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Income Security Act of 1974
and Committee Reports

Internal Revenue cumulative bulletin

1974-3

Department of the Treasury
Internal Revenue Service

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Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and consideration. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis. Occasionally an extra volume of the Cumulative Bulletin is required for publication of legislative matters.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The regulations, rulings, decisions, procedures, Public Laws, etc., published in the weekly Internal Revenue Bulletins 1974-26 through 1974-52 have been consolidated and are published in Internal Revenue Cumulative Bulletin 1974-2.

Cumulative Bulletin 1974-3 is devoted solely to Public Law 93-406, the Employment Retirement Income Security Act of 1974, and related Committee and Conference reports, which were not published in a weekly Bulletin.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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1954 Code Sections Added, Amended, or Repealed by Public Law 93-406

The following sections of the Internal Revenue Code of 1954 are affected by Public Law 93-406. New Sections added to the Code, and repealed sections, are so noted. Where a section is renumbered it is identified by the old number beside it in parentheses.

1954 Code Sections	Act. Secs.
37(c)(1)	2001(g)(1)
46(a)(3)	2001(g)(2)(B), 2002(g)(2), 2005(c)(4)
50(a)(3)	2001(g)(2)(B), 2002(g)(2), 2005(c)(4)
56(a)(2)	2001(g)(2)(D), 2002(g)(4), 2005(c)(7)
56(c)(1)	2001(g)(2)(D), 2002(g)(4), 2005(c)(7)
62	2002(g)(2), 2005(c)(9)
72(m)	2001, 2002
72(n) Repealed	2005(c)(3)
72(o)	2008(b)(2)
101(b)(2)(B)	2005(c)(15), 2008(b)(3)
122(a)	2008(a)
122(b)(2)	2005(c)(10), 2008(b)(1)
219 New	2002(a)(1)
220 (219)	2002(a)(1)
275(a)	1016(a)(1)
401(a)	1012, 1016, 1021, 1022, 2001, 2004
401(b)	1023
401(d)	1022, 2001
401(e)	2001
401(f)	1022
401(j)	2001
402(a)	2002, 2005
402(e)	2005
403(a)	2002, 2005
403(b)	1022, 2004
404(a)	1013, 1016, 2001, 2004
404(c)	2007
404(e)	2001
405(a)(1)	2004(c)(2)
405(e)	2005(c)(11)
406(b)(1)	1016(a)(4)
406(c)	2005(c)(12)
407(b)(1)	1016(a)(5)
407(c)	2005(c)(13)
408 New	2002(b)
409 New	2002(c)
410 New	1011
411 New	1012(a)
412 New	1013(a)
413 New	1014
414 New	1015
415 New	2004(a)(2)
503	2003(b)
801(g)(7)	2002(g)(11)
805(d)(1)	1016(a)(6), 2002(g)(9), 2004(c)(3)
871(b)(1)	2005(c)(8)
877(b)	2005(c)(8)
901(a)	2001(g)(2), 2002(g)(3), 2005(c)(5)
1304(b)(2)	2005(c)(6)
1348(b)(1)	2005(c)(14)
1379(b)(1)	2001(b)
2039(c)	2008(b)(4)
3401(a)(12)	2002(g)(7)
4971 New	1013(b)
4972 New	2001(f)
4973 New	2002(d)
4974 New	2002(e)
4975 New	2003(a)
6033(c)	1031(c)(2)
6047(d)	1031(c)(3), 2002(g)(8)
6051(a)	1022(k)
6057 New	1031(a)
6058 New	1031(a)
6059 New	1033(a)
6103	1022(h)
6104(a)	1022(g)
6104(b)	1022(g)
6161(b)(1)	1016(a)(7)
6201(d)	1016(a)(8)
6204(b)	1016(a)(27)
6211(a), (b)(2)	1016(a)(9)
6212	1016(a)(10)
6213(a), (e)	1016(a)(11)
6214(c), (d)	1016(a)(12)
6344(a)(1)	1016(a)(13)
6501(e)(3)	1016(a)(14)
6503(a)(1), (h)	1016(a)(15)
6511(d)	4081(b)
6512	1016(a)(16)
6601(d)	1016(a)(17)
6652(e), (f)	1031(b)(1)
6653(c)(1)	1016(a)(18)
6659(b)	1016(a)(19)
6676(b)	1016(a)(20)
6677(b)	1016(a)(21)
6679(b)	1016(a)(22)
6682(b)	1016(a)(23)
6690 New	1031(b)(2)
6692 New	1033(b)
6693 New	2002(f)
6861	1016(a)(24)
6862	1016(a)(25)
7422	1016(a)(26)
7451	1041(b)(1)
7459(c)	1041(b)(2)
7476 New	1041(a)
7482(b)(1)	1041(b)(3)
7701(a)(35)	3043
7802	1051(a)

Public Law 93-406

93rd Congress, H. R. 2 [1]

September 2, 1974

An Act To provide for pension reform.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE AND TABLE OF CONTENTS

SECTION 1. This Act may be cited as the "Employee Retirement Income Security Act of 1974".

TABLE OF CONTENTS [See front of book]

* * * * *

TITLE I—PROTECTION OF EMPLOYEE BENEFIT RIGHTS

SUBTITLE A—GENERAL PROVISIONS

FINDINGS AND DECLARATION OF POLICY

SEC. 2. (a) The Congress finds that the growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an important factor affecting the stability of employment and the successful development of industrial relations; that they have become an important factor in commerce because of the interstate character of their activities, and of the activities of their participants, and the employers, employee organizations, and other entities by which they are established or maintained; that a large volume of the activities of such plans is carried on by means of the mails and instrumentalities of interstate commerce; that owing to the lack of employee information and adequate safeguards concerning their operation, it is desirable in the interests of employees and their beneficiaries, and to provide for the general welfare and the free flow of commerce, that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of such plans; that they substantially affect the revenues of the United States because they are afforded preferential Federal tax treatment; that despite the enormous growth in such plans many employees with long years of employment are losing anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before

[1] House Report No. 93-298, page : House Report No. 93-533, page ; House Report No. 93-779, page : Conference Report No. 93-1280, page . House Report No. 93-807, Senate Report No. 93-394, and Conference Report No. 93-1090 are the same as House Report No. 93-779, House Report No. 93-298, and Conference Report No. 93-1280, respectively. Therefore, they are not being published.

requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness.

(b) It is hereby declared to be the policy of this Act to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.

(c) It is hereby further declared to be the policy of this Act to protect interstate commerce, the Federal taxing power, and the interests of participants in private pension plans and their beneficiaries by improving the equitable character and the soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance.

DEFINITIONS

SEC. 3. For purposes of this title:

(1) The terms "employee welfare benefit plan" and "welfare plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 302(c) of the Labor Management Relations Act, 1947 (other than pensions on retirement or death, and insurance to provide such pensions).

(2) The terms "employee pension benefit plan" and "pension plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—

(A) provides retirement income to employees, or

(B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond,

regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

(3) The term "employee benefit plan" or "plan" means an employee welfare benefit plan or an employee pension benefit plan or a plan which is both an employee welfare benefit plan and an employee pension benefit plan.

(4) The term "employee organization" means any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning an employee benefit plan, or other

matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose in whole or in part, of establishing such a plan.

(5) The term "employer" means 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.

(6) The term "employee" means any individual employed by an employer.

(7) The term "participant" means any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

(8) The term "beneficiary" means a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder.

(9) The term "person" means an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization.

(10) The term "State" includes any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam, Wake Island, and the Canal Zone. The term "United States" when used in the geographic sense means the States and the Outer Continental Shelf lands defined in the Outer Continental Shelf Lands Act (43 U.S.C. 1331–1343).

(11) The term "commerce" means trade, traffic, commerce, transportation, or communication between any State and any place outside thereof.

(12) The term "industry or activity affecting commerce" means any activity, business, or industry in commerce or in which a labor dispute would hinder or obstruct commerce or the free flow of commerce, and includes any activity or industry "affecting commerce" within the meaning of the Labor Management Relations Act, 1947, or the Railway Labor Act.

(13) The term "Secretary" means the Secretary of Labor.

(14) The term "party in interest" means, as to an employee benefit plan—

(A) any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan;

(B) a person providing services to such plan;

(C) an employer any of whose employees are covered by such plan;

(D) an employee organization any of whose members are covered by such plan;

(E) an owner, direct or indirect, of 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation.

(ii) the capital interest or the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise,

which is an employer or an employee organization described in subparagraph (C) or (D);

(F) a relative (as defined in paragraph (15)) of any individual described in subparagraph (A), (B), (C), or (E);

(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii) the capital interest or profits interest of such partnership, or

(iii) the beneficial interest of such trust or estate,

is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H) an employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors), or a 10 percent or more shareholder directly or indirectly, of a person described in subparagraph (B), (C), (D), (E), or (G), or of the employee benefit plan; or

(I) a 10 percent or more (directly or indirectly in capital or profits) partner or joint venturer of a person described in subparagraph (B), (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of the Treasury, may by regulation prescribe a percentage lower than 50 percent for subparagraph (E) and (G) and lower than 10 percent for subparagraph (H) or (I). The Secretary may prescribe regulations for determining the ownership (direct or indirect) of profits and beneficial interests, and the manner in which indirect stockholdings are taken into account.

(15) The term "relative" means a spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

(16) (A) The term "administrator" means—

(i) the person specifically so designated by the terms of the instrument under which the plan is operated;

(ii) if an administrator is not so designated, the plan sponsor; or

(iii) in the case of a plan for which an administrator is not designated and a plan sponsor cannot be identified, such other person as the Secretary may by regulation prescribe.

(B) The term "plan sponsor" means (i) the employer in the case of an employee benefit plan established or maintained by a single employer, (ii) the employee organization in the case of a plan established or maintained by an employee organization, or (iii) in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.

(17) The term "separate account" means an account established or maintained by an insurance company under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(18) The term "adequate consideration" when used in part 4 of subtitle B means (A) in the case of a security for which there is a generally recognized market, either (i) the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, or (ii) if the security is not traded on such a national securities exchange, a price not less

favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of any party in interest; and (B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary.

(19) The term "nonforfeitable" when used with respect to a pension benefit or right means a claim obtained by a participant or his beneficiary to that part of an immediate or deferred benefit under a pension plan which arises from the participant's service, which is unconditional, and which is legally enforceable against the plan. For purposes of this paragraph, a right to an accrued benefit derived from employer contributions shall not be treated as forfeitable merely because the plan contains a provision described in section 203(a)(3).

(20) The term "security" has the same meaning as such term has under section 2(1) of the Securities Act of 1933 (15 U.S.C. 77b(1)).

(21)(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 405(c)(1)(B).

(B) If any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940, such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this title, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

(22) The term "normal retirement benefit" means the greater of the early retirement benefit under the plan, or the benefit under the plan commencing at normal retirement age. The normal retirement benefit shall be determined without regard to—

(A) medical benefits, and

(B) disability benefits not in excess of the qualified disability benefit.

For purposes of this paragraph, a qualified disability benefit is a disability benefit provided by a plan which does not exceed the benefit which would be provided for the participant if he separated from the service at normal retirement age. For purposes of this paragraph, the early retirement benefit under a plan shall be determined without regard to any benefit under the plan which the Secretary of the Treasury finds to be a benefit described in section 204(b)(1)(G).

(23) The term "accrued benefit" means—

(A) in the case of a defined benefit plan, the individual's accrued benefit determined under the plan and, except as provided

in section 204(c)(3), expressed in the form of an annual benefit commencing at normal retirement age, or

(B) in the case of a plan which is an individual account plan, the balance of the individual's account.

(24) The term "normal retirement age" means the earlier of—

(A) the time a plan participant attains normal retirement age under the plan, or

(B) the later of—

(i) the time a plan participant attains age 65, or

(ii) the 10th anniversary of the time a plan participant commenced participation in the plan.

(25) The term "vested liabilities" means the present value of the immediate or deferred benefits available at normal retirement age for participants and their beneficiaries which are nonforfeitable.

(26) The term "current value" means fair market value where available and otherwise the fair value as determined in good faith by a trustee or a named fiduciary (as defined in section 402(a)(2)) pursuant to the terms of the plan and in accordance with regulations of the Secretary, assuming an orderly liquidation at the time of such determination.

(27) The term "present value", with respect to a liability, means the value adjusted to reflect anticipated events. Such adjustments shall conform to such regulations as the Secretary of the Treasury may prescribe.

