Proposals to Enhance the Private Retirement Plan System

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INTRODUCTION

The proposals in this document are intended to enhance the retirement security of American workers, both active and retired, through expanded coverage, simplification, tools to address longevity issues and improved disclosure. The proposals are primarily the work of ASPPA's Government Affairs Committee Legislative Relations Subcommittee.

Proposals to Enhance Coverage

1. Safe harbor for deferral-only 401(k) plans

A. Under current law, small business owners who can't afford to make a contribution on behalf of their employees have chosen not to sponsor a 401(k) plan. This has been further complicated by the top heavy rules requiring a 3% contribution due for all employees if they contribute. A SIMPLE plan cuts that back to 2%, but for a small business on a tight budget, this can still be a burden.

B. The proposal would provide a new 401(k) safe harbor deferral-only 401(k) plan.

(1) **Basic provisions.** Deferrals would be limited to $8,000 (with a $2,000 catch up for those at least age 50), and automatically enrolls eligible employees at the minimum default level of 3% of pay. Similar to limits of a QACA the rate would be at least 3%, but no more than 10%. Eligible employees would be all employees who are not excludable under IRC§410(a)(1)(A). Plans satisfying this safe harbor would be deemed to meet the top heavy test.

(2) **Simplified reporting.** DOL would be directed to develop simplified reporting rules (ERISA §§102, 103 and 105) for safe harbor deferral-only 401(k) plans.

(3) Would serve as the safe harbor in a DB (k) arrangement.

2. SIMPLE plans could be replaced by a safe harbor 401(k) plan mid-year.

This rule change would allow employers to transition from a SIMPLE to a 401(k) retirement plan in the same calendar year. The new rule would exclude same-year transitions from a SIMPLE plan to a safe harbor deferral only 401(k) plan.

3. Small employers could expand coverage beyond statutory requirements without incurring additional top-heavy contribution liability.

Small employers who do not utilize the deferral-only safe harbor would be encouraged to cover part-time employees who do not work 1000 hours or more per year by allowing the top heavy rules to be applied separately to this group, just as the non-discrimination rules can be applied separately just as ADP statutory exclusion rules apply.

4. Increase the minimum and maximum automatic enrollment contribution rates.

The minimum would be gradually increased from 3% to 6% and the maximum from 10% to 15%, with employees having the ability to reduce or change this at elected periods, no less than quarterly.

5. Additional time to adopt a qualified plan

A. **Current law -** Revenue Ruling 81-114 provides that a deduction for qualified plan contributions is not allowed for a prior taxable year if the plan is not established by the end of that taxable year. Accordingly, in order to be able to make deductible contributions for a taxable year, an employer must formally adopt a new qualified retirement plan by the end of such year. However, an employer can establish a Simplified Employee Pension (SEP) plan as late as the due date of the employer's tax filings, including extensions.

B. **Proposed change -** The proposal would permit an employer to adopt a qualified plan up to the due date (including extensions) for filing its tax return for the employer's taxable year in which the first plan year ends.

C. **Reason for change -** Frequently, the employer's profitability for a year will be a major factor in his or her decision to establish a plan, and reliable information on such profitability is often not available until after the close of the employer's taxable year. The proposed change will allow employers to consider the adoption of a qualified plan, or addition of non-elective contributions to an existing plan, when final results for a year are available, thereby expanding coverage and employer-funded retirement benefits. The extension of time to adopt a qualified plan will coordinate with the maximum time that an employer can make a deductible contribution with respect to a plan year. This rule also would place the timing for adopting qualified plans on par with the adoption of SEPs, enabling an employer to opt for an ERISA-covered program to cover its employees in lieu of adopting a non-ERISA covered SEP program.

D. **Modification to existing authority -** The proposal would add paragraph (38) to section 401(a) to provide as follows:

(38) The adoption of a plan by the applicable date shall not cause a plan to fail to meet the requirements of this section. The "applicable date" for this purpose means the due date (including extensions) for filing the Federal income tax return for the employer's taxable year in which ends the plan year for which the plan is effective. A plan adopted in accordance with this paragraph will be treated as established by the end of the taxable year for purposes of applying section 404(a).

6. Permit adoption of a 4% non-elective 401(k) safe harbor after the beginning of the year

A. Allowing for the adoption of a non-elective 401(k) safe harbor plan enhances the benefits offered from the employer for the non-highly compensated employees by increasing contributions within this group of employees.

Current law - To satisfy the requirements for being a safe harbor plan for a particular plan year, existing plans must issue a safe harbor notice within a reasonable time prior to the first day of the (safe harbor) plan year. See IRC §§401(k)(12)(D) and 401(k)(13)(E)(i). The IRS deems a reasonable period to be 30 to 90 days prior to the first day of the plan year. See IRS Notice 98-52 section V.2.b and Treas. Reg. 1.401(k)-3(d)(3)(ii). There is a more relaxed rule for new (non-successor) plans. See Treas. Reg. 1.401(k)-3(e)(2) and IRS Notice 98-52 section X.

The advance notice requirements apply to both matching safe harbor contributions and 3% (of pay) non-elective safe harbor contributions. However, the matching safe harbor contribution has a different effect on participants' deferral elections than the 3% non-elective safe harbor contribution.

Under the matching safe harbor contribution feature, a plan sponsor must make a mandatory commitment to the matching contribution. Advance notice of a mandatory safe harbor match will influence many participants to defer more compensation over the entire plan year than they would otherwise have deferred.

Under the 3% non-elective safe harbor contribution, the plan sponsor, prior to the plan year, may issue either a mandatory or conditional commitment to make the contribution. If the plan sponsor makes a conditional commitment, the sponsor is then obligated to confirm whether or not the contribution will be made (and be a safe harbor plan) no later than 30 days prior to the end of that plan year. In other words, a plan participant would not know whether a conditional 3% non-elective safe harbor contribution will be made until the plan year has nearly ended. Moreover, in either case, a participant's receipt of the 3% non-elective safe harbor contribution does not depend upon whether the participant defers income and, as such, it is reasonable to conclude that the 3% non-elective safe harbor contribution will not motivate a participant to defer income.

Employers, on the other hand, are usually motivated to adopt a 401(k) safe harbor provision after the end of the plan year during annual compliance testing and administration. For example, changes in the size or makeup of the sponsor's eligible workforce are often not fully known or assimilated until well after the end of a plan year. The sponsor of a plan that has failed an ADP or ACP test for the preceding year may prefer to make a 3% non-elective safe harbor contribution in the future, instead of refunding excess deferrals or (non-safe harbor) matching contributions. Merely refunding elective deferrals or matching contributions does not create retirement savings for any participant, highly or non-highly compensated. Unfortunately, under current law, by the end of a plan year, it is too late to adopt safe harbor measures for that plan year as well as the following plan year. As such, the process is repeated and non-highly compensated participants continue to miss out on 3% non-elective safe harbor contributions they very likely may have received. In particular, the current rules negatively affect small employers who generally have neither the budget nor human resources/finance staff available to prepare advance analysis to determine whether a safe harbor approach would be the best approach for the following plan year.

B. **Proposed change –**

(1) Allow employers to adopt a 4% non-elective safe harbor contribution plan provision for a given plan year up to the deadline for making distributions of excess 402(g) deferrals. Allow a provision that the plan would become 3% non-elective safe harbor contribution as of beginning of the following plan year.

(2) No annual notices would be required.

(3) Modified SPD required based upon only the plan provisions allowed in the 4% Non-elective 401(k) Safe Harbor.

C. **Reason for change -**

(1) The existence of a non-elective safe harbor does not influence the behavior of NHCEs (except possibly to reduce elective deferrals since the employer will contribute).

(2) Permitting an employer to decide on whether or not to use the non-elective safe harbor after the end of a year allows the employer to avoid making a commitment that may turn out not to be affordable. Adding a 1% contribution to the safe harbor requirement accounts for the fact that the employer has removed a level of risk by not choosing the safe harbor in advance.

