a written notice concerning the amendment. Notice may also be required if a plan amendment eliminates or reduces an early retirement benefit or retirement-type subsidy. The plan administrator is required to provide the notice to any participant or alternate payee whose rate of future benefit accrual may reasonably be expected to be significantly reduced by the plan amendment (and to any employee organization representing affected participants). The notice must be written in a manner calculated to be understood by the average plan participant and must provide sufficient information to allow recipients to understand the effect of the amendment. The plan administrator is generally required to pro-

[120] This result is sometimes referred to as "whipsaw."

[121] This notice is required under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and applies to plan amendments effective on or after June 7, 2001.

vide the notice at least 45 days before the effective date of the plan amendment.

REASONS FOR CHANGE

The Committee believes that cash balance and other hybrid plans may play a valuable role in the future of the defined benefit pension plan system and providing retirement income security for employees. The Committee recognizes that the design of these plans raises questions as to how the defined benefit pension plan rules should be applied to them.

In addition, cash balance plan issues arose as part of the Joint Committee staff's investigation (undertaken at the request of the Committee) relating to Enron Corporation and related entities, including a review of the qualified retirement plans covering Enron employees. In the report of its investigation, the Joint Committee staff found that the lack of clear guidance with respect to cash balance plan conversions and cash balance plans in general creates uncertainty for employers and employees and recommended that clear rules be adopted with respect to the operation of cash balance plans and the conversion of traditional defined benefit pension plans into cash balance plans.[122]

The Committee is also concerned about assuring adequate protections for participants in hybrid plans, including in the case of conversions to hybrid plans. For example, concern about cash balance plan conversions led to the enactment under EGTRRA of the notice requirement applicable in the case of a plan amendment that provides for a significant reduction in the rate of future benefit accrual.

The Committee believes that the uncertainty that exists with respect to certain aspects of hybrid plans should be resolved by providing rules that both accommodate the nature and design of these plans and include appropriate protections for participants.

EXPLANATION OF PROVISION

In general

The provision provides rules for qualified cash balance plans (as defined in the provision) that address: (1) application of the prohibition on age discrimination; and (2) determination of minimum lump-sum benefits. The provision also provides rules with respect to the conversion of a defined benefit pension plan to a cash balance plan design.

Under the provision, a qualified cash balance plan is a cash balance plan that meets certain vesting and interest credit requirements. With respect to vesting, benefits under the plan must be fully vested after three years of service. With respect to interest credits, the plan must generally provide that any interest credit (or equivalent amount) for any plan year is at a rate that is: (1) not less than the Federal mid-term interest rate (i.e., the rate on the average market yield on outstanding marketable Treasury securities with remaining periods to maturity of over three years, but not over nine years); and (2) not greater than the greater of the Fed-

[122] Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS–3–03), February 2003, at Vol. I, 19, 38, 487.

eral mid-term interest rate and a rate equivalent to the rate of interest on amounts invested conservatively in long-term investment grade corporate bonds.[123] In addition, if the interest credit rate under the plan is a variable rate, the plan must provide that, on plan termination, the rate of interest used to determine accrued benefits under the plan is equal to the average of the interest rates used under the plan during the five-year period ending on the termination date.

Under the provision, a cash balance plan is a defined benefit plan under which the accrued benefit is determined by reference to a hypothetical "accumulation" account, to which pay credits and interest credits are credited. In addition, the Secretary of the Treasury is directed to issue regulations that include in the definition of cash balance plan any defined benefit plan (or any portion of a defined benefit plan) that has an effect similar to a cash balance plan. The regulations may provide that if a plan sponsor represents in communications to participants and beneficiaries that a plan amendment results in a plan being a defined benefit plan having an effect similar to a cash balance plan, the plan is treated as a cash balance plan. The regulations may also provide for the treatment of a cash balance plan as a qualified cash balance plan if the plan has an effect similar to the effect of a qualified cash balance plan. For example, the regulations may provide rules under which a pension equity plan is treated as a qualified cash balance plan.

Age discrimination

Under the provision, a qualified cash balance plan does not violate the prohibition on age discrimination merely because it may reasonably be expected that the period over which interest credits will be made to a participant's accumulation account (or its equivalent) is longer for a younger participant, provided that the rate of any pay credit or interest credit to an account under the plan does not decrease by reason of the participant's attainment of any age.

Determination of minimum lump-sum benefits

Under the provision, except as provided in regulations, for purposes of determining the minimum present value of a participant's accrued benefit under a qualified cash balance plan, the present value of the accrued benefit is equal to the balance in the participant's accumulation account (or its equivalent) as of the time the present value determination is made.

Conversions

In general

Under the provision, for purposes of the anticutback rule, an "applicable" plan amendment is treated as reducing a participant's accrued benefit unless certain requirements are met. An applicable plan amendment is generally a plan amendment to a defined ben-

[123] The rate of interest on amounts invested conservatively in long-term investment grade corporate bonds is to be determined by the Secretary of the Treasury on the basis of two or more indices that are selected periodically by the Secretary. The Secretary is directed to make publicly available the indices and methodology used to determine the rate. It is intended that the Secretary of the Treasury will also issue regulations that provide alternatives to the use of the applicable Federal mid-term interest rate in appropriate circumstances. For example, in the case of pension equity plans, the interest credit requirement may be indirectly reflected in the benefit formula using a fixed rate of return, such as three percent, and reasonable service groupings.

efit plan that has the effect of converting the plan to a cash balance plan.[124]

The provision requires that, under the terms of the plan as in effect after the amendment, the accrued benefit of a participant who is a participant as of the effective date of the amendment cannot at any time be less than the accrued benefit determined under one of three methods (as described below), which is specified in the plan and applies uniformly to all participants. An applicable plan amendment is not treated as using one of the three methods if the plan amendment has the effect of converting the plan into a cash balance plan other than a qualified cash balance plan.

Methods of determining accrued benefits

Methods.—The three methods under which accrued benefits must be determined after an applicable plan amendment are as follows: (1) no wearaway; (2) greater of new or old plan terms or participant election; and (3) equivalent methods as provided by the Secretary.

No wearaway.—Under this method, the accrued benefit is the sum of: (1) a participant's accrued benefit for years of service before the effective date of the amendment, determined under the terms of the plan as in effect before the amendment; and (2) except for certain required benefits (described below), the participant's accrued benefit for years of service after the effective date of the plan amendment, determined under the terms of the plan as in effect after the terms of the amendment.

In applying (2) above, the plan must provide certain required benefits under one of two options. Under the first option, for each of the first five years for which the amendment is effective, the accrued benefit of all participants is the greater of the accrued benefits determined under the terms of the plan as in effect before and after the amendment. Under the second option, for all periods after the effective date of the amendment, the accrued benefit of all participants who, as of the effective date of the amendment, have attained the age of 40 and have a combined age and years of service of at least 55, is determined under either of the following methods as selected by the plan and specified in the amendment: (1) the accrued benefit is the greater of the accrued benefits determined under the terms of the plan as in effect before and after the amendment; or (2) at the election of the participant at the time of conversion, the accrued benefit is determined under the terms of the plan as in effect either before or after the amendment.

Requirements similar to the requirements described above must also be met with respect to any early retirement benefit or retirement-type subsidy.

Greater of new or old plan terms or participant election.—Under this method, the accrued benefit is determined under either of the following methods as selected by the plan and specified in the amendment: (1) the accrued benefit is the greater of the accrued benefits determined under the terms of the plan as in effect before

[124] If the benefits under two or more defined benefit plans established by an employer are coordinated in such a manner as to have the effect of the adoption of an applicable plan amendment, the sponsor of the defined benefit plan or plans providing for the coordination is treated as having adopted an applicable plan amendment as of the date the coordination begins. In addition, the Secretary of the Treasury is directed to issue regulations to prevent the avoidance of the requirements with respect to an applicable plan amendment through the use of two or more plan amendments rather than a single amendment.

and after the amendment; or (2) at the election of the participant at the time of conversion, the accrued benefit is determined under the terms of the plan as in effect either before or after the amendment.

Requirements similar to the requirements described above must also be met with respect to any early retirement benefit or retirement-type subsidy.

Regulations.—Under the third method, the accrued benefit is determined under regulations issued by the Secretary of Treasury that require a plan to provide a credit of additional amounts or increases in initial account balances in amounts substantially equivalent to the benefits that would be required to be provided in order to satisfy one of the two preceding methods.

Additional rules

If, for purposes of any of the methods, an applicable plan amendment provides that an amount will initially be credited to a participant's accumulation account (or its equivalent) on the effective date of the amendment with respect to a participant's accrued benefit for periods before the effective date, the method is treated as being satisfied with respect to such accrued benefit only if the amount initially credited is not less than the present value of the accrued benefit, determined using the mortality table applicable under the minimum present value rules and the lower of: (1) the interest rate applicable under the minimum present value rules or (2) the interest rate used to credit interest under the plan. For purposes of the first method described above, if any early retirement benefit or retirement-type subsidy is not included in the initial account balance, the plan shall credit the accumulation account with the amount of such benefit or subsidy for the plan year in which the participant retires if, as of such time, the participant has met any age, years of service, and other requirements under the plan for entitlement to the subsidy.

If a plan provides a participant with an election under the first or second method, the plan is not treated as satisfying the method unless the plan provides the participant with notice of the right to make the election, including information (meeting requirements prescribed by the Secretary of the Treasury) (1) which the participant may use to project benefits under the formulas from which the participant may choose and model the impact of the choice, and (2) with respect to circumstances under which the participant might not receive the projected accrued benefits by reason of a plan termination or otherwise. In addition, the plan must provide that if, during any of the first five plan years during which the participant's election is in effect, a plan amendment is adopted that results in a significant reduction in the future rate of benefit accrual, the accrued benefit of the participant must be determined as if the participant had made the election that resulted in the greatest accrued benefit. Moreover, a plan is not treated as satisfying either method if any other benefit is contingent (directly or indirectly) on the election.

The Secretary of the Treasury is directed to prescribe regulations under which, if a plan amendment is treated as meeting the requirements of the provision with respect to any participant because the participant is eligible to continue to accrue benefits in the same

manner as under the terms of the plan as in effect before the amendment: (1) the plan is not treated as failing to meet the accrual requirements if the requirements of the provision are met; and (2) subject to terms and conditions provided in the regulations, the plan is not treated as failing to satisfy the prohibition on discrimination in favor of highly compensated employees merely because the plan provides any accrual or benefit required to be provided under the method used to meet the requirements of the provision or because only participants as of the effective date of the amendment are eligible to continue to accrue benefits in the same manner as under the terms of the plan as in effect before the amendment, provided that the plan satisfied the prohibition on discrimination in favor of highly compensated employees under the terms of the plan as in effect before the amendment.

No inference regarding present law

Nothing in the provision is to be construed to infer the proper treatment of cash balance plans, or conversions to cash balance plans, under the rules prohibiting age discrimination or for determining the minimum present value of benefits as in effect before the provision is effective. Further, it is intended that no inference be drawn that a cash balance plan or conversion that occurred in the past is or was in violation of the law merely because it fails or failed to meet the requirements set forth in the bill for future cash balance plans and conversions.

EFFECTIVE DATE

The provisions relating to age discrimination and the determination of lump-sum benefits are generally effective for periods after July 26, 2005. In the case of a plan in existence on July 26, 2005, for purposes of the provisions relating to age discrimination and the determination of lump-sum benefits, the vesting and interest credit requirements that must be met in order to be a qualified cash balance plan apply for plan years beginning after December 31, 2006, unless the plan sponsor elects to apply these requirements for any period after July 26, 2005, and before the first plan year beginning after December 31, 2006. In the case of a plan maintained pursuant to one or more collective bargaining agreements ratified on or before the date of enactment, the vesting and interest credit requirements do not apply for plan years beginning before the earlier of: (1) the later of January 1, 2007, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment); or (2) January 1, 2009.

The provision relating to conversions is effective with respect to plan amendments adopted and taking effect after July 26, 2005, except that a plan sponsor may elect to apply the provision with respect to a plan amendment adopted before July 26, 2005, and taking effect after that date.

J. Defined Benefit Pension Plan Benefits Provided in Combination With a Qualified Cash-or-Deferred Arrangement

(Sec. 342 of the bill, new sec. 414(x) of the Code, and new sec. 210(e) of ERISA)

PRESENT LAW

In general

Under present law, most defined contribution plans may include a qualified cash or deferred arrangement (commonly referred to as a "section 401(k)" or "401(k)" plan),[125] under which employees may elect to receive cash or to have contributions made to the plan by the employer on behalf of the employee in lieu of receiving cash (referred to as "elective deferrals" or "elective contributions").[126] A section 401(k) plan may provide that elective deferrals are made for an employee at a specified rate unless the employee elects otherwise (i.e., elects not to make contributions or to make contributions at a different rate), provided that the employee has an effective opportunity to elect to receive cash in lieu of the default contributions. Such a design is sometimes referred to as "automatic enrollment."

Besides elective deferrals, a section 401(k) plan may provide for: (1) matching contributions, which are employer contributions that are made only if an employee makes elective deferrals; and (2) nonelective contributions, which are employer contributions that are made without regard to whether an employee makes elective deferrals. Under a section 401(k) plan, no benefit other than matching contributions can be contingent on whether an employee makes elective deferrals. Thus, an employee's eligibility for benefits under a defined benefit pension plan cannot be contingent on whether the employee makes elective deferrals.

A cash balance plan is a defined benefit pension plan with benefits resembling the benefits associated with defined contribution plans. Cash balance plans are sometimes referred to as "hybrid" plans because they combine features of a defined benefit pension plan and a defined contribution plan. Under a cash balance plan, benefits are determined by reference to a hypothetical account balance. An employee's hypothetical account balance is determined by reference to hypothetical annual allocations to the account ("pay credits") (e.g., a certain percentage of the employee's compensation for the year) and hypothetical earnings on the account ("interest credits"). Other types of hybrid plans exist as well, such as so-called "pension equity" plans.

The assets of a qualified retirement plan (either a defined contribution plan or a defined benefit pension plan) must be held in trust for the exclusive benefit of participants and beneficiaries. Defined benefit pension plans are subject to funding rules, which require employers to make contributions at specified minimum lev-

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[125] Legally, a section 401(k) plan is not a separate type of plan, but is a profit-sharing, stock bonus, or pre-ERISA money purchase plan that contains a qualified cash or deferred arrangement. The terms "section 401(k) plan" and "401(k) plan" are used here for convenience.

[126] The maximum annual amount of elective deferrals that can be made by an individual is subject to a limit ($14,000 for 2005). An individual who has attained age 50 before the end of the taxable year may also make catch-up contributions to a section 401(k) plan, subject to a limit ($4,000 for 2005).

els.[127] In addition, limits apply on the extent to which defined benefit pension plan assets may be invested in employer securities or real property. The minimum funding rules and limits on investments in employer securities or real property generally do not apply to defined contribution plans.

Nondiscrimination requirements

Under a general nondiscrimination requirement, the contributions or benefits provided under a qualified retirement plan must not discriminate in favor of highly compensated employees.[128] Treasury regulations provide detailed and exclusive rules for determining whether a plan satisfies the general nondiscrimination rules. Under the regulations, the amount of contributions or benefits provided under the plan and the benefits, rights and features offered under the plan must be tested.

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

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

Under a safe harbor, a section 401(k) plan is deemed to satisfy the special nondiscrimination test if the plan satisfies one of two contribution requirements and satisfies a notice requirement (a "safe harbor section 401(k) plan"). A plan satisfies the contribution requirement under the safe harbor rule if the employer either (1) satisfies a matching contribution requirement or (2) makes a nonelective contribution to a defined contribution plan of at least three percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the arrangement. A plan generally satisfies the matching contribution requirement if, under the arrangement: (1) the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to (a) 100 percent of the employee's elective deferrals up to three percent of compensation and (b) 50 percent of the employee's elective deferrals from three to five percent of compensation; and (2) the rate of matching contribution with respect to any

[127] The Pension Benefit Guaranty Corporation generally guarantees a minimum level of benefits under a defined benefit plan.

[128] Under special rules, referred to as the permitted disparity rules, higher contributions or benefits can be provided to higher-paid employees in certain circumstances without violating the general nondiscrimination rules.

rate of elective deferrals of a highly compensated employee is not greater than the rate of matching contribution with respect to the same rate of elective deferral of a nonhighly compensated employee.[129]

Employer matching contributions are also subject to a special nondiscrimination test, the "ACP test," which compares the average actual contribution percentages ("ACPs") of matching contributions for the highly compensated employee group and the nonhighly compensated employee group. The plan generally satisfies the ACP test if the ACP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ACP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the nonhighly compensated employee group for the prior plan year and not more than two percentage points greater than the ACP of the nonhighly compensated employee group for the prior plan year.

A safe harbor section 401(k) plan that provides for matching contributions must satisfy the ACP test. Alternatively, it is deemed to satisfy the ACP test if it satisfies a matching contribution safe harbor, under which (1) matching contributions are not provided with respect to elective deferrals in excess of six percent of compensation, (2) the rate of matching contribution does not increase as the rate of an employee's elective deferrals increases, and (3) the rate of matching contribution with respect to any rate of elective deferral of a highly compensated employee is no greater than the rate of matching contribution with respect to the same rate of deferral of a nonhighly compensated employee.

Vesting rules

A qualified retirement plan generally must satisfy one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of five years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after three years of service, 40 percent after four years of service, 60 percent after five years of service, 80 percent after six years of service, and 100 percent after seven years of service.

Special vesting rules apply to elective deferrals and matching contributions. Elective deferrals must be immediately vested. Matching contributions generally must vest at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of matching contributions upon the completion of three years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after six

[129] Alternatively, matching contributions may be provided at a different rate, provided that: (1) the rate of matching contribution doesn't increase as the rate of elective deferral increases; and (2) the aggregate amount of matching contributions with respect to each rate of elective deferral is not less than the amount that would be provided under the general rule.

years of service. However, matching contributions under a safe harbor section 401(k) plan must be immediately vested.

Top-heavy rules

Under present law, a top-heavy plan is a qualified retirement plan under which cumulative benefits are provided primarily to key employees. An employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of a certain amount ($135,000 for 2005), (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of $150,000. A plan that is top-heavy must provide (1) minimum employer contributions or benefits to participants who are not key employees and (2) more rapid vesting for participants who are not key employees (as discussed below).

In the case of a defined contribution plan, the minimum contribution is the lesser of (1) three percent of compensation, or (2) the highest percentage of compensation at which contributions were made for any key employee. In the case of a defined benefit pension, the minimum benefit is the lesser of (1) two percent of average compensation multiplied by the participant's years of service, or (2) 20 percent of average compensation. For this purpose, a participant's average compensation is generally average compensation for the consecutive-year period (not exceeding five years) during which the participant's aggregate compensation is the greatest.

Top-heavy plans must satisfy one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of contributions or benefits upon the completion of three years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of contributions or benefits for each year of service beginning with the participant's second year of service and ending with 100 percent after six years of service.[130]

A safe harbor section 401(k) plan is not subject to the top-heavy rules, provided that, if the provides for matching contributions, it must also satisfy the matching contribution safe harbor.

Other qualified retirement plan requirements

Qualified retirement plans are subject to various other requirements, some of which depend on whether the plan is a defined contribution plan or a defined benefit pension. Such requirements include limits on contributions and benefits and spousal protections.

In the case of a defined contribution plan, annual additions with respect to each plan participant cannot exceed the lesser of: (1) 100 percent of the participant's compensation; or (2) a dollar amount, indexed for inflation ($42,000 for 2005). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. In the case of a defined benefit pension, annual benefits payable under the plan generally may not exceed the lesser of: (1) 100 percent of average compensation; or (2) $170,000 (for 2005).

[130] The top-heavy vesting schedules are the same as the vesting schedules that apply to matching contributions.

Defined benefit pension plans are required to provide benefits in the form of annuity unless the participant (and his or her spouse, in the case of a married participant) consents to another form of benefit. In addition, in the case of a married participant, benefits generally must be paid in the form of a qualified joint and survivor annuity ("QJSA") unless the participant and his or her spouse consent to a distribution in another form. A QJSA is an annuity for the life of the participant, with a survivor annuity for the life of the spouse which is not less than 50 percent (and not more than 100 percent) of the amount of the annuity payable during the joint lives of the participant and his or her spouse. These spousal protection requirements generally do not apply to a defined contribution plan that does not offer annuity distributions.

Annual reporting by qualified retirement plans

The plan administrator of a qualified retirement plan generally must file an annual return with the Secretary of the Treasury and an annual report with the Secretary of Labor. In addition, in the case of a defined benefit pension, certain information is generally required to be filed with the Pension Benefit Guaranty Corporation ("PBGC"). Form 5500, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 with the Department of Labor.

The Form 5500 is due by the last day of the seventh month following the close of the plan year. The due date may be extended up to two and one-half months. Copies of filed Form 5500s are available for public examination at the U.S. Department of Labor.

A plan administrator must automatically provide participants with a summary of the annual report within two months after the due date of the annual report (i.e., by the end of the ninth month after the end of the plan year unless an extension applies). In addition, a copy of the full annual report must be provided to participants on written request.

REASONS FOR CHANGE

The Committee recognizes that, over time, coverage under defined benefit pension plans has declined and coverage under defined contribution plans, particularly section 401(k) plans, has grown. Defined benefit pension plans play a valuable role in providing retirement income security; for example, benefits are payable in the form of an annuity and benefits are guaranteed by the PBGC. In addition, providing defined benefit pension plan coverage in combination with a section 401(k) plan offers the opportunity for enhanced retirement savings. However, maintaining multiple plans may result in burdensome administrative costs, especially for smaller employers. Moreover, present law does not allow benefits provided under a defined benefit pension plan to be taken into account for purposes of the nondiscrimination test applicable to section 401(k) plans. The Committee believes that employers should be encouraged to provide defined benefit pension plans in combination with section 401(k) plans in a manner that reduces administrative costs and provides meaningful benefits to both rank-and-file and highly compensated employees.

EXPLANATION OF PROVISION

In general

The provision provides rules for an "eligible combined plan." An eligible combined plan is a plan: (1) which consists of a defined benefit plan and an "applicable" defined contribution plan; (2) the assets of which are held in a single trust forming part of the plan and are clearly identified and allocated to the defined benefit plan and the applicable defined contribution plan to the extent necessary for the separate application of the Code and ERISA; and (3) that meets certain benefit, contribution, and vesting requirements as discussed below. For this purpose, an applicable defined contribution plan is a defined contribution plan that includes a qualified cash or deferred arrangement (i.e., a section 401(k) plan).

Except as specified in the provision, the provisions of the Code and ERISA are applied to any defined benefit plan and any applicable defined contribution plan that are part of an eligible combined plan in the same manner as if each were not part of the eligible combined plan. Thus, for example, the present-law limits on contributions and benefits apply separately to contributions under an applicable defined contribution plan that is part of an eligible combined plan and to benefits under the defined benefit plan that is part of the eligible combined plan. In addition, the spousal protection rules apply to the defined benefit plan, but not to the applicable defined contribution plan except to the extent provided under present law. Moreover, although the assets of an eligible combined plan are held in a single trust, the funding rules apply to a defined benefit plan that is part of an eligible combined plan on the basis of the assets identified and allocated to the defined benefit, and the limits on investing defined benefit plan assets in employer securities or real property apply to such assets. Similarly, separate participant accounts are required to be maintained under the applicable defined contribution plan that is part of the eligible combined plan, and earnings (or losses) on participants' account are based on the earnings (or losses) with respect to the assets of the applicable defined contribution plan.

Requirements with respect to defined benefit plan

Under the provision, a defined benefit plan that is part of an eligible combined plan is required to provide each participant with a benefit of not less than the applicable percentage of the participant's final average pay. The applicable percentage is the lesser of: (1) one percent multiplied by the participant's years of service; or (2) 20 percent. For this purpose, final average pay is determined using the consecutive-year period (not exceeding five years) during which the participant has the greatest aggregate compensation.

