PLAN SPONSOR VOICE:
Federal Legislative and Regulatory Report
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I. The Pension Preservation and Savings Expansion Act of 2003
On April 11, 2003, Representatives Rob Portman and Ben Cardin introduced the Pension Preservation and Savings Expansion Act of 2003 (H.R. 1776). This bill is proposed as the next step in providing Americans with the tools they need to plan for their futures. You may find the full text of the bill by visiting http://thomas.loc.gov and entering H.R. 1776 in the box labeled Bill Number.

This discussion focuses primarily on provisions of the bill that will affect public sector employers and their employees. We’ve provided our comments in italics.

Securing 2001’s Retirement Savings Opportunities

- **Making Retirement Savings Opportunities Permanent.** The legislation will make all of the retirement savings and pension reforms contained in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) permanent. The 2001 reforms are currently scheduled to sunset at the end of 2010.

- **Accelerating Savings Limits.** The legislation will help Americans step up their retirement savings by accelerating the EGTRRA increases in 401(k), 403(b), 457 and IRA savings limits. The gradual limits increases scheduled under current law will become fully effective in 2004.
  - Workers under age 50 will be able to save up to $15,000 in their employer-sponsored salary deferral plans; workers age 50-and-older, up to $20,000 in these plans.
  - Workers under age 50 will be able to save up to $5,000 in an IRA; those age 50-and-over, up to $6,000 beginning in 2004.

- **Expanding and Making Permanent the Saver’s Credit for Modest-Income Savers.** The legislation will make permanent the EGTRRA tax credit, which is scheduled to sunset at the end of 2006. The Saver’s Credit is available to low- and moderate-income savers who contribute to an IRA or workplace retirement plan. The Credit, which supplements the existing deduction for IRA or plan contributions, recognizes that modest-income individuals may need additional financial assistance to be able to save.

  The proposed legislation makes more Americans eligible for the credit by increasing single filer eligibility to $30,000 and joint filer eligibility to $60,000 and increases the maximum amount of the credit to 60% of the first $2,000 in contributions.
Improving Pension Fairness and Aiding Savers with Special Needs

- **Allowing IRAs for Disabled Americans.** Today’s IRA rules prevent disabled Americans with no wage income from contributing to IRAs. The legislation will allow those who meet a specified definition of disability to provide for their retirement-income needs by permitting contributions to an IRA using income from non-wage sources.

- **Preventing Savings Spend-Down for SSI Eligibility.** The legislation will ensure that up to $75,000 of retirement savings do not disqualify the aged, blind and disabled from eligibility for supplemental security income (SSI).

Expanding IRAs

- **Accelerating Eligibility for Deductible IRAs.** In addition to accelerating the IRA limit to an immediate $5,000, the legislation will speed the gradual increases in income eligibility for traditional deductible IRAs enacted as part of the 1997 taxpayer relief act. More American families will be able to take tax deductions as they use this valuable retirement savings tool.

- **Eliminating the IRA Marriage Penalties.** Today’s rules for both traditional and Roth IRAs impose penalties on married couples because the income eligibility levels for couples are substantially less than twice what they are for individuals. Thus, by getting married, you become less eligible to contribute to these IRAs. The legislation corrects these “marriage penalties” by ensuring that the income eligibility levels for joint filers are exactly double those for single filers.

- **Correcting IRA Distribution Mistakes.** The legislation will initiate a correction mechanism to allow IRA investors to return funds to IRA accounts when distributions have been made in error, either by the IRA investor or a financial institution.

One of the most common mistakes is the inadvertent processing by a financial institution of IRA transfers as taxable distributions. Under current law, there is no mechanism to correct these types of errors and redeposit the funds back into the IRA account.

Revitalizing Private Sector Defined Benefit Plans

- **Replacing An Obsolete Pension Interest Rate.** The 30-year Treasury bond rate has fallen dramatically as a result of the discontinuation of the 30-year bond. The legislation will institute a new interest-rate benchmark for pension calculations to replace the 30-year Treasury bond rate.

  This new benchmark, based on long-term conservative corporate bond rates, will ensure that funding, premium and lump-sum calculations are based on a rational and realistic interest rate. The bill will provide very substantial transition assistance to older workers so that expectations regarding lump sum amounts are not undercut.

  This provision represents a solution to finding a long-term interest rate benchmark public sector employers may want to review for their defined benefit plans.

Preserving Retirement Assets

- **Reforming Required Minimum Distribution Rules.** The bill will reform the minimum required distribution rules that force individuals to begin taking their money at age 70½ by gradually increasing the starting age to 75.
In addition, the excise tax for individuals who fail to take their proper distributions will be reduced from 50% to 20% of the amount required to be distributed and avoids excessive penalties on individuals who make innocent mistakes.

