The Pension Preservation and Savings Expansion Act of 2003

Representatives Rob Portman and Ben Cardin

Congress enacted the Portman/Cardin Comprehensive Retirement Security and Pension Reform Act as part of the 2001 tax relief act. This landmark pension legislation, introduced as H.R. 10 in the 107th Congress, increased 401(k) and IRA savings limits, instituted catch-up contributions for older workers, enhanced pension portability through reduced vesting and removal of rollover barriers, encouraged small business pension coverage and simplified pension regulation. The new Portman/Cardin Pension Preservation and Savings Expansion Act builds on these important reforms by making the next generation of improvements to our nation's savings and pension systems. With adoption of these new proposals, Congress will provide individuals and families with a number of important new savings tools, will further strengthen and expand the employer-sponsored retirement system, will offer important new protections to retirement plan participants and will assist retirees in managing and preserving retirement assets and income. The Pension Preservation and Savings Expansion Act contains important reforms in the following areas:

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 2001 tax relief act — from catch-up contributions to portability enhancements to union and teacher pension improvements — 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 increases in 401(k) and IRA savings limits contained in the 2001 tax act. The gradual increases in these limits scheduled under current law will instead become fully effective in 2004 so that next year individuals can contribute $15,000 to their 401(k), $10,000 to their SIMPLE plan or $5,000 to their IRA. The catch-up contribution limits will also be accelerated to allow savers age 50 and over to make the full $5,000 plan catch-up and $1,000 IRA catch-up beginning in 2004.

- **Expanding and Making Permanent the Saver's Credit for Modest-Income Savers.** The legislation will make permanent the 2001 tax act's credit provided to low and moderate-income savers who contribute to an IRA or workplace retirement plan, which is scheduled to sunset at the end of 2006. This credit, which supplements the existing deduction for IRA or plan contributions, recognizes that modest-income individuals may need additional financial assistance in order to be able to save. The 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

- **Reducing Vesting Schedules.** The bill will reduce the required vesting schedule for all contributions made by employers into defined contribution plans (such as 401(k)s) so that these dollars more quickly become the property of the employee. With this change, the vesting schedule for non-matching contributions will be the same as that for matching contributions – either contributions must vest all at once after three years of service or gradually over six years of service.

- **Ensuring Fair Pension Divisions at Divorce.** The bill will enhance women's retirement security by clarifying that qualified domestic relations orders (awarding a share of a spouse's pension benefits earned during the period of the marriage) issued <u>after</u> a divorce are nonetheless valid and must be obeyed.

- **Allowing IRAs for Disabled Americans.** Today's IRA rules prevent disabled Americans with no wage income from contributing to IRAs and providing for their retirement income needs. Yet some disabled individuals are unable to work and must rely on income from other sources. The legislation corrects this inequity by allowing those who meet a standard definition of disability to contribute to an IRA using income from non-wage sources.

- **Preventing Savings Spend-Down for SSI Eligibility.** In addition, 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).

<u>Expanding IRAs</u>

- **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. This will enable more American families to use this valuable retirement savings tool, which provides an immediate tax deduction for contributions.

- **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, the very act of getting married makes you 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 also initiate a correction mechanism to allow IRA investors to return funds to their accounts when distributions have been made in error.

<u>Revitalizing Defined Benefit Plans</u>

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

- **Pension Financing Reforms.** The legislation will provide targeted funding relief for multi-employer pension plans managed jointly by union and employer trustees and will instruct the Treasury Department to update mortality assumptions to more accurately reflect the life expectancy of particular worker populations. It will also correct a number of glitches in the pension funding rules and will correct a flaw in the deduction rules that discourages employers from maintaining both a defined benefit and defined contribution plan.

- **Simplifying Defined Benefit Plan Administration.** The legislation will reform a variety of rules applicable to defined benefit plans that have complicated plan administration and discouraged employers from offering the guaranteed benefits these plans provide. For example, employee contributions to private-sector defined benefit plans will be treated as pre-tax rather than after-tax (as they currently are for public-sector plans) and the plan valuation data collection process would be streamlined.

<u>Preserving Retirement Assets</u>

- **Reforming Required Distribution Rules.** The bill will reform the minimum required distribution rules that force individuals to begin taking their money at age 70½ by raising the starting age to 75 (which will reflect increases in life expectancy since the rule was enacted in 1962). In addition, the excise tax for those who fail to take their proper distributions will be reduced from 50% to 20% of the amount not distributed – enough to deter gaming while avoiding draconian penalties on seniors who make innocent mistakes.

- **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.

- **Combating Pension Leakage.** Through adoption of fiduciary safe harbors, the legislation will fight leakage from the retirement system by allowing employers to establish easy to use default rollover options — to either IRAs or annuities — for departing employees.