If the defined benefit plan is a qualified cash balance plan,[131] the plan is treated as meeting the benefit requirement under the provision if each participant receives a pay credit for each plan year of not less than the percentage of compensation determined in accordance with the following table:

[131] Qualified cash balance plan is defined as under the provision relating to the treatment of cash balance and other hybrid defined benefit pension plans and means a cash balance plan (or other hybrid plan as provided under regulations) that meets certain vesting and interest credit requirements.

TABLE 3.—PERCENTAGE OF COMPENSATION

Participant's age as of the beginning of the plan year	*Percentage*
30 or less	2
Over 30 but less than 40	4
Over 40 but less than 50	6
50 or over	8

A defined benefit that is part of an eligible combined plan must provide the required benefit to each participant, regardless of whether the participant makes elective deferrals to the applicable defined contribution plan that is part of the eligible combined plan.

Any benefits provided under the defined benefit plan (including any benefits provided in addition to required benefits) must be fully vested after three years of service.

Requirements with respect to applicable defined contribution plan

Under the provision, certain automatic enrollment and matching contribution requirements must be met with respect to an applicable defined contribution plan that is part of an eligible combined plan. First, the qualified cash or deferred arrangement under the plan must constitute an automatic contribution arrangement, under which each employee eligible to participate is treated as having elected to make deferrals of four percent of compensation unless the employee elects otherwise (i.e., elects not to make deferrals or to make deferrals at a different rate). Participants must be given notice of their right to elect otherwise and must be given a reasonable period of time after receiving notice in which to make an election. In addition, participants must be given notice of their rights and obligations within a reasonable period before each year.

Under the applicable defined contribution plan, the employer must make matching contributions on behalf of each employee eligible to participate in the arrangement in an amount equal to 50 percent of the employee's elective deferrals up to four percent of compensation, and the rate of matching contribution with respect to any elective deferrals for highly compensated employees is not greater than the rate of match for nonhighly compensated employees.[132] Matching contributions in addition to the required matching contributions may also be made. The employer may also make nonelective contributions under the applicable defined contribution plan, but any nonelective contributions are not taken into account in determining whether the matching contribution requirement is met.

Any matching contributions under the applicable defined contribution plan (including any in excess of required matching contributions) must be fully vested when made. Any nonelective contributions made under the applicable defined contribution plan must be fully vested after three years of service.

Nondiscrimination and other rules

An applicable defined contribution plan satisfies the ADP test on a safe-harbor basis. Matching contributions under an applicable defined contribution plan must satisfy the ACP test or may satisfy

[132] As under present law, matching contributions may be provided at a different rate, provided that: (1) the rate of matching contribution doesn't increase as the rate of elective deferral increases; and (2) the aggregate amount of matching contributions with respect to each rate of elective deferral is not less than the amount that would be provided under the general rule.

the matching contribution safe harbor under present law, as modified to reflect the matching contribution requirements applicable under the provision.

Nonelective contributions under an applicable defined contribution plan and benefits under a defined benefit plan that are part of an eligible combined plan are generally subject to the nondiscrimination rules as under present law. However, neither a defined benefit plan nor an applicable defined contribution plan that is part of an eligible combined plan may be combined with another plan in determining whether the nondiscrimination requirements are met.[133]

An applicable defined contribution plan and a defined benefit plan that are part of an eligible combined plan are treated as meeting the top-heavy requirements.

The provision requires that all contributions, benefits, and other rights and features that are provided under a defined benefit plan or an applicable defined contribution plan that is part of an eligible combined plan must be provided uniformly to all participants. This requirement applies regardless of whether nonuniform contributions, benefits, or other rights or features could be provided without violating the nondiscrimination rules. However, it is intended that a plan will not violate the uniformity requirement merely because benefits accrued for periods before a defined benefit or defined contribution plan became part of an eligible combined plan are protected (as required under the anticutback rules).

Annual reporting

An eligible combined plan is treated as a single plan for purposes of annual reporting. Thus, only a single Form 5500 is required. All of the information required under present law with respect to a defined benefit plan or a defined contribution plan must be provided in the Form 5500 for the eligible combined plan. In addition, only a single summary annual report must be provided to participants.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2006.

K. STUDIES

(Secs. 451 and 452 of the bill)

1. Study on revitalizing the defined benefit plans

PRESENT LAW

Qualified retirement plans are broadly classified into two categories under the Code, defined benefit plans and defined contribution plans, based on the nature of the benefits provided. Under a defined benefit plan, benefits are determined under a plan formula, such as a formula based on the participant's compensation and years of service. Subject to certain limits, benefits under a defined benefit plan are guaranteed by the PBGC.

[133] The permitted disparity rules do not apply in determining whether an applicable defined contribution plan or a defined benefit plan that is part of an eligible combined plan satisfies (1) the contribution or benefit requirements under the provision or (2) the nondiscrimination requirements.

Under a defined contribution plan, benefits are based solely on contributions allocated to separate accounts for each plan participant (as adjusted by gains, losses, and expenses). Benefits under defined contribution plans are not insured by the PBGC.

REASONS FOR CHANGE

The Committee has a continuing interest in retirement income security and in the role that defined benefit plans pay in providing that security. The Committee bill address a number of issues with respect to defined benefit plans, including funding reforms and providing clear rules for cash balance and other hybrid plans. The Committee believes it appropriate to continue to study issues relating to defined benefit plans to determine further ways in which retirement security may be enhanced.

EXPLANATION OF PROVISION

The Department of the Treasury, the Department of Labor, and the PBGC are directed to jointly undertake a study on ways to revitalize employer interest in defined benefit plans. In conducting the study, the Treasury and Labor Departments and the PBGC are to consider: (1) ways to encourage the establishment of defined benefit plans by small and mid-sized employers; (2) ways to encourage the continued maintenance of defined benefit plans by larger employers; and (3) legislative provisions to accomplish these objectives.

Within two years after the date of enactment, the results of the study, together with any recommendations for legislative changes, are to be reported to the Senate Committees on Finance and Health, Education, Labor, and Pensions and to the House Committees on Ways and Means and Education and the Workforce.

EFFECTIVE DATE

The provision is effective on the date of enactment.

2. Study on floor-offset ESOPs

PRESENT LAW

Qualified retirement plans are broadly classified into two categories under the Code, defined benefit plans and defined contribution plans, based on the nature of the benefits provided. Under a defined benefit plan, benefits are determined under a plan formula, such as a formula based on the participant's compensation and years of service. Subject to certain limits, benefits under a defined benefit plan are guaranteed by the PBGC.

Under a defined contribution plan, benefits are based solely on contributions allocated to separate accounts for each plan participant (as adjusted by gains, losses, and expenses). Benefits under defined contribution plans are not insured by the PBGC.

Under ERISA, defined contribution plans are referred to as "individual account plans." Individual account plans may provide that plan participants may direct the investment of assets allocated to their accounts. If certain requirements are satisfied, ERISA fidu-

ciary liability does not apply to investment decisions made by plan participants under an individual account plan.[134]

ERISA generally prohibits qualified retirement plans from acquiring employer securities if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer securities.[135] This 10-percent limitation does not apply to eligible individual account plans.

A floor-offset arrangement is an arrangement under which benefits payable to a participant under a defined benefit plan are reduced by benefits under an individual account plan. The 10-percent limitation on the acquisition of employer securities applies to an individual account plan that is part of a floor-offset arrangement, unless the floor-offset arrangement was established on or before December 17, 1987.

An employee stock ownership plan (an "ESOP") is an individual account plan that is designed to invest primarily in employer securities and which meets certain other requirements. ESOPs are not subject to the 10-percent limit on the acquisition of employer securities, unless the ESOP is part of a floor-offset arrangement (as described above).

REASONS FOR CHANGE

Concerns have been raised with respect to the impact of grandfathered floor-offset arrangements on benefit security. For example, the Administration's Fiscal Year 2006 Budget includes a proposal to eliminate the grandfather for pre-1988 floor-offset arrangements. The rationale behind this proposal is that if a company with such a plan goes out of business, the employer stock held in the related defined contribution plan typically becomes worthless, with the result that the defined benefit plan is left with a large unfunded liability.[136] The Committee believes it appropriate to study the effects these arrangements may have on benefit security.

EXPLANATION OF PROVISION

The Department of the Treasury and the PBGC are directed to undertake a study to determine the number of floor-offset ESOPs still in existence and the extent to which such plans pose a risk to plan participants or beneficiaries or the PBGC. The study is to consider legislative provisions to address the risks posed by floor-offset ESOPs.

Within one year after the date of enactment, the Department of the Treasury and the PBGC are to report the results of the study, together with any recommendations for legislative changes, to the Senate Committees on Finance and Health, Education, Labor, and Pensions and the House Committees on Ways and Means and Education and the Workforce.

EFFECTIVE DATE

The provision is effective on the date of enactment.

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[134] ERISA sec. 404(c).

[135] ERISA sec. 407. The 10-percent limitation also applies to employer real property.

[136] Department of the Treasury, General Explanations of the Administration's Fiscal Year 2006 Revenue Proposals (February 2005) at 95.

TITLE IV—DISCLOSURE AND BENEFIT STATEMENT REQUIREMENTS FOR SINGLE-EMPLOYER DEFINED BENEFIT PENSION PLANS [137]

A. Actuarial Reports and Summary Annual Reports

(Sec. 401 of the bill, sec. 6059 and new sec. 4980K of the Code, and secs. 103, 104, 502, 4010 and 4011 of ERISA)

PRESENT LAW

Actuarial report

The plan administrator of a qualified retirement plan generally must file an annual return with the Secretary of the Treasury, an annual report with the Secretary of Labor, and certain information with the Pension Benefit Guaranty Corporation ("PBGC").[138] Form 5500, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 with the Department of Labor.

In the case of a defined benefit pension plan, the annual report must include an actuarial report (filed on Schedule B of the Form 5500).[139] The actuarial report must include, for example, information as to the value of plan assets, the plan's accrued and current liabilities, expected disbursements from the plan for the year, plan contributions, the plan's actuarial cost method and actuarial assumptions, and amortization bases established in the year. The report must be signed by an actuary enrolled to practice before the IRS, Department of Labor and the PBGC.

The Form 5500 is due by the last day of the seventh month following the close of the plan year. The due date may be extended up to two and one-half months. Copies of filed Form 5500s are available for public examination at the U.S. Department of Labor.

Summary annual report

A plan administrator must provide a summary of the annual report to participants, and beneficiaries receiving benefits under the plan, within two months after the due date of the annual report (i.e., by the end of the ninth month after the end of the plan year unless an extension applies).[140] The summary annual report must include information about the assets and liabilities of the plan, plan receipts and disbursements, the plan's funded status, and such other material as is necessary to fairly summarize the latest annual report. The summary annual report must also include a statement whether contributions were made to keep the plan funded in accordance with minimum funding requirements, or whether contributions were not made and the amount of the deficit. If an extension applies for the Form 5500, the summary annual report

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[137] In addition to the provisions described here, the bill also contains notice requirements that apply with respect to benefit limitations for underfunded single-employer defined benefit pension plans and bankruptcy of an employer. These notices are described respectively under Title III–B (above) and Title VI–B (below).

[138] Code secs. 6058 and 6059; ERISA secs. 103 and 4065.

[139] Code sec. 6059; ERISA sec. 103(d). Once the actuarial report for a plan year is filed, the actuarial assumptions used for that plan year may not be changed.

[140] ERISA sec. 104(b). A participant must also be provided with a copy of the full annual report on written request.

must be provided within two months after the extended due date. A plan administrator who fails to provide a summary annual report to a participant or beneficiary within 30 days of a written request may be liable to the participant or beneficiary for a civil penalty of up to $100 a day from the date of the failure.[141]

Certain notices must be provided to participants in a single-employer defined benefit pension plan relating to the funding status of the plan. In the case of an underfunded plan for which variable rate PBGC premiums are required, the plan administrator generally must notify plan participants of the plan's funding status and the limits on the PBGC benefit guarantee if the plan terminates while underfunded.[142]

Required reporting to the PBGC

Certain financial information with respect to the members of a controlled group and actuarial information with respect to plans maintained by members of the controlled group must be reported annually to the PBGC.[143] This information (referred to as "section 4010 information") must be reported if: (1) the aggregate unfunded vested benefits under all plans maintained by controlled-group members exceed $50 million; (2) required contributions totaling more than $1 million have not been made with respect to an underfunded plan maintained by a controlled-group member; or (3) any portion of a waived funding deficiency exceeding $1 million is outstanding with respect to a plan maintained by a controlled-group member. Section 4010 information provided to the PBGC is not available to the public.

REASONS FOR CHANGE

The Committee believes that additional information affecting the funding status of single-employ defined benefit pension plans should be available to plan participants, the Treasury and Labor Departments and the PBGC, and the public, in order to provide a more accurate picture of the funding status of such plans and the security of benefits promised under the plan. The Committee further believes that such information should be provided on a more timely basis. In addition, the Committee wishes to reduce administrative burdens by consolidating information required to be provided to plan participants and to strengthen enforcement of the summary annual report requirement.

EXPLANATION OF PROVISION

Actuarial report

Under the provision, an actuarial report with respect to a single-employer defined benefit pension plan must include the following information: (1) the fair market value of the plan's assets; (2) the plan's target liability and target normal cost; (3) the plan's at-risk target liability and at-risk normal cost (determined as if the plan sponsor is a financially-weak employer for the plan year and the

[141] ERISA sec. 502(c)(1)(B).
[142] ERISA sec. 4011.
[143] ERISA sec. 4010.

four immediately preceding plan years); and (4) any other information prescribed by the Secretary of Labor.[144]

Under the provision, if quarterly contributions are required with respect to a single-employer plan, the deadline for the actuarial report is accelerated.[145] The actuarial report is due on the 15th day of the second month following the close of the plan year (e.g., February 15 for calendar year plans).[146] If any contribution is subsequently made for the plan year, the additional contribution is required to be reflected in an amended actuarial report with the Form 5500.

Summary annual report

The provision changes the information that must be included in a summary annual report and the time by which the summary annual report must be provided. The provision also amends the Code to add a summary annual report requirement.

Under the provision, the summary annual report under ERISA must be provided to participants, and beneficiaries receiving benefits under the plan, within 15 days of the due date of the annual report and must include the following additional information: (1) a statement of the plan's funded target liability percentage (i.e., the value of the plan's assets as a percentage of the plan's target liability) for the plan year and the two preceding plan years; (2) a statement of whether the plan sponsor was a financially-weak employer for the plan year and the two preceding plan years; and (3) the limits on benefits guaranteed by the PBGC if the plan is terminated while underfunded.[147] In the case of a failure to provide the summary annual report to a participant or beneficiary, the Secretary of Labor may assess a civil penalty against the plan administrator of up to $100 a day from the date of the failure.

The provision adds a Code requirement of a summary annual report, similar to the summary annual report required under ERISA. The summary annual report is to be provided by the date prescribed by the Secretary of the Treasury. The Secretary of Labor may prescribe the form and manner of the summary annual report required under the Code. The summary annual report must be written in a manner calculated to be understood by the average plan participant and may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the recipient. It is intended that providing participants and beneficiaries with a summary annual report, containing the information required under the Code and ERISA, within the required timeframe, will satisfy the requirements under both the Code and ERISA.

Under the provision, an excise tax is generally imposed on the employer in the case of a failure to provide the summary annual

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[144] Target liability, target normal cost, at-risk target liability, at-risk normal cost, and financially-weak status are defined under the provision relating to funding requirements for single-employer plans.

[145] Because a plan covering 100 or fewer participants is not subject to the quarterly contributions requirements, the acceleration of the due date for the actuarial report does not apply to such a plan.

[146] It is intended that, once the actuarial report for a plan year is filed, the actuarial assumptions used for that plan year may not be changed.

[147] This information replaces the present-law requirement under ERISA section 4011 that plan participants be notified of the plan's funding status and the limits on the PBGC benefit guarantee.

report required under the Code. The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the summary annual report is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the requirement, the total excise tax imposed during a taxable year will not exceed $500,000. The $500,000 limit is applied separately with respect to each type of notice required.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the requirement. In addition, no tax is imposed if the employer uses reasonable diligence to comply and provides the summary annual report within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

Public disclosure of section 4010 information

Under the provision, section 4010 information provided to the PBGC is available to the public.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2006.

TITLE V—IMPROVEMENTS IN FUNDING RULES FOR MULTIEMPLOYER DEFINED BENEFIT PLANS

A. INCREASE IN DEDUCTION LIMITS

(Secs. 322 and 501 of the bill and sec. 404 of the Code)

PRESENT LAW

Employer contributions to qualified retirement plans are deductible subject to certain limits.[148] In general, the deduction limit depends on the kind of plan. Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year.

In the case of a defined benefit pension plan, the employer generally may deduct the greater of: (1) the amount necessary to satisfy the minimum funding requirement of the plan for the year; or (2) the amount of the plan's normal cost for the year plus the amount necessary to amortize certain unfunded liabilities over 10 years, but limited to the full funding limitation for the year.[149] The maximum amount otherwise deductible generally is not less than the plan's unfunded current liability.[150]

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[148] Code sec. 404.

[149] The full funding limitation is the excess, if any, of (1) the accrued liability of the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets. However, the full funding limit is not less than the excess, if any, of 90 percent of the plan's current liability (including the current liability normal cost) over the actuarial value of plan assets.

[150] In the case of a plan with 100 or fewer participants, current liability for this purpose does not include the liability attributable to benefit increases for highly compensated employees re-

Continued

In the case of a defined contribution plan, the employer generally may deduct contributions in an amount up to 25 percent of compensation paid or accrued during the employer's taxable year.

If an employer sponsors one or more defined benefit pension plans and one or more defined contribution plans that cover at least one of the same employees, an overall deduction limit applies to the total contributions to all plans for a plan year. The overall deduction limit generally is the greater of (1) 25 percent of compensation, or (2) the amount necessary to meet the minimum funding requirements of the defined benefit plan for the year, but not less than the amount of the plan's unfunded current liability.

REASONS FOR CHANGE

The Committee is concerned that the present-law deduction limits play a role in the underfunding of multiemployer defined benefit pension plans by creating the potential that contributions required under collective bargaining agreements might not be deductible by the employers obligated to make the contributions. In that case, employers' contribution obligations may be waived, or plan benefits (and thus plan liabilities) may be increased in order to assure that contributions are deductible. However, such measures may cause the plan's funded status to deteriorate, especially in a period of economic downturn. The Committee believes that the deduction limit for contributions to multiemployer defined benefit pension plans should be increased in order to reduce the possibility that contributions required under collective bargaining agreements are not deductible and to encourage contributions in amounts sufficient to assure that promised benefits are adequately funded. The Committee further believes that the overall limit on deductible contributions should not apply to multiemployer plans.

EXPLANATION OF PROVISION

The provision increases the limits on deductions for contributions to multiemployer plans. Under the provision, the maximum amount otherwise deductible for contributions to a multiemployer defined benefit pension plan is not less than the excess (if any) of (1) 130 percent of the plan's current liability, over (2) the value of plan assets.[151]

In addition, under the provision, multiemployer plans are not taken into account in applying the overall limit on deductions for contributions to combinations of defined benefit and defined contribution plans. Thus, the deduction for contributions to a defined benefit pension plan or a defined contribution plan is not affected by the overall deduction limit merely because employees are covered by both plans if either plan is a multiemployer plan (i.e., the separate deduction limits for contributions to defined contribution plans and defined benefit pension plans apply).

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sulting from an amendment that is made or becomes effective, whichever is later, within the last two years.

[151] The provision does not include the present-law rule under which, in the case of a plan with 100 or fewer participants, the liability attributable to certain benefit increases for highly compensated employees is disregarded.

EFFECTIVE DATE

The provision is effective for contributions for years beginning after December 31, 2005.

B. MULTIEMPLOYER PLAN FUNDING NOTICE

(Sec. 502 of the bill and new sec. 4980L of the Code)

PRESENT LAW

Under ERISA, effective for plan years beginning after December 31, 2004, the plan administrator of a multiemployer plan must provide an annual funding notice to: (1) each participant and beneficiary; (2) each labor organization representing such participants or beneficiaries; (3) each employer that has an obligation to contribute under the plan; and (4) the PBGC.[152]

Such a notice must include: (1) identifying information, including the name of the plan, the address and phone number of the plan administrator and the plan's principal administrative officer, each plan sponsor's employer identification number, and the plan identification number; (2) a statement as to whether the plan's funded current liability percentage for the plan year to which the notice relates is at least 100 percent (and if not, a statement of the percentage); (3) a statement of the value of the plan's assets, the amount of benefit payments, and the ratio of the assets to the payments for the plan year to which the notice relates; (4) a summary of the rules governing insolvent multiemployer plans, including the limitations on benefit payments and any potential benefit reductions and suspensions (and the potential effects of such limitations, reductions, and suspensions on the plan); (5) a general description of the benefits under the plan which are eligible to be guaranteed by the PBGC and the limitations of the guarantee and circumstances in which such limitations apply; and (6) any additional information which the plan administrator elects to include to the extent it is not inconsistent with regulations prescribed by the Secretary of Labor.

The annual funding notice must be provided no later than two months after the deadline (including extensions) for filing the plan's annual report for the plan year to which the notice relates (i.e., generally nine or eleven months after the end of the plan year). The funding notice must be provided in a form and manner prescribed in regulations by the Secretary of Labor. Additionally, it must be written so as to be understood by the average plan participant and may be provided in written, electronic, or some other appropriate form to the extent that it is reasonably accessible to persons to whom the notice is required to be provided.

A plan administrator that fails to provide the required notice to a participant or beneficiary may be liable to the participant or beneficiary in the amount of up to $100 a day from the time of the failure and for such other relief as a court may deem proper.

REASONS FOR CHANGE

The Committee believes that providing participants in multiemployer defined benefit pension plans with annual notices regarding

[152] ERISA sec. 101(f).

plan funding and solvency, and the potential effect on plan benefits, increases participants' understanding of the security of their retirement benefits. In addition, providing such notices to employee representatives, employers, and the PBGC increases the likelihood that possible funding problems are addressed promptly. The Committee believes that enhancing enforcement of the present-law notice requirement will help to ensure that required notices are provided.

EXPLANATION OF PROVISION

The provision amends the Code to include a multiemployer plan funding notice requirement similar to the present-law ERISA requirement.

Under the provision, an excise tax is generally imposed on the plan if a funding notice is not provided as required under the Code. The excise tax is $100 per day for each person with respect to whom the failure occurred, until notice is provided or the failure is otherwise corrected. If the plan administrator exercises reasonable diligence to meet the notice requirements, the total excise tax imposed during a taxable year will not exceed $500,000. No tax will be imposed with respect to a failure if the plan administrator does not know that the failure existed and exercises reasonable diligence to comply with the notice requirement. In addition, no tax will be imposed if the plan administrator exercises reasonable diligence to comply and provides the required notice as soon as reasonably practicable after learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

EFFECTIVE DATE

The provision is effective for failures to provide the required notice after the date of enactment.

C. Permit Qualified Transfers of Excess Pension Assets to Retiree Health Accounts by Multiemployer Plan

(Sec. 503 of the bill, sec. 420 of the Code and secs. 101, 403 and 408 of ERISA)

PRESENT LAW

Defined benefit plan assets generally may not revert to an employer prior to termination of the plan and satisfaction of all plan liabilities. In addition, a reversion may occur only if the plan so provides. A reversion prior to plan termination may constitute a prohibited transaction and may result in plan disqualification. Any assets that revert to the employer upon plan termination are includible in the gross income of the employer and subject to an excise tax. The excise tax rate is 20 percent if the employer maintains a replacement plan or makes certain benefit increases in connection with the termination; if not, the excise tax rate is 50 percent. Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested.