(3) Employers who fail to provide timely notice for the 3% safe harbor could self-correct by increasing the safe harbor contribution for the year from 3% to 4%.

D. **Modification to existing authority -**

IRC §401(k)(12)(D) and IRC §401(k)(13)(E)(i)

Simplification Proposals

1. Interim amendments

A. **Current law -**

(1) Revenue Procedure 2005-66, as modified by Rev. Proc. 2008-56, and Rev. Proc. 2012-50, provides staggered dates for written plan documents to be reviewed by the IRS as to a plan's qualified status. Individually designed plans are on five-year cycles, and pre-approved documents are on six-year cycles.

(2) During these cycles, plans must also adopt separate amendments to reflect changes to the qualification requirements, regardless of the reason for the change (e.g., legislative or regulatory). Except as provided by law or other guidance, these "interim amendments" must generally be adopted by the due date (including extensions) for filing the income tax return for the applicable employer's taxable year. The due dates of "interim amendments" required by statutory and regulatory changes are not coordinated with the cycle for submission of documents to IRS.

(3) Discretionary amendments (i.e., any amendments other than interim amendments) must generally be adopted by the last day of the plan year for which the amendment is effective.

B. **Proposed change -**

(1) The deadline for adopting interim amendments would be conformed to a plan's approval cycle.

(2) Plans would need to comply with applicable law in operation in the interim.

(3) Relief would be granted under IRC§ 411(d)(6) until the date the amendment is required.

(4) A discretionary amendment to a plan could be adopted up to the due date of the employer's taxable year in which the plan year ends, subject to the anti-cutback rule of IRC§ 411(d)(6).

C. **Reasons for change -**

(1) The laws and regulations governing qualified plans continually change. This results in the need to have numerous interim amendments during a plan's applicable review cycle.

(2) The current interim amendment requirements are overly complex and cause confusion within the industry. One of the top compliance issues found by the IRS on audit and within the voluntary compliance program (EPCRS) is the failure to timely adopt interim amendments.

(3) In some cases, amendments must be adopted even though there is no impact to a plan sponsor's plan (e.g., the deemed IRC §125 compensation amendment).

(4) In some cases, multiple amendments may be needed for the same provision of the law. The IRS has tried to reduce the occurrence of these situations, but sometimes the relief is provided too late. Interim amendments to conform to IRC §436 is a prime example of this deficiency with the current system. IRC §436 was part of the Pension Protection Act of 2006 and, by statute, an amendment was not needed until the end of 2009. Late in 2009, after many plan sponsors had amended their plans, the Treasury issued final regulations under IRC §436 and in December 2009, the IRS extended the amendment deadline to 2010. The IRS extended the deadline in November 2010 to 2011 (due to legislation that affected IRC §436). In November 2011 another extension to 2012 was granted, and the IRS issued sample amendment language. In December 2012 the deadline was extended to 2013. Thus, one provision in the law was impacted by regulations and a minor legislative change, and the amendment deadline was extended 4 times, in most cases less than a month before the deadline. The result is that for plan sponsors who did not procrastinate may have amended their plans for IRC §436 up to 4 times (initial law, after final regulations were issued, after law was changed in 2010, and after IRS issued sample amendment). Situations like this add unnecessary costs to the plan administrator which then get passed along to the plan sponsor.

(5) The IRS has not always required annual amendments. During the most recent remedial amendment period for GUST (including changes from the 1994 GATT law) and the prior remedial amendment period for TRA ‘86, the IRS allowed many changes to be made by retroactive amendments adopted before the end of the remedial amendment period— often many years after the effective date. This was user friendly and cost-effective.

(6) The current system is a burden to plan sponsors, practitioners, and the IRS. Any benefit to requiring interim amendments more frequently than the review cycles (every 5 or 6 years) is outweighed by the draconian results to plan sponsors and the resources expended on conforming to the requirements.

(7) The deadline to adopt discretionary amendments is one that seems unwarranted and detrimental to plan sponsors and plan participants. For example, a plan sponsor that wants to add a profit sharing component to a 401(k) plan after it determines that it had a successful year is precluded from doing so. Public policy should encourage plan sponsors to provide additional benefits to participants and not be constrained by procedural roadblocks.

D. **Modification to existing authority -**

(1) IRC §411(d)(6)
(2) Rev. Proc. 2007-44 a

2. Calculation of top heavy minimum allocation

A. **Current law –** The computation of the top-heavy minimum allocation is based on compensation as defined in IRC §415(c)(3) regardless of how a plan defines compensation for other allocation and/or nondiscrimination testing purposes.

B. **Proposed change –** Provide for computation of the top-heavy minimum allocation based on compensation as defined by the plan.

C. **Reason for the change –** Plan sponsors have the discretion to use alternative definitions of compensation for allocations and nondiscrimination testing as long as the definition used is not discriminatory. It is common for plans to exclude compensation paid prior to the date a participant becomes eligible for the plan. For example, an employee who becomes eligible for the plan on October 1 of a given plan year may receive allocations based on compensation from that entry date through the end of the year and not on compensation paid from January 1 through September 30. Assuming a constant rate of pay throughout the year, an employer could provide an allocation of up to 11% of compensation as defined by the plan and still not satisfy the top-heavy minimum allocation of 3% of full year compensation for this participant. This creates a compliance trap for otherwise compliant plan sponsors and an unnecessary windfall for participants who have just satisfied the eligibility requirements. Since IRC §414(s) and the regulations thereunder already include a safeguard to ensure that a plan's definition of compensation is not discriminatory, requiring the use of a specific definition for purposes of the top-heavy minimum allocation is overly burdensome and unnecessary.

D. **Modification to existing authority**:

(1) IRC §416(c)(2)
(2) Treas. Reg. §1.416-1, Q&A T-21
(3) Treas. Reg. §1.416-1, Q&A M-7

3. **Permit Amendments to a safe harbor 401(k) plan during the plan year**

    A. **Current law -** Section 401(k)(12) and (13) do not specify any rules regarding the timing of amendments to a plan that is designed to satisfy the safe harbor under section 401(k)(12) or section 401(k)(13). However, the IRS opined in Announcement 2007-59 that such amendments generally are prohibited because the provisions of the plan must be set as of the beginning of a plan year for which the plan is intended to be a safe harbor. However, Announcement 2007-59 describes two types of amendments that will be considered permissible, even though they are adopted during the plan year.

    B. **Proposed change -** The proposal would allow amendments to be made to a safe harbor 401(k) plan during the plan year, as long as the amendment, considered with the other plan provisions in effect for the entire plan year, do not cause the plan to violate the safe harbor requirements in paragraph (12) or paragraph (13) of section 401(k).

    C. **Reason for the change -** The IRS has indicated that there may be reasonable exceptions to this rule, but has not provided any guidance on the subject. The lack of guidance has resulted in a great deal of uncertainty in this area, and has caused employers to postpone amendments that clearly would be to the benefit of the plan participants and would not be contrary to the statutory provisions of section 401(k) and (13). It also has created uncertainty in situations where an employer wishes to expand the coverage of the plan during the plan year, or where the employer is involved in a business acquisition or disposition during the plan year that could result in a change in the eligibility requirements under the plan. The proposal would strike an appropriate balance to ensure that employers are not discouraged from offering enhanced benefits to employees through the safe harbor plan vehicle without compromising the intent of the safe harbor rules.