The bill changes the timing of the first required payment so that only one payment would be due in the first distribution year following retirement or age 70½. Currently, two minimum distribution payments are required in the first year after retirement or age 70½. This change should help ensure that payments are made on time and in the correct amount.

403(b) plans that are merged or transferred to 401 plans may retain grandfathering of certain amounts of the 403(b) money transferred to a 401 plan as long as it is separately accounted for. Under current law, certain portions of a 403(b) account balance may not be subject to minimum distribution payments until the participant reaches age 75.

Regulations will be issued for required minimum distribution from governmental plans. In the meantime, governmental plans will be treated as making a good faith attempt to comply with the minimum distribution rules.

- **Incentives for Lifetime Payments.** More Americans are retiring with lump sum payments from their retirement plans. They face the daunting prospect of making these assets last throughout their lives and the lives of their spouses.

Annuitizing some or all of one’s retirement savings is an effective way to protect against spousal poverty and outliving one’s assets. The bill will allow individuals with income of up to $90,000 to exclude up to $2,000 in annual retirement-plan annuity income from taxation.

- **Expanding Investment Education, Retirement Planning and Legal Advice.** The bill will also require employers to provide new investment education notices to employees in both public and private sector participant directed plans.

In addition, it will allow employees to pay for retirement planning service from qualified advisors on a pre-tax basis and will once again treat qualified group legal services on a tax-preferred basis.

**Financing Retiree Health**

- **Allowing Use of Pre-Tax Pension Payments for Retiree Medical Premiums.** Retiree medical costs are one of their most significant financial burdens. The bill will allow the retirees to pay health care premiums with pre-tax pension money, putting retirees on the same footing as active workers with respect to the tax treatment of health plan premiums.

- **Allowing profit sharing and 401(k) Sponsors to Pre-Fund Retiree Medical.** One reason more employers do not offer retiree medical coverage is that the ability to pre-fund these benefits is extremely limited. Under the bill, employers with defined contribution plans such as 401(k) plans will be eligible to establish a 401(h) account – available to defined benefit plans for a number of years – to fund a modest portion of retiree medical expenses on a pre-tax basis.

**Employers would able to contribute 5% of compensation to these accounts in 2004 increasing to 10% in 2006 and 20% in 2008.**
Enhancing Pension Portability

- **Improving Portability for State and Local Government Employees.** The legislation contains a number of provisions to assist state and local government employees with the portability of their retirement benefits. The purchase of permissive service credits would be improved.

  1. *Permissive service credit purchases will no longer be limited to 5 years.*
  2. *Employees will no longer be required to have been a participant in the defined benefit plan for 5 years to purchase permissive service credits.*
  3. *All amounts, including transferred amounts, distributed from the defined benefit plan will be subject to the terms of the defined benefit plan.*

  - Distributions to police and firefighters from DROP plans will not be subject to an early 10% distribution tax if these distributions are made prior to age 59½. *This is an enhancement for police and firefighters who often retire earlier than age 59½ and would be subject to this penalty unless an exception under current law applies.*
  - Subject to other restrictions, governmental defined benefit plans may not reduce the maximum dollar limit under the Code below $130,000 for benefits beginning on or after age 55 (current limit is $75,000). If the benefit paid begins before age 55, the benefit may not be reduced below the equivalent of $130,000 limitation at age 55. *This is a benefit improvement for public sector employees retiring at earlier ages.*
  - 457 plans of private sector tax-exempt employers will now be governed under a new section of the Code, IRC 459. Governmental 457 plans will remain under IRC 457. *This would eliminate the current confusion under 457 arising from two different sets of rules, one for state and local governments and the other for private sector tax-exempt employers.*

- **Rollovers to Spouses.** To enhance portability and provide new retirement planning tools for married couples, the legislation will allow individuals taking a distribution from their retirement plan and rolling them into an IRA (for example, at job change or retirement) to direct some or all of the distribution to the IRA of their spouse.

- **Rollovers by Non-Spouse Beneficiaries.** Today, when a retirement plan participant dies and the beneficiary is someone other than the participant’s spouse, the plan typically requires the beneficiary to take the benefits in lump sum form, forcing immediate taxation on the full amount. Surviving spouses of retirement plan participants (and all beneficiaries in the IRA context) do not confront this situation and can withdraw benefits over a period of years. The legislation would remedy this problem by allowing non-spouse beneficiaries to roll over the plan benefits to an IRA and take the money out over a period of years consistent with the minimum distribution rules.