A pension plan may provide medical benefits to retired employees through a separate account that is part of such plan. A qualified transfer of excess assets of a defined benefit plan to such a separate account within the plan may be made in order to fund retiree health benefits.[153] A qualified transfer does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. Thus, transferred assets are not includible in the gross income of the employer and are not subject to the excise tax on reversions. No more than one qualified transfer may be made in any taxable year. A qualified transfer may not be made from a multiemployer plan. No qualified transfer may be made after December 31, 2013.

Excess assets generally means the excess, if any, of the value of the plan's assets[154] over the greater of (1) the accrued liability under the plan (including normal cost) or (2) 125 percent of the plan's current liability.[155] In addition, excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. No deduction is allowed to the employer for (1) a qualified transfer or (2) the payment of qualified current retiree health liabilities out of transferred funds (and any income thereon).

Transferred assets (and any income thereon) must be used to pay qualified current retiree health liabilities for the taxable year of the transfer. Transferred amounts generally must benefit pension plan participants, other than key employees, who are entitled upon retirement to receive retiree medical benefits through the separate account. Retiree health benefits of key employees may not be paid out of transferred assets.

Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned to the general assets of the plan. These amounts are not includible in the gross income of the employer, but are treated as an employer reversion and are subject to a 20-percent excise tax.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation).

In order for a transfer to be qualified, the employer generally must maintain retiree health benefits at the same level for the taxable year of the transfer and the following four years.

In addition, ERISA provides that, at least 60 days before the date of a qualified transfer, the employer must notify the Secretary of Labor, the Secretary of the Treasury, employee representatives, and the plan administrator of the transfer, and the plan adminis-

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[153] Sec. 420.

[154] The value of plan assets for this purpose is the lesser of fair market value or actuarial value.

[155] In the case of plan years beginning before January 1, 2004, excess assets generally means the excess, if any, of the value of the plan's assets over the greater of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 170 percent of the plan's current liability (for 2003), or (2) 125 percent of the plan's current liability. The current liability full funding limit was repealed for years beginning after 2003. Under the general sunset provision of EGTRRA, the limit is reinstated for years after 2010.

trator must notify each plan participant and beneficiary of the transfer.[156]

Under present law, special deduction rules apply to a multiemployer defined benefit plan established before January 1, 1954, under an agreement between the Federal government and employee representatives in a certain industry.[157]

REASONS FOR CHANGE

The Committee believes that it is appropriate to allow the multiemployer defined benefit plan to which special deduction rules apply to make qualified transfers of excess benefit plan assets.

EXPLANATION OF PROVISION

The provision allows qualified transfers of excess defined benefit plan assets to be made by the multiemployer defined benefit plan to which special deduction rules apply (or a continuation or spinoff thereof) that primarily covers employees in the building and construction industry.

EFFECTIVE DATE

The provision is effective for transfers made in taxable years beginning after December 31, 2004.

TITLE VI—IMPROVEMENTS IN PBGC GUARANTEE PROVISIONS

A. INCREASES IN PBGC PREMIUMS FOR SINGLE-EMPLOYER PLANS

(Sec. 601 of the bill and sec. 4006 of ERISA)

PRESENT LAW

The PBGC

The minimum funding requirements permit an employer to fund defined benefit plan benefits over a period of time. Thus, it is possible that a plan may be terminated at a time when plan assets are not sufficient to provide all benefits accrued by employees under the plan. In order to protect plan participants from losing retirement benefits in such circumstances, the Pension Benefit Guaranty Corporation ("PBGC"), a corporation within the Department of Labor, was created in 1974 under ERISA to provide an insurance program for benefits under most defined benefit plans maintained by private employers.

Termination of single-employer defined benefit plans

An employer may voluntarily terminate a single-employer plan only in a standard termination or a distress termination. The PBGC may also involuntarily terminate a plan (that is, the termination is not voluntary on the part of the employer).

A standard termination is permitted only if plan assets are sufficient to cover benefit liabilities. If assets in a defined benefit plan are not sufficient to cover benefit liabilities, the employer may not

[156] ERISA sec. 101(e). ERISA also provides that a qualified transfer is not a prohibited transaction under ERISA or a prohibited reversion.

[157] Code sec. 404(c).

terminate the plan unless the employer (and members of the employer's controlled group) meets one of four criteria of financial distress.[158]

The PBGC may institute proceedings to terminate a plan if it determines that the plan in question has not met the minimum funding standards, will be unable to pay benefits when due, has a substantial owner who has received a distribution greater than $10,000 (other than by reason of death) while the plan has unfunded nonforfeitable benefits, or may reasonably be expected to increase PBGC's long-run loss unreasonably. The PBGC must institute proceedings to terminate a plan if the plan is unable to pay benefits that are currently due.

Guaranteed benefits

When an underfunded plan terminates, the amount of benefits that the PBGC will pay depends on legal limits, asset allocation, and recovery on the PBGC's employer liability claim. The PBGC guarantee applies to "basic benefits." Basic benefits generally are benefits accrued before a plan terminates, including (1) benefits at normal retirement age; (2) most early retirement benefits; (3) disability benefits for disabilities that occurred before the plan was terminated; and (4) certain benefits for survivors of plan participants. Generally only that part of the retirement benefit that is payable in monthly installments (rather than, for example, lump-sum benefits payable to encourage early retirement) is guaranteed.[159]

Retirement benefits that begin before normal retirement age are guaranteed, provided they meet the other conditions of guarantee (such as that before the date the plan terminates, the participant had satisfied the conditions of the plan necessary to establish the right to receive the benefit other than application for the benefit). Contingent benefits (for example, subsidized early retirement benefits) are guaranteed only if the triggering event occurs before plan termination.

For plans terminating in 2005, the maximum guaranteed benefit for an individual retiring at age 65 is $3,698.86 per month or $44,386.32 per year.[160] The dollar limit is indexed annually for inflation. The guaranteed amount is reduced for benefits starting before age 65.

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[158] The four criteria for a distress termination are: (1) the contributing sponsor, and every member of the controlled group of which the sponsor is a member, is being liquidated in bankruptcy or any similar Federal law or other similar State insolvency proceedings; (2) the contributing sponsor and every member of the sponsor's controlled group is being reorganized in bankruptcy or similar State proceeding; (3) the PBGC determines that termination is necessary to allow the employer to pay its debts when due; or (4) the PBGC determines that termination is necessary to avoid unreasonably burdensome pension costs caused solely by a decline in the employer's work force.

[159] ERISA sec. 4022(b) and (c).

[160] The PBGC generally pays the greater of the guaranteed benefit amount and the amount that was covered by plan assets when it terminated. Thus, depending on the amount of assets in the terminating plan, participants may receive more than the amount guaranteed by PBGC.

Special rules limit the guaranteed benefits of individuals who are substantial owners covered by plans whose benefits have not been increased by reason of any plan amendment. A substantial owner generally is an individual who: (1) owns the entire interest in an unincorporated trade or business; (2) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in the partnership; (3) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of the corporation or all the stock of the corporation; or (4) at any time within the preceding 60 months was a substantial owner under the plan. ERISA sec. 4022(b)(5).

In the case of a plan or a plan amendment that has been in effect for less than five years before a plan termination, the amount guaranteed is phased in by 20 percent a year.[161]

PBGC premiums

In general

The PBGC is funded by assets in terminated plans, amounts recovered from employers who terminate underfunded plans, premiums paid with respect to covered plans, and investment earnings. All covered single-employer plans are required to pay a flat per-participant premium and underfunded plans are subject to an additional rate variable premium based on the level of underfunding. The amount of both the flat rate premium and the variable rate premium are set by statute; the premiums are not indexed for inflation.

Flat rate premiums

The annual flat rate per participant premium is $19 per participant.

Variable rate premiums

The variable rate premium is equal to $9 per $1,000 of unfunded vested benefits. "Unfunded vested benefits" is the amount which would be the unfunded current liability (as defined under the minimum funding rules) if only vested benefits were taken into account and if benefits were valued at the variable premium interest rate. No variable rate premium is imposed for a year if contributions to the plan for the prior year were at least equal to the full funding limit for that year.

In determining the amount of unfunded vested benefits, the interest rate used is generally 85 percent of the interest rate on 30 year Treasury securities for the month preceding the month in which the plan year begins (100 percent of the interest rate on 30 year Treasury securities for plan years beginning in 2002 and 2003). Under PFEA 2004, in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes for plan years beginning after December 31, 2003, and before January 1, 2006, the interest rate used is 85 percent of the annual rate of interest determined by the Secretary of the Treasury on amounts invested conservatively in long term investment-grade corporate bonds for the month preceding the month in which the plan year begins.

REASONS FOR CHANGE

Modifications to the PBGC premium structure, in conjunction with the Committee's proposals relating to defined benefit plan funding, will provide for increased retirement income security. The current flat-rate premium has not been modified since 1991 and has not kept pace with increases in wages, which are typically reflected in pension benefits. Thus, the Committee bill increases the PBGC premium to reflect past increases in wages and provides for automatic increases in the future to reflect wage increases.

[161] The phase in does not apply if the benefit is less than $20 per month.

Changes to the variable rate premium are also appropriate to better reflect the risk that underfunded plans present to the pension insurance system. Thus, the Committee bill modifies the base for the premium to conform to the funding targets under the funding provisions of the bill.

EXPLANATION OF PROVISION

Flat rate premiums

The provision increases the flat-rate premium to $30 per participant for years beginning after December 31, 2005. After 2006, the flat-rate premium is indexed for increases in the social security contribution and benefit base (rounded to the nearest dollar).

Variable rate premium

Under the provision, for years beginning in 2006, the variable rate premium is equal to $9.00 for each $1,000 of a plan's unfunded current liability as of the close of the preceding plan year. The interest rate used in determining current liability for plan years beginning in 2005 continues to apply for plan years beginning in 2006.

For years beginning after 2006, the variable rate premium is equal to $9.00 for each $1,000 of a plan's unfunded target liability (determined as under the minimum funding rules) as of the close of the preceding plan year.[162]

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2005.

B. Rules Relating to Bankruptcy of Employer

(Secs. 403 and 602 of the bill and secs. 4022 and 4044 of ERISA)

PRESENT LAW

Guaranteed benefits

When an underfunded plan terminates, the amount of benefits that the PBGC will pay depends on legal limits, asset allocation, and recovery on the PBGC's employer liability claim. The PBGC guarantee applies to "basic benefits." Basic benefits generally are benefits accrued before a plan terminates, including (1) benefits at normal retirement age; (2) most early retirement benefits; (3) disability benefits for disabilities that occurred before the plan was terminated; and (4) certain benefits for survivors of plan participants. Generally only that part of the retirement benefit that is payable in monthly installments is guaranteed.[163]

Retirement benefits that begin before normal retirement age are guaranteed, provided they meet the other conditions of guarantee (such as that before the date the plan terminates, the participant had satisfied the conditions of the plan necessary to establish the right to receive the benefit other than application for the benefit).

[162] The rule providing that no variable rate premium is required if contributions for the prior plan year were at least equal to the full funding limit no longer applies under the provision for years beginning after December 31, 2006.

[163] ERISA sec. 4022(b) and (c).

Contingent benefits (for example, subsidized early retirement benefits) are guaranteed only if the triggering event occurs before plan termination.

For plans terminating in 2005, the maximum guaranteed benefit for an individual retiring at age 65 is $3,698.86 per month or $44,386.32 per year.[164] The dollar limit is indexed annually for inflation. The guaranteed amount is reduced for benefits starting before age 65.

In the case of a plan or a plan amendment that has been in effect for less than five years before a plan termination, the amount guaranteed is phased in by 20 percent a year.[165]

Asset allocation

ERISA contains rules for allocating the assets of a single-employer plan when the plan terminates. Plan assets available to pay for benefits under a terminating plan include all plan assets remaining after subtracting all liabilities (other than liabilities for future benefit payments), paid or payable from plan assets under the provisions of the plan. On termination, the plan administrator must allocate plan assets available to pay for benefits under the plan in the manner prescribed by ERISA. In general, plan assets available to pay for benefits under the plan are allocated to six priority categories. If the plan has sufficient assets to pay for all benefits in a particular priority category, the remaining assets are allocated to the next lower priority category. This process is repeated until all benefits in the priority categories are provided or until all available plan assets have been allocated.

REASONS FOR CHANGE

The PBGC reports that many plan sponsors continue to operate their plans until late in the bankruptcy process, and then terminate the plan just prior to emerging from bankruptcy or prior to liquidation. During the time the sponsor is in bankruptcy, payment of lump sums and annuity purchases may drain plan assets, which may reduce assets available for payment of non-guaranteed benefits to other participants. Benefits may also continue to accrue during bankruptcy and the PBGC limits on guarantees may continue to increase as a result of inflation adjustments, which may further increase unfunded benefits and the liability of the pension insurance system. In addition, the longer a company is in bankruptcy, the more participants earn a higher priority claim under the plan to share in limited plan assets and recoveries for payment of non-guaranteed benefits. This increase in the number of participants with higher priority claims dilutes the potential payments to those who have been retired or eligible to retire for the longest time.

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[164] The PBGC generally pays the greater of the guaranteed benefit amount and the amount that was covered by plan assets when it terminated. Thus, depending on the amount of assets in the terminating plan, participants may receive more than the amount guaranteed by PBGC.

Special rules limit the guaranteed benefits of individuals who are substantial owners covered by a plans whose benefits have not been increased by reason of any plan amendment. A substantial owner generally is an individual who: (1) owns the entire interest in an unincorporated trade or business; (2) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in the partnership; (3) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of the corporation or all the stock of the corporation; or (4) at any time within the preceding 60 months was a substantial owner under the plan.

[165] The phase in does not apply if the benefit is less than $20 per month.

EXPLANATION OF PROVISION

Under the provision, the amount of guaranteed benefits payable by the PBGC is frozen when a contributing sponsor enters bankruptcy or a similar proceeding.[166] If the plan terminates during the contributing sponsor's bankruptcy, the amount of guaranteed benefits payable by the PBGC is determined based on plan provisions, salary, service, and the guarantee in effect on the date the employer entered bankruptcy. The priority among participants for purposes of allocating plan assets and employer recoveries to nonguaranteed benefits in the event of plan termination is determined as of the date the sponsor enters bankruptcy or a similar proceeding.

A contributing sponsor of a single-employer plan is required to notify the plan administrator when the sponsor enters bankruptcy or a similar proceeding. Within a reasonable time after a plan administrator knows or has reason to know that a contributing sponsor has entered bankruptcy (or similar proceeding), the administrator is required to notify plan participants and beneficiaries of the bankruptcy and the limitations on benefit guarantees if the plan is terminated while underfunded, taking into account the bankruptcy.

The Secretary of Labor is to prescribe the form and manner of notices required under this provision. The notice is to be written in a manner calculated to be understood by the average plan participant and may be delivered in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the applicable individual.

The Secretary of Labor may assess a civil penalty of up to $100 a day for each failure to provide the notice required by the provision. Each violation with respect to any single participant or beneficiary is treated as a separate violation.

EFFECTIVE DATE

The provision is effective with respect to Federal bankruptcy or similar proceedings or arrangements for the benefit of creditors which are initiated on or after the date that is 30 days after enactment.

C. Limitation on PBGC Guarantee of Shutdown and Other Benefits

(Sec. 603 of the bill and sec. 4022 of ERISA)

PRESENT LAW

A plan may provide for unpredictable contingent event benefits, which are benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce. Under present law, unpredictable contingent event benefits generally are not taken into account for funding purposes until the event has occurred.

[166] For purposes of the provision, a contributing sponsor is considered to have entered bankruptcy if the sponsor files or has had filed against it a petition seeking liquidation or reorganization in a case under title 11 of the United States Code or under any similar Federal law or law of a State or political subdivision.

Under present law, defined benefit pension plans are not permitted to provide "layoff" benefits (i.e., severance benefits).[167] However, defined benefit pension plans may provide subsidized early retirement benefits, including early retirement window benefits.[168]

Within certain limits, the PBGC guarantees any retirement benefit that was vested on the date of plan termination (other than benefits that vest solely on account of the termination), and any survivor or disability benefit that was owed or was in payment status at the date of plan termination.[169] Generally only that part of the retirement benefit that is payable in monthly installments is guaranteed.[170]

Retirement benefits that begin before normal retirement age are guaranteed, provided they meet the other conditions of guarantee (such as that, before the date the plan terminates, the participant had satisfied the conditions of the plan necessary to establish the right to receive the benefit other than application for the benefit). Contingent benefits (for example, early retirement benefits provided only if a plant shuts down) are guaranteed only if the triggering event occurs before plan termination.

In the case of a plan or a plan amendment that has been in effect for less than five years before a plan termination, the amount guaranteed is phased in by 20 percent a year.

REASONS FOR CHANGE

Under present law, unpredictable contingent event benefits can create significant losses for the PBGC pension insurance system because such benefits cannot be funded due to the contingent nature of the event. In some cases, the PBGC has been faced with terminating a plan just prior to a plant shutdown in order to protect the system against further losses.

EXPLANATION OF PROVISION

The provision provides that the PBGC guarantee of certain benefits phases in under the rules relating to plan amendments. Under the provision, if a benefit is payable by reason of (1) a plant shutdown or similar event, or (2) any event other than attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability, the PBGC guarantee provisions apply as if a plan amendment had been adopted on the date such event occurred that provides for the payment of such benefits.

EFFECTIVE DATE

The provision is effective for benefits that become payable as a result of a plant shutdown or other covered event that occurs after July 26, 2005.

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[167] Treas. Reg. sec. 1.401–1(b)(1)(i).
[168] Treas. Reg. secs. 1.401(a)(4)–3(f)(4) and 1.411(a)–7(c).
[169] ERISA sec. 4022(a).
[170] ERISA sec. 4022(b) and (c).

D. PBGC Premiums for Small and New Plans

(Secs. 604 and 605 the bill and sec. 4006 of ERISA)

PRESENT LAW

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

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

REASONS FOR CHANGE

The Committee believes that reducing the PBGC premiums for new plans and plans of small employers will help encourage the establishment of defined benefit pension plans, particularly by small employers.

EXPLANATION OF PROVISION

Reduced flat-rate premiums for new plans of small employers

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

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

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

Reduced variable-rate PBGC premium for new plans

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

A new defined benefit pension plan is defined as described above under the provision relating to flat-rate premiums for new plans of small employers.

Reduced variable-rate PBGC premium for small plans

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

EFFECTIVE DATE

The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans apply to plans first effective after December 31, 2005. The reduction of the variable-rate premium for small plans applies to plan years beginning after December 31, 2005.

E. Authorization for PBGC To Pay Interest on Premium Overpayment Refunds

(Sec. 606 of the bill and sec. 4007(b) of ERISA)

PRESENT LAW

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

REASONS FOR CHANGE

The Committee believes that an employer or other person who overpays PBGC premiums should receive interest on a refund of the overpayment.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

The provision is effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

F. Rules for Substantial Owner Benefits in Terminated Plans

(Sec. 607 of the bill and secs. 4021, 4022, 4043, and 4044 of ERISA)

PRESENT LAW

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

REASONS FOR CHANGE

The Committee believes that the present-law rules concerning limitations on guaranteed benefits for substantial owners are overly complicated and restrictive and thus may discourage some small business owners from establishing defined benefit pension plans.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

The provision is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which pro-

ceedings for termination are instituted by the PBGC, after December 31, 2005.

G. Acceleration of PBGC Computation of Benefits Attributable to Recoveries from Employers

(Sec. 608 of the bill and secs. 4022(c) and 4062(c) of ERISA)

PRESENT LAW

In general

The Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay promised benefits.[171] The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. In general, the PBGC guarantees all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. For plans terminating in 2005, the maximum guaranteed benefit for an individual retiring at age 65 is $3,698.86 per month, or $44,386.32 per year.

The PBGC pays plan benefits, subject to the guarantee limits, when it becomes trustee of a terminated plan. The PBGC also pays amounts in addition to the guarantee limits ("additional benefits") if there are sufficient plan assets, including amounts recovered from the employer for unfunded benefit liabilities and contributions owed to the plan. The employer (including members of its controlled group) is statutorily liable for these amounts.

Plan underfunding recoveries

The PBGC's recoveries on its claims for unfunded benefit liabilities are shared between the PBGC and plan participants. The amounts recovered are allocated partly to the PBGC to help cover its losses for paying unfunded guaranteed benefits and partly to participants to help cover the loss of benefits that are above the PBGC's guarantees and are not funded. In determining the portion of the recovered amounts that will be allocated to participants, present law specifies the use of a recovery ratio based on plan terminations during a specified period, rather than the actual amount recovered for each specific plan. The recovery ratio that applies to a plan includes the PBGC's actual recovery experience for plan terminations in the five-Federal fiscal year period immediately preceding the Federal fiscal year in which falls the notice of intent to terminate for the particular plan.

The recovery ratio is used for all but very large plans taken over by the PBGC. For a very large plan (i.e., a plan for which participants' benefit losses exceed $20 million) actual recovery amounts with respect to the specific plan are used to determine the portion of the amounts recovered that will be allocated to participants.

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

Recoveries for due and unpaid employer contributions

Amounts recovered from an employer for contributions owed to the plan are treated as plan assets and are allocated to plan benefits in the same manner as other assets in the plan's trust on the plan termination date. The amounts recovered are determined on a plan-specific basis rather than based on an historical average recovery ratio.

REASONS FOR CHANGE

The Committee wishes to modify the rules for calculating certain recoveries by the PBGC to accelerate the time by which such recoveries can be determined, thereby accelerating the time by which benefits may be paid to participants in terminated plans.

EXPLANATION OF PROVISION

The provision makes two amendments to the PBGC insurance provisions of ERISA. First, it changes the five-year period used to determine the recovery ratio for unfunded benefit liabilities so that the period begins two years earlier. Thus, under the bill, the recovery ratio that applies to a plan includes the PBGC's actual recovery experience for plan terminations in the five-Federal fiscal year period ending with the third fiscal year preceding the fiscal year in which falls the notice of intent to terminate for the particular plan.

In addition, the provision creates a recovery ratio for determining amounts recovered for contributions owed to the plan, based on the PBGC's recovery experience over the same five-year period.

The provision does not apply to very large plans (i.e., plans for which participants' benefit losses exceed $20 million). As under present law, in the case of a very large plan, actual amounts recovered for unfunded benefit liabilities and for contributions owed to the plan are used to determine the amount available to provide additional benefits to participants.

EFFECTIVE DATE

The provision is effective for any plan termination for which notices of intent to terminate are provided (or, in the case of a termination by the PBGC, a notice of determination that the plan must be terminated is issued) on or after the date that is 30 days after the date of enactment.

TITLE VII—SPOUSAL PENSION PROTECTION

A. Study of Spousal Consent for Distributions From Defined Contribution Plans

(Sec. 701 of the bill)

PRESENT LAW

Qualified retirement plans are generally subject to requirements regarding the form in which benefits may be paid without spousal consent.[172] The extent to which the requirements apply depends on the type of plan.

[172] Code secs. 401(a)(11) and 417; ERISA sec. 205.

Defined benefit pension plans and money purchase pension plans[173] are generally required to provide benefits in the form of a qualified joint and survivor annuity ("QJSA") unless the participant and his or her spouse consent to another form of benefit. A QJSA is an annuity for the life of the participant, with a survivor annuity for the life of the spouse that is not less than 50 percent (and not more than 100 percent) of the amount of the annuity payable during the joint lives of the participant and his or her spouse. In addition, if a married participant dies before the commencement of retirement benefits, the surviving spouse must be provided with a qualified preretirement survivor annuity ("QPSA"), which generally must provide the surviving spouse with a benefit that is not less than the benefit that would have been provided under the survivor portion of a QJSA.[174]

The participant and his or her spouse may waive the right to a QJSA and QPSA if certain requirements are satisfied. In general, these requirements include providing the participant with a written explanation of the terms and conditions of the survivor annuity, the right to make, and the effect of, a waiver of the annuity, the rights of the spouse to waive the survivor annuity, and the right of the participant to revoke the waiver. In addition, the spouse must provide a written consent to the waiver, witnessed by a plan representative or a notary public, which acknowledges the effect of the waiver.