    D. **Modification to existing authority -** Section 401(k)(12) would be amended to add subparagraph (G) to read as follows:

       (G) A plan shall not fail to satisfy the requirements of paragraph (12) merely because an amendment is adopted to the plan that is effective on a date other than the first day of the plan. In the case of an amendment that directly affects the amount of the contribution described in subparagraph (B) or (C), or that affects the timing, amount or frequency with which a participant may make, revoke or modify a deferral election, this subparagraph shall apply except to the extent otherwise provided in regulations issued by the Secretary under this subparagraph. This subparagraph shall not apply to an amendment that, when considered along with the terms of the plan in effect for the plan year, causes the plan to fail to meet any of the requirements of paragraph (12) for such plan year. A plan sponsor may not rely on this subparagraph unless a notice, satisfying the requirements of subparagraph (D) (other than the timing requirement in that subparagraph), is provided within a reasonable period before the effective date of the amendment.

Section 401(k)(13) would be amended to add subparagraph (F) to read as follows:

(F) A plan shall not fail to satisfy the requirements of paragraph (13) merely because an amendment is adopted to the plan that is effective on a date other than the first day of the plan. In the case of an amendment that directly affects the amount of the contribution described in subparagraph (D), or that affects the timing, amount or frequency with which a participant may make, revoke or modify a deferral election, this subparagraph shall apply except to the extent otherwise provided in regulations issued by the Secretary under this subparagraph. This subparagraph shall not apply to an amendment that, when considered along with the terms of the plan in effect for the plan year, causes the plan to fail to meet any of the requirements of paragraph (13) for such plan year. A plan sponsor may not rely on this subparagraph unless a notice, satisfying the requirements of subparagraph (E) (other than the timing requirement in that subparagraph), is provided within a reasonable period before the effective date of the amendment.

4. Simplify rules for hardship distributions

1. **Eliminate restriction on distribution of gains attributable to employee elective contribution**

A. **Current law –** Participants in 401(k) plans can access certain funds in their accounts in the event of a financial hardship. The rules governing these distributions are found at Treas. Reg. §1.401(k)-1(d)(3).The amount of a hardship distribution is limited by three factors:

(1) The distribution is limited to qualifying "events" such as medical expenses, avoiding eviction or foreclosure on mortgage, purchase of a principal residence, post secondary college expense up to the next 12 months, burial or funeral expenses and repair of the employee's principal residence that would qualify for the casualty deduction

(2) The "needs" test limits the amount of the hardship distribution to the amount necessary to satisfy an immediate and heavy financial need of the employee and is necessary to satisfy the financial need.

(3) The maximum distributable amount is limited to the employee's total elective contributions as of the date of distribution, reduced by the amount of previous distributions. It cannot include earnings on the deferrals or any employer contributions attributable to QNECs or QMACs and contributions that are used to satisfy certain safe harbor alternatives to nondiscrimination tests.

B. **Proposed change –** Amend the maximum distributable amount to remove the restriction against accessing earnings on elective contributions to fund the hardship.

C. **Reasons for change -**

(1) The cost of the recordkeeping needed to comply with the requirement to exclude earnings on deferrals outweighs the benefit and this cost is increasing. The cost is frequently borne by all the plan participants at a time when their 401(k) expenses are considered overly high.

(2) The dollar amount of deferrals exclusive of earnings is often impossible to calculate: The current rule creates significant administrative cost and complexity and often cannot be calculated correctly. For employee elective contributions, there is no other reason to separately account for the earnings and contributions. If a plan does not initially provide for hardship withdrawals but is later amended to do so, this information is not available without extensive retroactive calculation or research.

(3) The hardship withdrawal restriction is particularly problematic in plan takeover situations. This is the case both for individual plan takeovers as well as block conversions occurring when record keepers consolidate. Employee elective contribution history and prior hardship history is generally not included in the data file, requiring a manual retrieval and exchange of information that is often inaccurate. In the interim, hardship withdrawals must be manually processed and the efficiency of electronic processing is lost.

(4) The cost and complexity is getting worse. The cost associated with limiting hardship withdrawals to employee elective contributions will increase under the Pension Protection Act (PPA) of 2006. Increases in automatic enrollment plans will hopefully improve participation by low income employees although they are expected to increase the volume of hardship withdrawal requests. Roth 401(k) accounts introduced substantial new complexity and cost in processing hardships, since both pre-tax and Roth accounts are combined for determining the amount available, but the distribution can be from either or both accounts. Further, the accounting for tracking hardship withdrawal basis in a Roth account does not line up with tracking basis to pre-tax accounts which adds further record keeping costs and complexity.

(5) There are already sufficient restrictions in place. The proposal is good policy – a win for participants and for plan sponsors. Hardship withdrawals are restricted on the front end by the “events” and the “needs” tests and on the back end by the aggressive taxation and penalties on the withdrawal. If the participant gets through these, the need is presumed to be high. Relatively speaking, the amount of earnings on employee elective

contributions is not substantial enough to significantly impact retirement savings, certainly not at a level justifying the substantial costs outlined above.

D. **Modification to existing authority -**

(1) IRC §401(k)(2)(B)(i)(IV)
(2) Treas. Reg. §1.401(k)-1(d)(3)(ii)

2. **Eliminate requirement to first take available participant loan**

A. **Current law –** The safe harbor test for establishing that the distribution is necessary to satisfy the financial need of a participant is met if all of the following requirements are satisfied:

(1) The distribution does not exceed the amount of the financial need (including taxes and penalties).

(2) The employee has received all currently available distributions (other than hardship), and all available nontaxable loans, from the 401(k) plan and all other plans maintained by the employer.

(3) The plan prohibits the employee from deferring or making employee contributions to all plans maintained by the employer for at least 6 months after the hardship distribution.

(4) For hardship withdrawals made before 2000, the employee's IRC §402(g) limit for the next calendar year had to be reduced by the amount of elective contributions made by the employee in the calendar year of the hardship distribution. This was eliminated effective January 1, 2002.

B. **Proposed change –** Eliminate the requirement for participants to take available loans before taking a hardship distribution regardless if the loan would increase the need.

C. **Reasons for change -**

(1) Explaining this requirement to the participant, calculating the maximum loan first and then the amount of the remaining available hardship is cumbersome to the administrator, confusing to the participant, and slows down access to needed funds. There may be fees associated with processing both the loan and the hardship that would take away from the available funds a participant has to satisfy the "need".

(2) The regulations have already addressed that loans should not increase the "need". Eliminating this requirement would remove the coordination of determining the maximum hardship amount for plans that allow for loans.

(3) Eliminating this requirement would not increase hardship requests, but would create less administrative burden on the plan sponsor. The request for withdrawing available funds is usually warranted by the “need” of the participant and meeting all the requirements. This change will not negatively impact the goal to preserve retirement plan savings.

D. **Modification to existing authority -**

(1) Treas. Reg. §1.401(k)-1(d)(3)(iv)(D)
(2) Treas. Reg. §1.401(k)-1(d)(3)(iv)(E)(1)

3. **Allow hardship withdrawals from safe harbor, Qualified Non-Elective Contributions (QNECs) and Qualified Matching Contributions (QMACs)**

A. **Current law –** Qualified non-elective contributions (QNECs) and qualified matching contributions (QMACs), as defined in IRC §§401(k)(3)(D) and 401(m)(4)(C), may not be distributed in a hardship withdrawal. Consistent with the treatment for QNECs and QMACs, the IRS interprets the 401(k) safe harbor rules under IRC §401(k)(12) and IRC §401(m)(13) to prohibit the hardship withdrawal of safe harbor 401(k) contributions.

B. **Proposed change –** Permit safe harbor contributions, QNECs and QMACs to be distributed in hardship withdrawals.

C. **Reason for change -**

(1) Hardship is the only distribution event listed under §401(k)(2) that is limited in this manner. Safe harbor contributions of QNECs and QMACs may be distributed under any of the other distribution events listed in IRC §401(k)(2) or (10) such as severance from employment or attainment of age 59 ½.

(2) Plans that have adopted the safe harbor plan design do so to avoid corrective distributions to the highly compensated and/or to meet the top heavy minimum rules. Since this is an employer plan design issue and is a required contribution, it should not penalize the participant. If the plan was not a safe harbor plan, but was top heavy and the key employees were deferring, the employer would be required to make a minimum top heavy contribution and this contribution could be eligible for hardship.

