Joint Committee on Taxation
July 11, 2002
JCX-76-02

ADDITIONAL CHAIRMAN'S MODIFICATIONS TO THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT"[1]

I. MODIFICATIONS TO EXISTING PROVISONS

A. Diversification of Defined Contribution Plan Assets

Under the Chairman's modification, the diversification requirements for defined contribution plans are phased in with respect to employer matching and nonelective contributions (and earnings thereon) that are invested in employer securities acquired before the first plan year to which the diversification requirements apply. Under this phase-in, the applicable percentage of such amounts that are subject to diversification is 33 percent for the first year the provision is effective, 66 percent the second year, and 100 percent the third year.

Under the additional modification, this phase-in would 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, 2002.

B. Clarification of Participant Access to Remedies under ERISA

The Chairman's modification clarifies that, in the case of a fiduciary breach with respect to a defined contribution plan, the relief under the general fiduciary provisions of ERISA would, to the extent the court deems appropriate, be apportioned to each individual account affected by the breach.

The additional modification would clarify that no inference is intended as to the scope of recovery available to participants under present law.

C. Optional Forms of Benefit

The Chairman's modification requires the Secretary of the Treasury to issue regulations requiring defined benefit and money purchase pension plan administrators to provide a statement comparing the relative values of each form of benefit payable under the plan. The statement is

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[1] A description of the Chairman's modifications may be found in Joint Committee on Taxation, *Description of Chairman's Modifications to the "National Employee Savings and Trust Equity Guarantee Act"* (JCX-74-02), July 9, 2002.

required to include such information as the Secretary determines appropriate to enable the average plan participant, spouse, or surviving spouse to make an informed decision as to what form of benefit to elect.

The additional modification provides that, for example, in the case of a plan that provides a subsidized early retirement annuity benefit, it is intended that the information would include, at a minimum, a quantification of how the subsidy is included in determining other forms of benefit (e.g., a lump sum) payable at early retirement age.

D. Treatment of Loans to Executives

The Chairman's modification provides that certain loans to officers, shareholders, five-percent owners, and employees who have outstanding loans from the employer in excess of $1 million would be treated as compensation.

The additional modification would clarify that it is not the intent that this proposal would impose tax on amounts otherwise includible in gross income.

II. ADDITIONAL PROVISIONS

A. Voluntary Early Retirement Incentive Plans Maintained by Local Educational Agencies and Other Entities

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, amounts that can be deferred under section 457 cannot exceed certain limits. 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). Amounts deferred under a plan that does not comply with section 457 (other than a qualified plan or similar arrangement) 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, sick leave, compensatory time, severance pay, disability pay, death benefit plan, 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 depends 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.

Age Discrimination in Employment Act

The Age Discrimination in Employment Act ("ADEA") generally prohibits discrimination in employment because of age. An exemption is provided from certain restrictions in the ADEA for certain defined benefit plans that offer early retirement benefits or social security supplements.

Description of Proposal

Early retirement incentive plans of local education agencies and education associations

Under the proposal, certain plans would be treated as (1) bona fide severance plans for purposes of section 457 (and therefore not subject to the limits of that section), (2) severance pay arrangements for purposes of ERISA, and (3) defined benefit plans exempt from provisions of ADEA.

The proposal would apply to voluntary early retirement incentive plans maintained by a local educational agency or tax-exempt education association if the plan makes payments only to provide subsidized early retirement benefits or social security supplements that could otherwise be provided under a qualified defined benefit plan maintained by a State or agency thereof or such an association.

Special rules for employment retention plans of local education agencies and education associations

The proposal would provide that certain payments not in excess of the dollar limit on deferrals under a section 457 plan are not includible in gross income until paid. This treatment would apply with respect to a participant in an employment retention plan maintained by a local education agency or a tax-exempt education association, to the extent the plan provides for a participant who is eligible to retire to receive a payment (not in excess of the dollar limit).

Effective Date

The proposal would be effective for amounts deferred after the date of enactment.