Defined contribution plans other than money purchase pension plans are generally not subject to the QJSA and QPSA rules unless the plan offers benefits in the form of an annuity and the participant elects an annuity. However, such defined contribution plans must provide that the participant's surviving spouse is the beneficiary of the participant's entire vested account balance under the plan, unless the spouse consents to designation of another beneficiary. In addition, the plan must not have received a transfer of assets from a plan to which the QJSA and QPSA requirements applied or must separately account for the transferred assets.

REASONS FOR CHANGE

Present law requires defined benefit pension plans and money purchase pensions plans to provide annuity benefits to a participant's surviving spouse unless the spouse consents to waive the annuity. The spousal consent rules provide important protections for spouses, particularly nonworking spouses. These rules also assist married employees and their spouses in determining how to meet their retirement income needs by requiring distributions in the form of a QJSA unless the participant and spouse consent to another form.

Most defined contribution plans do not offer benefits in the form of an annuity and thus are not subject to the QJSA and QPSA rules under present law. Requiring such plans to offer annuities (unless the participant and spouse elect otherwise) represents a

[173] A money purchase pension plan is a type of defined contribution plan that provides for a set level of required employer contributions, generally as a specified percentage of participants' compensation, and for the distribution of benefits in the form of an annuity.

[174] In the case of a money purchase pension plan, a QPSA means an annuity for the life of the surviving spouse that has an actuarial value of at least 50 percent of the participant's vested account balance as of the date of death.

significant policy change and is likely to increase administrative burdens for such plans. However, for many employees, a defined contribution plan is the only type of retirement plan offered by their employer. The Committee believes a study should be conducted on the feasibility and desirability of extending the spousal consent requirements to defined contribution plans.

EXPLANATION OF PROVISION

The Secretary of Labor and the Secretary of the Treasury are required to conduct a joint study of the feasibility and desirability of extending the spousal consent requirements to defined contribution plans to which the requirements do not apply under present law and to report the results thereof, with recommendations for legislative changes, within two years after the date of enactment, to the House Committees on Ways and Means and on Education and the Workforce and the Senate Committees on Finance and on Health, Education, Labor and Pensions. In conducting the study, the Secretary of Labor and the Secretary of the Treasury are required to consider: (1) any modifications of the spousal consent requirements that are necessary to apply the requirements to defined contribution plans; and (2) the feasibility of providing notice and spousal consent in electronic form that are capable of authentication.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Division of Pension Benefits Upon Divorce

(Sec. 702 of the bill)

PRESENT LAW

Benefits provided under a qualified retirement plan for a participant may not be assigned or alienated to creditors of the participant, except in very limited circumstances.[175] One exception to the prohibition on assignment or alienation is a qualified domestic relations order ("QDRO").[176] A QDRO is a domestic relations order that creates or recognizes a right of an alternate payee, including a former spouse, to any plan benefit payable with respect to a participant and that meets certain procedural requirements. In addition, a QDRO generally may not require the plan to provide any type or form of benefit, or any option, not otherwise provided under the plan, or to provide increased benefits.

Present law also provides that a QDRO may not require the payment of benefits to an alternate payee that are required to be paid to another alternate payee under a domestic relations order previously determined to be a QDRO. This rule implicitly recognizes that a domestic relations order issued after a QDRO may also qualify as a QDRO. However, present law does not otherwise provide specific rules for the treatment of a domestic relations order as a QDRO if the order is issued after another domestic relations order or a QDRO (including an order issued after a divorce decree) or revises another domestic relations order or a QDRO.

[175] Code sec. 401(a)(13); ERISA sec. 206(d).
[176] Code secs. 401(a)(13)(B) and 414(p); ERISA sec. 206(d)(3).

Present law provides specific rules that apply during any period in which the status of a domestic relations order as a QDRO is being determined (by the plan administrator, by a court, or otherwise). During such a period, the plan administrator is required to account separately for the amounts that would have been payable to the alternate payee during the period if the order had been determined to be a QDRO (referred to as "segregated amounts"). If, within the 18-month period beginning with the date on which the first payment would be required to be made under the order, the order (or modification thereof) is determined to be a QDRO, the plan administrator is required to pay the segregated amounts (including any interest thereon) to the person or persons entitled thereto. If, within the 18-month period, the order is determined not to be a QDRO, or its status as a QDRO is not resolved, the plan administrator is required to pay the segregated amounts (including any interest) to the person or persons who would be entitled to such amounts if there were no order. In such a case, any subsequent determination that the order is a QDRO is applied prospectively only.

REASONS FOR CHANGE

The Committee understands that uncertainty exists under present law as to the treatment of certain domestic relations orders as QDROs, such as those that are issued subsequent to divorce or that revise a previous domestic relations order or QDRO. The Committee understands that issues as to whether a subsequent domestic relations order is a QDRO have arisen even in cases involving the same former spouse, such as a domestic relations order that deals with benefits not dealt with in a QDRO previously issued to the same former spouse. The Committee believes the treatment of such domestic relations orders should be clarified.

EXPLANATION OF PROVISION

The Secretary of Labor is directed to issue, not later than one year after the date of enactment of the provision, regulations to clarify the status of certain domestic relations orders. In particular, the regulations are to clarify that a domestic relations order otherwise meeting the QDRO requirements will not fail to be treated as a QDRO solely because of the time it is issued or because it is issued after or revises another domestic relations order or another QDRO. The regulations are also to clarify that such a domestic relations order is in all respects subject to the same requirements and protections that apply to QDROs. For example, as under present law, such a domestic relations order may not require the payment of benefits to an alternate payee that are required to be paid to another alternate payee under an earlier QDRO. In addition, the present-law rules regarding segregated amounts that apply while the status of a domestic relations order as a QDRO is being determined continue to apply.

EFFECTIVE DATE

The provision is effective on the date of enactment.

C. Protection of Rights of Former Spouses Under the Railroad Retirement System

(Secs. 703 and 704 of the bill and secs. 2 and 5 of the Railroad Retirement Act of 1974)

PRESENT LAW

In general

The Railroad Retirement System has two main components. Tier I of the system is financed by taxes on employers and employees equal to the Social Security payroll tax and provides qualified railroad retirees (and their qualified spouses, dependents, widows, or widowers) with benefits that are roughly equal to Social Security. Covered railroad workers and their employers pay the Tier I tax instead of the Social Security payroll tax, and most railroad retirees collect Tier I benefits instead of Social Security. Tier II of the system replicates a private pension plan, with employers and employees contributing a certain percentage of pay toward the system to finance defined benefits to eligible railroad retirees (and qualified spouses, dependents, widows, or widowers) upon retirement; however, the Federal Government collects the Tier II payroll contribution and pays out the benefits.

Former spouses of living railroad employees

Generally, a former spouse of a railroad employee who is otherwise eligible for any Tier I or Tier II benefit cannot receive either benefit until the railroad employee actually retires and begins receiving his or her retirement benefits. This is the case regardless of whether a State divorce court has awarded such railroad retirement benefits to the former spouse.

Former spouses of deceased railroad employees

The former spouse of a railroad employee may be eligible for survivors benefits under Tier I of the Railroad Retirement System. However, a former spouse loses eligibility for any otherwise allowable Tier II benefits upon the death of the railroad employee.

REASONS FOR CHANGE

The Committee wishes to provide more equitable treatment of former spouses of railroad employees.

EXPLANATION OF PROVISION

Former spouses of living railroad employees

The bill eliminates the requirement that a railroad employee actually receive railroad retirement benefits for the former spouse to be entitled to any Tier I benefit or Tier II benefit awarded under a State divorce court decision.

Former spouses of deceased railroad employees

The bill provides that a former spouse of a railroad employee does not lose eligibility for otherwise allowable Tier II benefits upon the death of the railroad employee.

EFFECTIVE DATE

The railroad retirement provisions are effective one year after the date of enactment.

D. MODIFICATIONS OF JOINT AND SURVIVOR ANNUITY REQUIREMENTS

(Sec. 705 of the bill and secs. 401 and 417 of the Code and sec. 205 of ERISA)

PRESENT LAW

Defined benefit pension plans and money purchase pension plans are required to provide benefits in the form of a qualified joint and survivor annuity ("QJSA") unless the participant and his or her spouse consent to another form of benefit.[177] A QJSA is an annuity for the life of the participant, with a survivor annuity for the life of the spouse which is not less than 50 percent (and not more than 100 percent) of the amount of the annuity payable during the joint lives of the participant and his or her spouse.[178] In the case of a married participant who dies before the commencement of retirement benefits, the surviving spouse must be provided with a qualified preretirement survivor annuity ("QPSA"), which must provide the surviving spouse with a benefit that is not less than the benefit that would have been provided under the survivor portion of a QJSA.

The participant and his or her spouse may waive the right to a QJSA and QPSA provided certain requirements are satisfied. In general, these conditions include providing the participant with a written explanation of the terms and conditions of the survivor annuity, the right to make, and the effect of, a waiver of the annuity, the rights of the spouse to waive the survivor annuity, and the right of the participant to revoke the waiver. In addition, the spouse must provide a written consent to the waiver, witnessed by a plan representative or a notary public, which acknowledges the effect of the waiver.

Defined contribution plans other than money purchase pension plans are not required to provide a QJSA or QPSA if the participant does not elect an annuity as the form of payment, the surviving spouse is the beneficiary of the participant's entire vested account balance under the plan (unless the spouse consents to designation of another beneficiary),[179] and, with respect to the participant, the plan has not received a transfer from a plan to which the QJSA and QPSA requirements applied (or separately accounts for the transferred assets). In the case of a defined contribution plan subject to the QJSA and QPSA requirements, a QPSA means an annuity for the life of the surviving spouse that has an actuarial value of at least 50 percent of the participant's vested account balance as of the date of death.

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[177] Code secs. 401(a)(11) and 417; ERISA sec. 205.

[178] Thus, a plan could provide an annuity for the life of the participant, with a survivor annuity for the life of the spouse equal to 75 percent of the amount of the annuity payable during the joint lives of the participant and his or her spouse.

[179] Waiver and election rules apply to the waiver of the right of the spouse to be the beneficiary under a defined contribution plan that is not required to provide a QJSA.

REASONS FOR CHANGE

The Committee believes that it is appropriate to allow participants greater choice in selecting their form of benefits. The Committee believes that participants should have more options regarding their form of benefits so that they can determine the most appropriate option depending on the participant's individual circumstances. For example, some couples may prefer an option that pays a smaller benefit to the couple while they are both alive with a larger benefit to the surviving spouse.

EXPLANATION OF PROVISION

The provision revises the minimum survivor annuity requirements to require that, at the election of the participant, benefits will be paid in the form of a "qualified optional survivor annuity." A qualified optional survivor annuity means an annuity for the life of the participant with a survivor annuity for the life of the spouse which is equal to the applicable percentage of the amount of the annuity which is payable during the joint lives of the participant and the spouse and which is the actuarial equivalent of a single annuity for the life of the participant.

If the survivor annuity under plan's qualified joint and survivor annuity is less than 75 percent of the annuity payable during the joint lives of the participant and spouse, the applicable percentage is 75 percent. If the survivor annuity under plan's qualified joint and survivor annuity is greater than or equal to 75 percent of the annuity payable during the joint lives of the participant and spouse, the applicable percentage is 50 percent. Thus, for example, if the survivor annuity under the plan's qualified joint and survivor annuity is 50 percent, the survivor annuity under the qualified optional survivor annuity must be 75 percent.

The written explanation required to be provided to participants explaining the terms and conditions of the qualified joint and survivor annuity must also include the terms and conditions of the qualified optional survivor annuity.

Under the provision relating to plan amendments, a plan amendment made pursuant to a provision under the bill generally will not violate the anticutback rule if certain requirements are met (e.g., the plan amendment is made on or before the last day of the first plan year beginning on or after January 1, 2006). Thus, a plan is not treated as having decreased the accrued benefit of a participant solely by reason of the adoption of a plan amendment pursuant to the provision requiring that the plan offer a qualified optional survivor annuity. The elimination of a subsidized qualified joint and survivor annuity is not protected by the anticutback provision in the bill unless an equivalent or greater subsidy is retained in one of the forms offered under the plan as amended. For example, if a plan that offers a subsidized 50 percent qualified joint and survivor annuity is amended to provide an unsubsidized 50 percent qualified joint and survivor annuity and an unsubsidized 75 percent joint and survivor annuity as its qualified optional survivor annuity, the replacement of the subsidized 50 percent qualified joint and survivor annuity with the unsubsidized 50 percent qualified joint and survivor annuity is not protected by the anticutback protection.

EFFECTIVE DATE

The provision applies generally to plan years beginning after December 31, 2005. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision applies to plan years beginning on or after the earlier of (1) the later of January 1, 2006, and the last date on which an applicable collective bargaining agreement terminates (without regard to extensions), and (2) January 1, 2007.

TITLE VIII—IMPROVEMENTS IN PORTABILITY AND DISTRIBUTION RULES

A. PURCHASE OF PERMISSIVE SERVICE CREDIT

(Sec. 801 of the bill and secs. 403(b)(13), 415(n)(3), and 457(e)(17) of the Code)

PRESENT LAW

In general

Present law imposes limits on contributions and benefits under qualified plans.[180] The limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) a certain dollar amount ($170,000 for 2005) or (2) 100 percent of the participant's average compensation for his or her high three years.

A qualified retirement plan maintained by a State or local government employer may provide that a participant may make after-tax employee contributions in order to purchase permissive service credit, subject to certain limits.[181]

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

Permissive service credit

Definition of permissive service credit

Permissive service credit means credit for a period of service recognized by the governmental plan which the participant has not received under the plan and which the employee receives only if the employee voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of service and that is in addition to the regular employee contributions, if any, under the plan.

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[180] Sec. 415.
[181] Sec. 415(n)(3).

The IRS has ruled that credit is not permissive service credit where it is purchased to provide enhanced retirement benefits for a period of service already credited under the plan, as the enhanced benefit is treated as credit for service already received.[182]

Nonqualified service

Service credit is not permissive service credit if more than five years of permissive service credit is purchased for nonqualified service or if nonqualified service is taken into account for an employee who has less than five years of participation under the plan. Nonqualified service is service other than service (1) as a Federal, State or local government employee, (2) as an employee of an association representing Federal, State or local government employees, (3) as an employee of an educational institution which provides elementary or secondary education, as determined under State law, or (4) for military service. Service under (1), (2) and (3) is nonqualified service if it enables a participant to receive a retirement benefit for the same service under more than one plan.

Trustee-to-trustee transfers to purchase permissive service credit

Under EGTRRA, a participant is not required to include in gross income a direct trustee-to-trustee transfer to a governmental defined benefit plan from a section 403(b) annuity or a section 457 plan if the transferred amount is used (1) to purchase permissive service credit under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State).[183]

REASONS FOR CHANGE

The Committee believes that allowing employees to use their section 403(b) annuity and governmental section 457 plan benefits to purchase permissive service credits or make repayments with respect to forfeitures of service credit results in more significant retirement benefits for employees who would not otherwise be able to afford such credits or repayments. The Committee believes that it is appropriate to modify the provisions regarding such transfers in order to facilitate such purchases or repayments. The Committee also believes that it is appropriate to expand the definition of permissive service credit and to allow participants to purchase credit for other periods deemed appropriate by the public retirement systems.

EXPLANATION OF PROVISION

Permissive service credit

The provision modifies the definition of permissive service credit by providing that permissive service credit means service credit which relates to benefits to which the participant is not otherwise entitled under such governmental plan, rather than service credit which such participant has not received under the plan. Credit qualifies as permissive service credit if it is purchased to provide

[182] Priv. Ltr. Rul. 200229051 (April 26, 2002).
[183] Secs. 403(b)(13) and 457(e)(17).

an increased benefit for a period of service already credited under the plan (e.g., if a lower level of benefit is converted to a higher benefit level otherwise offered under the same plan) as long as it relates to benefits to which the participant is not otherwise entitled.

The provision allows participants to purchase credit for periods regardless of whether service is performed, subject to the limits on nonqualified service.

Under the provision, service as an employee of an educational organization providing elementary or secondary education can be determined under the law of the jurisdiction in which the service was performed. Thus, for example, permissive service credit can be granted for time spent teaching outside of the United States without being considered nonqualified service credit.

Trustee-to-trustee transfers to purchase permissive service credit

The provision provides that the limits regarding nonqualified service are not applicable in determining whether a trustee-to-trustee transfer from a section 403(b) annuity or a section 457 plan to a governmental defined benefit plan is for the purchase of permissive service credit. Thus, failure of the transferee plan to satisfy the limits does not cause the transferred amounts to be included in the participant's income. As under present law, the transferee plan must satisfy the limits in providing permissive service credit as a result of the transfer.

The provision provides that trustee-to-trustee transfers under sections 457(e)(17) and 403(b)(13) may be made regardless of whether the transfer is made between plans maintained by the same employer. The provision also provides that amounts transferred from a section 403(b) annuity or a section 457 plan to a governmental defined benefit plan to purchase permissive service credit are subject to the distribution rules applicable under the Internal Revenue Code to the defined benefit plan.

EFFECTIVE DATE

The provision is generally effective as if included in the amendments made by section 1526 of the Taxpayer Relief Act of 1997, except that the provision regarding trustee-to-trustee transfers is effective as if included in the amendments made by section 647 of the Economic Growth and Tax Relief Reconciliation Act of 2001.

B. Rollover of After-Tax Amounts in Annuity Contracts

(Sec. 802 of the bill and sec. 402(c)(2) of the Code)

PRESENT LAW

Employee after-tax contributions may be rolled over from a tax-qualified retirement plan into another tax-qualified retirement plan, if the plan to which the rollover is made is a defined contribution plan, the rollover is accomplished through a direct rollover, and the plan to which the rollover is made provides for separate accounting for such contributions (and earnings thereon). After-tax contributions can also be rolled over from a tax-sheltered annuity (a "section 403(b) annuity") to another tax-sheltered annuity if the rollover is a direct rollover, and the annuity to which the rollover

is made provides for separate accounting for such contributions (and earnings thereon). After-tax contributions may also be rolled over to an IRA. If the rollover is to an IRA, the rollover need not be a direct rollover and the IRA owner has the responsibility to keep track of the amount of after-tax contributions.[184]

REASONS FOR CHANGE

Under present law, tax-sheltered annuities may provide for after-tax contributions, but are not permitted to receive rollovers of after-tax contributions from qualified retirement plans. Under present law, after-tax contributions cannot be rolled over into a defined benefit plan. The Committee wishes to expand opportunities for portability with respect to after-tax contributions.

EXPLANATION OF PROVISION

The provision allows after-tax contributions to be rolled over from a qualified retirement plan to another qualified retirement plan (either a defined contribution or a defined benefit plan) or to a tax-sheltered annuity. As under present law, the rollover must be a direct rollover, and the plan to which the rollover is made must separately account for after-tax contributions (and earnings thereon).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2005.

C. Application of Minimum Distribution Rules to Governmental Plans

(Sec. 803 of the bill)

PRESENT LAW

Minimum distribution rules apply to tax-favored retirement arrangements, including governmental plans. In general, under these rules, distribution of minimum benefits must begin no later than the required beginning date. Minimum distribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax may be waived in certain cases.

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

[184] Sec. 402(c)(2); IRS Notice 2002–3, 2002–2 I.R.B. 289.

rangements (e.g., a defined contribution plan or an individual retirement arrangement), life expectancies of the participant and the participant's spouse generally may be recomputed annually.

The required beginning date generally is April 1 of the calendar year following the later of (1) the calendar year in which the participant attains age 70½ or (2) the calendar year in which the participant retires.

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

REASONS FOR CHANGE

The Committee believes that governmental plans should be provided greater flexibility in complying with the minimum distribution requirements to accommodate plan designs commonly used by governmental plans.

EXPLANATION OF PROVISION

The provision directs the Secretary of the Treasury to issue regulations under which a governmental plan is treated as complying with the minimum distribution requirements, for all years to which such requirements apply, if the plan complies with a reasonable, good faith interpretation of the statutory requirements. It is intended that the regulations apply for periods before the date of enactment.

EFFECTIVE DATE

The provision is effective on the date of enactment.

D. Waiver of 10-Percent Early Withdrawal Tax on Certain Distributions From Pension Plans for Public Safety Employees

(Sec. 804 of the bill and sec. 72(t) of the Code)

PRESENT LAW

Under present law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception to the tax applies. Among other exceptions, the early distribution tax does not apply to distributions made to an employee who separates from

service after age 55, or to distributions that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary.

REASONS FOR CHANGE

The Committee recognizes that public safety employees often retire earlier than workers in other professions. The Committee believes that public safety employees who separate from service after age 50 should be permitted to receive distributions from defined benefit pension plans without the imposition of the early withdrawal tax.

EXPLANATION OF PROVISION

Under the provision, the 10-percent early withdrawal tax does not apply to distributions from a governmental defined benefit pension plan to a qualified public safety employee who separates from service after age 50. A qualified public safety employee is an employee of a State or political subdivision of a State if the employee provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision.

EFFECTIVE DATE

The provision is effective for distributions made after the date of enactment.

E. Rollovers by Nonspouse Beneficiaries of Certain Retirement Plan Distributions

(Sec. 805 of the bill and secs. 402, 403(a)(4), 403(b)(8), and 457(e)(16) of the Code)

PRESENT LAW

Tax-free rollovers

Under present law, a distribution from a qualified retirement plan, a tax-sheltered annuity "section 403(b) annuity"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457 plan"), or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed. However, eligible rollover distributions may be rolled over tax free within 60 days to another plan, annuity, or IRA.[185]

In general, an eligible rollover distribution includes any distribution to the plan participant or IRA owner other than certain periodic distributions, minimum required distributions, and distributions made on account of hardship.[186] Distributions to a participant from a qualified retirement plan, a tax-sheltered annuity, or a governmental section 457 plan generally can be rolled over to any of

[185] The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual. Sec. 402(c)(3)(B).

[186] Sec. 402(c)(4). Certain other distributions also are not eligible rollover distributions, e.g., corrective distributions of elective deferrals in excess of the elective deferral limits and loans that are treated as deemed distributions.

such plans or an IRA.[187] Similarly, distributions from an IRA to the IRA owner generally are permitted to be rolled over into a qualified retirement plan, a tax-sheltered annuity, a governmental section 457 plan, or another IRA.

Similar rollovers are permitted in the case of a distribution to the surviving spouse of the plan participant or IRA owner, but not to other persons.

If an individual inherits an IRA from the individual's deceased spouse, the IRA may be treated as the IRA of the surviving spouse. This treatment does not apply to IRAs inherited from someone other than the deceased spouse. In such cases, the IRA is not treated as the IRA of the beneficiary. Thus, for example, the beneficiary may not make contributions to the IRA and cannot roll over any amounts out of the inherited IRA. Like the original IRA owner, no amount is generally included in income until distributions are made from the IRA. Distributions from the inherited IRA must be made under the rules that apply to distributions to beneficiaries, as described below.

Minimum distribution rules

Minimum distribution rules apply to tax-favored retirement arrangements. In the case of distributions prior to the death of the participant, distributions generally must begin by the April 1 of the calendar year following the later of the calendar year in which the participant (1) attains age 70½ or (2) retires.[188] The minimum distribution rules also apply to distributions following the death of the participant. If minimum distributions have begun prior to the participant's death, the remaining interest generally must be distributed at least as rapidly as under the minimum distribution method being used prior to the date of death. If the participant dies before minimum distributions have begun, then either (1) the entire remaining interest must be distributed within five years of the death, or (2) distributions must begin within one year of the death over the life (or life expectancy) of the designated beneficiary. A beneficiary who is the surviving spouse of the participant is not required to begin distributions until the date the deceased participant would have attained age 70½. In addition, if the surviving spouse makes a rollover from the plan into a plan or IRA of his or her own, the minimum distribution rules apply separately to the surviving spouse.