(3) Plans that utilize the correction method of contributing a QNEC or QMAC to pass the non-discrimination testing are increasing retirement plan savings for the rank and file employees. By utilizing this testing corrective measure the employer is providing additional benefits to his or her employees and avoiding the leakage caused

by returned deferrals and forfeited matching contributions. The participants should have the same right to the availability of these balances. The restrictions necessary to qualify for a hardship withdrawal will preserve retirement plan savings.

D. **Modification to existing authority -**

(1) IRC §401(k)(2)(B)
(2) Treas. Reg. §1.401(k)-1(d)(2)(ii)
(3) IRS Notice 98-52

5. Rollover of insurance contract to IRA

A. **Current law –** Code section 408(a)(3) currently prohibits individual retirement accounts ("IRAs") from holding life insurance contracts. In contrast, qualified retirement plans under Code section 401(a) and tax-sheltered annuities under Code section 403(b) can hold life insurance contracts, subject to certain limitations on the amount of insurance that can be maintained.

B. **Proposed change –** The Code should be amended to provide that, if an eligible rollover distribution from a qualified retirement plan or tax-sheltered annuity includes a life insurance contract that met the incidental death benefit requirements at the time of distribution from the qualified plan, the contract can be rolled over to and held by an IRA. Under no other circumstances would an IRA be permitted to hold life insurance contracts.

C. **Reasons for the change –** Qualified retirement plans generally do not hold life insurance contracts after a participant retires or otherwise terminates employment. As a result, a participant who wants to retain the life insurance protection after a termination of employment generally has two options: (1) take the life insurance contract out of the plan as a plan distribution and pay tax on the distribution, or (2) purchase the life insurance contract from the plan. Since most participants do not have cash available to purchase the policy, in order to retain the life insurance, the participant may need to borrow from the plan to purchase the policy, and incur distribution of the loan amount when employment is terminated. As a result of these difficulties, valuable life insurance coverage is generally liquidated.

Permitting rollover of insurance contracts to an IRA would:

(1) improve portability, and so reduce this “leakage”,

(2) facilitate retention of important life insurance coverage, particularly where the participant is otherwise uninsurable.

(3) In addition, the life income options for payment of insurance proceeds facilitate annuitization of the retirement income and/or the death benefit.

Example: Joe has terminated employment with ABC Company. He needs the life insurance protection and is no longer insurable. An insurance policy on his life is held by the plan. Under the current rules, Joe must take a distribution of the life insurance contract and pay taxes on the value of the life insurance and, in certain cases, the 10% penalty for taking an early distribution. With the proposed change, the participant would be able to roll the life insurance contract to an IRA and avoid adverse tax consequences.

D. **Modification to existing authority** – Amend IRC Section 408(a)(3) by inserting "other than insurance contracts that were rolled over to an IRA from a qualified retirement plan described in clause (iii), (iv), or (vi) of section 402(c)(8)(b)" after "contract".

6. Clarify that forfeitures can fund safe harbor contributions

A. **Current law -** Safe harbor contributions must be nonforfeitable. Forfeitures can be used to reduce employer contributions and/or to pay for a plan's administrative expenses.

B. **Proposed change –** To change the law so that forfeitures can fund safe harbor contributions. After forfeitures are used to fund safe harbor contributions, those contributions will become nonforfeitable.

C. **Reason for the change –** Employers should be able to use amounts they have already contributed, but which have become forfeitures, to fund safe harbor contributions as long as such amounts are nonforfeitable when they are designated as safe harbor contributions.

D. **Modification to existing authority -**

(1) Section 401(k) is amended by adding new paragraph (14) to provide as follows: "A matching contribution or nonelective contribution described in paragraph (3)(D)(ii), paragraph (12)(B) or (12)(C), or paragraph (13)(D) shall not fail to satisfy the definition under such paragraph merely because the contribution is funded in whole or in part by forfeitures."

(2) The provisions would apply to forfeitures allocated in accordance with such rule before, on or after the date of enactment.

7. Provide QPSA notice as part of SPD

A. **Current law –** Defined benefit plans and certain defined contributions plans must provide a notice to participants explaining their right to a Qualified Pre-retirement Survivor Annuity (QPSA) during the applicable period. The applicable period generally is the period that ends the latest of the following periods:

(3) The period beginning on the first day of the plan year in which the participant attains age of 32 and ending in the plan year the participant attains age 35

(4) A reasonable period after the individual becomes a participants

B. **Proposed change –** Provide that the applicable period is a reasonable period after the plan becomes a participant in the plan and that the notice may be part of the SPD.

C. **Reason for the change –** It is administratively difficult for plans to have processes in plan based upon the participant's attainment of age 32 and age 35.

D. **Modifications to existing authority -**

(1) IRC 417(a)(3)(B)(ii)

8. Amend minimum participation rules

A. **Current law -** A defined benefit (DB) plan must satisfy the minimum participation rules of IRC §401(a)(26) even if the employer has no non-excludable NHCEs (i.e., 40 percent of employees or 50 employees, whichever is less, but no less than two employees).

Each DB plan must be tested separately for compliance with the minimum participation rules of IRC §401(a)(26).

Frozen defined benefit plans satisfy IRC §401(a)(26) by reference to employees who benefited under the plan prior to the plan being frozen.

Under regulations issued by the IRS, underfunded PBGC-covered frozen defined benefit plans satisfy IRC §401(a)(26).

B. **Proposed change -**

(1) If an employer maintains a DC plan under which a group of NHCEs sufficient to satisfy the requirements of IRC §401(a)(26) receive a minimum allocation of at least 7.5% of compensation, the employer is not required to separately satisfy IRC §401(a)(26) for a DB plan where the DC plan is aggregated for IRC §§401(a)(4) and 410(b).

i. Example: Employer maintains a DC plan and DB plan. There are 40 non-excludable employees for IRC

§401(a)(26) purposes, which consist of five HCEs and 35 NHCEs. The DC plan covers all 35 of the non-excludable NHCEs and the DB plan covers the five HCEs. So long as at least 16 NHCES receive a minimum allocation of 7.5 percent (i.e., 40 percent of the total group of 40), the DB plan would not be required to separately comply with IRC §401(a)(26), provided that, when aggregated, the DB and DC plan pass IRC §§401(a)(4) and 410(b).

(2) Exempt frozen defined benefit plans from IRC 401(a)(26) provided no other defined benefit plan is maintained in the controlled group for the current plan year or for five year period after this method of satisfying 401(a)(26) is used. If a plan is adopted within the applicable five year period, non-highly compensated employees (if any) would receive a retro-active accrual to satisfy IRC 401(a)(26) for all plan years in the applicable five year period.

(3) For purposes of satisfying 401(a)(26), a frozen defined benefit plan may be aggregated with any other defined benefit or defined contribution plan maintained in the same controlled group. For this purpose, only non-highly compensated accruals in other plans shall be considered.

C. **Reason for the change -**

(1) The minimum participation rules of IRC §401(a)(26) are intended to ensure that a DB plan is not used as a means to disproportionately benefit only a few highly compensated employees (HCEs). This rule was instituted to discourage the use of a comparability analysis under Rev. Rul. 81-202, wherein the HCEs participated in the DB plan and the other employees were covered only by a DC plan. Where there are no non-excludable NHCE's or the pension plan is frozen, this concern is irrelevant.

(2) As new employees are hired who never participated in the frozen defined benefit plan, it becomes harder to satisfy IRC 401(a)(26) because the frozen group at some point is less than 40% of the entire group. This forces plan sponsors to terminate plans instead of maintaining them and possibly unfreezing them at some point in the future.