No inference (including an inference as to whether a voluntary early retirement incentive plan maintained by a local education agency constitutes or constituted a defined benefit plan) would be intended with respect to the law applicable to plans or arrangements not described in the proposal or with respect to the law in effect prior to the effective date of the proposal.

B. Exclusion of Incentive Stock Options and Employee Stock Purchase Plan Stock Options from Wages

Present Law

Generally, when an employee exercises a compensatory option on employer stock, the difference between the option price and the fair market value of the stock (i.e., the "spread") is includible in income as compensation. In the case of an incentive stock option or an option to

purchase stock under an employee stock purchase plan (collectively referred to as "statutory stock options"), the spread is not included in income at the time of exercise.[2]

If the statutory holding period requirements are satisfied with respect to stock acquired through the exercise of a statutory stock option, the spread, and any additional appreciation, will be taxed as capital gain upon disposition of such stock. Compensation income is recognized, however, if there is a disqualifying disposition (i.e., if the statutory holding period is not satisfied) of stock acquired pursuant to the exercise of a statutory stock option.

Federal Insurance Contribution Act ("FICA") and Federal Unemployment Tax Act ("FUTA") taxes are generally imposed in an amount equal to a percentage of wages paid by the employer with respect to employment.[3] The applicable Code provisions[4] do not provide an exception from FICA and FUTA taxes for wages paid to an employee arising from the exercise of a statutory stock option.

There has been uncertainty in the past as to employer withholding obligations upon the exercise of statutory stock options. On June 25, 2002, the IRS announced in Notice 2002-47[5] that until further guidance is issued, it would not assess FICA or FUTA taxes, or impose Federal income tax withholding obligations, upon either the exercise of a statutory stock option or the disposition of the stock acquired pursuant to the exercise of a statutory stock option.

Description of Proposal

The proposal would provide specific exclusions from FICA and FUTA wages for remuneration on account of the transfer of stock pursuant to the exercise of an incentive stock option or under an employee stock purchase plan, or any disposition of such stock. Thus, under the proposal, FICA and FUTA taxes would not apply upon the exercise of a statutory stock option.[6] The proposal would also provide that such remuneration is not taken into account for purposes of determining Social Security benefits.

Additionally, the proposal would provide that Federal income tax withholding is not required on a disqualifying disposition, nor when compensation is recognized in connection with an employee stock purchase plan discount. Present law reporting requirements would continue to apply.

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[2] Sec. 421.

[3] Secs. 3101, 3111 and 3301.

[4] Secs. 3121 and 3306.

[5] Notice 2002-47, 2002-28 I.R.B. 1.

[6] The proposal would also provide a similar exclusion for wages under the Railroad Retirement Tax Act.

Effective Date

The proposal would be effective on the date of enactment.

C. Capital Gain Treatment on Sale of Stock Acquired from Exercise of Statutory Stock Options to Comply with Conflict of Interest Requirements

Present Law

Statutory stock options

Generally, when an employee exercises a compensatory option on employer stock, the difference between the option price and the fair market value of the stock (i.e., the "spread") is includible in income as compensation. Upon such exercise, an employer is allowed a corresponding compensation deduction. In the case of an incentive stock option or an option to purchase stock under an employee stock purchase plan (collectively referred to as "statutory stock options"), the spread is not included in income at the time of exercise.[7]

If an employee disposes of stock acquired upon the exercise of a statutory option, the employee generally is taxed at capital gains rates with respect to the excess of the fair market value of the stock on the date of disposition over the option price, and no compensation expense deduction is allowable to the employer, unless the employee fails to meet a holding period requirement. The employee fails to meet this holding period requirement if the disposition occurs within two years after the date the option is granted or one year after the date the option is exercised. A disposition that occurs prior to the expiration of the applicable holding period(s) (a "disqualifying disposition") does not qualify for capital gains treatment. In the event of a disqualifying disposition, the income attributable to the disposition is treated by the employee as income received in the taxable year in which the disposition occurs, and a corresponding deduction is allowable to the employer for the taxable year in which the disposition occurs.