REASONS FOR CHANGE

The Committee understands that, in practice, many plans provide that distributions to a beneficiary who is not the surviving spouse of the participant are paid out soon after the death of participant in a lump sum, even though the minimum distribution rules would permit a longer payout period. The Committee understands that many beneficiaries would like to avoid the adverse tax consequences of an immediate lump sum, as well as take advantage of the opportunity to receive periodic payments for life or over

[187] Some restrictions or special rules may apply to certain distributions. For example, after-tax amounts distributed from a plan can be rolled over only to a plan of the same type or to an IRA.

[188] In the case of five-percent owners and distributions from an IRA, distributions must begin by the April 1 of the calendar year following the year in which the individual attains age 70½.

the beneficiary's lifetime. The Committee wishes to provide beneficiaries with additional flexibility regarding timing of distributions, consistent with the minimum distribution rules applicable to nonspouse beneficiaries. To accomplish this result, the Committee bill allows nonspouse beneficiaries to roll over benefits received after the death of the participant to an IRA and to receive distributions in a manner consistent with the minimum distribution rules for nonspouse beneficiaries.

EXPLANATION OF PROVISION

The provision provides that benefits of a beneficiary other than a surviving spouse may be transferred directly to an IRA. The IRA is treated as an inherited IRA of the nonspouse beneficiary. Thus, for example, distributions from the inherited IRA are subject to the distribution rules applicable to beneficiaries. The provision applies to amounts payable to a beneficiary under a qualified retirement plan, governmental section 457 plan, or a tax-sheltered annuity. To the extent provided by the Secretary, the provision applies to benefits payable to a trust maintained for a designated beneficiary to the same extent it applies to the beneficiary.

EFFECTIVE DATE

The provision is effective for distributions made after December 31, 2005.

F. Faster Vesting of Employer Nonelective Contributions

(Sec. 806 of the bill, sec. 411 of the Code, and sec. 203 of ERISA)

PRESENT LAW

Under present law, in general, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of five years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after three years of service, 40 percent after four years of service, 60 percent after five years of service, 80 percent after six years of service, and 100 percent after seven years of service.[189]

Faster vesting schedules apply to employer matching contributions. Employer matching contributions are required to vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of three years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second

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

year of service and ending with 100 percent after six years of service.

REASONS FOR CHANGE

For many employees, a defined contribution plan is the only type of retirement plan offered by their employer. Providing faster vesting for all employer contributions to such plans will enable shorter-service employees to accumulate greater retirement savings.

In addition, providing the same vesting rule for all employer contributions to defined contribution plans will provide simplification.

EXPLANATION OF PROVISION

The provision applies the present-law vesting schedule for matching contributions to all employer contributions to defined contribution plans.

EFFECTIVE DATE

The provision is generally effective for contributions (including allocations of forfeitures) for plan years beginning after December 31, 2005. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is not effective for contributions (including allocations of forfeitures) for plan years beginning before the earlier of (1) the later of the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof on or after the date of enactment) or January 1, 2006, or, or (2) January 1, 2008. The provision does not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date is taken into account.

G. Allow Direct Rollovers From Retirement Plans to Roth IRAs

(Sec. 807 of the bill and sec. 408A(e) of the Code)

PRESENT LAW

IRAs in general

There are two general types of individual retirement arrangements ("IRAs"): traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs.

Traditional IRAs

An individual may make deductible contributions to an IRA up to the lesser of a dollar limit (generally $4,000 for 2005)[190] or the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.[191] If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction limit is phased out for taxpayers with adjusted gross in-

[190] The dollar limit is scheduled to increase until it is $5,000 in 2008–2010. Individuals age 50 and older may make additional, catch-up contributions.

[191] In the case of a married couple, deductible IRA contributions of up to the dollar limit can be made for each spouse (including, for example, a homemaker who does not work outside the home), if the combined compensation of both spouses is at least equal to the contributed amount.

come ("AGI") over certain levels for the taxable year. A different, higher, income phaseout applies in the case of an individual who is not an active participant in an employer sponsored plan but whose spouse is.

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

Amounts held in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Includible amounts withdrawn prior to attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death or disability, is made in the form of certain periodic payments, or is used for certain specified purposes.

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contributions that can be made to all of an individuals IRAs (both traditional and Roth) cannot exceed the maximum deductible IRA contribution limit. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with income above certain levels.

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

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

Rollover contributions

If certain requirements are satisfied, a participant in a tax-qualified retirement plan, a tax-sheltered annuity (sec. 403(b)), or a governmental section 457 plan may roll over distributions from the plan or annuity into a traditional IRA. Distributions from such plans may not be rolled over into a Roth IRA.

Taxpayers with modified AGI of $100,000 or less generally may roll over amounts in a traditional IRA into a Roth IRA. The amount rolled over is includible in income as if a withdrawal had been made, except that the 10-percent early withdrawal tax does not apply. Married taxpayers who file separate returns cannot roll over amounts in a traditional IRA into a Roth IRA. Amounts that have been distributed from a tax-qualified retirement plan, a tax-sheltered annuity, or a governmental section 457 plan may be rolled over into a traditional IRA, and then rolled over from the traditional IRA into a Roth IRA.

REASONS FOR CHANGE

Under present law if an individual wishes to roll over amounts from a qualified retirement plan or similar arrangement to a Roth IRA, they may do so, but only by first making a rollover into a traditional IRA and then converting the amounts in the traditional IRA into a Roth IRA. The Committee believes it unnecessary to impose such complications on rollovers from qualified retirement plans to Roth IRAs.

EXPLANATION OF PROVISION

The provision allows distributions from tax-qualified retirement plans, tax-sheltered annuities, and governmental 457 plans to be rolled over directly from such plan into a Roth IRA, subject to the present law rules that apply to rollovers from a traditional IRA into a Roth IRA. For example, a rollover from a tax-qualified retirement plan into a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10–percent early distribution tax does not apply. Similarly, an individual with AGI of $100,000 or more could not roll over amounts from a tax-qualified retirement plan directly into a Roth IRA.

EFFECTIVE DATE

The provision is effective for distributions made after December 31, 2005.

H. Elimination of Higher Early Withdrawal Tax on Certain SIMPLE Plan Distributions

(Sec. 808 of the bill and sec. 72(t) of the Code)

PRESENT LAW

SIMPLE plans

Under present law, certain small businesses can establish a simplified retirement plan called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans can be adopted by employers: (1) that employ 100 or fewer employees who received at least $5,000 in compensation during the preceding year; and (2) that do not maintain another employer-sponsored retirement plan. A SIMPLE plan can be either an individual retirement arrangement (an "IRA")[192] for each employee or part of a qualified cash or deferred arrangement (a "section 401(k) plan").[193] The rules applicable to SIMPLE IRAs and SIMPLE section 401(k) plans are similar, but not identical.

If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified retirement plans (including the top-heavy rules) and simplified reporting requirements apply. If established as part of a section 401(k) plan, the SIMPLE does not have to satisfy the special nondiscrimination tests applicable to section 401(k) plans and is not subject to the

[192] A SIMPLE IRA may not be in the form of a Roth IRA. References herein to IRAs do not refer to Roth IRAs.

[193] Because State or local governments generally are not permitted to maintain section 401(k) plans, they also generally are not permitted to maintain SIMPLE section 401(k) plans. However, a State or local government with a pre-May 6, 1986, grandfathered section 401(k) plan may adopt a SIMPLE section 401(k) plan.

top-heavy rules. The other qualified retirement plan rules apply to SIMPLE section 401(k) plans.

Elective deferrals under a section 401(k) plan generally may not be distributable before the occurrence of certain specified events, such as severance of employment, death, disability, attainment of age 59½, or financial hardship. This restriction on distributions applies to elective deferrals made under a SIMPLE section 401(k) plan, but not elective deferrals made under a SIMPLE IRA.

Early withdrawal tax

Taxable distributions made from an IRA or from certain employer-sponsored retirement plans (including a section 401(k) plan) before age 59½, death, or disability generally are subject to an additional 10-percent income tax. Early withdrawals from a SIMPLE plan generally are subject to the additional 10-percent tax. However, in the case of a SIMPLE IRA, early withdrawals during the two-year period beginning on the date the employee first participated in the SIMPLE IRA are subject to an additional 25-percent tax.

REASONS FOR CHANGE

The Committee believes that early withdrawals from SIMPLE IRAs should be subject to the same additional tax as other early withdrawals.

EXPLANATION OF PROVISION

The provision eliminates the 25-percent tax on early withdrawals from a SIMPLE IRA during the two-year period beginning on the date the employee first participated in the SIMPLE IRA. Thus, such withdrawals are subject to the 10-percent early withdrawal tax.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2005.

I. SIMPLE PLAN PORTABILITY

(Sec. 809 of the bill and secs. 402(c) and 408(d) of the Code)

PRESENT LAW

Under present law, certain small businesses can establish a simplified retirement plan called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans can be adopted by employers: (1) that employ 100 or fewer employees who received at least $5,000 in compensation during the preceding year; and (2) that do not maintain another employer-sponsored retirement plan. A SIMPLE plan can be either an individual retirement arrangement (an "IRA")[194] for each employee or part of a qualified cash or deferred arrangement (a "section 401(k) plan").[195] The

[194] A SIMPLE IRA may not be in the form of a Roth IRA. References herein to IRAs do not refer to Roth IRAs.

[195] Because State or local governments generally are not permitted to maintain section 401(k) plans, they also generally are not permitted to maintain SIMPLE section 401(k) plans. However,

Continued

rules applicable to SIMPLE IRAs and SIMPLE section 401(k) plans are similar, but not identical.

If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified retirement plans (including the top-heavy rules) and simplified reporting requirements apply. If established as part of a section 401(k) plan, the SIMPLE does not have to satisfy the special nondiscrimination tests applicable to section 401(k) plans and is not subject to the top-heavy rules. The other qualified retirement plan rules apply to SIMPLE section 401(k) plans.

Distributions from employer-sponsored retirement plans and IRAs (including SIMPLE plans) are generally includible in gross income, except to the extent the amount distributed represents a return of after-tax contributions (i.e., basis). If certain requirements are satisfied, distributions from a tax-favored retirement arrangement (i.e., a qualified retirement plan, a tax-sheltered annuity, a governmental section 457 plan, or an IRA) may generally be rolled over on a nontaxable basis to another tax-favored retirement arrangement. However, a distribution from a SIMPLE IRA during the two-year period beginning on the date the employee first participated in the SIMPLE IRA may be rolled over only to another SIMPLE IRA.

REASONS FOR CHANGE

The Committee believes that allowing rollovers between SIMPLE IRAs and other tax-favored retirement arrangements will help preserve retirement savings.

EXPLANATION OF PROVISION

The provision allows distributions from a SIMPLE IRA to be rolled over to another tax-favored retirement arrangement (i.e., an IRA, a qualified retirement plan, a tax-sheltered annuity, or a governmental section 457 plan) and distributions from another tax-favored retirement arrangement to be rollover over to a SIMPLE IRA.

EFFECTIVE DATE

The provision is effective for years beginning after December 31, 2005.

J. Eligibility for Participation in Eligible Deferred Compensation Plans

(Sec. 810 of the bill)

PRESENT LAW

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

Amounts deferred under an eligible deferred compensation plan of a non-governmental tax-exempt organization are includible in

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a State or local government with a pre-May 6, 1986, grandfathered section 401(k) plan may adopt a SIMPLE section 401(k) plan.

gross income for the year in which amounts are paid or made available. Under present law, if the amount payable to a participant does not exceed $5,000, a plan may allow a distribution up to $5,000 without such amount being treated as made available if the distribution can be made only if no amount has been deferred under the plan by the participant during the two-year period ending on the date of the distribution and there has been no prior distribution under the plan. Prior to the Small Business Job Protection Act of 1996, under former section 457(e)(9), benefits were not treated as made available because a participant could elect to receive a lump sum payable after separation from service and within 60 days of the election if (1) the total amount payable under the plan did not exceed $3,500 and (2) no additional amounts could be deferred under the plan.

REASONS FOR CHANGE

The Committee believes that individuals should not be precluded from participating in an eligible deferred compensation plan by reason of certain prior distributions.

EXPLANATION OF PROVISION

Under the provision, an individual is not precluded from participating in an eligible deferred compensation plan by reason of having received a distribution under section 457(e)(9) as in effect before the Small Business Job Protection Act of 1996.

EFFECTIVE DATE

The provision is effective on the date of enactment.

K. BENEFIT TRANSFERS TO THE PBGC

(Sec. 811 of the bill, sec. 401(a)(31) of the Code, and sec. 4050 of ERISA)

PRESENT LAW

Involuntary distributions and automatic rollovers

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant (an "involuntary distribution") and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000.[196] Generally, a participant may roll over an involuntary distribution from a qualified plan to an individual retirement arrangement (an "IRA") or to another qualified plan.

In the case of an involuntary distribution that exceeds $1,000 and that is an eligible rollover distribution from a qualified retirement plan, the plan administrator must roll the distribution over to an IRA (an "automatic rollover") in certain cases.[197] That is, the

[196] The portion of a participant's benefit that is attributable to amounts rolled over from another plan may be disregarded in determining the present value of the participant's vested accrued benefit.

[197] Sec. 401(a)(31)(B). This provision was enacted by section 657 of EGTRRA and applies to distributions after the issuance of final regulations by the Department of Labor providing safe harbors for satisfying fiduciary requirements related to automatic rollovers. Proposed regula-

Continued

plan administrator must make a direct trustee-to-trustee transfer of the distribution to an IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly.

Before making a distribution that is eligible for rollover, a plan administrator must provide the participant with a written explanation of the ability to have the distribution rolled over directly to an IRA or another qualified plan and the related tax consequences. In the case of an automatic rollover to an IRA, the written explanation provided by the plan administrator is required to explain that an automatic rollover will be made unless the participant elects otherwise. The plan administrator is also required to notify the participant in writing (as part of the general written explanation or separately) that the distribution may be transferred to another IRA.

Missing participant benefits

In the case of a defined benefit pension plan that is subject to the plan termination insurance program under Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), is maintained by a single employer, and terminates under a standard termination, the plan administrator generally must purchase annuity contracts from a private insurer to provide the benefits to which participants are entitled and distribute the annuity contracts to the participants.

If the plan administrator of a terminating single employer plan cannot locate a participant after a diligent search (a "missing participant"), the plan administrator may satisfy the distribution requirement only by purchasing an annuity from an insurer or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.[198]

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

REASONS FOR CHANGE

The Committee believes that allowing plan administrators to make automatic rollovers to the PBGC will facilitate automatic rollovers and reduce administrative burdens while providing adequate participant protections.

EXPLANATION OF PROVISION

The provision provides an alternative to the automatic rollover to an IRA of an involuntary distribution that exceeds $1,000. Under the provision, unless the participant elects to have the distribution transferred to an IRA or a qualified retirement plan or to receive it directly, the plan may provide for the transfer of the distribution

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tions providing such a safe harbor were issued by the Department of Labor, to be effective six months after the issuance of final regulations. 69 Fed. Reg. 9900 (March 2, 2004). The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

[198] Secs. 4041(b)(3)(A) and 4050 of ERISA.

to the PBGC, instead of to an IRA.[199] The written explanation provided to the participant by the plan administrator before the involuntary distribution must explain that a transfer to the PBGC will be made unless the participant elects otherwise.

The provision extends the provisions relating to the PBGC missing participant program to involuntary distributions that are transferred to the PBGC. Benefits transferred to the PBGC under the provision are to be distributed by the PBGC to the participant upon application filed by the participant with the PBGC in such form and manner as prescribed by the PBGC in regulations. Benefits are to be distributed in a single sum (plus interest) or in another form as specified in PBGC regulations.

Under the provision, on a transfer of benefits to the PBGC, a plan administrator must provide information required by the PBGC with respect to the benefits transferred. The PBGC may charge a reasonable fee for costs incurred in connection with the transfer and management of transferred amounts.

The transfer of an involuntary distribution to the PBGC is treated as a transfer to an IRA (i.e., the amount transferred is not included in the participant's income). An amount distributed by the PBGC is generally treated as a distribution from an IRA.

EFFECTIVE DATE

The provision is generally effective as if included in the amendments made by section 657 of EGTRRA, i.e., after the issuance of final regulations by the Department of Labor. The extension of the PBGC missing participant program to involuntary distributions that are transferred to the PBGC is effective for distributions made after the issuance of final regulations implementing such extension. The PBGC is directed to issue such regulations not later than December 31, 2006.

L. Missing Participants

(Sec. 812 of the bill and sec. 4050 of ERISA)

PRESENT LAW

In the case of a defined benefit pension plan that is subject to the plan termination insurance program under Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), is maintained by a single employer, and terminates under a standard termination, the plan administrator generally must purchase annuity contracts from a private insurer to provide the benefits to which participants are entitled and distribute the annuity contracts to the participants.

If the plan administrator of a terminating single employer plan cannot locate a participant after a diligent search (a "missing participant"), the plan administrator may satisfy the distribution requirement only by purchasing an annuity from an insurer or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the

[199] The provision applies to all automatic rollovers, not just those for missing participants or from terminating plans.

missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.[200]

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

REASONS FOR CHANGE

The Committee recognizes that no statutory provision or formal regulatory guidance exists concerning an appropriate method of handling the benefits of missing participants in terminated multiemployer plans or defined contribution plans and other plans not subject to the PBGC termination insurance program. Therefore, sponsors of these plans face uncertainty with respect to the benefits of missing participants. The Committee believes that it is appropriate to extend the established PBGC missing participant program to these plans in order to reduce uncertainty for plan sponsors and increase the likelihood that missing participants will receive their retirement benefits.

EXPLANATION OF PROVISION

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

In addition, plan administrators of certain types of plans not subject to the PBGC termination insurance program under present law are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the provision extends the missing participants program (in accordance with regulations) to defined contribution plans, defined benefit pension plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit pension plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

EFFECTIVE DATE

The provision is effective for distributions made after final regulations implementing the provision are prescribed.

TITLE IX—ADMINISTRATIVE PROVISIONS

A. Updating of Employee Plans Compliance Resolution System

(Sec. 901 of the bill)

PRESENT LAW

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the re-

[200] Secs. 4041(b)(3)(A) and 4050 of ERISA.

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

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), section 403(b), section 408(k), or section 408(p) as applicable.[201] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

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

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established compliance practices and procedures to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

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

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision clarifies that the Secretary has the full authority to establish and implement EPCRS (or any successor program) and any other employee plans correction policies, including the authority to waive income, excise or other taxes to ensure that any tax,

[201] Rev. Proc. 2003–44, 2003–25 I.R.B. 1051.

penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure.

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

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Extension to all Governmental Plans of Moratorium on Application of Certain Nondiscrimination Rules

(Sec. 902 of the bill, sec. 1505 of the Taxpayer Relief Act of 1997, and secs. 401(a) and 401(k) of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government is exempt from the requirements concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). A qualified retirement plan maintained by a State or local government is also treated as meeting the participation and nondiscrimination requirements applicable to a qualified cash or deferred arrangement (sec. 401(k)(3)). Other governmental plans are subject to these requirements.[202]

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision exempts all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules. The provision also treats all governmental plans as meeting the participation and nondiscrimination requirements applicable to a qualified cash or deferred arrangement.

[202] The IRS has announced that governmental plans that are subject to the nondiscrimination requirements are deemed to satisfy such requirements pending the issuance of final regulations addressing this issue. Notice 2003–6, 2003–3 I.R.B. 298; Notice 2001–46, 2001–2 C.B. 122.

EFFECTIVE DATE

The provision is effective for plan years beginning after December 31, 2005.

C. Notice and Consent Period Regarding Distributions

(Sec. 903 of the bill, sec. 417(a) of the Code, and sec. 205(c) of ERISA)

PRESENT LAW

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

If the present value of the participant's vested accrued benefit exceeds $5,000,[203] the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or individual retirement arrangement ("IRA"), and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements are applicable, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

REASONS FOR CHANGE

The Committee understands that an employee is not always able to evaluate distribution alternatives, select the most appropriate alternative, and notify the plan of the selection within a 90-day period. The Committee believes that requiring a plan to furnish multiple distribution notices to an employee who does not make a distribution election within 90 days is administratively burdensome. In addition, the Committee believes that participants who are entitled to defer distributions should be informed of the impact of a decision not to defer distribution on the taxation and accumulation of their retirement benefits.

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[203] The portion of a participant's benefit that is attributable to amounts rolled over from another plan may be disregarded in determining the present value of the participant's vested accrued benefit.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

The provision and the modifications required to be made under the provision apply to years beginning after December 31, 2005. In the case of a description of the consequences of a participant's failure to defer receipt of a distribution that is made before the date, 90 days after the date on which the Secretary of the Treasury makes modifications to the applicable regulations, the plan administrator is required to make a reasonable attempt to comply with the requirements of the provision.

D. Pension Plan Reporting Simplification

(Sec. 904 of the bill)

PRESENT LAW

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[204] The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Department of Labor, which forwards the form to the Internal Revenue Service and the PBGC.

The Form 5500 series consists of 2 different forms: Form 5500 and Form 5500–EZ. Form 5500 is the more comprehensive of the forms and requires the most detailed financial information. The plan administrator of a "one-participant plan" generally may file Form 5500–EZ, which consists of only one page. For this purpose, a plan is a one-participant plan if: (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses); (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b); (3) the plan does not provide benefits to anyone other than the sole owner of the business (or the sole

[204] Treas. Reg. sec. 301.6058–1(a).

owner and spouse) or the partners in the business (or the partners and spouses); (4) the employer is not a member of a related group of employers; and (5) the employer does not use the services of leased employees. In addition, the plan administrator of a one-participant plan is not required to file a return if the plan does not have an accumulated funding deficiency and the total value of the plan assets as of the end of the plan year and all prior plan years beginning on or after January 1, 1994, does not exceed $100,000.

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

REASONS FOR CHANGE

The Committee believes that simplification of the reporting requirements applicable to plans of small employers will encourage such employers to provide retirement benefits for their employees.

EXPLANATION OF PROVISION

The Secretary of the Treasury, in consultation with the Secretary of Labor, is directed to modify the annual return filing requirements with respect to a one-participant plan to provide that if the total value of the plan assets of such a plan as of the end of the plan year does not exceed $250,000, the plan administrator is not required to file a return. In addition, the provision directs the Secretary of the Treasury and the Secretary of Labor to provide simplified reporting requirements for plan years beginning after December 31, 2006, for certain plans with fewer than 25 participants.

EFFECTIVE DATE

The provision relating to one-participant retirement plans is effective for plan years beginning on or after January 1, 2006. The provision relating to simplified reporting for plans with fewer than 25 participants is effective on the date of enactment.

E. Voluntary Early Retirement Incentive and Employment Retention Plans Maintained by Local Educational Agencies and Other Entities

(Sec. 904 of the bill, secs. 457(e)(11) and 457(f) of the Code, sec. 3(2)(B) of ERISA, and sec. 4(l)(1) of the ADEA)

PRESENT LAW

Eligible deferred compensation plans of State and local governments and tax-exempt employers

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, the amount that can be deferred annually under section 457 cannot exceed a certain dollar limit ($14,000 for 2005). Amounts deferred under a section 457 plan are generally includible in gross income when paid or made available (or, in the case of governmental section 457 plans, when paid). Sub-

ject to certain exceptions, amounts deferred under a plan that does not comply with section 457 (an "ineligible plan") are includible in income when the amounts are not subject to a substantial risk of forfeiture. Section 457 does not apply to any bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plan. Additionally, section 457 does not apply to qualified retirement plans or qualified governmental excess benefit plans that provide benefits in excess of those that are provided under a qualified retirement plan maintained by the governmental employer.