D. **Modification to existing authority -**

(1) IRC §401(a)(26)

9. 403(b) plan termination

A. **Current law –**. Other than certain Church Plans adopted pursuant to 403(b)(9), 403(b) Plans have been required to invest in annuity contracts (section 403(b)(1)) and custodial account contracts holding mutual funds (section 403(b)(7)) only. For a number of reasons spanning over 50 years, a large percentage of these contracts have been issued to individuals who control all aspects of these contracts, instead of being issued to plan trustees in the manner of the typical 401(a) plan.

This individual ownership and control of 403(b) contracts has created complications for employers who wish to terminate their 403(b) plans. The 403(b) plan termination rules under Tax regulation 1.403((b)-10(a) requires the assets of the plan to be distributed upon termination. However, without control of those individually controlled contracts, the State laws which govern such contracts prevent employers from forcing a termination distribution from them without the individual's consent.

The IRS attempted to address this problem by issuing Revenue Ruling 2011-7, which permitted a plan to distribute "fully paid" annuity contracts (instead of the assets in the annuity contract) upon plan termination. A plan then could avoid the State law issues by merely distributing the contract itself, and not trying to impermissibly force assets from the contract.

Two problems have since arisen. First, the IRS has taken the position that custodial account contracts cannot be distributed in the same manner as annuity contracts upon plan termination. In that significant numbers of 403(b) plans are funded with individually owned custodial accounts, this has had the effect of making plan terminations impossible without the unanimous consent of individual 403(b) custodial account owners. Secondly, questions have arisen regarding the definition of what constitutes a "fully paid annuity contract" for purposes of making a terminating distribution of an annuity contract.

B. **Proposed change –** Distribution of 403(b)(7) custodial accounts and annuities containing account balances should be permitted, consistent with the treatment of "fully paid" annuity contracts under Revenue Ruling 2011-7 for purposes of distributing the "contract/agreement."

Following termination of the plan, participants and beneficiaries who now hold the "distributed custodial accounts" and annuity contracts with account balances (treated similar to fully paid insurance annuity contracts) are entitled to payments in accordance with the terms of the those contracts (which may permit single-sum payments in connection with plan termination, partial payments, substantially equal periodic payments under 72(t) and rollover distributions). All rights under the custodial agreement will continue to apply after the terminated "distribution of the 403(b) contract", and therefore will not violate State law regarding the agreement.

C. **Reason for the change –** Employers need the ability to effectively terminate their 403(b) plans in the same manner, and often for the same reasons, that they would need to terminate a 401(a) plan. They cannot currently do so, however, because of the IRS's positions related to custodial accounts and questions related to what is a "fully paid annuity contract." Particularly since the final regulations were enacted in 2009 (which imposed greater accountability on employers for 403(b) plan compliance), there have been Employers who are attempting to terminate their plan for various reasons, including business reorganizations; adopting a different type of plan, such as a 401(k) plan; and the need of employers who will be or are no longer in business to terminate their plan; but cannot do so. This last, in particular result in merely creating an abandoned plan that will need to be dealt with in the future.

Longevity Proposals

Statement of principles regarding longevity

We followed these basic principals in reviewing proposals and developing longevity-related recommendations:

- Plan sponsors should be encouraged (but not required) to offer annuity/lifetime income options, though with an effort to avoid any additional burdens placed on the private retirement system.
    - Traditional defined benefit plans/cash balance plans/money purchase plans should continue to be required to offer annuity options.
    - Additional requirements traditionally placed on the plan sponsor should be transferable to insurers willing and able to support these requirements.
- Employees should be encouraged to structure their retirement distributions to protect against longevity risk.
    - For some individuals, annuities and lifetime income would be helpful.
    - Applicable products would include longevity insurance, true annuities and other similar products designed to reduce longevity risk.
    - Products should be provided emphasizing portability and enabling consolidation where possible to facilitate an individual's management of the contracts and their expense.
- While not required to offer life income or longevity risk products, defined contribution plans should be required to disclose equivalent annuity/life-time income amounts payable from the participant's account balance.
    - The calculations could be determined from established (safe harbor) assumptions and method for projection/conversion.
    - These income options should be provided/made available to participants on an ongoing basis, e.g., through an annual statement or via the Internet
- Proposals should be very sensitive the tax costs.

For now, the focus will be on the distribution aspects of life income/longevity protection, leaving accumulation-related issued to be considered at a future time.

Specific longevity proposals begin on the following page.

1. **MRD eliminated where portion of benefit is annuitized**

   The Minimum Required Distribution would be eliminated with respect to distributions where the participant annuitizes a significant portion of such distribution.

   A. The participant would be required to annuitize at least 50% of the retirement plan account on or after age 60, but prior to their SSNRA.

   B. Any account balance in excess of *the sum of*

      (1) Amounts annuitized and

      (2) Amounts not annuitized up to, but not exceeding the lesser of
         - the amount annuitized and
         - $1 million

      would remain subject to the MRD requirement.

   C. Participants would bear the responsibility for dealing with multiple accounts if trying to avail themselves of the annuitization/MRD exemption.

      (1) The default result will be for each separate account to be treated separately.

      (2) Multiple IRAs and multiple 403(b)s balances could be aggregated at the participant's discretion, who would determine the amount required to be annuitized and from where. The custodian(s) would continue to report as usual; IRS already has the capability to compare and audit multiple 5498's and 1099Rs as they relate to MRDs.

      (3) Each qualified plan account balance would need to comply separately.

   D. If the employee makes such election (annuitization/MRD waiver on balance) and later takes a distribution, funds subject to the MRD waiver would be required to be maintained in a segregated rollover account to retain the MRD exemption.

   E. Treasury would be given the authority to determine what products in addition to immediate life annuities would be eligible for the exemption.

   F. Rollovers and mergers will need attention and protection of such prior elections made.

   G. Details of the minimum % to be annuitized and/or the minimum age for annuity at commencement may be adjusted as needed to create a neutral tax cost over a 10 year period.

2. **Modify mortality table for MRDs**

   The Life Expectancy Factors use to determine the age 70½ distributions are based on mortality factor that are over 10 years old. We propose an update of the mortality table for age 70½ distributions and/or provide an alternative table which is more regularly updated.

3. Allow MRD to be converted to Roth without distribution

At the participant's option, in lieu of requiring the MRD to be paid out of the plan, allow the participant to elect the required distribution amount to be converted to a Roth amount inside the plan and/or IRA, generating a taxable payment, but preserving the value inside the retirement account until the income is truly needed.

A. Election can be Allow such elections to be changed on a year by year basis

B. Facilitates the continued accumulation of retirement income until truly needed while still creating a taxable event.

4. Permit transfer of annuity income options and notice requirements from plan sponsor to annuity provider

Obstacles for participants in selecting lifetime annuity income options include participant misconceptions, all or nothing requirements inherent in most plans and real or perceived expense-related cost issues in the annuity market. Obstacles for plan sponsors include fiduciary risk in the selection of annuity providers and the cost and complexity of complying with joint & survivor annuity requirements. In the face of these challenges, the number electing annuity options continues its sharp decline, increasing overall costs resulting from anti-selection in the marketplace. This impact has already been demonstrated in the health insurance market and defined benefit pension plans (particularly multi-employer plans). One long time provider (Relius Standard) recently announced its withdrawal from the individual annuity market.

Nonetheless, insurers continue to develop innovative provisions in annuity contracts and have the expertise in the area of annuity administration. We recommend:

A. The plan sponsor should be permitted to transfer responsibility for administration of the joint and survivor annuity rules to an annuity provider.

B. Provided that the plan sponsor or administrator has prudently selected and retained selection of the annuity provider, enforcement actions for failure to comply with the joint and survivor annuity rules would apply only against the annuity provider, not the plan sponsor.

C. Partial annuity options should be permitted from all plans

D. Fees would be paid by the participant, though the plan sponsor could voluntarily absorb any/all fees. Maximum permissible fees charged by an insurer may be required.