Sale of property to comply with conflict of interest rules

The Code provides special rules for recognizing gain on sales of property which are required in order to comply with certain conflict of interest requirements imposed by the Federal government.[8] Certain executive branch Federal employees (and their spouses and children) who are required to divest property in order to comply with conflict of interest rules can postpone the recognition of resulting gains by electing to reduce the basis of certain replacement property purchased within a 60-day period. Permitted replacement property is limited to any obligation of the United States or any diversified investment fund approved by regulations issued by the Office of Government Ethics. The rule applies only to sales under certificates of divestiture issued by the President or the Director of the Office of Government Ethics.

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[7] Sec. 421.

[8] Sec. 1043.

Description of Proposal

Under the proposal, an eligible person who, in order to comply with the Office of Government Ethics conflict of interest requirements, is required to sell shares of stock acquired pursuant to the exercise of a statutory stock option would be treated as satisfying the statutory holding period requirements, regardless of how long the stock was actually held. Because the sale would not be treated as a disqualifying disposition, the individual would be afforded capital gain treatment on any resulting gains. Under the proposal, such gains would be eligible for the deferral treatment under section 1043. An eligible person generally includes an officer or employee of the executive branch of the Federal Government (and any spouse or minor or dependent children whose ownership in property is attributable to the officer or employee).

The employer granting the option would not be allowed a deduction upon the sale of the stock by the individual.

Effective Date

The proposal would be effective for stock sales after July 1, 2002.

D. Interest Rate Range for Additional Funding Requirements

Present Law

In general

ERISA and the Code impose both minimum and maximum[9] funding requirements with respect to defined benefit pension plans. The minimum funding requirements are designed to provide at least a certain level of benefit security by requiring the employer to make certain minimum contributions to the plan. The amount of contributions required for a plan year 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.

Additional contributions for underfunded plans

Additional contributions are required under a special funding rule if a single-employer defined benefit pension plan is underfunded.[10] Under the special rule, a plan is considered underfunded for a plan year if the value of the plan assets is less than 90 percent of the plan's

[9] The maximum funding requirement for a defined benefit plan is referred to as the full funding limitation. Additional contributions are not required if a plan has reached the full funding limitation.

[10] Plans with no more than 100 participants on any day in the preceding plan year are not subject to the special funding rule. Plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under the special funding rule.

current liability.[11] The value of plan assets as a percentage of current liability is the plan's "funded current liability percentage."

If a plan is underfunded, the amount of additional required contributions is based on certain elements, including whether the plan has an unfunded liability related to benefits accrued before 1988 or 1995 or to changes in the mortality table used to determine contributions, and whether the plan provides for unpredictable contingent event benefits (that is, benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce). However, the amount of additional contributions cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent.

Required interest rate

In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan. The interest rate used to determine a plan's current liability must be within a permissible range of the weighted average of the interest rates on 30-year Treasury securities for the four-year period ending on the last day before the plan year begins.[12] The permissible range is from 90 percent to 105 percent. As a result of debt reduction, the Department of the Treasury does not currently issue 30-year Treasury securities.

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, estimated contributions for the current plan year must be made in quarterly installments during the current plan year. 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.[13]

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[11] Under an alternative test, a plan is not considered underfunded if (1) the value of the plan assets is at least 80 percent of current liability and (2) the value of the plan assets was at least 90 percent of current liability for each of the two immediately preceding years or each of the second and third immediately preceding years.

[12] The interest rate used under the plan 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 (section 412(b)(5)(B)(iii)(II)).

[13] No additional quarterly contributions are due once the plan's funded current liability percentage for the plan year reaches 100 percent.