- **Reuniting Lost Participants with Retirement Benefits.** The legislation will initiate a new program to help safeguard benefits when employers are unable to locate departing employees who are entitled to pension payments. Employers will be able send the benefits for these "lost participants" to the Pension Benefit Guaranty Corporation, which will use its existing Missing Participants program to match individuals with missing benefits.

<u>Reforming Company Stock and Executive Compensation Practices</u>

- **Providing New Diversification Rights to Employees.** The legislation will contain the Portman/Cardin Employee Retirement Savings Bill of Rights (H.R. 3669 of the 107th Congress). This measure, which was approved by the Ways & Means Committee in April 2002 and reforms retirement plan rules in the wake of the Enron bankruptcy, will provide employees with new rights to diversify company stock contributed to their 401(k) accounts after either three or five years of service (depending on the nature of the contribution). The bill will also direct the Secretary of the Treasury to evaluate possible ways to lessen the effects of market volatility on defined contribution plan savings.

- **Expanding Investment Education, Retirement Planning and Legal Advice.** The bill will also require employers to provide new investment education notices to employees. In addition, the legislation will allow employees to save for retirement planning expenses on a pre-tax basis and will once again treat qualified group legal services on a tax-preferred basis.

- **Preventing Executives from Draining Assets from Failing Companies.** To address the corporate and executive abuses brought to light in recent scandals, the bill will impose an excise tax on excessive corporate payments to senior executives in the period prior to bankruptcy. This will prevent insiders from draining assets from a company as it declines.

Expanding Small Business Pension Coverage

- **Expanding and Improving SIMPLE Plans.** The legislation will make a number of improvements to the existing SIMPLE IRA and SIMPLE 401(k) small business pension design to encourage more small employers to offer retirement benefits to their employees. Employers would be authorized to make additional contributions to SIMPLE plans for all workers, they would be permitted to step up from a SIMPLE plan to a full-fledged 401(k) plan in mid-year, and they would have the low-cost option of setting up a salary-reduction only SIMPLE plan. In addition, SIMPLE 401(k)s would be given the same flexibility on matching contributions as SIMPLE IRAs.

- **Expanding and Improving SEP Plans.** Another important small business pension plan – the Simplified Employee Pension (SEP) — would be improved. First, a new reverse match SEP would be created. Under this new design, employees would be able to contribute twice what employers contribute to SEP accounts. This will encourage employers to make greater contributions for everyone so that employees can save more with their own dollars. Employers would also be able to make level dollar contributions to SEPs for all workers and families would be encouraged to establish SEPs for domestic workers.

- **Small Retirement Plan Payroll Tax Equity.** Today, unlike large employers, small businesses (proprietorships, partnerships, S corporations) must pay payroll taxes on the employer contributions they make to retirement plans. The bill will end this payroll tax penalty so that small businesses are treated the same way as large corporations, removing a significant disincentive for small businesses to offer retirement benefits to their employees.

Financing Retiree Health

- **Allowing Use of Pre-Tax Pension Payments for Retiree Medical Premiums.** Retiree medical costs are one of the most significant financial burdens faced by older Americans. Today, when a retiree receives a payment from a pension plan and wishes to use that money to pay her retiree medical premium she must pay tax on the pension payment and pay the premium with after-tax money. The bill will allow the retiree to cover her premium with pre-tax pension money, thus putting retirees on the same tax footing as active workers with respect to the tax treatment of their health plan premiums.

- **Allowing 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)s will be given a new mechanism to fund a modest portion of retiree medical expenses on a pre-tax basis.

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 service credit regime — under which state and local workers can buy discounted pension credits to reflect service in another jurisdiction — would be improved. In addition, special pension plans for public safety workers that allow employees to roll their pensions over to plan accounts that will continue to grow (so-called "DROP" plans) would be enhanced.

- **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 (potentially on unneeded health services) before the end of the year. The bill will instead 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 limits on plan and IRA contributions.

- **Improving Rollover Rules.** In furtherance of the portability improvements enacted in 2001, the bill will make clear that participants can roll after-tax retirement plan contributions between 401(k)s and 403(b)s when they change jobs and will allow portability of retirement savings between SIMPLE small business plans and other defined contribution plans such as 401(k)s. It will also ease transfers or mergers from 401(k) plans to 403(b) arrangements and vice versa.

Regulatory Simplification

- **Cutting Pension Red Tape.** The bill will continue the regulatory simplification efforts begun in past Portman/Cardin pension bills by reforming a variety of administrative rules that have unnecessarily increased the cost and complexity of retirement plan sponsorship and administration. For example, the bill will improve the IRS's retirement plan self-correction program, enhance the use of electronic technology for plan operations, and remove barriers that have impeded the adoption of catch-up contributions. The bill does not make any changes to the top-heavy rules.