E. A safe harbor approach should be provided for plan sponsors/fiduciaries to follow for the selection of annuity providers.

F. The electronic delivery rules should be modified to allow greater use of electronic means for administration of the J & S rules.

5. New notice regarding the affect of not annuitizing

Require plan sponsors (and/or the plan's investment providers) to provide an additional notice (to replace failure to defer)

A. Contents would address the potential consequences of not annuitizing and/or the benefits of choosing to annuitize income, i.e., that an annuity creates guaranteed income that cannot be outlived, thus addressing longevity risk and facilitating the budgeting of an account balance over the participant's lifetime.

B. This notice could be incorporated as part of the 402(f) special tax notice for distributions.

C. This new notice requirement would be effective only after the Treasury issues sample wording.

ERISA Provisions

1. Make electronic disclosure the default delivery system (with opt-out) –

A. **Current law -**

(1) In 2002, the Labor Department issued final regulations relating to electronic communication by ERISA pension and welfare benefit plans. The final rule's safe harbor allows electronic delivery of documents that must be furnished or made available to participants and beneficiaries under ERISA Title I (e.g., summary plan descriptions, summary of material modifications and summary annual reports).

(2) The safe harbor automatically extends to any employee who can access electronic documents at any location where he or she works and whose access to the employer's electronic information system is an *integral* part of his or her duties.

(3) However, participants, beneficiaries or other persons entitled to documents who do not have access to the employer's electronic information system as an integral part of their employment duties must *affirmatively* consent to receiving documents electronically for the safe harbor to be available. Prior to consenting, the individual must be provided with a clear and conspicuous statement indicating the types of documents to which the consent would apply; that consent can be withdrawn at any time without charge; the procedures for withdrawing consent and updating necessary information; the right to request and obtain a paper version of an electronically furnished document; and any hardware and software requirements.

B. **Proposed change -**

(1) Eliminate the affirmative consent requirement for participants, beneficiaries and others whose duties do not require them to regularly access the employer's electronic information system. Instead, required ERISA disclosures for participants and beneficiaries would automatically be made available to such individuals in an electronic manner. The individuals would have the right to opt out and instead receive paper documents. Plan administrators would be required to provide such individuals with an advance notice describing the process and notifying them of their right to opt for paper documentation.

C. **Reason for the change -**

(1) Since the Labor Department regulations were finalized in 2002, there have been significant increases in the availability and

accessibility of the Internet for most Americans through smart phones, computers, and many other portable electronic devices. Notwithstanding, the great majority of Americans have home based Internet access. And many Americans are Internet users even if they don't have access at home because of free public access to the Internet through hotspots at locations like public libraries, coffee shops and many other public places of business.

(2) Providing ERISA disclosures for participants and beneficiaries through non-electronic media is less efficient, less reliable, less timely and more expensive than electronic media as a means of delivery.

(3) Very few employers use the current affirmative consent process because it is costly and burdensome to administer.

D. **Modification to existing authority -**

(1) ERISA §104
(2) DOL Regulation 29 CFR §2520.104b-1

2. Required updates to summary plan description

A. **Current law -**

(1) ERISA §104(b) generally requires the plan's Summary Plan Description ("SPD") to be restated every fifth year.

(2) Plan sponsors using individually designed plan documents must generally restate their plans to comply with legislative and regulatory changes every fifth year with a deadline based on the last digit of the plan sponsor's taxpayer identification number.

(3) Plan sponsors using pre-approved plan documents must generally restate their plans to comply with legislative and regulatory changes every six years with a deadline based on the date the Internal Revenue Service approves the specimen or lead plan.

B. **Proposed change –** The frequency with which a plan must update its SPD should be conformed to the deadline by which the plan must be restated to comply with legislative and regulatory changes. The SPD would be due 210 days after the restatement deadline.

C. **Reason for the change –** It is considerably more efficient to update the SPD at the same time a plan document is restated. However, the required cycles for updating plan documents and SPDs are different, creating confusion, unintentionally missed deadlines and unnecessary added cost to the plan sponsor.

D. **Modification to existing authority**

(1) ERISA §104(b)
(2) DOL Reg. §2520.104b-2(b)

3. Base audit requirements on participants with accrued benefits

A. **Current law –** Qualified retirement plans covering 100 or more participants are subject to an annual audit requirement. The number of participants is based on a determination of those eligible to participate, not those with account balances or benefits under the plan.

B. **Proposed change –** Base the audit requirement on the number of participants that actually have account balances or accrued benefits under the plan, not the number eligible to participate.

C. **Reason for the change –** Basing the requirement on eligible employees, not actual participants, inflates the size of the plan, and creates unnecessary expense for plan sponsors.

D. **Modification to existing authority -**

(1) ERISA §103(a)(3)

ADDENDUM

Defined Benefit Simplification Proposals

1. **No reduction of assets by carryover or pre-funding balances for purposes of funding-based limitations on benefits and benefit accruals**

   A. **Current Law -** The Pension Protection Act introduced certain benefits restrictions that apply to plans that are less than 80% funded. To determine if the restrictions apply, a pension plan's actuary must certify the plan's Adjusted Funding Target Attainment Percentage ('AFTAP') annually. The AFTAP is the ratio of the plan's assets to the plan's target liability. A pension plan with an 'AFTAP' of less than 80% may only pay partial lump sum benefits. A pension plan with an AFTAP of less than 60% may not pay lump sums benefits and future benefit accruals are frozen. Additional restrictions may apply based upon a Plan's AFTAP.

   When an employer contributes more than the required minimum contribution amount to a plan, the excess can be credited to a "pre-funding balance", and used to offset future contributions provided the plan is at least 80% funded without regard to the credit balance. In determining a plan's AFTAP, the plan's assets are reduced by both the prefunding balance (and any "carryover balance" from pre-PPA contributions) unless the plan's AFTAP without regard to these reductions is greater than or equal to 100%.

   B. **Proposed Change –** In determining a plan's AFTAP, the plan's assets would not be reduced by the prefunding or carryover balance. This would also eliminate provisions requiring or permitting the deemed reduction of credit balances in the event a restriction would otherwise apply. To avoid "double counting" of prefunding and carryover balances, assets would still be reduced by both for purposes of determining the plan's minimum required contributions.

   C. **Reason for the Change -** The current rule makes plans that have benefitted from employer contributions in excess of those required by law appear less well funded than they actually are and discourages employers from funding plans well in "good times" to provide flexibility when in an economic downturn. Elimination of the credit balance offset for purposes of applying benefit restrictions would also be a significant step toward simplifying the operation of defined benefit plans. The level of complexity introduced by this offset is particularly problematic when dealing with a "presumed AFTAP" or an "inclusive presumed AFTAP"[1], and the imputation of the amount of deemed reduction necessary to avoid application of a restriction.

D. **Modification to Existing Authority --**

(1) Modify IRC §436(j) and eliminate IRC §436(f)(3)

(2) Modify ERISA §206(g)(9)(B) and eliminate ERISA §206(g)(5)(C)

2. No reduction of assets by carryover or pre-funding balances for purposes of determining if quarterly contributions are required

A. **Current Law –** Generally, the minimum required contribution for a plan year is due within 8 ½ months of the end of the plan year. However, if a pension plan had a funding shortfall in the previous year, the plan is subject to quarterly contribution requirements. In determining whether or not there is a funding shortfall, assets are reduced by any prefunding balance or pre-PPA carryover balance. Additional interest charges apply if a quarterly installment is not made on time, and a complicated set of rules applies to the use of a pre-funding balance to satisfy a quarterly contribution requirement.

B. **Proposed Change –** Do not reduce assets by pre-funding or carryover balances when determining if quarterly contributions are required.

C. **Reason for the Change –** The purpose of quarterly contributions is to assure that under-funded plan make progress toward improved funding during a plan year. However, if a plan's assets, including credit balances, already exceed liabilities, the cash is already in the plan, and the complexity added by the quarterly contribution requirement outweighs the benefit.