PBGC premiums

Because benefits under a defined benefit pension plan may be funded over a period of years, plan assets may not be sufficient to provide the benefits owed under the plan to employees and their beneficiaries if the plan terminates before all benefits are paid. In order to protect employees and their beneficiaries, the Pension Benefit Guaranty Corporation ("PBGC") generally insures the benefits owed under defined benefit pension plans. Employers pay premiums to the PBGC for this insurance coverage.

In the case of an underfunded plan, additional PBGC premiums are required based on the amount of unfunded vested benefits. These premiums are referred to as "variable rate premiums." In determining the amount of unfunded vested benefits, the interest rate used is 85 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Special interest rate for 2002 and 2003

Section 405 of the Job Creation and Worker Assistance Act of 2002,[14] enacted March 9, 2002, provides a special interest rate rule applicable in determining the amount of additional contributions for plan years beginning after December 31, 2001, and before January 1, 2004 (the "applicable plan years"). The special rule expands the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of applying the additional contribution requirements for the applicable plan years. The permissible range is from 90 percent to 120 percent for these years.

Under a related special rule, the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes is increased to 100 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the applicable plan year begins.

Description of Proposal

The proposal would expand the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of determining the amount of additional contributions for a plan year beginning in 2001 (the "2001 plan year") that must be contributed to the plan within 8½ months after the end of the plan year (e.g., by September 15, 2002, in the case of a plan that uses the calendar year as the plan year). The permissible range would be from 90 percent to 108 percent for this purpose.

In addition, with respect to the provision of the Job Creation and Worker Assistance Act of 2002 providing a special rule for the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes, the proposal would make conforming changes so that the special rule would apply for purposes of notices and reporting required with respect to underfunded plans.

[14] Pub. L. No. 107-147.

Effective Date

The proposal would be effective as if included in section 405 of the Job Creation and Worker Assistance Act of 2002.

E. Automatic Rollovers of Certain Mandatory Distributions

Present Law

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan. Before making a distribution that is eligible for rollover, a plan administrator must provide the participant with a written explanation of the ability to have the distribution rolled over directly to an IRA or another qualified plan and the related tax consequences.

Revenue Ruling 2000-36[15] holds that a qualified retirement plan may provide that the default form of payment of an involuntary distribution is a direct rollover to an IRA, unless the participant elects a direct rollover to another qualified retirement plan or IRA or to receive the payment in cash. Under the plan, the plan administrator selects an IRA trustee, custodian or issuer, establishes the IRA on behalf of the participant, and makes initial investment choices for the account. Footnote 1 of Revenue Ruling 2000-36 states:

"The Department of Labor (the "DOL") has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act ("ERISA"), in the context of a default direct rollover described in this ruling, where the distribution constitutes the entire benefit rights of the participant, the participant will cease to be a participant covered under the plan within the meaning of 29 CFR § 2510.3-3(d)(2)(ii)(B), and the distributed assets will cease to be plan assets within the meaning of 29 CFR § 2510.3-101. The DOL also noted that the selection of an IRA trustee, custodian or issuer and IRA investment for purposes of a default direct rollover would constitute a fiduciary act subject to the general fiduciary standards and prohibited transaction provisions of ERISA. In addition, plan provisions governing the default direct rollover of distributions, including the participant's ability to affirmatively opt out of the arrangement, must be described in the plan's summary plan description furnished to participants and beneficiaries."

Under section 657 of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), a direct rollover to an IRA must be the default option for an involuntary distribution that exceeds $1,000 and that is an eligible rollover distribution from a qualified retirement plan. That is, the distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly.

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[15] 2000-2 C.B. 140.

This provision of EGTRRA also amended the fiduciary rules of ERISA so that, in the case of an automatic direct rollover, the participant is treated as exercising control over the assets in the IRA upon (1) the earlier of a rollover of all or a portion of the amount to another IRA, or one year after the automatic rollover is made, or (2) an automatic rollover made in a manner consistent with guidance provided by the Secretary of Labor.[16] EGTRRA directed the Secretary of Labor to prescribe regulations, not later than three years after the date of enactment of EGTRRA, providing safe harbors under which the designation of an institution and investment of funds in accordance with the automatic direct rollover provision are deemed to satisfy the requirements of section 404(a) of ERISA. The EGTRRA provisions apply to distributions made after the Department of Labor has adopted final regulations providing the required safe harbor.