(28) The term "normal service cost" or "normal cost" means the annual cost of future pension benefits and administrative expenses assigned, under an actuarial cost method, to years subsequent to a particular valuation date of a pension plan. The Secretary of the Treasury may prescribe regulations to carry out this paragraph.

(29) The term "accrued liability" means the excess of the present value, as of a particular valuation date of a pension plan, of the projected future benefit costs and administrative expenses for all plan participants and beneficiaries over the present value of future contributions for the normal cost of all applicable plan participants and beneficiaries. The Secretary of the Treasury may prescribe regulations to carry out this paragraph.

(30) The term "unfunded accrued liability" means the excess of the accrued liability, under an actuarial cost method which so provides, over the present value of the assets of a pension plan. The Secretary of the Treasury may prescribe regulations to carry out this paragraph.

(31) The term "advance funding actuarial cost method" or "actuarial cost method" means a recognized actuarial technique utilized for establishing the amount and incidence of the annual actuarial cost of pension plan benefits and expenses. Acceptable actuarial cost methods shall include the accrued benefit cost method (unit credit method), the entry age normal cost method, the individual level premium cost method, the aggregate cost method, the attained age normal cost method, and the frozen initial liability cost method. The terminal funding cost method and the current funding (pay-as-you-go) cost method are not acceptable actuarial cost methods. The Secretary of the Treasury shall issue regulations to further define acceptable actuarial cost methods.

(32) The term "governmental plan" means a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term "governmental plan" also includes any plan to which the Railroad Retirement Act of 1935 or 1937 applies, and which is financed by contributions required under that Act and any plan of an international

organization which is exempt from taxation under the provisions of the International Organizations Immunities Act (59 Stat. 669).

(33) (A) The term "church plan" means (i) a plan established and maintained for its employees by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954, or (ii) a plan described in subparagraph (C).

(B) The term "church plan" (notwithstanding the provisions of subparagraph (A)) does not include a plan—

(i) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Internal Revenue Code of 1954), or

(ii) which is a plan maintained by more than one employer, if one or more of the employers in the plan is not a church (or a convention or association of churches) which is exempt from tax under section 501 of the Internal Revenue Code of 1954.

(C) Notwithstanding the provisions of subparagraph (B) (ii), a plan in existence on January 1, 1974, shall be treated as a "church plan" if it is established and maintained by a church or convention or association of churches for its employees and employees of one or more agencies of such church (or convention or association) for the employees of such church (or convention or association) and the employees of one or more agencies of such church (or convention or association), and if such church (or convention or association) and each such agency is exempt from tax under section 501 of the Internal Revenue Code of 1954. The first sentence of this subparagraph shall not apply to any plan maintained for employees of an agency with respect to which the plan was not maintained on January 1, 1974. The first sentence of this subparagraph shall not apply with respect to any plan for any plan year beginning after December 31, 1982.

(34) The term "individual account plan" or "defined contribution plan" means a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

(35) The term "defined benefit plan" means a pension plan other than an individual account plan; except that a pension plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant—

(A) for the purposes of section 202, shall be treated as an individual account plan, and

(B) for the purposes of paragraph (23) of this section and section 204, shall be treated as an individual account plan to the extent benefits are based upon the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan.

(36) The term "excess benefit plan" means a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by section 415 of the Internal Revenue Code of 1954 on plans to which that section applies, without regard to whether the plan is funded. To the extent that a separable part of a plan (as determined by the Secretary of Labor) maintained by an employer is maintained for such purpose, that part shall be treated as a separate plan which is an excess benefit plan.

(37) (A) The term "multiemployer plan" means a plan—

(i) to which more than one employer is required to contribute,

(ii) which is maintained pursuant to one or more collective-bargaining agreements between an employee organization and more than one employer,

(iii) under which the amount of contributions made under the plan for a plan year by each employer making such contributions is less than 50 percent of the aggregate amount of contributions made under the plan for that plan year by all employers making such contributions,

(iv) under which benefits are payable with respect to each participant without regard to the cessation of contributions by the employer who had employed that participant except to the extent that such benefits accrued as a result of service with the employer before such employer was required to contribute to such plan, and

(v) which satisfies such other requirements as the Secretary may by regulations prescribe.

(B) For purposes of this paragraph—

(i) if a plan is a multiemployer plan within the meaning of subparagraph (A) for any plan year, clause (iii) of subparagraph (A) shall be applied by substituting "75 percent" for "50 percent" for each subsequent plan year until the first plan year following a plan year in which the plan had one employer who made contributions of 75 percent or more of the aggregate amount of contributions made under the plan for that plan year by all employers making such contributions, and

(ii) all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) of the Internal Revenue Code of 1954, determined without regard to section 1563(e)(3)(C) of such Code) shall be deemed to be one employer.

(38) The term "investment manager" means any fiduciary (other than a trustee or named fiduciary, as defined in section 402(a)(2))—

(A) who has the power to manage, acquire, or dispose of any asset of a plan;

(B) who is (i) registered as an investment adviser under the Investment Advisers Act of 1940; (ii) is a bank, as defined in that Act; or (iii) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and

(C) has acknowledged in writing that he is a fiduciary with respect to the plan.

(39) The terms "plan year" and "fiscal year of the plan" mean with respect to a plan, calendar, policy, or fiscal year on which the records of the plan are kept.

COVERAGE

SEC. 4. (a) Except as provided in subsection (b) and in sections 201, 301, and 401, this title shall apply to any employee benefit plan if it is established or maintained—

(1) by any employer engaged in commerce or in any industry or activity affecting commerce; or

(2) by any employee organization or organizations representing employees engaged in commerce or in any industry or activity affecting commerce; or

(3) by both.

(b) The provisions of this title shall not apply to any employee benefit plan if—

(1) such plan is a governmental plan (as defined in section 3(32));

(2) such plan is a church plan (as defined in section 3(33)) with respect to which no election has been made under section 410(d) of the Internal Revenue Code of 1954;

(3) such plan is maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws;

(4) such plan is maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens; or

(5) such plan is an excess benefit plan (as defined in section 3(36)) and is unfunded.

Subtitle B—Regulatory Provisions

Part I—Reporting and Disclosure

DUTY OF DISCLOSURE AND REPORTING

Sec. 101. (a) The administrator of each employee benefit plan shall cause to be furnished in accordance with section 104(b) to each participant covered under the plan and to each beneficiary who is receiving benefits under the plan—

(1) a summary plan description described in section 102(a)(1); and

(2) the information described in section 104(b)(3) and 105(a) and (c).

(b) The administrator shall, in accordance with section 104(a), file with the Secretary—

(1) the summary plan description described in section 102(a)(1);

(2) a plan description containing the matter required in section 102(b);

(3) modifications and changes referred to in section 102(a)(2);

(4) the annual report containing the information required by section 103; and

(5) terminal and supplementary reports as required by subsection (c) of this section.

(c)(1) Each administrator of an employee pension benefit plan which is winding up its affairs (without regard to the number of participants remaining in the plan) shall, in accordance with regulations prescribed by the Secretary, file such terminal reports as the Secretary may consider necessary. A copy of such report shall also be filed with the Pension Benefit Guaranty Corporation.

(2) The Secretary may require terminal reports to be filed with regard to any employee welfare benefit plan which is winding up its affairs in accordance with regulations promulgated by the Secretary.

(3) The Secretary may require that a plan described in paragraph (1) or (2) file a supplementary or terminal report with the annual report in the year such plan is terminated and that a copy of such supplementary or terminal report in the case of a plan described in paragraph (1) be also filed with the Pension Benefit Guaranty Corporation.

(d) Cross Reference.—

For regulations relating to coordination of reports to the Secretaries of Labor and the Treasury, see section 3004.

PLAN DESCRIPTION AND SUMMARY PLAN DESCRIPTION

SEC. 102. (a)(1) A summary plan description of any employee benefit plan shall be furnished to participants and beneficiaries as provided in section 104(b). The summary plan description shall include the information described in subsection (b), shall be written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan. A summary of any material modification in the terms of the plan and any change in the information required under subsection (b) shall be written in a manner calculated to be understood by the average plan participant and shall be furnished in accordance with section 104(b)(1).

(2) A plan description (containing the information required by subsection (b)) of any employee benefit plan shall be prepared on forms prescribed by the Secretary, and shall be filed with the Secretary as required by section 104(a)(1). Any material modification in the terms of the plan and any change in the information described in subsection (b) shall be filed in accordance with section 104(a)(1)(D).

(b) The plan description and summary plan description shall contain the following information: The name and type of administration of the plan; the name and address of the person designated as agent for the service of legal process, if such person is not the administrator; the name and address of the administrator; names, titles, and addresses of any trustee or trustees (if they are persons different from the administrator); a description of the relevant provisions of any applicable collective bargaining agreement; the plan's requirements respecting eligibility for participation and benefits; a description of the provisions providing for nonforfeitable pension benefits; circumstances which may result in disqualification, ineligibility, or denial or loss of benefits; the source of financing of the plan and the identity of any organization through which benefits are provided; the date of the end of the plan year and whether the records of the plan are kept on a calendar, policy, or fiscal year basis; the procedures to be followed in presenting claims for benefits under the plan and the remedies available under the plan for the redress of claims which are denied in whole or in part (including procedures required under section 503 of this Act).

ANNUAL REPORTS

SEC. 103. (a)(1)(A) An annual report shall be published with respect to every employee benefit plan to which this part applies. Such report shall be filed with the Secretary in accordance with section 104(a), and shall be made available and furnished to participants in accordance with section 104(b).

(B) The annual report shall include the information described in subsections (b) and (c) and where applicable subsections (d) and (e) and shall also include—

(i) a financial statement and opinion, as required by paragraph (3) of this subsection, and

(ii) an actuarial statement and opinion, as required by paragraph (4) of this subsection.

(2) If some or all of the information necessary to enable the administrator to comply with the requirements of this title is maintained by—

(A) an insurance carrier or other organization which provides some or all of the benefits under the plan, or holds assets of the plan in a separate account,

(B) a bank or similar institution which holds some or all of the assets of the plan in a common or collective trust or a separate trust, or custodial account, or

(C) a plan sponsor as defined in section 3(16)(B),

such carrier, organization, bank, institution, or plan sponsor shall transmit and certify the accuracy of such information to the administrator within 120 days after the end of the plan year (or such other date as may be prescribed under regulations of the Secretary).

(3)(A) Except as provided in subparagraph (C), the administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer his opinion as to whether the separate schedules specified in subsection (b)(3) of this section and the summary material required under section 104(b)(3) present fairly, and in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion by the independent qualified public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104(a)(2) a plan is required only to file a simplified annual report, the Secretary may waive the requirements of this paragraph.

(B) In offering his opinion under this section the accountant may rely on the correctness of any actuarial matter certified to by an enrolled actuary, if he so states his reliance.

(C) The opinion required by subparagraph (A) need not be expressed as to any statements required by subsection (b)(3)(G) prepared by a bank or similar institution or insurance carrier regulated and supervised and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institution, or insurance carrier as accurate and are made a part of the annual report.

(D) For purposes of this title, the term "qualified public accountant" means—

(i) a person who is a certified public accountant, certified by a regulatory authority of a State;

(ii) a person who is a licensed public accountant, licensed by a regulatory authority of a State; or

(iii) a person certified by the Secretary as a qualified public accountant in accordance with regulations published by him for a person who practices in States where there is no certification or licensing procedure for accountants.

(4)(A) The administrator of an employee pension benefit plan subject to the reporting requirement of subsection (d) of this section shall engage, on behalf of all plan participants, an enrolled actuary who shall be responsible for the preparation of the materials comprising the actuarial statement required under subsection (d) of this section. In a case where a plan is not required to file an annual report, the

requirement of this paragraph shall not apply, and, in a case where by reason of section 104(a)(2), a plan is required only to file a simplified report, the Secretary may waive the requirement of this paragraph.

(B) The enrolled actuary shall utilize such assumptions and techniques as are necessary to enable him to form an opinion as to whether the contents of the matters reported under subsection (d) of this section—

(i) are in the aggregate reasonably related to the experience of the plan and to reasonable expectations; and

(ii) represent his best estimate of anticipated experience under the plan.

The opinion by the enrolled actuary shall be made with respect to, and shall be made a part of, each annual report.