ERISA

ERISA provides rules governing the operation of most employee benefit plans. The rules to which a plan is subject depend on whether the plan is an employee welfare benefit plan or an employee pension benefit plan. For example, employee pension benefit plans are subject to reporting and disclosure requirements, participation and vesting requirements, funding requirements, and fiduciary provisions. Employee welfare benefit plans are not subject to all of these requirements. Governmental plans are exempt from ERISA.

Age Discrimination in Employment Act

The Age Discrimination in Employment Act ("ADEA") generally prohibits discrimination in employment because of age. However, certain defined benefit pension plans may lawfully provide payments that constitute the subsidized portion of an early retirement benefit or social security supplements pursuant to ADEA[205], and employers may lawfully provide a voluntary early retirement incentive plan that is consistent with the purposes of ADEA.[206]

REASONS FOR CHANGE

The Committee is aware that some public school districts and related tax-exempt education associations provide certain employees with voluntary early retirement incentive benefits similar to benefits that can be provided under a defined benefit pension plan. If provided under a defined benefit pension plan, these benefits would not be includible in income until paid and would also generally be permitted under ADEA. However, for reasons related to the structure of State-maintained defined benefit pension plans covering these employees and fiscal operations of the local school districts, these benefits are provided to the employees directly, rather than under the defined benefit pension plan. The Committee believes it is appropriate to treat these benefits in a manner similar to the treatment that would apply if the benefits were provided under the defined benefit pension plan. The Committee also believes that it is appropriate to address the treatment of certain employment retention plans maintained by local school districts and related tax-exempt education associations.

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[205] See ADEA sec. 4(l)(1).
[206] See ADEA sec. 4(f)(2).

EXPLANATION OF PROVISION

Early retirement incentive plans of local educational agencies and education associations

In general

The provision addresses the treatment of certain voluntary early retirement incentive plans under section 457, ERISA, and ADEA.

Code section 457

Under the provision, special rules apply under section 457 to a voluntary early retirement incentive plan that is maintained by a local educational agency or a tax-exempt education association which principally represents employees of one or more such agencies and that makes payments or supplements as an early retirement benefit, a retirement-type subsidy, or a social security supplement in coordination with a defined benefit pension plan maintained by a State or local government or by such an association. Such a voluntary early retirement incentive plan is treated as a bona fide severance plan for purposes of section 457, and therefore is not subject to the limits under section 457, to the extent the payments or supplements could otherwise be provided under the defined benefit pension plan. For purposes of the provision, the payments or supplements that could otherwise be provided under the defined benefit pension plan are to be determined by applying the accrual and vesting rules for defined benefit pension plans.[207]

ERISA

In addition, such voluntary early retirement incentive plans are treated as welfare benefit plans for purposes of ERISA (other than governmental plans that are exempt from ERISA).

ADEA

The provision also addresses the treatment under ADEA of voluntary early retirement incentive plans that are maintained by local educational agencies and tax-exempt education associations which principally represent employees of one or more such agencies, and that make payments or supplements that constitute the subsidized portion of an early retirement benefit or a social security supplement and that are made in coordination with a defined benefit pension plan maintained by a State or local government or by such an association. Under the provision, for purposes of ADEA, such a plan is treated as part of the defined benefit pension plan and the payments or supplements under the plan are not severance pay that may be subject to certain deductions under ADEA.

Employment retention plans of local educational agencies and education associations

The provision addresses the treatment of certain employment retention plans under section 457 and ERISA. The provision applies to employment retention plans that are maintained by local educational agencies or tax-exempt education associations which prin-

[207] The accrual and vesting rules have the effect of limiting the social security supplements and early retirement benefits that may be provided under a defined benefit pension plan; however, government plans are exempt from these rules.

cipally represent employees of one or more such agencies and that provide compensation to an employee (payable on termination of employment) for purposes of retaining the services of the employee or rewarding the employee for service with educational agencies or associations.

Under the provision, special tax treatment applies to the portion of an employment retention plan that provides benefits that do not exceed twice the applicable annual dollar limit on deferrals under section 457 ($14,000 for 2005). The provision provides an exception from the rules under section 457 for ineligible plans with respect to such portion of an employment retention plan. This exception applies for years preceding the year in which benefits under the employment retention plan are paid or otherwise made available to the employee. In addition, such portion of an employment retention plan is not treated as providing for the deferral of compensation for tax purposes.

Under the provision, an employment retention plan is also treated as a welfare benefit plan for purposes of ERISA (other than a governmental plan that is exempt from ERISA).

EFFECTIVE DATE

The provision is generally effective on the date of enactment. The amendments to section 457 apply to taxable years ending after the date of enactment. The amendments to ERISA apply to plan years ending after the date of enactment. Nothing in the provision alters or affects the construction of the Code, ERISA, or ADEA as applied to any plan, arrangement, or conduct to which the provision does not apply.

F. No Reduction in Unemployment Compensation as a Result of Pension Rollovers

(Sec. 906 of the bill and sec. 3304(a)(15) of the Code)

PRESENT LAW

Under present law, unemployment compensation payable by a State to an individual generally is reduced by the amount of retirement benefits received by the individual. Distributions from certain employer-sponsored retirement plans or IRAs that are transferred to a similar retirement plan or IRA ("rollover distributions") generally are not includible in income. Some States currently reduce the amount of an individual's unemployment compensation by the amount of a rollover distribution.

REASONS FOR CHANGE

Unlike an individual's unemployment compensation, rollover distributions are not intended to meet current living expenses. To the extent that a reduction of an individual's unemployment compensation results in that individual liquidating a portion of a rollover distribution to meet current living expenses, the Committee believes that the purpose of the rules permitting rollover distributions, which are designed to ensure that the amounts contributed to employer-sponsored retirement plans or IRAs are used for retirement purposes, are defeated.

EXPLANATION OF PROVISION

The provision amends the Code so that the reduction of unemployment compensation payable to an individual by reason of the receipt of retirement benefits does not apply in the case of a rollover distribution.

EFFECTIVE DATE

The provision is effective for weeks beginning on or after the date of enactment.

G. Withholding on Certain Distributions From Governmental Eligible Deferred Compensation Plans

(Sec. 907 of the bill and sec. 457 of the Code)

PRESENT LAW

Before the Economic Growth and Tax Relief Reconciliation Act of 2001[208] ("EGTRRA"), distributions from an eligible deferred compensation plan under section 457 (a "section 457 plan") were subject to the withholding rules for wages, rather than the withholding rules for distributions from qualified retirement plans. Under the wage withholding rules, graduated withholding applies based on the amount of the wages. Under the withholding rules for qualified retirement plans, an individual may generally elect not to have taxes withheld from distributions. However, withholding is required at a 20-percent rate in the case of an eligible rollover distribution that is not automatically rolled over into another retirement plan. Eligible rollover distributions include distributions that are payable over a period of less than 10 years.

EGTRRA conformed the rollover rules and withholding rules for governmental section 457 plans to the rules for qualified retirement plans.[209] The EGTRRA changes are effective for distributions after December 31, 2001. As a result, as of 2002, required withholding at a 20-percent rate applies to distributions made from a governmental section 457 plan for a period of less than 10 years, including distributions that began before the effective date of the EGTRRA changes.

REASONS FOR CHANGE

The Committee believes that distributions that have already begun from governmental section 457 plans under the prior-law rules should not have to be modified to conform to the EGTRRA withholding provisions.

EXPLANATION OF PROVISION

Under the provision, the pre-EGTRRA withholding rules may be applied to distributions from a governmental section 457 plan if the distribution is part of a series of distributions which began before January 1, 2002, and is payable for less than 10 years.

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[208] Pub. L. No. 107–16.
[209] EGTRRA sec. 641.

EFFECTIVE DATE

The provision is effective as if included in section 641 of EGTRRA.

H. Defined Benefit Plans Maintained by Tribal Governments

(Sec. 908 of the bill)

PRESENT LAW

Under present law, in some cases governmental plans are subject to different rules than other qualified plans. For example, governmental plans generally are not subject to the same nondiscrimination rules as other plans and the minimum funding rules do not apply to such plans.

REASONS FOR CHANGE

Questions have arisen with respect to the application of the qualified plan rules to plans of tribal governments. Clarification of the status of such plans would provide greater certainty for plan sponsors, plan participants, and the IRS.

EXPLANATION OF PROVISION

The bill provides that, in the case of defined benefit plans, the term "governmental plan" under the Code and ERISA includes a plan established or maintained for its employees by an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency instrumentality (or subdivision) of an Indian tribal government, or an entity established under Federal, State, or tribal law which is wholly owned or controlled by any of the foregoing. In addition, under the provision, certain special rules applicable to defined benefit plans maintained by State or local governments apply also to defined benefit plans maintained by Indian tribal governments, and such plans are not subject to the PBGC insurance program. No inference is intended that the provision is not present law or that defined contributions plans maintained by an employer described in the proposal are not governmental plans.

EFFECTIVE DATE

The provision is effective for any year beginning before, on, or after the date of enactment.

I. Treatment of Plan of Certain Nonprofit Organization as a Governmental Plan

(Sec. 909 of the bill)

PRESENT LAW

Under present law, in some cases governmental plans are subject to different rules than other qualified plans. For example, governmental plans generally are not subject to the same nondiscrimination rules as other plans and the minimum funding rules do not apply to such plans.

REASONS FOR CHANGE

Questions have arisen as to the application of the qualified plan rules to a plan of a nonprofit organization that is a governmental entity under applicable State law. Clarification of the status of such plan would provide greater certainty for the plan sponsor, plan participants, and the IRS.

EXPLANATION OF PROVISION

The bill provides that a defined benefit plan of a nonprofit organization is treated as a governmental plan under the Code and ERISA if the organization was: (1) incorporated on September 16, 1998, under a State nonprofit corporation statute; and (2) organized for the express purpose of supporting the missions and goals of a public corporation which was (a) created by a State statute effective on July 1, 1995, (b) is a governmental entity under State law, and (c) is a member of the nonprofit corporation.

EFFECTIVE DATE

The provision is effective for any year beginning before, on, or after the date of enactment.

J. PROVISIONS RELATING TO PLAN AMENDMENTS

(Sec. 910 of the bill)

PRESENT LAW

Present law provides a remedial amendment period during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements.[210] In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

The Code and ERISA provide that, in general, accrued benefits cannot be reduced by a plan amendment.[211] This prohibition on the reduction of accrued benefits is commonly referred to as the "anticutback rule."

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision permits certain plan amendments made pursuant to the changes made by the bill or by the Economic Growth and Tax Relief Reconciliation Act of 2001[212] ("EGTRRA"), or regulations issued thereunder, to be retroactively effective. If the plan amendment meets the requirements of the provision, then the plan will be treated as being operated in accordance with its terms and

[210] Sec. 401(b).
[211] Code sec. 411(d)(6); ERISA sec. 204(g).
[212] Pub. L. No. 107–16.

the amendment will not violate the anticutback rule. In order for this treatment to apply, the plan amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2006, or such later date as provided by the Secretary of the Treasury. Governmental plans are given an additional two years in which to make required plan amendments. If the amendment is required to be made to retain qualified status as a result of the changes in the law (or regulations), the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan and the plan is required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to the changes made by the bill or EGTRRA (or applicable regulations) may be made retroactively effective as of the first day the plan is operated in accordance with the amendment.

A plan amendment will not be considered to be pursuant to the bill or EGTRRA (or applicable regulations) if it has an effective date before the effective date of the provision under the bill or EGTRRA (or regulations) to which it relates. Similarly, the provision does not provide relief from the anticutback rule for periods prior to the effective date of the relevant provision (or regulations) or the plan amendment.

The Secretary of the Treasury is authorized to provide exceptions to the relief from the prohibition on reductions in accrued benefits. It is intended that the Secretary will not permit inappropriate reductions in contributions or benefits that are not directly related to the provisions under the bill or EGTRRA. For example, it is intended that a plan that incorporates the section 415 limits by reference can be retroactively amended to impose the section 415 limits in effect before EGTTRA.[213] On the other hand, suppose a plan incorporates the section 401(a)(17) limit on compensation by reference and provides for an employer contribution of three percent of compensation. It is expected that the Secretary will provide that, in that case, the plan cannot be amended retroactively to reduce the contribution percentage for those participants not affected by the section 401(a)(17) limit, even though the reduction will result in the same dollar level of contributions for some participants because of the increase in compensation taken into account under the plan as a result of the increase in the section 401(a)(17) limit under EGTRRA. As another example, suppose that under present law a plan is top-heavy and therefore a minimum benefit is required under the plan, and that under the provisions of EGTRRA, the plan is not considered to be top-heavy. It is expected that the Secretary will generally permit plans to be retroactively amended to reflect the new top-heavy provisions of EGTRRA.

EFFECTIVE DATE

The provision is effective on the date of enactment.

[213] See also, section 411(j)(3) of the Job Creation and Worker Assistance Act of 2002, which provides a special rule for plan amendments adopted on or before June 30, 2002, in connection with EGTRRA, in the case of a plan that incorporated the section 415 limits by reference on June 7, 2001, the date of enactment of EGTRRA.

TITLE X—UNITED STATES TAX COURT MODERNIZATION

A. Tax Court Pension and Compensation

1. Judges of the Tax Court (secs. 1001–1007 and 1013 of the bill and secs. 7443, 7447, 7448, and 7472 of the Code)

PRESENT LAW

The Tax Court is established by the Congress pursuant to Article I of the U.S. Constitution.[214] The salary of a Tax Court judge is the same salary as received by a U.S. District Court judge.[215] Present law also provides Tax Court judges with some benefits that correspond to benefits provided to U.S. District Court judges, including specific retirement and survivor benefit programs for Tax Court judges.[216]

Under the retirement program, a Tax Court judge may elect to receive retirement pay from the Tax Court in lieu of benefits under another Federal retirement program. A Tax Court judge may also elect to participate in a plan providing annuity benefits for the judge's surviving spouse and dependent children (the "survivors" annuity plan"). Generally, benefits under the survivors' annuity plan are payable only if the judge has performed at least five years of service. Cost-of-living increases in benefits under the survivors' annuity plan are generally based on increases in pay for active judges.

Tax Court judges participate in the Federal Employees Group Life Insurance program (the "FEGLI" program). Retired Tax Court judges are eligible to participate in the FEGLI program as the result of an administrative determination of their eligibility, rather than a specific statutory provision.

Tax Court judges are not covered by the leave system for Federal Executive Branch employees. As a result, an individual who works in the Federal Executive Branch before being appointed to the Tax Court does not continue to accrue annual leave under the same leave program and may not use leave accrued prior to his or her appointment to the Tax Court.

Tax Court judges are not eligible to participate in the Thrift Savings Plan.

Under the retirement program for Tax Court judges, retired judges generally receive retired pay equal to the rate of salary of an active judge and must be available for recall to perform judicial duties as needed by the court for up to 90 days a year (unless the judge consents to more). However, retired judges may elect to freeze the amount of their retired pay, and those who do so are not available for recall.

Retired Tax Court judges on recall are subject to the limitations on outside earned income that apply to active Federal employees under the Ethics in Government Act of 1978. However, retired District Court judges on recall may receive compensation for teaching without regard to the limitations on outside earned income. Retired Tax Court judges who elect to freeze the amount of their retired

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[214] Sec. 7441.
[215] Sec. 7443(c).
[216] Secs. 7447 and 7448.

pay (thus making themselves unavailable for recall) are not subject to the limitations on outside earned income.

REASONS FOR CHANGE

Tax Court judges receive compensation at the same rate as District Court judges. In addition, the benefit programs for Tax Court judges are intended to accord with similar programs applicable to District Court judges.[217] However, subsequent legislative changes in the benefits provided to District Court judges and judges in certain other Article I courts have not applied to Tax Court judges, thus creating disparities between the treatment of Tax Court judges and the treatment of other Federal judges.

The Committee believes that, as a general matter, parity should exist between the benefits provided to Tax Court judges and those provided to District Court judges. Thus, the benefits provided to Tax Court judges should be updated to reflect benefits currently provided to District Court judges.

In addition, the Committee is concerned that certain aspects of the present-law rules relating to Tax Court judges may be inequitable in that Tax Court judges are treated less favorably than District Court judges and judges in certain other Article I courts. With respect to increases in FEGLI premiums for Tax Court judges age 65 or older, the Committee believes that the Tax Court should be authorized to pay for such increases, similar to authority in other Federal courts. In addition, because Tax Court judges are not covered by the leave system for Federal Executive Branch employees, a judge who has unused accrued annual leave for service with the Federal Executive Branch should be able to receive a lump sum payment for such accrued annual leave. Moreover, the Committee believes that exempting from the limitation on outside earned income compensation received by retired Tax Court judges for teaching will encourage such judges to remain available for recall by the court.

EXPLANATION OF PROVISION

Survivor annuities for assassinated judges

Under the provision, benefits under the survivors' annuity plan are payable if a Tax Court judge is assassinated before the judge has performed five years of service.

Cost-of-living adjustments for survivor annuities

The provision provides that cost-of-living increases in benefits under the survivors' annuity plan are generally based on cost-of-living increases in benefits paid under the Civil Service Retirement System.

Life insurance coverage

Under the provision, a judge or retired judge of the Tax Court is deemed to be an employee continuing in active employment for purposes of participation in the Federal Employees Group Life Insurance program. In addition, in the case of a Tax Court judge age 65 or over, the Tax Court is authorized to pay on behalf of the

[217] See, e.g., S. Rep. No. 91–552, at 303 (1969).

judge any increase in employee premiums under the FEGLI program that occur after April 24, 1999,[218] including expenses generated by such payment, as authorized by the chief judge of the Tax Court in a manner consistent with payments authorized by the Judicial Conference of the United States (i.e., the body with policy-making authority over the administration of the courts of the Federal judicial branch).

Accrued annual leave

Under the provision, in the case of a judge who is employed by the Federal executive branch before appointment to the Tax Court, the judge is entitled to receive a lump-sum payment for the balance of his or her accrued annual leave on appointment to the Tax Court.

Thrift Savings Plan participation

Under the provision, Tax Court judges are permitted to participate in the Thrift Savings Plan. A Tax Court judge is not eligible for agency contributions to the Thrift Savings Plan.

Exemption for teaching compensation from outside earned income limitations

Under the provision, compensation earned by a retired Tax Court judge for teaching is not treated as outside earned income for purposes of limitations under the Ethics in Government Act of 1978.

EFFECTIVE DATE

The provisions are effective on the date of enactment, except that: (1) the provision relating to cost-of-living increases in benefits under the survivors' annuity plan applies with respect to increases in Civil Service Retirement benefits taking effect after the date of enactment; (2) the provision relating to FEGLI coverage applies to any individual serving as a Tax Court judge or any retired Tax Court judge on or after the date of enactment; (3) the provision relating to payment of accrued annual leave applies to any Tax Court judge with an outstanding leave balance as of the date of enactment and to any individual appointed to serve as a Tax Court judge after such date; and (4) the provision relating to teaching compensation of a retired Tax Court judge applies to any individual serving as a retired Tax Court judge on or after the date of enactment.

2. Special trial judges of the Tax Court (secs. 1008–1013 of the bill and sec. 7448 and new secs. 7443A, 7443B, and 7443C of the Code)

PRESENT LAW

The Tax Court is established by the Congress pursuant to Article I of the U.S. Constitution.[219] The chief judge of the Tax Court may appoint special trial judges to handle certain cases.[220] Special trial judges serve for an indefinite term. Special trial judges receive a

[218] This date relates to changes in the FEGLI program, including changes to premium rates to reflect employees' ages.
[219] Sec. 7441.
[220] Sec. 7443A.

salary of 90 percent of the salary of a Tax Court judge and are generally covered by the benefit programs that apply to Federal executive branch employees, including the Civil Service Retirement System or the Federal Employees' Retirement System.

REASONS FOR CHANGE

Special trial judges of the Tax Court perform a role similar to that of magistrate judges in courts established under Article III of the U.S. Constitution ("Article III" courts). However, disparities exist between the positions of magistrate judges of Article III courts and special trial judges of the Tax Court. For example, magistrate judges of Article III courts are appointed for a specific term, are subject to removal only in limited circumstances, and are eligible for coverage under special retirement and survivor benefit programs. The Committee believes that special trial judges of the Tax Court and magistrate judges of Article III courts should receive comparable treatment as to the status of the position, salary, and benefits. This will better enable the Tax Court to attract and retain qualified persons to serve in this capacity.

EXPLANATION OF PROVISION

Magistrate judges of the Tax Court

Under the provision, the position of special trial judge of the Tax Court is renamed as magistrate judge of the Tax Court. Magistrate judges are appointed (or reappointed) to serve for eight-year terms and are subject to removal in limited circumstances.

Under the provision, a magistrate judge receives a salary of 92 percent of the salary of a Tax Court judge.

The provision exempts magistrate judges from the leave program that applies to employees of the Federal executive branch and provides rules for individuals who are subject to such leave program before becoming exempt.

Survivors' annuity plan

Under the provision, magistrate judges of the Tax Court may elect to participate in the survivors' annuity plan for Tax Court judges. An election to participate in the survivors' annuity plan must be filed not later than the latest of: (1) twelve months after the date of enactment of the provision; (2) six months after the date the judge takes office; or (3) six months after the date the judge marries.

Retirement annuity program for magistrate judges

The provision establishes a new retirement annuity program for magistrate judges of the Tax Court, under which a magistrate judge may elect to receive a retirement annuity from the Tax Court in lieu of benefits under another Federal retirement program. A magistrate judge may elect to be covered by the retirement program within five years of appointment or five years of date of enactment. A magistrate judge who elects to be covered by the retirement program generally receives a refund of contributions (with interest) made to the Civil Service Retirement System or the Federal Employees' Retirement System.

A magistrate judge may retire at age 65 with 14 years of service and receive an annuity equal to his or her salary at the time of retirement. For this purpose, service may include service performed as a special trial judge or a magistrate judge, provided the service is performed no earlier than 9½ years before the date of enactment of the provision. The provision also provides for payment of a reduced annuity in the case a magistrate judge with at least eight years of service or in the case of disability or failure to be reappointed.

A magistrate judge receiving a retirement annuity is entitled to cost-of-living increases based on cost-of-living increases in benefits paid under the Civil Service Retirement System. However, such an increase cannot cause the retirement annuity to exceed the current salary of a magistrate judge.

Contributions of one percent of salary are withheld from the salary of a magistrate judge who elects to participate in the retirement annuity program. Such contributions must be made also with respect to prior service for which the magistrate judge elects credit under the retirement annuity program. No contributions are required after 14 years of service. A lump sum refund of the magistrate judge's contributions (with interest) is made if no annuity is payable, for example, if the magistrate judge dies before retirement.

A magistrate judge's right to a retirement annuity is generally suspended or reduced in the case of employment outside the Tax Court.

The provision includes rules under which annuity payments may be made to a person other than the magistrate judge in certain circumstances, such as divorce or legal separation, under a court decree, a court order, or court-approved property settlement.

The provision establishes the Tax Court Judicial Officers' Retirement Fund (the "Fund"). Amounts in the Fund are authorized to be appropriated for the payment of annuities, refunds, and other payments under the retirement annuity program. Contributions withheld from a magistrate judge's salary are deposited in the Fund. In addition, the provision authorizes to be appropriated to the Fund amounts required to reduce the Fund's unfunded liability to zero. For this purpose, the Fund's unfunded liability means the estimated excess, actuarially determined on an annual basis, of the present value of benefits payable from the Fund over the sum of (1) the present value of contributions to be withheld from the future salary of the magistrate judges and (2) the balance in the Fund as of the date the unfunded liability is determined.

Under the provision, a magistrate judge who elects to participate in the retirement annuity program is also permitted to participate in the Thrift Savings Plan. Such a magistrate judge is not eligible for agency contributions to the Thrift Savings Plan.