- **Rollovers from Flexible Spending Accounts.** Today, employees must either forfeit unused amounts in their flexible spending accounts (FSAs) or spend these amounts before the end of the year. The bill will allow employees to roll up to $500 of unused FSA money into their 401(k), 403(b), 457 or IRA at the end of the year, subject to all the existing contribution limits on plan and IRA contributions.
• **Improving Rollover Rules.** This bill clarifies that participants can roll after-tax retirement plan contributions from qualified plans to 403(b) plans. The bill will also permit transfers or mergers from 401(k) plans to 403(b) arrangements and vice versa.

    *This legislation will solve a long-standing problem for sponsors of 403(b) plans who are no longer eligible or want to sponsor a 403(b) plan. Under current law, 403(b) plans cannot be terminated, merged, or transferred to a 401(k) plan. The 403(b) plan remains frozen, requiring ongoing plan administration, until the last participant in the 403(b) plan is able to take a distribution from the 403(b) plan according to the 403(b) distribution rules.*

    *In some cases, employers eligible to sponsor both 401(k) and 403(b) plans may want to transfer their 401(k) plans to a 403(b) plan because:*

    • Non discrimination testing is not required on deferral contributions
    • Possibility of increased catch-up options
    • Employer could contribute up to $40,000 a year of employee's accumulated sick and vacation pay to the 403(b) plan up to five years after employee terminates employment. These payments would not be subject to FICA taxation and would grow tax deferred until distributions are required to be made.
    • Ease of making in service transfers from the 403(b) to a governmental defined benefit plan for the purchase of service credits.

**Miscellaneous Provisions**

• **Cutting Pension Red Tape.** This bill will continue the regulatory simplification efforts by reforming a variety of administrative rules that have unnecessarily increased the cost and complexity of retirement plan sponsorship and administration, especially in the private sector.

    The bill will improve the IRS's retirement plan self-correction program under the Employee Plans Correction Resolution System (EPCRS) by extending periods for self correction, give employers 6 months instead of 2½ months to remove excess contributions from their qualified and 403(b) deferral plans without incurring double taxation, enhance the use of electronic technology for plan operations and remove barriers that have prevented the adoption of catch-up contributions.

• **Commission Study of Defined Contribution Plan Losses.** The bill also requires the Secretary of the Treasury to conduct studies on the affect of volatility of the market conditions on investment losses in defined contribution plans to determine:

    • How volatility affects the continuation and establishment of new defined contribution plans
    • How investment alternatives and lifetime distributions might reduce market risk
    • What legislative steps need to be taken to lessen future losses in defined contribution plans

    The report will be due one year from the date of enactment of this bill and will need to include recommendations for legislative and administrative actions.

    Many benefit experts believe that defined contribution plans will have to provide some type of guarantee on a portion of a participant’s account balance to help ensure that defined contribution plans meet participant retirement needs.
II. House Bill Changes Social Security GPO Exemption Requirement

The Social Security Protection Act of 2003 (H.R.743) introduced recently would increase the amount of time from one day to five years that a worker must spend in Social Security covered employment to be eligible for an exemption to the Government Pension Offset (GPO). Under current law, individuals planning to retire from state or local government jobs not covered by social security may transfer briefly to another state/local government job covered by Social Security to avoid the GPO, provided that the Social Security-covered job is also covered by the same state/local government pension plan system.

Background

Many state/local retirement systems are divided, meaning some jobs are covered under Social Security and others are not. Police, fire and teachers are frequently not covered under Social Security. Under current law, employees in divided systems are exempt from the GPO if the employee's last day of state/local employment is in a position covered by both Social Security and the state or local government's pension system.

Social Security pays retirement and disability benefits to

- Workers covered under Social Security and
- Spouses of these retired, disabled or deceased workers

If both spouses work in Social Security covered jobs, each may not receive both the benefits earned as a worker and the full spousal benefit, but the higher of the two benefits. Before 1977, government workers not working in positions covered under Social Security could receive both their full pension from non-Social Security covered government employment and their full Social Security spousal benefits as if they were non-working spouses.

Purpose of GPO

The GPO, introduced in 1977, is designed to prevent workers from receiving a full pension and spousal benefits under Social Security in addition their pension earned from non-covered public employment.

The GPO reduces any Social Security spousal, surviving spousal benefit by two thirds of the government pension received from the public retirement system. Many times this reduction leaves spouses and surviving spouses with greatly reduced or no Social Security benefits.

Recent congressional hearings and media coverage indicate that the GPO as well as its current exemption are very controversial, viewed as unfair by a variety of employee groups, and likely to provoke more debate when as this bill moves to the Senate.

You may find the full text of the bill by visiting http://thomas.loc.gov and entering H.R. 743 in the box labeled Bill Number.