(C) For purposes of this title, the term "enrolled actuary" means an actuary enrolled under subtitle C of title III of this Act.

(D) In making a certification under this section the enrolled actuary may rely on the correctness of any accounting matter under section 103(b) as to which any qualified public accountant has expressed an opinion, if he so states his reliance.

(b) An annual report under this section shall include a financial statement containing the following information:

(1) With respect to an employee welfare benefit plan: a statement of assets and liabilities; a statement of changes in fund balance; and a statement of changes in financial position. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fully and fairly present the financial statements of the plan.

(2) With respect to an employee pension benefit plan: a statement of assets and liabilities, and a statement of changes in net assets available for plan benefits which shall include details of revenues and expenses and other changes aggregated by general source and application. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; the funding policy (including policy with respect to prior service cost), and any changes in such policies during the year; a description of any significant changes in plan benefits made during the period; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fully and fairly present the financial statements of such pension plan.

(3) With respect to all employee benefit plans, the statement required under paragraph (1) or (2) shall have attached the following information in separate schedules:

(A) a statement of the assets and liabilities of the plan aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the previous fiscal year of the plan;

(B) a statement of receipts and disbursements during the preceding twelve-month period aggregated by general sources and applications;

(C) a schedule of all assets held for investment purposes aggregated and identified by issuer, borrower, or lessor, or similar party to the transaction (including a notation as to whether such party is known to be a party in interest), maturity date, rate of interest, collateral, par or maturity value, cost, and current value;

(D) a schedule of each transaction involving a person known to be party in interest, the identity of such party in interest and his relationship or that of any other party in interest to the plan, a description of each asset to which the transaction relates; the purchase or selling price in case of a sale or purchase, the rental in case of a lease, or the interest rate and maturity date in case of a loan; expenses incurred in connection with the transaction; the cost of the asset, the current value of the asset, and the net gain (or loss) on each transaction;

(E) a schedule of all loans or fixed income obligations which were in default as of the close of the plan's fiscal year or were classified during the year as uncollectable and the following information with respect to each loan on such schedule (including a notation as to whether parties involved are known to be parties in interest) : the original principal amount of the loan, the amount of principal and interest received during the reporting year, the unpaid balance, the identity and address of the obligor, a detailed description of the loan (including date of making and maturity, interest rate, the type and value of collateral, and other material terms), the amount of principal and interest overdue (if any) and an explanation thereof;

(F) a list of all leases which were in default or were classified during the year as uncollectable; and the following information with respect to each lease on such schedule (including a notation as to whether parties involved are known to be parties in interest) : the type of property leased (and, in the case of fixed assets such as land, buildings, leasehold, and so forth, the location of the property), the identity of the lessor or lessee from or to whom the plan is leasing, the relationship of such lessors and lessees, if any, to the plan, the employer, employee organization, or any other party in interest, the terms of the lease regarding rent, taxes, insurance, repairs, expenses, and renewal options; the date the leased property was purchased and its cost. the date the property was leased and its approximate value at such date, the gross rental receipts during the reporting period, expenses paid for the leased property during the reporting period, the net receipts from the lease, the amounts in arrears, and a statement as to what steps have been taken to collect amounts due or otherwise remedy the default;

(G) if some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier or a separate trust maintained by a bank as trustee, the report shall include the most recent annual statement of assets and liabilities of such common or collective trust, and in the case of a separate account or a separate trust, such other information as is required by the administrator in order to comply with this subsection; and

(H) a schedule of each reportable transaction, the name of each party to the transaction (except that, in the case of an acquisition or sale of a security on the market, the report need not identify

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the person from whom the security was acquired or to whom it was sold) and a description of each asset to which the transaction applies; the purchase or selling price in case of a sale or purchase, the rental in case of a lease, or the interest rate and maturity date in case of a loan; expenses incurred in connection with the transaction; the cost of the asset, the current value of the asset, and the net gain (or loss) on each transaction. For purposes of the preceding sentence, the term "reportable transaction" means a transaction to which the plan is a party if such transaction is—

(i) a transaction involving an amount in excess of 3 percent of the current value of the assets of the plan;

(ii) any transaction (other than a transaction respecting a security) which is part of a series of transactions with or in conjunction with a person in a plan year, if the aggregate amount of such transactions exceeds 3 percent of the current value of the assets of the plan;

(iii) a transaction which is part of a series of transactions respecting one or more securities of the same issuer, if the aggregate amount of such transactions in the plan year exceeds 3 percent of the current value of the assets of the plan; or

(iv) a transaction with or in conjunction with a person respecting a security, if any other transaction with or in conjunction with such person in the plan year respecting a security is required to be reported by reason of clause (i).

(4) The Secretary may, by regulation, relieve any plan from filing a copy of a statement of assets and liabilities (or other information) described in paragraph (3)(G) if such statement and other information is filed with the Secretary by the bank or insurance carrier which maintains the common or collective trust or separate account.

(c) The administrator shall furnish as a part of a report under this section the following information:

(1) The number of employees covered by the plan.

(2) The name and address of each fiduciary.

(3) Except in the case of a person whose compensation is minimal (determined under regulations of the Secretary) and who performs solely ministerial duties (determined under such regulations), the name of each person (including but not limited to, any consultant, broker, trustee, accountant, insurance carrier, actuary, administrator, investment manager, or custodian who rendered services to the plan or who had transactions with the plan) who received directly or indirectly compensation from the plan during the preceding year for services rendered to the plan or its participants, the amount of such compensation, the nature of his services to the plan or its participants, his relationship to the employer of the employees covered by the plan, or the employee organization, and any other office, position, or employment he holds with any party in interest.

(4) An explanation of the reason for any change in appointment of trustee, accountant, insurance carrier, enrolled actuary, administrator, investment manager, or custodian.

(5) Such financial and actuarial information including but not limited to the material described in subsections (b) and (d) of this section as the Secretary may find necessary or appropriate.

(d) With respect to an employee pension benefit plan (other than (A) a profit sharing, savings, or other plan, which is an individual account plan, (B) a plan described in section 301(b), or (C) a plan described both in section 4021(b) and in paragraph (1), (2), (3), (4), (5), (6), or (7) of section 301(a)) an annual report under this

section for a plan year shall include a complete actuarial statement applicable to the plan year which shall include the following:

(1) The date of the plan year, and the date of the actuarial valuation applicable to the plan year for which the report is filed.

(2) The date and amount of the contribution (or contributions) received by the plan for the plan year for which the report is filed and contributions for prior plan years not previously reported.

(3) The following information applicable to the plan year for which the report is filed: the normal costs, the accrued liabilities, an identification of benefits not included in the calculation; a statement of the other facts and actuarial assumptions and methods used to determine costs, and a justification for any change in actuarial assumptions or cost methods; and the minimum contribution required under section 302.

(4) The number of participants and beneficiaries, both retired and nonretired, covered by the plan.

(5) The current value of the assets accumulated in the plan, and the present value of the assets of the plan used by the actuary in any computation of the amount of contributions to the plan required under section 302 and a statement explaining the basis of such valuation of present value of assets.

(6) The present value of all of the plan's liabilities for nonforfeitable pension benefits allocated by the termination priority categories as set forth in section 4044 of this Act, and the actuarial assumptions used in these computations. The Secretary shall establish regulations defining (for purposes of this section) "termination priority categories" and acceptable methods, including approximate methods, for allocating the plan's liabilities to such termination priority categories.

(7) A certification of the contribution necessary to reduce the accumulated funding deficiency to zero.

(8) A statement by the enrolled actuary—

(A) that to the best of his knowledge the report is complete and accurate, and

(B) the requirements of section 302(c)(3) (relating to reasonable actuarial assumptions and methods) have been complied with.

(9) A copy of the opinion required by subsection (a)(4).

(10) Such other information regarding the plan as the Secretary may by regulation require.

(11) Such other information as may be necessary to fully and fairly disclose the actuarial position of the plan.

Such actuary shall make an actuarial valuation of the plan for every third plan year, unless he determines that a more frequent valuation is necessary to support his opinion under subsection (a)(4) of this section.

(e) If some or all of the benefits under the plan are purchased from and guaranteed by an insurance company, insurance service, or other similar organization, a report under this section shall include a statement from such insurance company, service, or other similar organization covering the plan year and enumerating—

(1) the premium rate or subscription charge and the total premium or subscription charges paid to each such carrier, insurance service, or other similar organization and the approximate number of persons covered by each class of such benefits; and

(2) the total amount of premiums received, the approximate number of persons covered by each class of benefits, and the total claims paid by such company, service, or other organization; dividends or retroactive rate adjustments, commissions, and adminis-

trative service or other fees or other specific acquisition costs paid by such company, service, or other organization; any amounts held to provide benefits after retirement; the remainder of such premiums; and the names and addresses of the brokers, agents, or other persons to whom commissions or fees were paid, the amount paid to each, and for what purpose. If any such company, service, or other organization does not maintain separate experience records covering the specific groups it serves, the report shall include in lieu of the information required by the foregoing provisions of this paragraph (A) a statement as to the basis of its premium rate or subscription charge, the total amount of premiums or subscription charges received from the plan, and a copy of the financial report of the company, service, or other organization and (B) if such company, service, or organization incurs specific costs in connection with the acquisition or retention of any particular plan or plans, a detailed statement of such costs.

FILING WITH SECRETARY AND FURNISHING INFORMATION TO PARTICIPANTS

SEC. 104. (a)(1) The administrator of any employee benefit plan subject to this part shall file with the Secretary—

(A) the annual report for a plan year within 210 days after the close of such year (or within such time as may be required by regulations promulgated by the Secretary in order to reduce duplicative filing);

(B) the plan description within 120 days after such plan becomes subject to this part and an updated plan description, no more frequently than once every 5 years, as the Secretary may require;

(C) a copy of the summary plan description at the time such summary plan description is required to be furnished to participants and beneficiaries pursuant to subsection (b)(1)(B) of this section; and

(D) modifications and changes referred to in section 102(a)(2) within 60 days after such modification or change is adopted or occurs, as the case may be.

The Secretary shall make copies of such plan descriptions, summary plan descriptions, and annual reports available for inspection in the public document room of the Department of Labor. The administrator shall also furnish to the Secretary, upon request, any documents relating to the employee benefit plan, including but not limited to the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated.

(2)(A) With respect to annual reports required to be filed with the Secretary under this part, he may by regulation prescribe simplified annual reports for any pension plan which covers less than 100 participants. In addition, and without limiting the foregoing sentence, the Secretary may waive or modify the requirements of section 103(d)(6) in such cases or categories of cases as to which he finds that (i) the interests of the plan participants are not harmed thereby and (ii) the expense of compliance with the specific requirements of section 103(d)(6) is not justified by the needs of the participants, the Pension Benefit Guaranty Corporation, and the Department of Labor for some portion or all of the information otherwise required under section 103(d)(6).

(B) Nothing contained in this paragraph shall preclude the Secretary from requiring any information or data from any such plan to which this part applies where he finds such data or information is necessary to carry out the purposes of this title nor shall the Secretary

be precluded from revoking provisions for simplified reports for any such plan if he finds it necessary to do so in order to carry out the objectives of this title.

(3) The Secretary may by regulation exempt any welfare benefit plan from all or part of the reporting and disclosure requirements of this title, or may provide for simplified reporting and disclosure if he finds that such requirements are inappropriate as applied to welfare benefit plans.

(4) The Secretary may reject any filing under this section—

(A) if he determines that such filing is incomplete for purposes of this part; or

(B) if he determines that there is any material qualification by an accountant or actuary contained in an opinion submitted pursuant to section 103(a)(3)(A) or section 103(a)(4)(B).

(5) If the Secretary rejects a filing of a report under paragraph (4) and if a revised filing satisfactory to the Secretary is not submitted within 45 days after the Secretary makes his determination under paragraph (4) to reject the filing, and if the Secretary deems it in the best interest of the participants, he may take any one or more of the following actions—

(A) retain an independent qualified public accountant (as defined in section 103(a)(3)(D)) on behalf of the participants to perform an audit,

(B) retain an enrolled actuary (as defined in section 103(a)(4)(C) of this Act) on behalf of the plan participants, to prepare an actuarial statement.

(C) bring a civil action for such legal or equitable relief as may be appropriate to enforce the provisions of this part, or

(D) take any other action authorized by this title.