D. **Modifications to Existing Authority**

(1) ERISA §303(j)(3)(A)

(2) IRC §430(j)(3)(A)

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1 If the AFTAP for a plan year has not been determined by the 1st day of the fourth month, and the AFTAP for the preceding plan year was 80% but less than 90%, or 60% but less than70%, the "presumed" AFTAP for the year is the previous year's AFTAP less 10%. Otherwise the presumed AFTAP is the previous year's AFTAP.

3. Permit an election to discount contributions from final due date

A. **Current Law --** A pension plan's minimum required contribution for a plan year is determined as of the plan's valuation date. The required minimum is increased with interest to the date of the actual contribution.

For plans using a beginning of year valuation date, employer contributions for the prior plan year are discounted from the date of the employer contribution to the valuation date. Late quarterly contributions are discounted at the plan's effective rate plus 500 basis points. Other contributions are discounted at the plan's effective rate.

B. **Proposed Change –** For purposes of adding employer contributions to the prefunding balance and determining the value of plan assets, a plan sponsor would optionally be able to discount contributions from the later of the date of the actual employer contribution and eight and half months after the end of the plan year

C. **Reason for the Change --** The plan's actuary completes the Schedule SB based on information received from the employer. The current law requirement to discount from the actual date of the employer contribution causes work to need to be redone if the actual date of employer contribution turns out to be a few days different than reported by the employer. The changes are often for very small dollar amounts. By allowing the plan sponsor to elect to discount employer contributions from the later of the actual contribution and eight and half months after the end of the plan year instead of the actual date, the employer would have the option of simplifying administration by including a slightly lower amount of discounted employer contributions in the plan assets and pre-funding balance.

D. **Modifications to Existing Authority –**

(1) IRC §430(j)(2) and ERISA §303(j)(2)

4. Simplify elections and notices

A. **Current Law --**

(1) PPA requires various elections from the plan sponsor and plan administrator for decisions made that impact the funded status of the plan. For example, a decision has to be made as to whether or not to apply a credit balance to a required quarterly contribution, or to 'burn" a credit balance to improve the funded status of the plan. Elections must be made at various times throughout the year.

(2) Large plans must provide the annual funding notice within 120 days of the beginning of a plan year. Small plans need not provide the notice

until the date the Annual Report (Form 5500) is filed. Other types of plans provide participants with a "Summary Annual Report" which is due 60 days after the due date of the Annual Report.

B. **Proposed Changes --**

(1) All PPA elections would be considered timely if made no later than the filing date of the Schedule SB for that plan year.

(2) Provide a single AFN deadline for small plans and large plans that were at least 80% funded in the preceding plan year which coincides with the deadline for providing the Summary Annual Report.

C. **Reason for the Change --**

(1) The lack of uniformity in the timing of elections is confusing, and can lead to unintentional errors. Since the elections are all related to the minimum funding requirements documented in the Schedule SB, providing a uniform deadline that corresponds to completion of the SB will go a long way toward simplifying the operation of these plans.

(2) The 120 day deadline is difficult to meet, and serves no real purpose for a well-funded plan.

D. **Modification to Existing Authority --**

(1) IRC § 430 and ERISA § 302

(2) ERISA § 101(f)(3)

Other Simplification Proposals

1. Consolidate deadlines for corrective distributions of excess contributions as a result of failed ADP/ACP tests

A. **Current law –** If an ADP or ACP test fails, corrective action must be taken within the 12 months following the close of the plan year as dictated by Treasury regulations in order for the plan to maintain its qualification status. Corrective action generally results in plan sponsors making certain corrective distributions of the excess contributions identified in the ADP/ACP tests to plan participants under IRC §401(k)(8).

Employers are liable for an excise tax under IRC §4979 if the corrective action is not taken within a certain period of time depending on plan design. The excise tax under IRC §4979 is equal to 10% of the amount of the excess contributions distributed. For plans that are not eligible automatic contribution arrangements, the deadline is 2½ months after the end of the plan year (or March 15 for calendar year plans). For plans that are eligible automatic contribution arrangements, the deadline is 6 months after the end of the plan year (or June 30 for calendar year plans). The amounts distributed are included in the recipient's income in the taxable year in which the *distributions* are made.

B. **Proposed change –** Amend §4979 of the Internal Revenue Code to give 6 months after the end of the plan year, (or June 30 for calendar year plans), to all plans that need to make corrective distributions of excess contributions.

C. **Reason for the change –** Before the Pension Protection Act ("PPA") (P.L. 109-280), excess contributions that were distributed as a result of a failed ADP/ACP test were included in the recipient's income in the taxable year in which the *contributions* were made, unless those distributions were less than $100. In other words, these distributions were usually recognized as income for tax purposes in the *prior* calendar year. Therefore, the current deadline for plans that are not eligible automatic contribution arrangements made more sense in order to incentivize employers to distribute excess contributions before the individual tax filing deadline for the prior calendar year on April 15.

PPA amended IRC §4979 to change the timing of the income recognition of excess contribution distributions from the year in which the *contributions* were made to the year in which the *distributions* were made. PPA also amended IRC §4979 to extend the deadline for excess contribution distributions to 6 months after the end of the plan year, (or June 30 for calendar year plans), for eligible automatic contribution arrangements.

The proposed change would simplify plan administration by designating a single deadline for excess contribution distributions for all qualified plans, regardless of plan design.

D. **Modification to existing authority –**

IRC §4979

2. Modification of the safe harbor annual notice requirements

A. **Current law –** Under IRC §401(k)(12)(D) and §401(k)(13)(E), a sponsor of any type of safe harbor 401(k) plan is required to provide all eligible employees an annual written notice which describes the employee's rights and obligations under the arrangement. The purpose of this requirement is to encourage eligible employees to enroll in the plan, if they haven't already done so, by serving as a reminder to employees of the advantages of participating in the 401(k) arrangement and informing current participants of how they can make (or modify) deferral elections.

B. **Proposed change –** Narrow the annual notice requirement to only those safe harbor arrangements that do not auto-enroll eligible employees but provide matching employer contributions to participants.

C. **Reason for the change –** Under Title I of ERISA, participants and beneficiaries in qualified retirement plans, including all of the safe harbor 401(k) plan arrangements, receive multiple documents on a regular basis about the plan including: the summary plan description ("SPD"), the summary of material modifications ("SMM") when necessary, the summary annual report ("SAR"), and periodic employee benefits statements. These required disclosures provide all of the information that is required under the safe harbor annual notice requirement and more. The only difference is that these documents only go to participants and beneficiaries in qualified plans, not to all of the eligible employees. However, for certain plan designs like the non-elective contribution safe harbor and the qualified automatic contribution arrangement ("QACA") safe harbor all of the eligible employees *are* the participants and beneficiaries under the plan. So the safe harbor annual notice requirement is unnecessary and needlessly adds complexity and cost to plan sponsors and administrators.

D. **Modification to existing authority –**

(1) IRC §401(k)(12)(D)
(2) IRC §401(k)(13)(E)
(3) IRS Notice 98-52

(4) Treas. Reg. §1.401(k)-3(d)

3. Modify family attribution rules

A. **Current law –** As a general rule, under IRC §1563(e)(5), an individual is attributed any ownership interest held by the individual's spouse, unless the individual and the spouse are legally separated under a decree of divorce. However, there is an exception to this spousal attribution provided that all of the following four conditions are met. One, the individual does not have direct ownership in that business. Two, the individual is not a director or employee, and does not participate in the management of the business. Three, no more than 50% of that business' gross income for a taxable year is derived from passive investments. Four, the spouse's ownership interest is not subject to disposition restrictions running in favor of the individual or the minor children of the individual and spouse.