Retirement annuity rule for incumbent magistrate judges

The provision provides a transition rule for magistrate judges in active service on the date of enactment of the provision. Under the transition rule, such a magistrate judge is entitled to an annuity under the Civil Service Retirement System or the Federal Employees' Retirement System based on prior service that is not credited under the magistrate judges' retirement annuity program. If the

magistrate judge made contributions to the Civil Service Retirement System or the Federal Employees' Retirement System with respect to service that is credited under the magistrate judges' retirement annuity program, such contributions are refunded (with interest).

A magistrate judge who elects the transition rule is also entitled to the annuity payable under the magistrate judges' retirement program in the case of retirement with at least eight years of service or on failure to be reappointed. This annuity is based on service as a magistrate judge or special trial judge of the Tax Court that is performed no earlier than 9½ years before the date of enactment of the provision and for which the magistrate judge makes contributions of one percent of salary.

Recall of retired magistrate judges

The provision provides rules under which a retired magistrate judge may be recalled to perform services for up to 90 days a year.

EFFECTIVE DATE

The provisions are effective on date of enactment.

B. Tax Court Procedure

1. Jurisdiction of Tax Court over collection due process cases (sec. 1021 of the bill and sec. 6330 of the Code)

PRESENT LAW

In general, the Internal Revenue Service ("IRS") is required to notify taxpayers that they have a right to a fair and impartial hearing before levy may be made on any property or right to property.[221] Similar rules apply with respect to liens.[222] The hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. The appeal must be brought to the United States Tax Court (the "Tax Court"), unless the Tax Court does not have jurisdiction over the underlying tax liability. If that is the case, then the appeal must be brought in the district court of the United States.[223] If a court determines that an appeal was not made to the correct court, the taxpayer has 30 days after such determination to file with the correct court.

The Tax Court is established under Article I of the United States Constitution[224] and is a court of limited jurisdiction.[225] The Tax Court only has the jurisdiction that is expressly conferred on it by statute. For example, the jurisdiction of the Tax Court includes the authority to redetermine the correct amount of an income, estate, or gift tax deficiency, to make certain types of declaratory judgments, and to determine certain worker classification status issues, but does not include jurisdiction over most excise taxes imposed by the Internal Revenue Code. Thus, the Tax Court lacks jurisdiction

[221] Sec. 6330(a).
[222] Sec. 6320.
[223] Sec. 6330(d).
[224] Sec. 7441.
[225] Sec. 7442.

over the appeal of a due process hearing relating to certain collections matters.

REASONS FOR CHANGE

The Tax Court does not have jurisdiction over all of the tax issues underlying collection due process cases. For example, the jurisdiction of the Tax Court does not extend to issues involving most excise taxes. Thus, a taxpayer seeking to appeal the collection due process determination must know whether the Tax Court or a district court has jurisdiction over the underlying tax liability.

The judicial appeals structure of present law was designed in recognition of these jurisdictional limitations; however, in many cases the underlying taxes are not involved in determining the due process issue. The present-law structure can lead to taxpayer confusion over which court is the proper court in which to file an appeal. Some believe that this confusion may also be used by some taxpayers seeking to delay the collection process. Accordingly, the Committee believes that the Tax Court should have jurisdiction over all appeals of collection due process determinations. The Committee believes that the simplification provided by the provision will benefit the taxpayers seeking judicial review and benefit the IRS by eliminating confusion over which court is the proper venue for appeal and will reduce the period of time before judicial review. This provision will also eliminate the opportunity to use the present-law rules in unintended ways to delay or defeat the collection process.

EXPLANATION OF PROVISION

The provision modifies the jurisdiction of the Tax Court by providing that all appeals of collection due process determinations are to be made to the Tax Court.

EFFECTIVE DATE

The provision applies to determinations made by the IRS after the date which is 60 days after the date of enactment.

2. Authority for magistrate judges to hear and decide certain employment status cases (sec. 1022 of the bill and sec. 7443A of the Code)

PRESENT LAW

In connection with the audit of any person, if there is an actual controversy involving a determination by the IRS as part of an examination that (1) one or more individuals performing services for that person are employees of that person or (2) that person is not entitled to relief under section 530 of the Revenue Act of 1978, the Tax Court has jurisdiction to determine whether the IRS is correct and the proper amount of employment tax under such determination.[226] Any redetermination by the Tax Court has the force and effect of a decision of the Tax Court and is reviewable.

An election may be made by the taxpayer for small case procedures if the amount of the employment taxes in dispute is $50,000

[226] Sec. 7436.

or less for each calendar quarter involved.[227] The decision entered under the small case procedure is not reviewable in any other court and should not be cited as authority.

The chief judge of the Tax Court may assign proceedings to special trial judges. The Code enumerates certain types of proceedings that may be so assigned and may be decided by a special trial judge.[228] In addition, the chief judge may designate any other proceeding to be heard by a special trial judge.[229]

REASONS FOR CHANGE

The Committee believes that it is important for special trial judges to preside over and enter decisions in proceedings involving a determination of employment status in which the amount of employment taxes in dispute is $50,000 or less for each calendar quarter. The Committee believes that this clarification will improve the operations and internal functioning of the Tax Court.

EXPLANATION OF PROVISION

The provision clarifies that the chief judge of the Tax Court may assign to special trial judges any employment tax cases that are subject to the small case procedure and may authorize special trial judges to decide such small tax cases.[230]

EFFECTIVE DATE

The provision is effective for any employment status proceeding in the Tax Court with respect to which a decision has not become final before the date of enactment.

3. Confirmation of Tax Court authority to apply doctrine of equitable recoupment (sec. 1023 of the bill and sec. 6214 of the Code)

PRESENT LAW

Equitable recoupment is a common-law equitable principle that permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[231] In *Estate of Mueller* v. *Commissioner*,[232] the Court of Appeals for the Sixth Circuit held that the Tax Court may not apply the doctrine of equitable recoupment. More recently, the Court of Appeals for the Ninth Circuit, in *Branson* v. *Commissioner*,[233] held that the Tax Court may apply the doctrine of equitable recoupment.

REASONS FOR CHANGE

The conflict among the circuit courts regarding the application of the doctrine of equitable recoupment results in uncertainty and

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[227] Sec. 7436(c).
[228] Sec. 7443A(b) and (c).
[229] Sec. 7443A(b)(5).
[230] Under another provision of the bill, the position of special trial judge is renamed magistrate judge.
[231] See *Stone* v. *White*, 301 U.S. 532 (1937); *Bull* v. *United States*, 295 U.S. 247 (1935).
[232] 153 F.3d 302 (6th Cir. 1998), cert. den., 525 U.S. 1140 (1999).
[233] 264 F.3d 904 (9th Cir. 2001), cert. den., 535 U.S. 927 (2002).

confusion. For example, the cases of similarly situated taxpayers may be resolved differently simply because the taxpayers reside in different circuit court jurisdictions. The Committee believes that it is important to clarify the applicability of the doctrine of equitable recoupment in order to eliminate the uncertainty or confusion of differing results in differing circuits. The Committee also believes that the provision will provide simplification benefits to both taxpayers and the IRS.

EXPLANATION OF PROVISION

The provision confirms that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal civil tax cases by the U.S. District Courts or the U.S. Court of Federal Claims. No negative inference should be drawn as to whether the Tax Court has the authority to continue to apply other equitable principles in deciding matters over which it has jurisdiction.

EFFECTIVE DATE

The provision is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

4. Tax Court filing fees (sec. 1024 of the bill and sec. 7451 of the Code)

PRESENT LAW

The Tax Court is authorized to impose a fee of up to $60 for the filing of any petition for the redetermination of a deficiency or for declaratory judgments relating to the status and classification of 501(c)(3) organizations, the judicial review of final partnership administrative adjustments, and the judicial review of partnership items if an administrative adjustment request is not allowed in full.[234] The statute does not specifically authorize the Tax Court to impose a filing fee for the filing of a petition for review of the IRS's failure to abate interest or for failure to award administrative costs and other areas of jurisdiction for which a petition may be filed. The practice of the Tax Court is to impose a $60 filing fee in all cases commenced by petition.[235]

REASONS FOR CHANGE

The Committee believes it is appropriate to clarify that the Tax Court filing fee applies to any case commenced by the filing of a petition.

EXPLANATION OF PROVISION

The provision clarifies that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition. No negative inference should be drawn as to whether the Tax Court has the authority under present law to impose a filing fee for any case commenced by the filing of a petition.

[234] Sec. 7451.
[235] See Rule 20(a) of the Tax Court Rules of Practice and Procedure.

EFFECTIVE DATE

The provision is effective on the date of enactment.

5. Appointment of Tax Court employees (sec. 1025 of the bill and sec. 7471(a) of the Code)

PRESENT LAW

The Tax Court is a legislative court established by the Congress pursuant to Article I of the U.S. Constitution (an "Article I" court).[236] The Tax Court is authorized to appoint employees, subject to the rules applicable to employment with the Executive Branch of the Federal Government (generally referred to as "competitive service"), as administered by the Office of Personnel Management.[237]

Employment with the Federal Executive Branch is governed by certain general statutory principles, such as recruitment of qualified individuals, fair and equitable treatment of employees and applicants, maintenance of high standards of employee conduct, and protection of employees against arbitrary action. The rules for employment in the Federal Executive Branch address various aspects of such employment, including: (1) procedures for the appointment of employees in the competitive service, including preferences for certain individuals (e.g., veterans); (2) compensation, benefits, and leave programs for employees; (3) appraisals of employee performance; (4) disciplinary actions; and (5) employee rights, including appeal rights. In addition, employees are protected from certain personnel practices (referred to as "prohibited personnel practices"), such as discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition.

REASONS FOR CHANGE

The Tax Court was established as an Article I court in part because of its need for independence from the Executive Branch and its responsibility for reviewing determinations of a Federal Executive Branch agency (i.e., the Internal Revenue Service).[238] Accordingly, the Committee believes that the Tax Court should have the authority to establish its own personnel system, rather than being subject to the rules administered by the Federal Executive Branch. Similar authority has previously been provided to other Article I courts and to courts established under Article III of the U.S. Constitution ("Article III" courts). Currently, the Tax Court is the only Federal court (Article I or III) that does not have its own personnel system. Authority to establish its own personnel system will also provide the Tax Court with greater flexibility in meeting its staffing needs, thus enabling the court to operate more effectively. The Committee also believes that a personnel system established by the Tax Court should be consistent with the general principles that govern other employment with the Federal Government and should provide certain protections to employees.

[236] Sec. 7441.
[237] Sec. 7471.
[238] See, e.g., S. Rep. No. 91–552, at 302 (1969).

EXPLANATION OF PROVISION

The provision extends to the Tax Court authority to establish its own personnel management system. Any personnel management system adopted by the Tax Court must: (1) include the merit system principles that govern employment with the Federal Executive Branch; (2) prohibit personnel practices that are prohibited in the Federal Executive Branch; and (3) in the case of an individual eligible for preference for employment in the Federal Executive Branch, provide preference for that individual in a manner and to an extent consistent with preference in the Federal Executive Branch.

The provision requires the Tax Court to prohibit discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition. The Tax Court is also required to promulgate procedures for resolving complaints of discrimination by employees and applicants for employment.

The provision allows the Tax Court to appoint a clerk without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the provision, the clerk serves at the pleasure of the Tax Court.

The provision also allows the Tax Court to appoint other necessary employees without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the provision, these deputies and employees are subject to removal by the Tax Court.

The provision allows judges and special trial judges of the Tax Court to appoint law clerks and secretaries, in such numbers as the Tax Court may approve, without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the provision, a law clerk or secretary serves at the pleasure of the appointing judge.

The provision exempts law clerks from the sick leave and annual leave provisions applicable to employees of the Federal Executive Branch. Any unused sick or annual leave to the credit of a law clerk as of the effective date of the provision remains credited to the individual and is available to the individual upon separation from the Federal Government, or upon transfer to a position subject to such sick leave and annual leave provisions.

The provision allows the Tax Court to fix and adjust the compensation of the clerk and other employees without regard to the Federal Executive Branch rules regarding employee classifications and pay rates. To the maximum extent feasible, Tax Court employees are to be compensated at rates consistent with those of employees holding comparable positions in the Federal Judicial Branch. The Tax Court may also establish programs for employee evaluations, premium pay, and resolution of employee grievances.

In the case of an individual who is an employee of the Tax Court on the day before the effective date of the provision, the provision preserves certain rights that the employee is entitled to as of that day. The provision preserves the right to: (1) appeal a reduction in grade or removal; (2) appeal an adverse action; (3) appeal a prohibited personnel practice; (4) make an allegation of a prohibited personnel practice; or (5) file an employment discrimination appeal.

These rights are preserved for as long as the individual remains an employee of the Tax Court.

Under the provision, a Tax Court employee who completes at least one year of continuous service under a nontemporary appointment with the Tax Court acquires competitive service status for appointment to any position in the Federal Executive Branch competitive service for which the employee possesses the required qualifications.

The provision also allows the Tax Court to procure the services of experts and consultants in accordance with Federal Executive Branch rules.

EFFECTIVE DATE

The provision is effective on the date that the Tax Court adopts a personnel management system after the date of enactment of the provision.

6. Expanded use of practice fees (sec. 1026 of the bill and sec. 7475 of the Code)

PRESENT LAW

The Tax Court is authorized to impose on practitioners admitted to practice before the Tax Court a fee of up to $30 per year.[239] These fees are to be used to employ independent counsel to pursue disciplinary matters.

REASONS FOR CHANGE

The Committee understands that many pro se taxpayers are not familiar with Tax Court procedures and applicable legal requirements. The Committee believes it is beneficial for Tax Court fees imposed on practitioners also to be available to provide services to pro se taxpayers.

EXPLANATION OF PROVISION

The provision provides that Tax Court fees imposed on practitioners also are available to provide services to pro se taxpayers.

EFFECTIVE DATE

The provision is effective on the date of enactment.

TITLE XI—OTHER PROVISIONS

A. Transfer of Funds Attributable to Black Lung Trust Funds to Combined Benefit Fund

(Sec. 1101 of the bill and secs. 501(c)(21) and 9705 of the Code)

PRESENT LAW

Qualified black lung benefit trusts

A qualified black lung benefit trust is exempt from Federal income taxation. Contributions to a qualified black lung benefit trust generally are deductible to the extent such contributions are necessary to fund the trust.

[239] Sec. 7475.

Under present law, no assets of a qualified black lung benefit trust may be used for, or diverted to, any purpose other than (1) to satisfy liabilities, or pay insurance premiums to cover liabilities, arising under the Black Lung Acts, (2) to pay administrative costs of operating the trust, (3) to pay accident and health benefits or premiums for insurance exclusively covering such benefits (including administrative and other incidental expenses relating to such benefits) for retired coal miners and their spouses and dependents (within certain limits) or (4) investment in Federal, State, or local securities and obligations, or in time demand deposits in a bank or insured credit union. Additionally, trust assets may be paid into the national Black Lung Disability Trust Fund, or into the general fund of the U.S. Treasury.

The amount of assets in qualified black lung benefit trusts available to pay accident and health benefits or premiums for insurance exclusively covering such benefits (including administrative and other incidental expenses relating to such benefits) for retired coal miners and their spouses and dependents may not exceed a yearly limit or an aggregate limit, whichever is less. The yearly limit is the amount of trust assets in excess of 110 percent of the present value of the liability for black lung benefits determined as of the close of the preceding taxable year of the trust. The aggregate limit is the excess of the sum of the yearly limit as of the close of the last taxable year ending before October 24, 1992, plus earnings thereon as of the close of the taxable year preceding the taxable year involved over the aggregate payments for accident of health benefits for retired coal miners and their spouses and dependents made from the trust since October 24, 1992. Each of these determinations is required to be made by an independent actuary.

In general, amounts used to pay retiree accident or health benefits are not includible in the income of the company, nor is a deduction allowed for such amounts.

United Mine Workers of America Combined Benefit Fund

The United Mine Workers of America ("UMWA") Combined Benefit Fund was established by the Coal Industry Retiree Health Benefit Act of 1992 to assume responsibility of payments for medical care expenses of retired miners and their dependents who were eligible for health care from the private 1950 and 1974 UMWA Benefit Plans. The UMWA Combined Benefit Fund is financed by assessments on current and former signatories to labor agreements with the UMWA, past transfers from an overfunded United Mine Workers pension fund, and transfers from the Abandoned Mine Reclamation Fund.

REASONS FOR CHANGE

The Committee believes that better than expected market performance of black lung trust assets and fewer black lung claims have resulted in a situation where some coal companies have significant unanticipated excess assets in their black lung trusts. Removing the aggregate limit on the amount of black lung benefit trusts available to pay accident and health benefits or premiums for insurance exclusively covering such benefits for retired coal miners will allow coal companies to use greater amounts of their excess black lung trust assets to fund such benefits. Depositing the

revenue raised by eliminating the aggregate limit into the UMWA Combined Benefit Fund will help to fund retired coal miners' health benefits.

EXPLANATION OF PROVISION

The provision eliminates the aggregate limit on the amount of excess black lung benefit trust assets that may be used to pay accident and health benefits or premiums for insurance exclusively covering such benefits (including administrative and other incidental expenses relating to such benefits) for retired coal miners and their spouses and dependents. In addition, under the provision, each fiscal year, the Secretary of the Treasury will transfer to the UMWA Combined Benefit Fund an amount which the Secretary estimates to be the additional amounts received in the Treasury for that fiscal year by reason of the elimination of the aggregate limit. The Secretary will adjust the amount transferred for any year to the extent necessary to correct errors in any estimate for any prior year. Any amount transferred to the UMWA Combined Benefit Fund under the provision will be used to proportionately reduce the unassigned beneficiary premium of each assigned operator for any plan year beginning after December 31, 2002.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2002.

B. TAX TREATMENT OF COMPANY-OWNED LIFE INSURANCE ("COLI")

(Secs. 1102 and 813 of the bill and new secs. 101(j) and 6039I of the Code)

PRESENT LAW

Amounts received under a life insurance contract

Amounts received under a life insurance contract paid by reason of the death of the insured are not includible in gross income for Federal tax purposes.[240] No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract (inside buildup).[241]

Distributions from a life insurance contract (other than a modified endowment contract) that are made prior to the death of the insured generally are includible in income to the extent that the amounts distributed exceed the taxpayer's investment in the contract (i.e., basis). Such distributions generally are treated first as a tax-free recovery of basis, and then as income.[242]

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[240] Sec. 101(a).

[241] This favorable tax treatment is available only if a life insurance contract meets certain requirements designed to limit the investment character of the contract (sec. 7702).

[242] Sec. 72(e). In the case of a modified endowment contract, however, in general, distributions are treated as income first, loans are treated as distributions (i.e., income rather than basis recovery first), and an additional 10-percent tax is imposed on the income portion of distributions made before age 59½ and in certain other circumstances (secs. 72(e) and (v)). A modified endowment contract is a life insurance contract that does not meet a statutory "7-pay" test, i.e., generally is funded more rapidly than seven annual level premiums (sec. 7702A).

Premium and interest deduction limitations[243]

Premiums

Under present law, no deduction is permitted for premiums paid on any life insurance, annuity or endowment contract, if the taxpayer is directly or indirectly a beneficiary under the contract.[244]

Interest paid or accrued with respect to the contract

No deduction generally is allowed for interest paid or accrued on any debt with respect to a life insurance, annuity or endowment contract covering the life of any individual.[245] An exception is provided under this provision for insurance of key persons.

Interest that is otherwise deductible (e.g., is not disallowed under other applicable rules or general principles of tax law) may be deductible under the key person exception, to the extent that the aggregate amount of the debt does not exceed $50,000 per insured individual. The deductible interest may not exceed the amount determined by applying a rate based on a Moody's Corporate Bond Yield Average-Monthly Average Corporates. A key person is an individual who is either an officer or a 20-percent owner of the taxpayer. The number of individuals that can be treated as key persons may not exceed the greater of (1) five individuals, or (2) the lesser of five percent of the total number of officers and employees of the taxpayer, or 20 individuals.[246]

Pro rata interest limitation

A pro rata interest deduction disallowance rule also applies. Under this rule, in the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values.[247] Interest expense is allocable to unborrowed policy cash values based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance, annuity and endowment contracts, to (2) the sum of the average unborrowed cash values (or average adjusted bases, for other assets) of all the taxpayer's assets.

Under the pro rata interest disallowance rule, an exception is provided for any contract owned by an entity engaged in a trade or business, if the contract covers an individual who is a 20-percent owner of the entity, or an officer, director, or employee of the trade or business. The exception also applies to a joint-life contract covering a 20-percent owner and his or her spouse.

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[243] In addition to the statutory limitations described below, interest deductions under company-owned life insurance arrangements have also been limited by recent cases applying general principles of tax law. See *Winn-Dixie Stores, Inc.* v. *Commissioner*, 113 T.C. 254 (1999), aff'd 254 F.3d 1313 (11th Cir. 2001), cert. denied, April 15, 2002; *Internal Revenue Service* v. *CM Holdings, Inc.*, 254 B.R. 578 (D. Del. 2000), aff'd, 301 F.3d 96 (3d Cir. 2002); *American Electric Power, Inc.* v. *U.S.*, 136 F. Supp. 2d 762 (S. D. Ohio 2001), aff'd, 326 F.3d 737 (6th Cir. 2003), reh. denied, 338 F.3d 534 (6th Cir. 2003), cert. denied, U.S. No. 03–529 (Jan. 12, 2004); but see *Dow Chemical Company v. U.S.*, 250 F. Supp. 2d 748 (E.D. Mich. 2003), modified, 278 F. Supp. 2d 844 (E.D. Mich. 2003).

[244] Sec. 264(a)(1).

[245] Sec. 264(a)(4).

[246] Sec. 264(e)(3).

[247] Sec. 264(f). This applies to any life insurance, annuity or endowment contract issued after June 8, 1997.

"Single premium" and "4-out-of-7" limitations

Other interest deduction limitation rules also apply with respect to life insurance, annuity and endowment contracts. Present law provides that no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a single premium life insurance, annuity or endowment contract.[248] In addition, present law provides that no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a life insurance, annuity or endowment contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract (either from the insurer or otherwise).[249] Under this rule, several exceptions are provided, including an exception if no part of four of the annual premiums due during the initial seven-year period is paid by means of such debt (known as the "4-out-of-7 rule").

Definitions of highly compensated employee

Present law defines highly compensated employees and individuals for various purposes. For purposes of nondiscrimination rules relating to qualified retirement plans, an employee, including a self-employed individual, is treated as highly compensated with respect to a year if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of $95,000 (for 2005) or (b) at the election of the employer had compensation in excess of $95,000 (for 2005) and was in the highest paid 20 percent of employees for such year.[250] The $95,000 dollar amount is indexed for inflation.

For purposes of nondiscrimination rules relating to self-insured medical reimbursement plans, a highly compensated individual is an employee who is one of the five highest paid officers of the employer, a shareholder who owns more than 10 percent of the value of the stock of the employer, or is among the highest paid 25 percent of all employees.[251]

REASONS FOR CHANGE

The Committee is aware of companies who have, in the past, purchased insurance on rank-and-file employees and collect the proceeds years after the employee terminated employment with the company. To curtail this practice, when proceeds are payable more than 12 months after termination of employment, the bill excludes from income only proceeds on policies purchased on the lives of directors and highly compensated individuals, including the highest-paid 35 percent of employees.

The Committee is also aware of reports that in some cases the insured employee is not aware that his or her life has been insured. The Committee believes that it is important for employers to provide notice to insured employees and to obtain the consent of em-

[248] Sec. 264(a)(2).
[249] Sec. 264(a)(3).
[250] Sec. 414(q). For purposes of determining the top-paid 20 percent of employees, certain employees, such as employees subject to a collective bargaining agreement, are disregarded.
[251] Sec. 105(h)(5). For purposes of determining the top-paid 25 percent of employees, certain employees, such as employees subject to a collective bargaining agreement, are disregarded.

ployees to be insured, and consequently, the bill imposes notice and consent requirements in order for the exceptions to the income inclusion rule to apply.