The administrator shall permit such accountant or actuary to inspect whatever books and records of the plan are necessary for such audit. The plan shall be liable to the Secretary for the expenses for such audit or report, and the Secretary may bring an action against the plan in any court of competent jurisdiction to recover such expenses.

(b) Publication of the summary plan descriptions and annual reports shall be made to participants and beneficiaries of the particular plan as follows:

(1) The administrator shall furnish to each participant, and each beneficiary receiving benefits under the plan, a copy of the summary, plan description, and all modifications and changes referred to in section 102(a)(1)—

(A) within 90 days after he becomes a participant, or (in the case of a beneficiary) within 90 days after he first receives benefits, or

(B) if later, within 120 days after the plan becomes subject to this part.

The administrator shall furnish to each participant, and each beneficiary receiving benefits under the plan, every fifth year after the plan becomes subject to this part an updated summary plan description described in section 102 which integrates all plan amendments made within such five-year period, except that in a case where no amendments have been made to a plan during such five-year period this sentence shall not apply. Notwithstanding the foregoing, the administrator shall furnish to each participant, and to each beneficiary receiving benefits under the plan, the summary plan description described in section 102 every tenth year after the plan becomes subject to this part. If there is a modification or change described in section 102(a)(1), a summary description of such modification or change shall be

furnished not later than 210 days after the end of the plan year in which the change is adopted to each participant, and to each beneficiary who is receiving benefits under the plan.

(2) The administrator shall make copies of the plan description and the latest annual report and the bargaining agreement, trust agreement, contract, or other instruments under which the plan was established or is operated available for examination by any plan participant or beneficiary in the principal office of the administrator and in such other places as may be necessary to make available all pertinent information to all participants (including such places as the Secretary may prescribe by regulations).

(3) Within 210 days after the close of the fiscal year of the plan, the administrator shall furnish to each participant, and to each beneficiary receiving benefits under the plan, a copy of the statements and schedules, for such fiscal year, described in subparagraphs (A) and (B) of section 103(b)(3) and such other material as is necessary to fairly summarize the latest annual report.

(4) The administrator shall, upon written request of any participant or beneficiary, furnish a copy of the latest updated summary plan description, plan description, and the latest annual report, any terminal report, the bargaining agreement, trust agreement, contract, or other instruments under which the plan is established or operated. The administrator may make a reasonable charge to cover the cost of furnishing such complete copies. The Secretary may by regulation prescribe the maximum amount which will constitute a reasonable charge under the preceding sentence.

(c) The Secretary may by regulation require that the administrator of any employee benefit plan furnish to each participant and to each beneficiary receiving benefits under the plan a statement of the rights of participants and beneficiaries under this title.

(d) CROSS REFERENCE—

For regulations respecting coordination of reports to the Secretaries of Labor and the Treasury, see section 3004.

REPORTING OF PARTICIPANT'S BENEFIT RIGHTS

SEC. 105. (a) Each administrator of an employee pension benefit plan shall furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information—

(1) the total benefits accrued, and

(2) the nonforfeitable pension benefits, if any, which have accrued, or the earliest date on which benefits will become nonforfeitable.

(b) In no case shall a participant or beneficiary be entitled under this section to receive more than one report described in subsection (a) during any one 12 month period.

(c) Each administrator required to register under section 6057 of the Internal Revenue Code of 1954 shall, before the expiration of the time prescribed for such registration, furnish to each participant described in subsection (a)(2)(C) of such section, an individual statement setting forth the information with respect to such participant required to be contained in the registration statement required by section 6057(a)(2) of such Code.

(d) Subsection (a) of this section shall apply to a plan to which more than one unaffiliated employer is required to contribute only to the extent provided in regulations prescribed by the Secretary in coordination with the Secretary of the Treasury.

REPORTS MADE PUBLIC INFORMATION

SEC. 106. (a) Except as provided in subsection (b), the contents of the descriptions, annual reports, statements, and other documents filed with the Secretary pursuant to this part shall be public information and the Secretary shall make any such information and data available for inspection in the public document room of the Department of Labor. The Secretary may use the information and data for statistical and research purposes, and compile and publish such studies, analyses, reports, and surveys based thereon as he may deem appropriate.

(b) Information described in section 105(a) and 105(c) with respect to a participant may be disclosed only to the extent that information respecting that participant's benefits under title II of the Social Security Act may be disclosed under such Act.

RETENTION OF RECORDS

SEC. 107. Every person subject to a requirement to file any description or report or to certify any information therefor under this title or who would be subject to such a requirement but for an exemption or simplified reporting requirement under section 104(a) (2) or (3) of this title shall maintain records on the matters of which disclosure is required which will provide in sufficient detail the necessary basic information and data from which the documents thus required may be verified, explained, or clarified, and checked for accuracy and completeness, and shall include vouchers, worksheets, receipts, and applicable resolutions, and shall keep such records available for examination for a period of not less than six years after the filing date of the documents based on the information which they contain, or six years after the date on which such documents would have been filed but for an exemption or simplified reporting requirement under section 104(a) (2) or (3).

RELIANCE ON ADMINISTRATIVE INTERPRETATIONS

SEC. 108. In any criminal proceeding under section 501 based on any act or omission in alleged violation of this part or section 412, no person shall be subject to any liability or punishment for or on account of the failure of such person to (1) comply with this part or section 412, if he pleads and proves that the act of omission complained of was in good faith, in conformity with, and in reliance on any regulation or written ruling of the Secretary, or (2) publish and file any information required by any provision of this part if he pleads and proves that he published and filed such information in good faith, and in conformity with any regulation or written ruling of the Secretary issued under this part regarding the filing of such reports. Such a defense, if established, shall be a bar to the action or proceeding, notwithstanding that (A) after such act or omission, such interpretation or opinion is modified or rescinded or is determined by judicial authority to be invalid or of no legal effect, or (B) after publishing or filing the plan description, annual reports, and other reports required by this title, such publication or filing is determined by judicial authority not to be in conformity with the requirements of this part.

FORMS

SEC. 109. (a) Except as provided in subsection (b) of this section, the Secretary may require that any information required under this title to be submitted to him, including but not limited to the information required to be filed by the administrator pursuant to section

103(b)(3) and (c), must be submitted on such forms as he may prescribe.

(b) The financial statement and opinion required to be prepared by an independent qualified public accountant pursuant to section 103(a)(3)(A), the actuarial statement required to be prepared by an enrolled actuary pursuant to section 103(a)(4)(A) and the summary plan description required by section 102(a) shall not be required to be submitted on forms.

(c) The Secretary may prescribe the format and content of the summary plan description, the summary of the annual report described in section 104(b)(3) and any other report, statements or documents (other than the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated), which are required to be furnished or made available to plan participants and beneficiaries receiving benefits under the plan.

ALTERNATIVE METHODS OF COMPLIANCE

SEC. 110. (a) The Secretary on his own motion or after having received the petition of an administrator may prescribe an alternative method for satisfying any requirement of this part with respect to any pension plan, or class of pension plans, subject to such requirement if he determines—

(1) that the use of such alternative method is consistent with the purposes of this title and that it provides adequate disclosure to the participants and beneficiaries in the plan, and adequate reporting to the Secretary,

(2) that the application of such requirement of this part would—

(A) increase the costs to the plan, or

(B) impose unreasonable administrative burdens with respect to the operation of the plan, having regard to the particular characteristics of the plan or the type of plan involved; and

(3) that the application of this part would be adverse to the interests of plan participants in the aggregate.

(b) An alternative method may be prescribed under subsection (a) by regulation or otherwise. If an alternative method is prescribed other than by regulation, the Secretary shall provide notice and an opportunity for interested persons to present their views, and shall publish in the Federal Register the provisions of such alternative method.

REPEAL AND EFFECTIVE DATE

SEC. 111. (a)(1) The Welfare and Pension Plans Disclosure Act is repealed except that such Act shall continue to apply to any conduct and events which occurred before the effective date of this part.

(2)(A) Section 664 of title 18, United States Code, is amended by striking out "any such plan subject to the provisions of the Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "any employee benefit plan subject to any provision of title I of the Employee Retirement Income Security Act of 1974".

(B)(i) Section 1027 of such title 18 is amended by striking out "Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "title I of the Employee Retirement Income Security Act of 1974", and by striking out "Act" each place it appears and inserting in lieu thereof "title".

(ii) The heading for such section is amended by striking out "WELFARE AND PENSION PLANS DISCLOSURE ACT" and inserting in lieu thereof "EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974".

(iii) The table of sections of chapter 47 of such title 18 is amended by striking out "Welfare and Pension Plans Disclosure Act" in the item relating to section 1027 and inserting in lieu thereof "Employee Retirement Income Security Act of 1974".

(C) Section 1954 of such title 18 is amended by striking out "any plan subject to the provisions of the Welfare and Pension Plans Disclosure Act as amended" and inserting in lieu thereof "any employee welfare benefit plan or employee pension benefit plan, respectively, subject to any provision of title I of the Employee Retirement Income Security Act of 1974"; and by striking out "sections 3(3) and 5(b)(1) and (2) of the Welfare and Pension Plans Disclosure Act, as amended" and inserting in lieu thereof "sections 3(4) and (3)(16) of the Employee Retirement Income Security Act of 1974".

(D) Section 211 of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 441) is amended by striking out "Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "Employee Retirement Income Security Act of 1974".

(b)(1) Except as provided in paragraph (2), this part (including the amendments and repeals made by subsection (a)) shall take effect on January 1, 1975.

(2) In the case of a plan which has a plan year which begins before January 1, 1975, and ends after December 31, 1974, the Secretary may postpone by regulation the effective date of the repeal of any provision of the Welfare and Pension Plans Disclosure Act (and of any amendment made by subsection (a)(2)) and the effective date of any provision of this part, until the beginning of the first plan year of such plan which begins after January 1, 1975.

(c) The provisions of this title authorizing the Secretary to promulgate regulations shall take effect on the date of enactment of this Act.

Part 2—Participation and Vesting

COVERAGE

Sec. 201. This part shall apply to any employee benefit plan described in section 4(a) (and not exempted under section 4(b)) other than—

(1) an employee welfare benefit plan;

(2) a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;

(3) (A) a plan established and maintained by a society, order, or association described in section 501(c)(8) or (9) of the Internal Revenue Code of 1954, if no part of the contributions to or under such plan are made by employers of participants in such plan, or

(B) a trust described in section 501(c)(18) of such Code;

(4) a plan which is established and maintained by a labor organization described in section 501(c)(5) of the Internal Revenue Code of 1954 and which does not at any time after the date of enactment of this Act provide for employer contributions;

(5) any agreement providing payments to a retired partner or a deceased partner's successor in interest, as described in section 736 of the Internal Revenue Code of 1954;

(6) an individual retirement account or annuity described in section 408 of the Internal Revenue Code of 1954, or a retirement bond described in section 409 of such Code; or

(7) an excess benefit plan.

MINIMUM PARTICIPATION STANDARDS

SEC. 202. (a)(1)(A) No pension plan may require, as a condition of participation in the plan, that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of the following dates—

(i) the date on which the employee attains the age of 25; or

(ii) the date on which he completes 1 year of service.

(B)(i) In the case of any plan which provides that after not more than 3 years of service each participant has a right to 100 percent of his accrued benefit under the plan which is nonforfeitable at the time such benefit accrues, clause (ii) of subparagraph (A) shall be applied by substituting "3 years of service" for "1 year of service".

(ii) In the case of any plan maintained exclusively for employees of an educational institution (as defined in section 170(b)(1)(A)(ii) of the Internal Revenue Code of 1954) by an employer which is exempt from tax under section 501(a) of such Code, which provides that each participant having at least 1 year of service has a right to 100 percent of his accrued benefit under the plan which is nonforfeitable at the time such benefit accrues, clause (i) of subparagraph (A) shall be applied by substituting "30" for "25". This clause shall not apply to any plan to which clause (i) applies.

(2) No pension plan may exclude from participation (on the basis of age) employees who have attained a specified age, unless—

(A) the plan is a—

(i) defined benefit plan, or

(ii) target benefit plan (as defined under regulations prescribed by the Secretary of the Treasury), and

(B) such employees begin employment with the employer after they have attained a specified age which is not more than 5 years before the normal retirement age under the plan.

(3)(A) For purposes of this section, the term "year of service" means a 12-month period during which the employee has not less than 1,000 hours of service. For purposes of this paragraph, computation of any 12-month period shall be made with reference to the date on which the employee's employment commenced, except that, in accordance with regulations prescribed by the Secretary, such computation may be made by reference to the first day of a plan year in the case of an employee who does not complete 1,000 hours of service during the 12-month period beginning on the date his employment commenced.