There are two main problems with the current language of the spousal attribution exception. The first is that an individual's community property interest in his or her spouse's business ownership would appear to disqualify the individual from the spousal attribution exception. The community property interest would have to either be relinquished or the spouse's business ownership would have to be deemed separate property under the applicable community property law in order to qualify for the exception.

The second problem is that if the individual and spouse have minor children (defined in statute as under the age of 21) then other attribution rules would apply that would nullify the spousal attribution exception. Under IRC §1563(e)(6)(A), any interest held by the individual is attributed to the minor child. Conversely, any interest held by that minor child is deemed to be owned by the individual. Therefore, even though a husband and wife might not be attributed each other's ownership interest in their respective businesses, a controlled group relationship would be created solely through the minor child because the child is automatically attributed the stock in each company.

B. **Proposed change –** Modify the spousal attribution exception in IRC §1563(e)(5) to provide that an indirect ownership interest due to the application of community property law would not invalidate the exception (as long as a spouse otherwise satisfies the conditions set forth in that exception). Extend the spousal attribution exception to minor children that satisfy the conditions of §1563(e)(5) with respect to a business owned by a parent.

C. **Reason for the change –** Clarifying the spousal attribution exception would encourage more small businesses to create qualified retirement plans for their employees without fear of being deemed part of a larger controlled group of businesses through complex family attribution rules. This is because all businesses under a controlled group are subject to one set of IRC §415 limitations, in addition to coverage and nondiscrimination testing. If separate businesses do not realize that they are a part of a controlled group and have separate retirement plans, than those businesses could be violating the tax laws.

D. **Modification to existing authority –**

(1) IRC §1563(e)(5)

Multiple Employer Plans

1. **Qualification of multiple employer defined contribution plans under the Internal Revenue Code**

   A. **Current Law –** Section 413(c) of the Internal Revenue Code of 1986 (the "Code") contains special rules that generally apply if a retirement plan is maintained by more than one unrelated employer. (Collectively bargained, "multi-employer" plans are excluded and are instead governed by the rules in Code Section 413(b).)

   In order to qualify for favorable tax treatment, a retirement plan must meet numerous "qualification" requirements set forth in the Code. If these requirements are not satisfied, the IRS can seek to "disqualify" the plan and in doing so, seek back taxes from the plan sponsor, plan participants and the plan itself. IRS regulations provide that in the case of a multiple employer plan, the failure by any one of the participating employers to satisfy the qualification requirements will result in the entire plan being disqualified. This can result in adverse tax consequences to not only the offending plan sponsor, but also to all the other innocent participants and plan sponsors.

   B. **Proposed Change –** Code Section 413(c) would be amended to provide that in the case of a multiple employer defined contribution plan, the plan's terms shall designate a "multiple employer defined contribution plan provider" who shall be responsible for performing the tests and other plan administrative duties which are reasonably necessary to ensure the plan remains qualified under the Internal Revenue Code. If the "multiple employer defined contribution provider" fulfills those responsibilities, the qualification requirements would be determined separately for each employer, so that a failure by one employer would only affect that employer and not otherwise disqualify the entire plan. If the "multiple employer defined contribution provider" does not perform or otherwise oversee the administration of the plan to reasonably ensure compliance with the qualification requirements, the entire plan would be subject to disqualification and the provider would be jointly and severally liable for any taxes due from participating employers as a result of the plan's disqualification. The designated "multiple employer defined contribution provider" would be required to register and provide identifying information to the Internal Revenue Service, which would have express authority to audit the provider under the proposed change.

   C. **Reason for Change –** Multiple employer defined contribution plans can increase coverage of American workers in employer sponsored retirement arrangements. The current rules regarding plan disqualification are unfair when the acts of a culpable employer can result in adverse tax consequences to the blameless. However, by eliminating the potential for complete disqualification, the proposal could inadvertently create an incentive for less responsible providers to ignore compliance with the qualification rules. Thus, under the proposal the "multiple employer defined contribution plan provider" would be required to perform such tests or otherwise apply oversight to ensure reasonable compliance with the qualification requirements or otherwise the entire plan would be subject to disqualification and the provider would be jointly and severally liable for any taxes due from participating employers as a result of the plan's disqualification. This potential joint and several liability should provide a strong incentive to the designated "multiple employer defined contribution plan provider" to fulfill its administrative responsibilities. It is expected that the registration requirement would be satisfied through a schedule attached to the plan's annual report (Form 5500). The express audit authority with respect to the "multiple employer defined contribution plan provider" will enable the Service to monitor and ensure that administrative and compliance responsibilities are being fulfilled.

D. **Modification to Existing Authority –**

(1) IRC §413(c)

2. Defining multiple employer defined contribution plans under ERISA

A. **Current Law –** The Employee Retirement Income Security Act of 1974 ("ERISA") generally requires that an employee pension benefit plan be established or maintained by an employer or by an employee organization. For this purpose, employer is defined to mean "… any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity."

B. **Proposed Change –** ERISA Section 3(2) would be amended to clarify that a program would not fail to be an "employee pension benefit plan" or a "pension plan" merely because the employers sponsoring the plan share no common interest other than their joint participation in the plan, provided:

(1) The plan is an individual account plan;

(2) The participating plan sponsors retain fiduciary responsibility for the selection and monitoring of the person designated under the plan's terms as the multiple employer defined contribution plan provider, the person designated as the plan's named fiduciary, if different from the provider, and to the extent not otherwise delegated to another fiduciary, the investment and management of that portion of the plan's assets attributable to the employees of that individual plan sponsor;

(3) The participating plan sponsors may not be subjected to unreasonable restrictions, fees, or penalties with regard to ceasing participation or otherwise transferring assets of the plan; and

(4) The annual report required under Section 104(a) of ERISA includes the name and identifying information for each participating employer and for the person designated as the sponsor or provider of the arrangement.

C. **Reason for Change –** Concerns have been raised as to whether unrelated employers who wish to jointly sponsor an individual account type pension plan can do so if they share no common interest other than their co-sponsorship of the plan. In order to facilitate the use of multiple employer defined contribution plans to increase coverage and to otherwise be consistent with current law, the amendment would clarify the application of ERISA in these circumstances, provided the plan sponsor retains a certain minimum level of fiduciary responsibility; participating employers are not unreasonably restricted in ceasing participation and/or transferring plan assets; and certain reporting requirements are met. Such responsibilities are intended to be no more or less than what a plan sponsor would be responsible for if adopting their own plan.

D. **Modification to Existing Authority –**

(1) ERISA §3(2)

3. Make simplified reporting requirements for small plans under ERISA applicable to small multiple employer defined contribution plans

A. **Current Law –** Under current law, the plan administrator of an employee pension benefit plan required to file an annual report is generally required to engage an independent qualified public accountant "(IQPA")and include his or her opinion as part of the report. Section 104(a)(2)(A) of ERISA permits the Department of Labor (the "Department") to prescribe by regulation simplified annual reports for pension plans with fewer than 100 participants. Section 103(a)(3)(A) of ERISA permits the Department to waive the requirement of an IQPA's opinion for small plans that qualify to file a simplified report. Under regulations, the Department has exercised such authority and waives the requirement under certain circumstances.

B. **Proposed Change –** ERISA Section 104(a)(2)(A) would be amended to provide that simplified annual reporting and potential waiver of the requirement to include the opinion of an IQPA would also be available to a multiple employer individual account plan, as described in ERISA Section 3(2)(C), if the plan in total covers no more than 1,000 participants and no single employer who has adopted the plan has more than 100 participants

C. **Reason for Change –** The same policies that apply to simplified reporting are applicable to a small multiple employer individual account plan. In this case, the relief would only be available if no single employer participating in the multiple employer defined contribution plan had more than 100 participants and the plan as a whole covered fewer than 1,000 participants in total.

D. **Modification to Existing Authority –**

(1) ERISA §104(a)(2)(A)