In order to aid compliance with the provisions and facilitate IRS enforcement, the bill also imposes recordkeeping requirements with respect to employer-owned life insurance contracts issued after the date of enactment.

EXPLANATION OF PROVISION

The provision provides generally that, in the case of an employer-owned life insurance contract, the amount excluded from the applicable policyholder's income as a death benefit cannot exceed the premiums and other amounts paid by such applicable policyholder for the contract. The excess death benefit is included in income.

Exceptions to this income inclusion rule are provided. In the case of an employer-owned life insurance contract with respect to which the notice and consent requirements of the provision are met, the income inclusion rule does not apply to an amount received by reason of the death of an insured individual who, with respect to the applicable policyholder, was an employee at any time during the 12-month period before the insured's death, or who, at the time the contract was issued, was a director or highly compensated employee or highly compensated individual. For this purpose, such a person is one who is either: (1) a highly compensated employee as defined under the rules relating to qualified retirement plans, determined without regard to the election regarding the top-paid 20 percent of employees; or (2) a highly compensated individual as defined under the rules relating to self-insured medical reimbursement plans, determined by substituting the highest-paid 35 percent of employees for the highest-paid 25 percent of employees.[252]

In the case of an employer-owned life insurance contract with respect to which the notice and consent requirements of the provision are met, the income inclusion rule does not apply to an amount received by reason of the death of an insured, to the extent the amount is (1) paid to a member of the family[253] of the insured, to an individual who is the designated beneficiary of the insured under the contract (other than an applicable policyholder), to a trust established for the benefit of any such member of the family or designated beneficiary, or to the estate of the insured; or (2) used to purchase an equity (or partnership capital or profits) interest in the applicable policyholder from such a family member, beneficiary, trust or estate. It is intended that such amounts be so paid or used by the due date of the tax return for the taxable year of the applicable policyholder in which they are received as a death benefit under the insurance contract, so that the payment of the amount to such a person or persons, or the use of the amount to make such a purchase, is known in the taxable year for which the exception from the income inclusion rule is claimed.

An employer-owned life insurance contract is defined for purposes of the provision as a life insurance contract which (1) is

[252] As under present law, certain employees are disregarded in making the determinations regarding the top-paid groups.

[253] For this purpose, a member of the family is defined in section 267(c)(4) to include only the individual's brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

owned by a person engaged in a trade or business and under which such person (or a related person) is directly or indirectly a beneficiary, and (2) covers the life of an individual who is an employee with respect to the trade or business of the applicable policyholder on the date the contract is issued.

An applicable policyholder means, with respect to an employer-owned life insurance contract, the person (including related persons) that owns the contract, if the person is engaged in a trade or business, and if the person (or a related person) is directly or indirectly a beneficiary under the contract.

For purposes of the provision, a related person includes any person that bears a relationship specified in section 267(b) or 707(b)(1)[254] or is engaged in trades or businesses that are under common control (within the meaning of section 52(a) or (b)).

The notice and consent requirements of the provision are met if, before the issuance of the contract, (1) the employee is notified in writing that the applicable policyholder intends to insure the employee's life, and is notified of the maximum face amount at issue of the life insurance contract that the employer might take out on the life of the employee, (2) the employee provides written consent to being insured under the contract and that such coverage may continue after the insured terminates employment, and (3) the employee is informed in writing that an applicable policyholder will be a beneficiary of any proceeds payable on the death of the employee.

For purposes of the provision, an employee includes an officer, a director, and a highly compensated employee; an insured means, with respect to an employer-owned life insurance contract, an individual covered by the contract who is a U.S. citizen or resident. In the case of a contract covering the joint lives of two individuals, references to an insured include both of the individuals.

The provision requires annual reporting and recordkeeping by applicable policyholders that own one or more employer-owned life insurance contracts. The information to be reported is (1) the number of employees of the applicable policyholder at the end of the year, (2) the number of employees insured under employer-owned life insurance contracts at the end of the year, (3) the total amount of insurance in force at the end of the year under such contracts, (4) the name, address, and taxpayer identification number of the applicable policyholder and the type of business in which it is engaged, and (5) a statement that the applicable policyholder has a valid consent (in accordance with the consent requirements under the provision) for each insured employee and, if all such consents were not obtained, the total number of insured employees for whom such consent was not obtained. The applicable policyholder is required to keep records necessary to determine whether the requirements of the reporting rule and the income inclusion rule of new section 101(j) are met.

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[254] The relationships include specified relationships among family members, shareholders and corporations, corporations that are members of a controlled group, trust grantors and fiduciaries, tax-exempt organizations and persons that control such organizations, commonly controlled S corporations, partnerships and C corporations, estates and beneficiaries, commonly controlled partnerships, and partners and partnerships. Detailed rules apply to determine the specific relationships.

EFFECTIVE DATE

The amendments made by this section generally apply to contracts issued after the date of enactment, except for contracts issued after such date pursuant to an exchange described in section 1035 of the Code. In addition, certain material increases in the death benefit or other material changes will generally cause a contract to be treated as a new contract, with an exception for existing lives under a master contract. Increases in the death benefit that occur as a result of the operation of section 7702 of the Code or the terms of the existing contract, provided that the insurer's consent to the increase is not required, will not cause a contract to be treated as a new contract. In addition, certain changes to a contract will not be considered material changes so as to cause a contract to be treated as a new contract. These changes include administrative changes, changes from general to separate account, or changes as a result of the exercise of an option or right granted under the contract as originally issued.

Examples of situations in which death benefit increases would not cause a contract to be treated as a new contract include the following:

1. Section 7702 provides that life insurance contracts need to either meet the cash value accumulation test of section 7702(b) or the guideline premium requirements of section 7702(c) and the cash value corridor of section 7702(d). Under the corridor test, the amount of the death benefit may not be less than the applicable percentage of the cash surrender value. Contracts may be written to comply with the corridor requirement by providing for automatic increases in the death benefit based on the cash surrender value. Death benefit increases required by the corridor test or the cash value accumulation test do not require the insurer's consent at the time of increase and occur in order to keep the contract in compliance with section 7702.

2. Death benefits may also increase due to normal operation of the contract. For example, for some contracts, policyholder dividends paid under the contract may be applied to purchase paid-up additions, which increase the death benefits. The insurer's consent is not required for these death benefit increases.

3. For variable contracts and universal life contracts, the death benefit may increase as a result of market performance or the contract design. For example, some contracts provide that the death benefit will equal the cash value plus a specified amount at risk. With these contracts, the amount of the death benefit at any time will vary depending on changes in the cash value of the contract. The insurance company's consent is not required for these death benefit increases.

III. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

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

ESTIMATED BUDGET EFFECTS OF
THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT OF 2005,"
AS REPORTED BY THE COMMITTEE ON FINANCE

Fiscal Years 2006 - 2015

[Millions of Dollars]

Provision	Effective	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-10	2006-15
I. Diversification Rights and Other Defined Contribution Participant Protections													
A. Defined Contribution Plans Required to Provided Employees with Freedom to Invest their Plan Assets	generally pyba 12/31/05	*Negligible Revenue Effect*											
B. Notice of Freedom to Divest Employer Securities or Real Property	generally pyba 12/31/05	*Negligible Revenue Effect*											
C. Periodic Pension Benefit Statements for Defined Contribution Plans	generally pyba 12/31/06	---	*Negligible Revenue Effect*										
D. Notice to Participants and Beneficiaries of Blackout Periods	[1]	*Negligible Revenue Effect*											
E. Additional IRA Contributions and Credit for Certain Individuals (sunset taxable years beginning after 12/31/09; sunset credit taxable years beginning after 12/31/07)	tyba 12/31/04	-87	-85	-51	-10	-8	-6	-6	-6	-6	-6	-240	-270
Total of Diversification Rights and Other Defined Contribution Participant Protections		**-87**	**-85**	**-51**	**-10**	**-8**	**-6**	**-6**	**-6**	**-6**	**-6**	**-240**	**-270**
II. Information to Assist Pension Plan Participants													
A. Investment Education Requirements for Defined Contribution Plan Participants	generally pyba 12/31/06	---	*Negligible Revenue Effect*										
B. Information Relating to Investment in Employer Securities	generally pyba 12/31/05	*Negligible Revenue Effect*											
C. Periodic Pension Benefit Statements for Defined Benefit Pension Plans	generally pyba 12/31/06	---	*No Revenue Effect*										
D. Safe Harbor for Independent Investment Advice Provided to Plan Participants	iada DOE	*Negligible Revenue Effect*											
E. Treatment of Employer-Provided Qualified Retirement Planning Services (sunset 12/31/10)	tyba 12/31/05	-12	-24	-32	-36	-39	-43	-11	---	---	---	-142	-196
Total of Information to Assist Pension Plan Participants		**-12**	**-24**	**-32**	**-36**	**-39**	**-43**	**-11**	**[2]**	**[2]**	**[2]**	**-142**	**-196**
III. Improvements in Funding Rules for Single-Employer Defined Benefit Pension Plans and Related Provisions													
A. Minimum Funding Rules for Single-Employer Defined Benefit Pension Plans [3]	[4]	759	3,326	2,856	-1,644	-3,267	-2,391	-1,530	-1,007	-825	-298	2,030	-4,021
B. Benefit Limitations Under Single-Employer Defined Benefit Pension Plans	generally pyba 2006	*Estimate Included in Item III.A.*											
C. Increase in Deduction Limits	tyba 12/31/05	*Estimate Included in Item III.A.*											

Provision	Effective	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-10	2006-15
D. Interest Rate Assumption for Determination of Lump-Sum Distributions	pyba 12/31/06	*Negligible Revenue Effect*											
E. Interest Rate Assumption for Applying Benefit Limitations to Lump-Sum Distributions	yba 2005	*Negligible Revenue Effect*											
F. Restrictions on Funding of Nonqualified Deferred Compensation Plan when Employer's Defined Benefit Pension Plan is 80% Underfunded	taoroaa 12/31/06	---	7	11	11	10	16	17	14	12	9	39	107
G. Rules relating to cash balance and other hybrid plans	[5]	-24	-26	-33	-35	-42	-34	2	45	67	61	-160	-19
H. Defined Benefit Pension Plan Benefits Provided in Combination with a Qualified Cash-or-Deferred Arrangement	pyba 12/31/06	-2	-10	-32	-68	-116	-181	-237	-290	-347	-409	-227	-1,692
I. Studies													
1. Study on revitalizing defined benefit plans	DOE	*No Revenue Effect*											
2. Study on floor-offset ESOPs	DOE	*No Revenue Effect*											
Total of Improvements in Funding Rules for Single-Employer Defined Benefit Pension Plans and Related Provisions		**733**	**3,297**	**2,802**	**-1,736**	**-3,415**	**-2,590**	**-1,748**	**-1,238**	**-1,093**	**-637**	**1,682**	**-5,625**
IV. Disclosure and Benefit Statement Requirements for Single Employer Defined Benefit Pension Plans													
A. Actuarial Reports and Summary Annual Reports	pyba 12/31/06	--- *Negligible Revenue Effect*											
B. Notice of Benefit Limitations	pyba 12/31/06	--- *Negligible Revenue Effect*											
C. Notice of Bankruptcy Filing	pyba 12/31/06	--- *Negligible Revenue Effect*											
Total of Disclosure and Benefit Statement Requirements for Single Employer Defined Benefit Pension Plans		**---**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**
V. Improvements in Funding Rules for Multiemployer Defined Benefit Plans													
A. Increase in Deduction Limits	tyba 12/31/05	[2]	-2	-5	-5	-5	-5	-5	-5	-5	-5	-17	-42
B. Multiemployer Plan Funding Notice	DOE	*Negligible Revenue Effect*											
C. Permit Qualified Transfers of Excess Pension Assets to Retiree Health Accounts by Multiemployer Plan	tyba 12/31/04	*Negligible Revenue Effect*											
Total of Improvements in Funding Rules for Multiemployer Defined Benefit Plans		**[2]**	**-2**	**-5**	**-5**	**-5**	**-5**	**-5**	**-5**	**-5**	**-5**	**-17**	**-42**
VI. Improvements in PBGC Guarantee Provisions													
A. Increases in PBGC Premiums for Single-Employer Plans	pyba 12/31/05	*Estimate to be Provided by the Congressional Budget Office*											
B. Rules Relating to Bankruptcy of Employer	[6]	*Estimate to be Provided by the Congressional Budget Office*											
C. Limitation on PBGC Guarantee of Shutdown and Other Benefits	[7]	*Estimate to be Provided by the Congressional Budget Office*											
D. PBGC Premiums for New Plans of Small Employers	ptea 12/31/05	*Estimate to be Provided by the Congressional Budget Office*											
E. PBGC Premiums for Small and New Plans	ptea 12/31/05 & pyba 12/31/05	*Estimate to be Provided by the Congressional Budget Office*											
F. Authorization for PBGC to Pay Interest on Premium Overpayment Refunds	iafpbnet DOE	*Estimate to be Provided by the Congressional Budget Office*											
G. Rules for Substantial Owner Benefits in Terminated Plans	[8]	*Estimate to be Provided by the Congressional Budget Office*											

Provision	Effective	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-10	2006-15
H. Acceleration of PBGC Computation of Benefits Attributable to Recoveries from Employers	noitto/a 30da DOE	*Estimate to be Provided by the Congressional Budget Office*											
Total of Improvements in PBGC Guarantee Provisions		---	---	---	---	---	---	---	---	---	---	---	---
VII. Spousal Pension Protection													
A. Study of Spousal Consent for Distributions from Defined Contribution Plans	DOE	*No Revenue Effect*											
B. Division of Pension Benefits Upon Divorce	DOE	*Negligible Revenue Effect*											
C. Protection of Rights of Former Spouses under the Railroad Retirement System	1ya DOE	*Estimate to be Provided by the Congressional Budget Office*											
D. Modifications of Joint and Survivor Annuity Requirements	generally pyba 12/31/05	*Negligible Revenue Effect*											
Total of Spousal Pension Protection		**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**
VIII. Improvements in Portability and Distribution Rules													
A. Purchase of Permissive Service Credit	[9]	*Negligible Revenue Effect*											
B. Rollover of After-Tax Amounts in Annuity Contracts	tyba 12/31/05	*Negligible Revenue Effect*											
C. Application of Minimum Distribution Rules to Governmental Plans	DOE	*No Revenue Effect*											
D. Waiver of 10-Percent Early Withdrawal Tax on Certain Distributions from Pension Plans for Public Safety Employees	dma DOE	-1	-3	-3	-3	-3	-3	-4	-4	-4	-4	-13	-32
E. Rollovers by Nonspouse Beneficiaries of Certain Retirement Plan Distributions	dma 12/31/05	-8	-23	-32	-37	-35	-33	-30	-28	-26	-23	-134	-274
F. Faster Vesting of Employer Nonelective Contributions	generally cf pyba 12/31/05	-3	-6	-7	-7	-7	-7	-8	-8	-8	-8	-30	-69
G. Allow Direct Rollovers from Retirement Plans to Roth IRAs	dma 12/31/05	*Negligible Revenue Effect*											
H. Elimination of Higher Early Withdrawal Tax on Certain SIMPLE Plan Distributions	yba 12/31/05	[10]	-20	-21	-22	-22	-23	-24	-25	-26	-27	-85	-211
I. SIMPLE Plan Portability [11]	yba 12/31/05	-6	-13	-13	-14	-14	-14	-14	-14	-13	-13	-60	-127
J. Eligibility for Participation in Eligible Deferred Compensation Plans	DOE	-1	-1	-1	-1	-1	-1	-1	-2	-2	-2	-5	-13
K. Benefit Transfers to the PBGC	[12]	*Estimate to be Provided by the Congressional Budget Office*											
L. Missing Participants	dma fripp	*Estimate to be Provided by the Congressional Budget Office*											
Total of Improvements in Portability and Distribution Rules		**-19**	**-66**	**-77**	**-84**	**-82**	**-81**	**-81**	**-81**	**-79**	**-77**	**-327**	**-726**
IX. Administrative Provisions													
A. Updating of Employee Plans Compliance Resolution System	DOE	*Negligible Revenue Effect*											
B. Extension to all Governmental Plans of Moratorium on Application of Certain Nondiscrimination Rules	pyba 12/31/05	*Negligible Revenue Effect*											
C. Notice and Consent Period Regarding Distributions	yba 12/31/05	*Negligible Revenue Effect*											
D. Pension Plan Reporting Simplification	pybo/a 1/1/06 & DOE	*No Revenue Effect*											
E. Voluntary Early Retirement Incentive and Employment Retention Plans Maintained by Local Educational Agencies and Other Entities	generally DOE	[10]	-1	-1	-4	-9	-13	-15	-13	-11	-9	-14	-74

Provision	Effective	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-10	2006-15
F. No Reduction in Unemployment Compensation as a Result of Pension Rollovers	wbo/a DOE	*Estimate to be Provided by the Congressional Budget Office*											
G. Withholding on Certain Distributions from Governmental Eligible Deferred Compensation Plans	[12]	-1	[13]	[13]	[13]	[13]	[13]	[13]	[13]	[13]	[13]	[10]	[10]
H. Defined benefit plans maintained by tribal governments	ybbo/a DOE	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]
I. Treatment of plan of certain nonprofit organization as a governmental plan	ybbo/a DOE	[10]	[10]	[10]	[10]	[10]	-1	-1	-1	-1	-1	-2	-5
J. Provisions Relating to Plan Amendments	DOE	*No Revenue Effect*											
Total of Administrative Provisions		**-1**	**-1**	**-1**	**-4**	**-9**	**-14**	**-16**	**-14**	**-12**	**-10**	**-16**	**-79**
X. United States Tax Court Modernization													
A. Tax Court Procedure	generally DOE	*Negligible Revenue Effect*											
B. Tax Court Pension and Compensation [14]	generally DOE	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	-1
Total of United States Tax Court Modernization		**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**[10]**	**-1**
XI. Other Provisions													
A. Transfer of Excess Funds From Black Lung Disability Trusts to United Mine Workers of America Combined Benefit Fund	tyba 12/31/02	2	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	2	2
B. Tax Treatment of Company-Owned Life Insurance ("COLI")	generally cia DOE	*Negligible Revenue Effect*											
Total of Other Provisions		**2**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**[2]**	**2**	**2**
NET TOTAL		**616**	**3,119**	**2,636**	**-1,875**	**-3,558**	**-2,739**	**-1,867**	**-1,344**	**-1,195**	**-735**	**942**	**-6,937**

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NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be November 1, 2005.

Legend for "Effective" column:

cia = contracts issued after
DOE = date of enactment
dma = distributions made after
iada = investment advisors designated after
iafpbnet = interest accruing for periods beginning not earlier than
fripp = final regulations implementing the provision are prescribed
noitto/a = notice of intent to terminate on or after
pyba = plan years beginning after
pybo/a = plan years beginning on or after
taoroaa = transfers and other reservations of assets after
tyba = taxable years beginning after
wbo/a = weeks beginning on or after
yba = years beginning after
ybbo/a = years beginning before, on, or after
30da = 30 days after
1ya = 1 year after

[1] The amendments to the Internal Revenue Code apply to failures to provide the required notice after the date of enactment. The amendments to ERISA made by the proposal are effective as if included in section 306 of the Sarbanes-Oxley Act of 2002.
[2] Negligible revenue effect.
[3] Estimate does not include effects on PBGC premiums which will be estimated by the Congressional Budget Office.
[4] The extension of the present-law interest rate is effective for plan years beginning after December 31, 2005, and before January 1, 2007. The modifications to the single-employer plan funding rules are generally effective for plan years beginning after December 31, 2006.
[5] The proposals relating to the age discrimination rules and minimum lump-sum distributions are effective for periods after July 26, 2005. The proposal relating to conversions is effective for conversions made pursuant to a plan amendment adopted and effective after July 26, 2005. In addition, in the case of a conversion pursuant to a plan amendment adopted before July 26, 2005, but effective after that date, the employer may elect to apply the proposal to the conversion. The proposals relating to interest credits and vesting are generally effective for plan years beginning after December 31, 2006.

[Footnotes for the Table are continued on the following page]

Footnotes for the Table continued:

[6] Effective with respect to Federal bankruptcy or similar proceedings or arrangements for the benefit of creditors which are initiated on or after the date that is 30 days after enactment.
[7] Effective for benefits that become payable as a result of a plant shutdown or other covered event that occurs after July 26, 2005.
[8] Effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC after December 31, 2005.
[9] Generally effective as if included in the amendments made by section 1526 of the Taxpayer Relief Act of 1997, except that the provision regarding trustee-to-trustee transfers is effective as if included in the amendments made by section 647 of the Economic Growth and Tax Relief Reconciliation Act of 2001.
[10] Loss of less than $500,000.
[11] Estimate includes interaction effects with item VIII. H.
[12] Effective as if included in the Economic Growth and Tax Relief Reconciliation Act of 2001.
[13] Gain of less than $500,000.
[14] Only includes the estimated revenue effects associated with the provision relating to participation by Tax Court judges in the Thrift Savings Plan and does not include any outlay or revenue effects associated with other provisions included in the proposal. These remaining items will be estimated by the Congressional Budget Office.
[15] No net budgetary effect.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the provisions of section 1010 of the bill involve new or increased budget authority with respect to the Tax Court Judicial Officers' Retirement Fund.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the bill involve increased tax expenditures (see revenue table in Part III.A., above). The revenue increasing provisions of the bill generally involve reduced tax expenditures (see revenue table in Part III.A., above).

C. Consultation With Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on the bill. The letter from the Congressional Budget Office has not been received, and therefore will be provided separately.

IV. VOTES OF THE COMMITTEE

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

Motion to report the bill

The bill, as modified, was ordered favorably reported by voice vote, a quorum being present, on July 26, 2005.

Votes on amendments

No amendments were offered for vote.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

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

Impact on individuals and businesses

The bill includes provisions relating to qualified retirement plans, including provisions designed to increase retirement income security by (1) providing employees with greater opportunity to diversify plan investments in employer securities, (2) requiring plans to provide additional information with respect to plan benefits and investments, (3) improving funding of defined benefit plans and the Pension Benefit Guaranty Corporation and clarifying the rules for cash balance and other hybrid plans, and (4) improving employees' retirement savings opportunities, portability, and spousal protections. The bill also includes a variety of provisions intended to re-

duce administrative burdens on employers with regard to a variety of pension plan issues. The bill also includes directives for a number of studies relating to specific issues that affect retirement income security. The bill also contains a provision dealing with the tax treatment of company-owned life insurance. Some of the provisions of the bill provisions may impose additional administrative requirements on employers that sponsor retirement plans; however, in some cases the employer may avoid application of the provisions through plan design. In addition, some of the provisions will reduce regulatory burdens on employers that sponsor retirement plans. The funding provisions of the bill will require additional plan contributions from some employers with currently underfunded plans. These provisions are designed to increase the retirement income security of employees covered by such plans.

The bill includes various other provisions that are not expected to impose additional administrative requirements or regulatory burdens on individuals or businesses.

Impact on personal privacy and paperwork

The provisions of the bill do not impact personal privacy.

Some provisions of the bill relating to pension plans will reduce paperwork burdens on employers that sponsor qualified retirement plans. Other provisions may impose additional burdens on employers; however, in many cases an employer may reduce such burdens through plan design. The provision regarding withholding requirements with respect to certain stock options will reduce regulatory burdens on individuals and businesses that may currently apply withholding to these options.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the revenue provisions of the bill do not contain Federal mandates on the private sector. The Committee has determined that the revenue provisions of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

C. Tax Complexity Analysis

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

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

VI. CHANGES IN EXISTING LAW MADE BY THE BILL AS REPORTED

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

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