(B) In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of service" shall be such period as may be determined under regulations prescribed by the Secretary.

(C) For purposes of this section, the term "hour of service" means a time of service determined under regulations prescribed by the Secretary.

(D) For purposes of this section, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary may prescribe regulations to carry out the purposes of this subparagraph.

(4) A plan shall be treated as not meeting the requirements of paragraph (1) unless it provides that any employee who has satisfied the minimum age and service requirements specified in such paragraph, and who is otherwise entitled to participate in the plan, commences participation in the plan no later than the earlier of—

(A) the first day of the first plan year beginning after the date on which such employee satisfied such requirements, or

(B) the date 6 months after the date on which he satisfied such requirements,

unless such employee was separated from the service before the date referred to in subparagraph (A) or (B), whichever is applicable.

(b)(1) Except as otherwise provided in paragraphs (2), (3), and (4), all years of service with the employer or employers maintaining the plan shall be taken into account in computing the period of service for purposes of subsection (a)(1).

(2) In the case of any employee who has any 1-year break in service (as defined in section 203(b)(3)(A)) under the plan to which the service requirements of clause (i) of subsection (a)(1)(B) apply, if such employee has not satisfied such requirements, service before such break shall not be required to be taken into account.

(3) In computing an employee's period of service for purposes of subsection (a)(1) in the case of any participant who has any 1-year break in service (as defined in section 203(b)(3)(A)), service before such break shall not be required to be taken into account under the plan until he has completed a year of service (as defined in subsection (a)(3)) after his return.

(4) In the case of an employee who does not have any nonforfeitable right to an accrued benefit derived from employer contributions, years of service with the employer or employers maintaining the plan before a break in service shall not be required to be taken into account in computing the period of service for purposes of subsection (a)(1) if the number of consecutive 1-year breaks in service equals or exceeds the aggregate number of such years of service before such break. Such aggregate number of years of service before such break shall be deemed not to include any years of service not required to be taken into account under this paragraph by reason of any prior break in service.

MINIMUM VESTING STANDARDS

SEC. 203. (a) Each pension plan shall provide that an employee's right to his normal retirement benefit is nonforfeitable upon the attainment of normal retirement age and in addition shall satisfy the requirements of paragraphs (1) and (2) of this subsection.

(1) A plan satisfies the requirements of this paragraph if an employee's rights in his accrued benefit derived from his own contributions are nonforfeitable.

(2) A plan satisfies the requirements of this paragraph if it satisfies the requirements of subparagraph (A), (B), or (C).

(A) A plan satisfies the requirements of this subparagraph if an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of his accrued benefit derived from employer contributions.

(B) A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions which percentage is not less than the percentage determined under the following table:

Years of service:	Nonforfeitable percentage
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100.

(C) (i) A plan satisfies the requirements of this subparagraph if a participant who is not separated from the service, who has completed at least 5 years of service, and with respect to whom the sum of his age and years of service equals or exceeds 45, has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions determined under the following table:

If years of service equal or exceed—	and sum of age and service equals or exceeds—	then the nonforfeitable percentage is—
5	45	50
6	47	60
7	49	70
8	51	80
9	53	90
10	55	100.

(ii) Notwithstanding clause (i), a plan shall not be treated as satisfying the requirements of this subparagraph unless any participant who has completed at least 10 years of service has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and to not less than an additional 10 percent for each additional year of service thereafter.

(3) (A) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that it is not payable if the participant dies (except in the case of a survivor annuity which is payable as provided in section 205).

(B) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that the payment of benefits is suspended for such period as the employee is employed, subsequent to the commencement of payment of such benefits—

(i) in the case of a plan other than a multiemployer plan, by an employer who maintains the plan under which such benefits were being paid; and

(ii) in the case of a multiemployer plan, in the same industry, in the same trade or craft, and the same geographic area covered by the plan, as when such benefits commenced.

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph, including regulations with respect to the meaning of the term "employed".

(C) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because plan amendments may be given retroactive application as provided in section 302(c)(8).

(D) (i) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that, in the case of a participant who does not have a nonforfeitable right to at least 50 percent of his accrued benefit derived from employer contributions, such accrued benefit may be forfeited on account of the withdrawal by the participant of any amount attributable to the benefit derived from mandatory contributions (as defined in the last sentence of section 204(c)(2)(C)) made by such participant.

(ii) Clause (i) shall not apply to a plan unless the plan provides that any accrued benefit forfeited under a plan provision described in such clause shall be restored upon repayment by the participant of the full amount of the withdrawal described in such clause plus, in the case of a defined benefit plan, interest. Such interest shall be computed on such amount at the rate determined for purposes of section 204(c)(2)(C) (if such subsection applies) on the date of such

repayment (computed annually from the date of such withdrawal). In the case of a defined contribution plan the plan provision required under this clause may provide that such repayment must be made before the participant has any 1-year break in service commencing after the withdrawal.

(iii) In the case of accrued benefits derived from employer contributions which accrued before the date of the enactment of this Act, a right to such accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that an amount of such accrued benefit may be forfeited on account of the withdrawal by the participant of an amount attributable to the benefit derived from mandatory contributions, made by such participant before the date of the enactment of this Act if such amount forfeited is proportional to such amount withdrawn. This clause shall not apply to any plan to which any mandatory contribution is made after the date of the enactment of this Act. The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out the purposes of this clause.

(iv) For purposes of this subparagraph, in the case of any class-year plan, a withdrawal of employee contributions shall be treated as a withdrawal of such contributions on a plan year by plan year basis in succeeding order of time.

(v) CROSS REFERENCE.—

For nonforfeitably where the employee has a nonforfeitable right to at least 50 percent of his accrued benefit, see section 206(c).

(b) (1) In computing the period of service under the plan for purposes of determining the nonforfeitable percentage under subsection (a) (2), all of an employee's years of service with the employer or employers maintaining the plan shall be taken into account, except that the following may be disregarded:

(A) years of service before age 22, except that in the case of a plan which does not satisfy subparagraph (A) or (B) of subsection (a) (2), the plan may not disregard any such year of service during which the employee was a participant;

(B) years of service during a period for which the employee declined to contribute to a plan requiring employee contributions,

(C) years of service with an employer during any period for which the employer did not maintain the plan or a predecessor plan, defined by the Secretary of the Treasury;

(D) service not required to be taken into account under paragraph (3);

(E) years of service before January 1, 1971, unless the employee has had at least 3 years of service after December 31, 1970; and

(F) years of service before this part first applies to the plan if such service would have been disregarded under the rules of the plan with regard to breaks in service, as in effect on the applicable date.

(2) (A) For purposes of this section, except as provided in subparagraph (C), the term "year of service" means a calendar year, plan year, or other 12-consecutive month period designated by the plan (and not prohibited under regulations prescribed by the Secretary) during which the participant has completed 1,000 hours of service.

(B) For purposes of this section, the term "hour of service" has the meaning provided by section 202(a) (3) (C).

(C) In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of service" shall be such period as determined under regulations of the Secretary.

(D) For purposes of this section, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary may prescribe regulations to carry out the purposes of this subparagraph.

(3)(A) For purposes of this paragraph, the term "1-year break in service" means a calendar year, plan year, or other 12-consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary) during which the participant has not completed more than 500 hours of service.

(B) For purposes of paragraph (1), in the case of any employee who has any 1-year break in service, years of service before such break shall not be required to be taken into account until he has completed a year of service after his return.

(C) For purposes of paragraph (1), in the case of any participant in an individual account plan or an insured defined benefit plan which satisfies the requirements of subsection 204(b)(1)(F) who has any 1-year break in service, years of service after such break shall not be required to be taken into account for purposes of determining the nonforfeitable percentage of his accrued benefit derived from employer contributions which accrued before such break.

(D) For purposes of paragraph (1), in the case of a participant who, under the plan, does not have any nonforfeitable right to an accrued benefit derived from employer contributions, years of service before any 1-year break in service shall not be required to be taken into account if the number of consecutive 1-year breaks in service equals or exceeds the aggregate number of such years of service prior to such break. Such aggregate number of years of service before such break shall be deemed not to include any years of service not required to be taken into account under this subparagraph by reason of any prior break in service.

(4) CROSS REFERENCES.—

(A) For definitions of "accrued benefit" and "normal retirement age", see sections 3 (23) and (24).

(B) For effect of certain cash out distributions, see section 204(d)(1).

(c)(1)(A) A plan amendment changing any vesting schedule under the plan shall be treated as not satisfying the requirements of subsection (a)(2) if the nonforfeitable percentage of the accrued benefit derived from employer contributions (determined as of the later of the date such amendment is adopted, or the date such amendment becomes effective) of any employee who is a participant in the plan is less than such nonforfeitable percentage computed under the plan without regard to such amendment.

(B) A plan amendment changing any vesting schedule under the plan shall be treated as not satisfying the requirements of subsection (a)(2) unless each participant having not less than 5 years of service is permitted to elect, within a reasonable period after adoption of such amendment, to have his nonforfeitable percentage computed under the plan without regard to such amendment.

(2) Subsection (a) shall not apply to benefits which may not be provided for designated employees in the event of early termination of the plan under provisions of the plan adopted pursuant to regulations prescribed by the Secretary of the Treasury to preclude the discrimination prohibited by section 401(a)(4) of the Internal Revenue Code of 1954.

(3) The requirements of subsection (a)(2) shall be deemed to be satisfied in the case of a class year plan if such plan provides that 100 percent of each employee's right to or derived from the contributions of the employer on his behalf with respect to any plan year are

nonforfeitable not later than the end of the 5th plan year following the plan year for which such contributions were made. For purposes of this part, the term "class year plan" means a profit sharing, stock bonus, or money purchase plan which provides for the separate nonforfeitability of employees' rights to or derived from the contributions for each plan year.

(d) A pension plan may allow for nonforfeitable benefits after a lesser period and in greater amounts than are required by this part.

BENEFIT ACCRUAL REQUIREMENTS

SEC. 204. (a) Each pension plan shall satisfy the requirements of subsection (b)(2), and in the case of a defined benefit plan shall also satisfy the requirements of subsection (b)(1).

(b)(1)(A) A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which each participant is entitled upon his separation from the service is not less than—

(i) 3 percent of the normal retirement benefit to which he would be entitled at the normal retirement age if he commenced participation at the earliest possible entry age under the plan and served continuously until the earlier of age 65 or the normal retirement age specified under the plan, multiplied by

(ii) the number of years (not in excess of 33⅓) of his participation in the plan.

In the case of a plan providing retirement benefits based on compensation during any period, the normal retirement benefit to which a participant would be entitled shall be determined as if he continued to earn annually the average rate of compensation which he earned during consecutive years of service, not in excess of 10, for which his compensation was the highest. For purposes of this suparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

(B) A defined benefit plan satisfies the requirements of this paragraph of a particular plan year if under the plan the accrued benefit payable at the normal retirement age is equal to the normal retirement benefit and the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year is not more than 133⅓ percent of the annual rate at which he can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year. For purposes of this subparagraph—

(i) any amendment to the plan which is in effect for the current year shall be treated as in effect for all other plan years;

(ii) any change in an accrual rate which does not apply to any individual who is or could be a participant in the current year shall be disregarded;

(iii) the fact that benefits under the plan may be payable to certain employees before normal retirement age shall be disregarded; and

(iv) social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after the current year.

(C) A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which any participant is entitled upon

his separation from the service is not less than a fraction of the annual benefit commencing at normal retirement age to which he would be entitled under the plan as in effect on the date of his separation if he continued to earn annually until normal retirement age the same rate of compensation upon which his normal retirement benefit would be computed under the plan, determined as if he had attained normal retirement age on the date any such determination is made (but taking into account no more than the 10 years of service immediately preceding his separation from service). Such fraction shall be a fraction, not exceeding 1, the numerator of which is the total number of his years of participation in the plan (as of the date of his separation from the service) and the denominator of which is the total number of years he would have participated in the plan if he separated from the service at the normal retirement age. For purposes of this subparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

(D) Subparagraphs (A), (B), and (C) shall not apply with respect to years of participation before the first plan year to which this section applies but a defined benefit plan satisfies the requirements of this subparagraph with respect to such years of participation only if the accrued benefit of any participant with respect to such years of participation is not less than the greater of—

(i) his accrued benefit determined under the plan, as in effect from time to time prior to the date of the enactment of this Act, or

(ii) an accrued benefit which is not less than one-half of the accrued benefit to which such participant would have been entitled if subparagraph (A), (B), or (C) applied with respect to such years of participation.