Description of Proposal

The proposal would repeal the ERISA provision (section 404(c)(3) of ERISA) that was enacted by section 657 of EGTRRA. The proposal would thus clarify that amounts that are transferred from a qualified retirement plan to an IRA in an automatic rollover are no longer plan assets for ERISA purposes, consistent with the Department of Labor's position as described in Revenue Ruling 2000-36.

Effective Date

The proposal would be effective as if included in the provisions of EGTRRA.

F. Chief Executive Officer Required To Sign Corporate Income Tax Returns

Present Law

The Code requires[17] that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes[18] a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than $100,000[19] ($500,000 in the case of a corporation) or imprisonment of not more than three years, or both, together with the costs of prosecution.

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[16] Sec. 404(c)(3) of ERISA. Section 411(t) of the Job Creation and Worker Assistance Act of 2002 made clerical corrections to the wording of this provision.

[17] Sec. 6062.

[18] Sec. 7206.

[19] Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is $250,000.

Description of Proposal

The proposal would require that the income tax return of a corporation must be signed by the chief executive officer of that corporation. Special rules would apply if the corporation did not have a chief executive officer or had multiple chief executive officers; otherwise, no other person would be permitted to sign the income tax return of a corporation.

Effective Date

The proposal would be effective for returns filed after the date of enactment.

G. Other Provisions Relating to Pensions

1. Employee Plans Compliance Resolution System

Present Law

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

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), or section 403(b), as applicable.[20] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

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

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") program permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected,

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[20] Rev. Proc. 2001-17, 2001-7 I.R.B. 589.

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.

Description of Proposal

The proposal would clarify that the Secretary of the Treasury 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, penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure.

The Secretary of the Treasury would be 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 proposal would be effective on the date of enactment.

2. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to state and local government plans

Present Law

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

Description of Proposal

The proposal would exempt all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2002.

3. Notice and consent period regarding distributions

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

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. In that case, the plan must provide that, if the amount of the distribution exceeds $1,000, the plan administrator will transfer the distribution to a designated IRA unless the participant elects to receive the distribution directly or have it directly transferred to another retirement plan or IRA. Before making a distribution, the plan administrator generally is required to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, (2) the fact that a distribution that exceeds $1,000 will be transferred to a designated IRA unless the participant elects otherwise, and (3) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

Description of Proposal

Under the proposal, a qualified retirement plan would be required to provide the applicable distribution notice no less than 30 days and no more than 180 days before the date

[21] 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.

distribution commences. The Secretary of the Treasury would be 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 must also describe the consequences of failing to defer such receipt.

Effective Date

The modifications made or required by the proposal would be effective for years beginning after December 31, 2002. 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 would be required to make a reasonable attempt to comply with the requirements of the proposal.

4. Technical corrections to Saver Act

Present Law

The Savings Are Vital to Everyone's Retirement ("SAVER") Act initiated a public-private partnership to educate American workers about retirement savings and directed the Department of Labor to maintain an ongoing program of public information and outreach. The Act also convened a National Summit on Retirement Savings held June 4-5, 1998. A second National Summit on Retirement Savings was held February 27 through March 1, 2002, co-hosted by the President and the bipartisan Congressional leadership. The National Summit brings together experts in the fields of employee benefits and retirement savings, key leaders of government, and interested parties from the private sector and general public. The delegates are selected by the Congressional leadership and the President. The National Summit is a public-private partnership, receiving substantial funding from private sector contributions. The goals of the National Summits are to: (1) advance the public's knowledge and understanding of retirement savings and facilitate the development of a broad-based, public education program; (2) identify the barriers which hinder workers from setting aside adequate savings for retirement and impede employers, especially small employers, from assisting their workers in accumulating retirement savings; and (3) develop specific recommendations for legislative, executive, and private sector actions to promote retirement income savings among American workers.