(E) Notwithstanding subparagraphs (A), (B), and (C) of this paragraph, a plan shall not be treated as not satisfying the requirements of this paragraph solely because the accrual of benefits under the plan does not become effective until the employee has two continuous years of service. For purposes of this subparagraph, the term "years of service" has the meaning provided by section 202(a)(3)(A).

(F) Notwithstanding subparagraphs (A), (B), and (C), a defined benefit plan satisfies the requirements of this paragraph if such plan—

(i) is funded exclusively by the purchase of insurance contracts, and

(ii) satisfies the requirements of paragraphs (2) and (3) of section 301(b) (relating to certain insurance contract plans),

but only if an employee's accrued benefit as of any applicable date is not less than the cash surrender value his insurance contracts would have on such applicable date if the requirements of paragraphs (4), (5), and (6) of section 301(b) were satisfied.

(G) Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if the participant's accrued benefit is reduced on account of any increase in his age or service. The preceding sentence shall not apply to benefits under the plan commencing before benefits payable under title II of the Social Security Act which benefits under the plan—

(i) do not exceed social security benefits, and

(ii) terminate when such social security benefits commence.

(2) A plan satisfies the requirements of this paragraph if—

(A) in the case of a defined benefit plan, the plan requires separate accounting for the portion of each employee's accrued benefit derived from any voluntary employee contributions permitted under the plan; and

(B) in the case of any plan which is not a defined benefit plan, the plan requires separate accounting for each employee's accrued benefit.

(3)(A) For purposes of determining an employee's accrued benefit, the term "year of participation" means a period of service (beginning at the earliest date on which the employee is a participant in the plan and which is included in a period of service required to be taken into account under section 202(b)) as determined under regulations prescribed by the Secretary which provide for the calculation of such period on any reasonable and consistent basis.

(B) For purposes of this paragraph, except as provided in subparagraph (C), in the case of any employee whose customary employment is less than full time, the calculation of such employee's service on any basis which provides less than a ratable portion of the accrued benefit to which he would be entitled under the plan if his customary employment were full time shall not be treated as made on a reasonable and consistent basis.

(C) For purposes of this paragraph, in the case of any employee whose service is less than 1,000 hours during any calendar year, plan year or other 12-consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary) the calculation of his period of service shall not be treated as not made on a reasonable and consistent basis merely because such service is not taken into account.

(D) In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of participation" shall be such period as determined under regulations prescribed by the Secretary.

(E) For purposes of this subsection in the case of any maritime industry, 125 days of service shall be treated as a year of participation. The Secretary may prescribe regulations to carry out the purposes of this subparagraph.

(c)(1) For purposes of this section and section 203 an employee's accrued benefit derived from employer contributions as of any applicable date is the excess (if any) of the accrued benefit for such employee as of such applicable date over the accrued benefit derived from contributions made by such employee as of such date.

(2)(A) In the case of a plan other than a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is—

(i) except as provided in clause (ii), the balance of the employee's separate account consisting only of his contributions and the income, expenses, gains, and losses attributable thereto, or

(ii) if a separate account is not maintained with respect to an employee's contributions under such a plan, the amount which bears the same ratio to his total accrued benefit as the total amount of the employee's contributions (less withdrawals) bears to the sum of such contributions and the contributions made on his behalf by the employer (less withdrawals).

(B)(i) In the case of a defined benefit plan providing an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the accrued benefit derived from contributions made by an employee as of any applicable date is the

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annual benefit equal to the employee's accumulated contributions multiplied by the appropriate conversion factor.

(ii) For purposes of clause (i), the term "appropriate conversion factor" means the factor necessary to convert an amount equal to the accumulated contributions to a single life annuity (without ancillary benefits) commencing at normal retirement age and shall be 10 percent for a normal retirement age of 65 years. For other normal retirement ages the conversion factor shall be determined in accordance with regulations prescribed by the Secretary of the Treasury or his delegate.

(C) For purposes of this subsection, the term "accumulated contributions" means the total of—

(i) all mandatory contributions made by the employee,

(ii) interest (if any) under the plan to the end of the last plan year to which section 203(a)(2) does not apply (by reason of the applicable effective date), and

(iii) interest on the sum of the amounts determined under clauses (i) and (ii) compounded annually at the rate of 5 percent per annum from the beginning of the first plan year to which section 203(a)(2) applies (by reason of the applicable effective date) to the date upon which the employee would attain normal retirement age.

For purposes of this subparagraph, the term "mandatory contributions" means amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.

(D) The Secretary of the Treasury is authorized to adjust by regulation the conversion factor described in subparagraph (B), the rate of interest described in clause (iii) of subparagraph (C), or both, from time to time as he may deem necessary. The rate of interest shall bear the relationship to 5 percent which the Secretary of the Treasury determines to be comparable to the relationship which the long-term money rates and investment yields for the last period of 10 calendar years ending at least 12 months before the beginning of the plan year bear to the long-term money rates and investment yields for the 10-calendar year period 1964 through 1973. No such adjustment shall be effective for a plan year beginning before the expiration of 1 year after such adjustment is determined and published.

(E) The accrued benefit derived from employee contributions shall not exceed the greater of—

(i) the employee's accrued benefit under the plan, or

(ii) the accrued benefit derived from employee contributions determined as though the amounts calculated under clauses (ii) and (iii) of subparagraph (C) were zero.

(3) For purposes of this section, in the case of any defined benefit plan, if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age, or if the accrued benefit derived from contributions made by an employee is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the employee's accrued benefit, or the accrued benefits derived from contributions made by an employee, as the case may be, shall be the actuarial equivalent of such benefit or amount determined under paragraph (1) or (2).

(4) In the case of a defined benefit plan which permits voluntary employee contributions, the portion of an employee's accrued benefit derived from such contributions shall be treated as an accrued benefit derived from employee contributions under a plan other than a defined benefit plan.

(d) Notwithstanding section 203(b)(1), for purposes of determining the employee's accrued benefit under the plan, the plan may disregard service performed by the employee with respect to which he has received—

(1) a distribution of the present value of his entire nonforfeitable benefit if such distribution was in an amount (not more than $1,750) permitted under regulations prescribed by the Secretary of the Treasury, or

(2) a distribution of the present value of his nonforfeitable benefit attributable to such service which he elected to receive.

Paragraph (1) shall apply only if such distribution was made on termination of the employee's participation in the plan. Paragraph (2) shall apply only if such distribution was made on termination of the employee's participation in the plan or under such other circumstances as may be provided under regulations prescribed by the Secretary of the Treasury.

(e) For purposes of determining the employee's accrued benefit, the plan shall not disregard service as provided in subsection (d) unless the plan provides an opportunity for the participant to repay the full amount of a distribution described in subsection (d) with, in the case of a defined benefit plan, interest at the rate determined for purposes of subsection (c)(2)(C) and provides that upon such repayment the employee's accrued benefit shall be recomputed by taking into account service so disregarded. This subsection shall apply only in the case of a participant who—

(1) received such a distribution in any plan year to which this section applies, which distribution was less than the present value of his accrued benefit,

(2) resumes employment covered under the plan, and

(3) repays the full amount of such distribution with, in the case of a defined benefit plan, interest at the rate determined for purposes of subsection (c)(2)(C).

In the case of a defined contribution plan, the plan provision required under this subsection may provide that such repayment must be made before the participant has any 1-year break in service commencing after such withdrawal.

(f) For the purposes of this part, an employer shall be treated as maintaining a plan if any employee of such employer accrues benefits under such plan by reason of service with such employer.

(g) The accrued benefit of a participant under a plan may not be decreased by an amendment of the plan, other than an amendment described in section 302(c)(8).

(h) CROSS REFERENCE.—

For special rules relating to class year plans and plan provisions adopted to preclude discrimination, see sections 203(c) (2) and (3).

JOINT AND SURVIVOR ANNUITY REQUIREMENT

SEC. 205. (a) If a pension plan provides for the payment of benefits in the form of an annuity, such plan shall provide for the payment of annuity benefits in a form having the effect of a qualified joint and survivor annuity.

(b) In the case of a plan which provides for the payment of benefits before the normal retirement age as defined in section 3(24), the plan is not required to provide for the payment of annuity benefits in a form having the effect of a qualified joint and survivor annuity during the period beginning on the date on which the employee enters into the plan as a participant and ending on the later of—

(1) the date the employee reaches the earliest retirement age, or

(2) the first day of the 120th month beginning before the date on which the employee reaches normal retirement age.

(c)(1) A plan described in subsection (b) does not meet the requirements of subsection (a) unless, under the plan, a participant has a reasonable period in which he may elect the qualified joint and survivor annuity form with respect to the period beginning on the date on which the period described in subsection (b) ends and ending on the date on which he reaches normal retirement age if he continues his employment during that period.

(2) A plan does not meet the requirements of this subsection unless, in the case of such election, the payments under the survivor annuity are not less than the payments which would have been made under the joint annuity to which the participant would have been entitled if he had made an election under this subsection immediately prior to his retirement and if his retirement had occurred on the date immediately preceding the date of his death and within the period within which an election can be made.

(d) A plan shall not be treated as not satisfying the requirements of this section solely because the spouse of the participant is not entitled to receive a survivor annuity (whether or not an election has been made under subsection (c)) unless the participant and his spouse have been married throughout the 1-year period ending on the date of such participant's death.

(e) A plan shall not be treated as satisfying the requirements of this section unless, under the plan, each participant has a reasonable period (as prescribed by the Secretary of the Treasury by regulations) before the annuity starting date during which he may elect in writing (after having received a written explanation of the terms and conditions of the joint and survivor annuity and the effect of an election under this subsection) not to take such joint and survivor annuity.

(f) A plan shall not be treated as not satisfying the requirements of this section solely because, under the plan there is a provision that any election under subsection (c) or (e), and any revocation of any such election, does not become effective (or ceases to be effective) if the participant dies within a period (not in excess of 2 years) beginning on the date of such election or revocation, as the case may be. The preceding sentence does not apply unless the plan provision described in the preceding sentence also provides that such an election or revocation will be given effect in any case in which—

(1) the participant dies from accidental causes,

(2) a failure to give effect to the election or revocation would deprive the participant's survivor of a survivor annuity, and

(3) such election or revocation is made before such accident occurred.

(g) For purposes of this section:

(1) The term "annuity starting date" means the first day of the first period for which an amount is received as an annuity (whether by reason of retirement or by reason of disability).

(2) The term "earliest retirement age" means the earliest date on which, under the plan, the participant could elect to receive retirement benefits.

(3) The term "qualified joint and survivor annuity" means an annuity for the life of the participant with a survivor annuity for the life of his spouse which is not less than one-half of, or greater than, the amount of the annuity payable during the joint lives of the participant and his spouse and which is the actuarial equivalent of a single annuity for the life of the participant.

(h) For the purposes of this section, a plan may take into account in any equitable fashion (as determined by the Secretary of the Treasury) any increased costs resulting from providing joint and survivor annuity benefits under an election made under subsection (c).

(i) This section shall apply only if—

(1) the annuity starting date did not occur before the effective date of this section, and

(2) the participant was an active participant in the plan on or after such effective date.

OTHER PROVISIONS RELATING TO FORM AND PAYMENT OF BENEFITS

SEC. 206. (a) Each pension plan shall provide that unless the participant otherwise elects, the payment of benefits under the plan to the participant shall begin not later than the 60th day after the latest of the close of the plan year in which—

(1) the date on which the participant attains the earlier of age 65 or the normal retirement age specified under the plan,

(2) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or

(3) the participant terminates his service with the employer.

In the case of a plan which provides for the payment of an early retirement benefit, such plan shall provide that a participant who satisfied the service requirements for such early retirement benefit, but separated from the service (with any nonforfeitable right to an accrued benefit) before satisfying the age requirement for such early retirement benefit, is entitled upon satisfaction of such age requirement to receive a benefit not less than the benefit to which he would be entitled at the normal retirement age, actuarially reduced under regulations prescribed by the Secretary of the Treasury.

(b) If—

(1) a participant or beneficiary is receiving benefits under a pension plan, or

(2) a participant is separated from the service and has nonforfeitable rights to benefits,

a plan may not decrease benefits of such a participant by reason of any increase in the benefit levels payable under title II of the Social Security Act or the Railroad Retirement Act of 1937, or any increase in the wage base under such title II, if such increase takes place after the date of the enactment of this Act or (if later) the earlier of the date of first entitlement of such benefits or the date of such separation.

(c) No pension plan may provide that any part of a participant's accrued benefit derived from employer contributions (whether or not otherwise nonforfeitable) is forfeitable solely because of withdrawal by such participant of any amount attributable to the benefit derived from contributions made by such participant. The preceding sentence shall not apply (1) to the accrued benefit of any participant unless, at the time of such withdrawal, such participant has a nonforfeitable right to at least 50 percent of such accrued benefit, or (2) to the extent that an accrued benefit is permitted to be forfeited in accordance with section 203(a)(3)(D)(iii).

(d)(1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.

(2) For the purposes of paragraph (1) of this subsection, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment, or of any irrevocable assignment or alienation of benefits executed before the

date of enactment of this Act. The preceding sentence shall not apply to any assignment or alienation made for the purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 of the Internal Revenue Code of 1954 (relating to tax on prohibited transactions) by reason of section 4975(d)(1) of such Code.

TEMPORARY VARIANCES FROM CERTAIN VESTING REQUIREMENTS

SEC. 207. In the case of any plan maintained on January 1, 1974, if, not later than 2 years after the date of enactment of this Act, the administrator petitions the Secretary, the Secretary may prescribe an alternate method which shall be treated as satisfying the requirements of section 203(a)(2) or 204(b)(1) (other than subparagraph (D) thereof) or both for a period of not more than 4 years. The Secretary may prescribe such alternate method only when he finds that—

(1) the application of such requirements would increase the costs of the plan to such an extent that there would result a substantial risk to the voluntary continuation of the plan or a substantial curtailment of benefit levels or the levels of employees' compensation,

(2) the application of such requirements or discontinuance of the plan would be adverse to the interests of plan participants in the aggregate, and

(3) a waiver or extension of time granted under section 303 or 304 of this Act would be inadequate.

In the case of any plan with respect to which an alternate method has been prescribed under the preceding provisions of this subsection for a period of not more than 4 years, if, not later than 1 year before the expiration of such period, the administrator petitions the Secretary for an extension of such alternate method, and the Secretary makes the findings required by the preceding sentence, such alternate method may be extended for not more than 3 years.

MERGERS AND CONSOLIDATIONS OF PLANS OR TRANSFERS OF PLAN ASSETS

SEC. 208. A pension plan may not merge or consolidate with, or transfer its assets or liabilities to, any other plan after the date of the enactment of this Act, unless each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). This paragraph shall apply in the case of a multiemployer plan only to the extent determined by the Pension Benefit Guaranty Corporation.

RECORDKEEPING AND REPORTING REQUIREMENTS

SEC. 209. (a)(1) Except as provided by paragraph (2) every employer shall, in accordance with regulations prescribed by the Secretary, maintain records with respect to each of his employees sufficient to determine the benefits due or which may become due to such employees. The plan administrator shall make a report, in such manner and at such time as may be provided in regulations prescribed by the

Secretary, to each employee who is a participant under the plan and who—

(A) requests such report, in such manner and at such time as may be provided in such regulations,

(B) terminates his service with the employer, or

(C) has a 1-year break in service (as defined in section 203 (b)(3)(A)).

The employer shall furnish to the plan administrator the information necessary for the administrator to make the reports required by the preceding sentence. Not more than one report shall be required under subparagraph (A) in any 12-month period. Not more than one report shall be required under subparagraph (C) with respect to consecutive 1-year breaks in service. The report required under this paragraph shall be sufficient to inform the employee of his accrued benefits under the plan and the percentage of such benefits which are nonforfeitable under the plan.

(2) If more than one employer adopts a plan, each such employer shall, in accordance with regulations prescribed by the Secretary, furnish to the plan administrator the information necessary for the administrator to maintain the records and make the reports required by paragraph (1). Such administrator shall maintain the records and, to the extent provided under regulations prescribed by the Secretary, make the reports, required by paragraph (1).

(b) If any person who is required, under subsection (a), to furnish information or maintain records for any plan year fails to comply with such requirement, he shall pay to the Secretary a civil penalty of $10 for each employee with respect to whom such failure occurs, unless it is shown that such failure is due to reasonable cause.

PLANS MAINTAINED BY MORE THAN ONE EMPLOYER, PREDECESSOR PLANS, AND EMPLOYER GROUPS

SEC. 210. (a) Notwithstanding any other provision of this part or part 3, the following provisions of this subsection shall apply to a plan maintained by more than one employer:

(1) Section 202 shall be applied as if all employees of each of the employers were employed by a single employer.

(2) Sections 203 and 204 shall be applied as if all such employers constituted a single employer, except that the application of any rules with respect to breaks in service shall be made under regulations prescribed by the Secretary.

(3) The minimum funding standard provided by section 302 shall be determined as if all participants in the plan were employed by a single employer.

(b) For purposes of this part and part 3—

(1) in any case in which the employer maintains a plan of a predecessor employer, service for such predecessor shall be treated as service for the employer, and

(2) in any case in which the employer maintains a plan which is not the plan maintained by a predecessor employer, service for such predecessor shall, to the extent provided in regulations prescribed by the Secretary of the Treasury, be treated as service for the employer.

(c) For purposes of sections 202, 203, and 204, all employees of all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) of the Internal Revenue Code of 1954, determined without regard to section 1563(a)(4) and (e)(3)(C) of such code) shall be treated as employed by a single employer.

With respect to a plan adopted by more than one such corporation, the minimum funding standard of section 302 shall be determined as if all such employers were a single employer, and allocated to each employer in accordance with regulations prescribed by the Secretary of the Treasury.

(d) For purposes of sections 202, 203, and 204, under regulations prescribed by the Secretary of the Treasury, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer. The regulations prescribed under this subsection shall be based on principles similar to the principles which apply in the case of subsection (c).

EFFECTIVE DATES

SEC. 211. (a) Except as otherwise provided in this section, this part shall apply in the case of plan years beginning after the date of the enactment of this Act.

(b)(1) Except as otherwise provided in subsection (d), sections 205, 206(d), and 208 shall apply with respect to plan years beginning after December 31, 1975.

(2) Except as otherwise provided in subsections (c) and (d) in the case of a plan in existence on January 1, 1974, this part shall apply in the case of plan years beginning after December 31, 1975.

(c)(1) In the case of a plan maintained on January 1, 1974, pursuant to one or more agreements which the Secretary finds to be collective bargaining agreements between employee organizations and one or more employers, no plan shall be treated as not meeting the requirements of sections 204 and 205 solely by reason of a supplementary or special plan provision (within the meaning of paragraph (2)) for any plan year before the year which begins after the earlier of—

(A) the date on which the last of such agreements relating to the plan terminates (determined without regard to any extension thereof agreed to after the date of the enactment of this Act), or

(B) December 31, 1980.

For purposes of subparagraph (A) and section 306(c), any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement contained in this Act or the Internal Revenue Code of 1954 shall not be treated as a termination of such collective bargaining agreement. This paragraph shall not apply unless the Secretary determines that the participation and vesting rules in effect on the date of enactment of this Act are not less favorable to participants, in the aggregate, than the rules provided under sections 202, 203, and 204.

(2) For purposes of paragraph (1), the term "supplementary or special plan provision" means any plan provision which—

(A) provides supplementary benefits, not in excess of one-third of the basic benefit, in the form of an annuity for the life of the participant, or

(B) provides that, under a contractual agreement based on medical evidence as to the effects of working in an adverse environment for an extended period of time, a participant having 25 years of service is to be treated as having 30 years of service.

(3) This subsection shall apply with respect to a plan if (and only if) the application of this subsection results in a later effective date for this part than the effective date required by subsection (b).

(d) If the administrator of a plan elects under section 1017(d) of this Act to make applicable to a plan year and to all subsequent plan years the provisions of the Internal Revenue Code of 1954 relating to

participation, vesting, funding, and form of benefit, this part shall apply to the first plan year to which such election applies and to all subsequent plan years.

(e) (1) No pension plan to which section 202 applies may make effective any plan amendment with respect to breaks in service (which amendment is made or becomes effective after January 1, 1974, and before the date on which section 202 first becomes effective with respect to such plan) which provides that any employee's participation in the plan would commence at any date later than the later of—

(A) the date on which his participation would commence under the break in service rules of section 202(b), or

(B) the date on which his participation would commence under the plan as in effect on January 1, 1974.

(2) No pension plan to which section 203 applies may make effective any plan amendment with respect to breaks in service (which amendment is made or becomes effective after January 1, 1974, and before the date on which section 203 first becomes effective with respect to such plan) if such amendment provides that the nonforfeitable benefit derived from employer contributions to which any employee would be entitled is less than the lesser of the nonforfeitable benefit derived from employer contributions to which he would be entitled under—

(A) the break in service rules of section 202(b)(3), or

(B) the plan as in effect on January 1, 1974.

Subparagraph (B) shall not apply if the break in service rules under the plan would have been in violation of any law or rule of law in effect on January 1, 1974.

Part 3—Funding

coverage

Sec. 301. (a) This part shall apply to any employee pension benefit plan described in section 4(a), (and not exempted under section 4(b)), other than—

(1) an employee welfare benefit plan;

(2) an insurance contract plan described in subsection (b);

(3) a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;

(4) (A) a plan which is established and maintained by a society, order, or association described in section 501(c) (8) or (9) of the Internal Revenue Code of 1954, if no part of the contributions to or under such plan are made by employers of participants in such plan; or

(B) a trust described in section 501(c)(18) of such Code;

(5) a plan which has not at any time after the date of enactment of this Act provided for employer contributions;

(6) an agreement providing payments to a retired partner or deceased partner or a deceased partner's successor in interest as described in section 736 of the Internal Revenue Code of 1954;

(7) an individual retirement account or annuity as described in section 408(a) of the Internal Revenue Code of 1954, or a retirement bond described in section 409 of such Code;

(8) an individual account plan (other than a money purchase plan) and a defined benefit plan to the extent it is treated as an individual account plan (other than a money purchase plan) under section 3(35)(B) of this title; or

(9) an excess benefit plan.

(b) For the purposes of paragraph (2) of subsection (a) a plan is an "insurance contract plan" if—

(1) the plan is funded exclusively by the purchase of individual insurance contracts,

(2) such contracts provide for level annual premium payments to be paid extending not later than the retirement age for each individual participating in the plan, and commencing with the date the individual became a participant in the plan (or, in the case of an increase in benefits, commencing at the time such increase becomes effective),

(3) benefits provided by the plan are equal to the benefits provided under each contract at normal retirement age under the plan and are guaranteed by an insurance carrier (licensed under the laws of a State to do business with the plan) to the extent premiums have been paid,

(4) premiums payable for the plan year, and all prior plan years under such contracts have been paid before lapse or there is reinstatement of the policy,

(5) no rights under such contracts have been subject to a security interest at any time during the plan year, and

(6) no policy loans are outstanding at any time during the plan year.

A plan funded exclusively by the purchase of group insurance contracts which is determined under regulations prescribed by the Secretary of the Treasury to have the same characteristics as contracts described in the preceding sentence shall be treated as a plan described in this subsection.

MINIMUM FUNDING STANDARDS

SEC. 302. (a)(1) Every employee pension benefit plan subject to this part shall satisfy the minimum funding standard (or the alternative minimum funding standard under section 305) for any plan year to which this part applies. A plan to which this part applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year the plan does not have an accumulated funding deficiency.

(2) For the purposes of this part, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this part applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years.

(b)(1) Each plan to which this part applies shall establish and maintain a funding standard account. Such account shall be credited and charged solely as provided in this section.