Description of Proposal

Under the proposal, future National Summits on Retirement Savings would be held in 2006 and 2010. To facilitate the administration of future National Summits, the Department of Labor would be given authority to enter into cooperative agreements (pursuant to the Federal Grant and Cooperative Agreement Act of 1977) with any appropriate, qualified entity.

Six new statutory delegates would be added to future National Summits: the Chairman and Ranking Member of the Senate Finance Committee, the House Ways and Means Committee, and the Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce. Further, the President, in consultation with the Congressional leadership, would be permitted to appoint additional Summit participants, not to exceed the lesser of 3 percent of all additional participants or 10 participants, from a list of nominees provided by the

private sector partner in Summit administration. The proposal would also clarify that new delegates are to be appointed for each future National Summit (as was the intent of the original legislation) and would set deadlines for their appointment.

The proposal would also set deadlines for the Department of Labor to publish the Summit agenda, give the Department of Labor limited reception and representation authority, and specify that the Department of Labor consult with the Congressional leadership in drafting the post-Summit report.

Effective Date

The proposal would be effective on the date of enactment.

5. Missing participants

Present Law

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

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

Description of Proposal

The PBGC would be 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 would be permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the proposal would extend the missing participants program (in accordance with regulations) to defined contribution plans, defined benefit plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

Effective Date

The proposal would be effective for distributions made after final regulations implementing the proposal are prescribed.

6. Reduced PBGC premiums for small and new plans

Present Law

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

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

Description of Proposal

Reduced flat-rate premiums for new plans of small employers

Under the proposal, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium would be $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 would 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) would be taken into account in determining whether the plan is a plan of a small employer.

A new plan would mean a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) had 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 proposal would provide that the variable-rate premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable-rate premium would be a percentage of the variable premium otherwise due, as follows: zero percent of the otherwise applicable variable-rate premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan would be defined as described above under the flat-rate premium provision of the proposal relating to new small employer plans.

Reduced variable-rate PBGC premium for small plans

In the case of a plan of a small employer, the variable-rate premium would be 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 proposal, a small employer would be 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 would 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) would be taken into account in determining whether the plan is a plan of a small employer.

Effective Date

The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans would be effective with respect to plans first effective after December 31, 2002. The reduction of the variable-rate premium for small plans would be effective with respect to plan years beginning after December 31, 2002.

7. Authorization for PBGC to pay interest on premium overpayment refunds

Present Law

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

Description of Proposal

The proposal would allow the PBGC to pay interest on overpayments made by premium payors. Interest paid on overpayments would be calculated at the same rate and in the same manner as interest charged on premium underpayments.

Effective Date

The proposal would be effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

8. Rules for substantial owner benefits in terminated plans

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.

Description of Proposal

The proposal would provide 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 would occur over a 10-year period and would depend on the number of years the plan has been in effect. The majority owner's guaranteed benefit would be limited so that it cannot be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets would apply to substantial owners, other than majority owners, in the same manner as other participants.

Effective Date

The proposal would be 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, 2002.

9. Benefit suspension notice

Present Law

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

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

Description of Proposal

Under the proposal, the Secretary of Labor would be required to modify the regulations relating to the benefit suspension notice (1) to permit the information currently required to be set forth in a suspension notice generally to be included in the summary plan description, rather than in a separate notice, and (2) not to require that the notice include a copy of relevant plan provisions. However, individuals reentering the workforce to resume work with a former employer after having begun to receive benefits would still receive the notification of the suspension of benefits (and a copy of the plan's provisions relating to suspension of payments). Such notice would be required to be provided during the first calendar month, or during the first 4- or 5-week payroll period ending in a calendar month, in which the plan withholds payments.

Effective Date

The proposal would apply for plan years beginning after December 31, 2002.