(2) For a plan year, the funding standard account shall be charged with the sum of—

(A) the normal cost of the plan for the plan year,

(B) the amounts necessary to amortize in equal annual installments (until fully amortized)—

(i) in the case of a plan in existence on January 1, 1974, the unfunded past service liability under the plan on the first day of the first plan year to which this part applies, over a period of 40 plan years,

(ii) in the case of a plan which comes into existence after January 1, 1974, the unfunded past service liability under the plan on the first day of the first plan year to which this

part applies, over a period of 30 plan years (40 plan years in the case of a multiemployer plan),

(iii) separately, with respect to each plan year, the net increase (if any) in unfunded past service liability under the plan arising from plan amendments adopted in such year, over a period of 30 plan years (40 plan years in the case of a multiemployer plan),

(iv) separately, with respect to each plan year, the net experience loss (if any) under the plan, over a period of 15 plan years (20 plan years in the case of a multiemployer plan), and

(v) separately, with respect to each plan year, the net loss (if any) resulting from changes in actuarial assumptions used under the plan, over a period of 30 plan years,

(C) the amount necessary to amortize each waived funding deficiency (within the meaning of section 303 (c)) for each prior plan year in equal annual installments (until fully amortized) over a period of 15 plan years, and

(D) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 5 plan years any amount credited to the funding standard account under paragraph (3)(D).

(3) For a plan year, the funding standard account shall be credited with the sum of—

(A) the amount considered contributed by the employer to or under the plan for the plan year,

(B) the amount necessary to amortize in equal annual installments (until fully amortized)—

(i) separately, with respect to each plan year, the net decrease (if any) in unfunded past service liability under the plan arising from plan amendments adopted in such year, over a period of 30 plan years (40 plan years in the case of a multiemployer plan),

(ii) separately, with respect to each plan year, the net experience gain (if any) under the plan, over a period of 15 plan years (20 plan years in the case of a multiemployer plan), and

(iii) separately, with respect to each plan year, the net gain (if any) resulting from changes in actuarial assumptions used under the plan, over a period of 30 plan years.

(C) the amount of the waived funding deficiency (within the meaning of section 303(c)) for the plan year, and

(D) in the case of a plan year for which the accumulated funding deficiency is determined under the funding standard account if such plan year follows a plan year for which such deficiency was determined under the alternative minimum funding standard, the excess (if any) of any debit balance in the funding standard account (determined without regard to this subparagraph) over any debit balance in the alternative minimum funding standard account.

(4) Under regulations prescribed by the Secretary of the Treasury, amounts required to be amortized under paragraph (2) or paragraph (3), as the case may be—

(A) may be combined into one amount under such paragraph to be amortized over a period determined on the basis of the remaining amortization period for all items entering into such combined amount, and

(B) may be offset against amounts required to be amortized under the other such paragraph, with the resulting amount to be amortized over a period determined on the basis of the remaining amortization periods for all items entering into whichever of the two amounts being offset is the greater.

(5) The funding standard account (and items therein) shall be charged or credited (as determined under regulations prescribed by the Secretary of the Treasury) with interest at the appropriate rate consistent with the rate or rates of interest used under the plan to determine costs.

(c)(1) For purposes of this part, normal costs, accrued liability, past service liabilities, and experience gains and losses shall be determined under the funding method used to determine costs under the plan.

(2)(A) For purposes of this part, the value of the plan's assets shall be determined on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under regulations prescribed by the Secretary of the Treasury.

(B) For purposes of this part, the value of a bond or other evidence of indebtedness which is not in default as to principal or interest may, at the election of the plan administrator, be determined on an amortized basis running from initial cost at purchase to par value at maturity or earliest call date. Any election under this subparagraph shall be made at such time and in such manner as the Secretary of the Treasury shall by regulations provide, shall apply to all such evidences of indebtedness, and may be revoked only with the consent of the Secretary of the Treasury.

(3) For purposes of this part, all costs, liabilities, rates of interest, and other factors under the plan shall be determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer the actuary's best estimate of anticipated experience under the plan.

(4) For purposes of this section, if—

(A) a change in benefits under the Social Security Act or in other retirement benefits created under Federal or State law, or

(B) a change in the definition of the term "wages" under section 3121 of the Internal Revenue Code of 1954, or a change in the amount of such wages taken into account under regulations prescribed for purposes of section 401(a)(5) of the Internal Revenue Code of 1954,

results in an increase or decrease in accrued liability under a plan, such increase or decrease shall be treated as an experience loss or gain.

(5) If the funding method for a plan is changed, the new funding method shall become the funding method used to determine costs and liabilities under the plan only if the change is approved by the Secretary of the Treasury. If the plan year for a plan is changed, the new plan year shall become the plan year for the plan only if the change is approved by the Secretary of the Treasury.

(6) If, as of the close of a plan year, a plan would (without regard to this paragraph) have an accumulated funding deficiency (determined without regard to the alternative minimum funding standard account permitted under subsection (g)) in excess of the full funding limitation—

(A) the funding standard account shall be credited with the amount of such excess, and

(B) all amounts described in paragraphs (2), (B), (C), and (D) and (3)(B) of subsection (b) which are required to be amor-

tized shall be considered fully amortized for purposes of such paragraphs.

(7) For purposes of paragraph (6), the term "full funding limitation" means the excess (if any) of—

(A) the accrued liability (including normal cost) under the plan (determined under the entry age normal funding method if such accrued liability cannot be directly calculated under the funding method used for the plan), over

(B) the lesser of the fair market value of the plan's assets or the value of such assets determined under paragraph (2).

(8) For purposes of this part, any amendment applying to a plan year which—

(A) is adopted after the close of such plan year but no later than 2½ months after the close of the plan year (or, in the case of a multiemployer plan, no later than 2 years after the close of such plan year),

(B) does not reduce the accrued benefit of any participant determined as of the beginning of the first plan year to which the amendment applies, and

(C) does not reduce the accrued benefit of any participant determined as of the time of adoption except to the extent required by the circumstances,

shall, at the election of the plan administrator, be deemed to have been made on the first day of such plan year. No amendment described in this paragraph which reduces the accrued benefits of any participant shall take effect unless the plan administrator files a notice with the Secretary notifying him of such amendment and the Secretary has approved such amendment or, within 90 days after the date on which such notice was filed, failed to disapprove such amendment. No amendment described in this subsection shall be approved by the Secretary unless he determines that such amendment is necessary because of a substantial business hardship (as determined under section 303(b)) and that waiver under section 303(a) is unavailable or inadequate.

(9) For purposes of this part, a determination of experience gains and losses and a valuation of the plan's liability shall be made not less frequently than once every 3 years, except that such determination shall be made more frequently to the extent required in particular cases under regulations prescribed by the Secretary of the Treasury.

(10) For purposes of this part, any contributions for a plan year made by an employer after the last day of such plan year, but not later than 2½ months after such day, shall be deemed to have been made on such last day. For purposes of this paragraph, such 2½ month period may be extended for not more than 6 months under regulations prescribed by the Secretary of the Treasury.

(d) CROSS REFERENCE.—For alternative amortization method for certain multiemployer plans see section 1013(d) of this Act.

VARIANCE FROM MINIMUM FUNDING STANDARD

SEC. 303. (a) If an employer, or in the case of a multiemployer plan, 10 percent or more of the number of employers contributing to or under the plan are unable to satisfy the minimum funding standard for a plan year without substantial business hardship and if application of the standard would be adverse to the interests of plan participants in the aggregate, the Secretary of the Treasury may waive the requirements of section 302(a) for such year with respect to all or any portion of the minimum funding standard other than the portion thereof determined under section 302(b)(2)(C). The Secretary of the Treasury shall not waive the minimum funding standard with respect to a plan for more than 5 of any 15 consecutive plan years.

(b) For purposes of this part, the factors taken into account in determining substantial business hardship shall include (but shall not be limited to) whether—

(1) the employer is operating at an economic loss,

(2) there is substantial unemployment or underemployment in the trade or business and in the industry concerned,

(3) the sales and profits of the industry concerned are depressed or declining, and

(4) it is reasonable to expect that the plan will be continued only if the waiver is granted.

(c) For purposes of this part, the term "waived funding deficiency" means the portion of the minimum funding standard (determined without regard to subsection (b)(3)(C) of section 302) for a plan year waived by the Secretary of the Treasury and not satisfied by employer contributions.

(d) CROSS REFERENCE.—

For corresponding duties of the Secretary of the Treasury with regard to implementation of the Internal Revenue Code of 1954, see section 412(d) of such Code.

EXTENSION OF AMORTIZATION PERIODS

SEC. 304. (a) The period of years required to amortize any unfunded liability (described in any clause of subsection (b)(2)(B) of section 302) of any plan may be extended by the Secretary for a period of time (not in excess of 10 years) if he determines that such extension would carry out the purposes of this Act and would provide adequate protection for participants under the plan and their beneficiaries and if he determines that the failure to permit such extension would—

(1) result in—

(A) a substantial risk to the voluntary continuation of the plan, or

(B) a substantial curtailment of pension benefit levels or employee compensation, and

(2) be adverse to the interests of plan participants in the aggregate.

(b)(1) No amendment of the plan which increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits become nonforfeitable under the plan shall be adopted if a waiver under section 303(a) or an extension of time under subsection (a) of this section is in effect with respect to the plan, or if a plan amendment described in section 302(c)(8) has been made at any time in the preceding 12 months (24 months in the case of a multiemployer plan). If a plan is amended in violation of the preceding sentence, any such waiver, or extension of time, shall not apply to any plan year ending on or after the date on which such amendment is adopted.

(2) Paragraph (1) shall not apply to any plan amendment which—

(A) the Secretary determines to be reasonable and which provides for only de minimis increases in the liabilities of the plan.

(B) only repeals an amendment described in section 302(c)(8), or

(C) is required as a condition of qualification under part I of subchapter D, of chapter 1, of the Internal Revenue Code of 1954.

ALTERNATIVE MINIMUM FUNDING STANDARD

SEC. 305. (a) A plan which uses a funding method that requires contributions in all years not less than those required under the entry age normal funding method may maintain an alternative minimum funding standard account for any plan year. Such account shall be credited and charged solely as provided in this section.

(b) For a plan year the alternative minimum funding standard accounts shall be

(1) charged with the sum of—

(A) the lesser of normal cost under the funding method used under the plan or normal cost determined under the unit credit method,

(B) the excess, if any, of the present value of accrued benefits under the plan over the fair market value of the assets, and

(C) an amount equal to the excess, if any, of credits to the alternative minimum funding standard account for all prior plan years over charges to such account for all such years, and

(2) credited with the amount considered contributed by the employer to or under the plan (within the meaning of section 302(c)(10)) for the plan year.

(c) The alternative minimum funding standard account (and items therein) shall be charged or credited with interest in the manner provided under section 302(b)(5) with respect to the funding standard account.

EFFECTIVE DATES

SEC. 306. (a) Except as otherwise provided in this section, this part shall apply in the case of plan years beginning after the date of the enactment of this Act.

(b) Except as otherwise provided in subsections (c) and (d), in the case of a plan in existence on January 1, 1974, this part shall apply in the case of plan years beginning after December 31, 1975.

(c) (1) In the case of a plan maintained on January 1, 1974, pursuant to one or more agreements which the Secretary finds to be collective bargaining agreements between employee representatives and one or more employers, this part shall apply only with respect to plan years beginning after the earlier of the date specified in subparagraph (A) or (B) of section 211(c)(1).

(2) This subsection shall apply with respect to a plan if (and only if) the application of this subsection results in a later effective date for this part than the effective date required by subsection (b).

(d) In the case of a plan the administrator of which elects under section 1017(d) of this Act to have the provisions of the Internal Revenue Code of 1954 relating to participation, vesting, funding, and form of benefit to apply to a plan year and to all subsequent plan years, this part shall apply to plan years beginning on the earlier of the first plan year to which such election applies or the first plan year determined under subsections (a), (b), and (c) of this section.

(e) In the case of a plan maintained by a labor organization which is exempt from tax under section 501(c)(5) of the Internal Revenue Code of 1954 exclusively for the benefit of its employees and their beneficiaries, this part shall be applied by substituting for the term "December 31, 1975" in subsection (b), the earlier of—

(1) the date on which the second convention of such labor organization held after the date of the enactment of this Act ends, or

(2) December 31, 1980,

but in no event shall a date earlier than the later of December 31, 1975, or the date determined under subsection (c) be substituted.

PART 4—FIDUCIARY RESPONSIBILITY

COVERAGE

SEC. 401. (a) This part shall apply to any employee benefit plan described in section 4(a) (and not exempted under section 4(b)), other than—

(1) a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees; or

(2) any agreement described in section 736 of the Internal Revenue Code of 1954, which provides payments to a retired partner or deceased partner or a deceased partner's successor in interest.

(b) For purposes of this part:

(1) In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company.

(2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph:

(A) The term "insurer" means an insurance company, insurance service, or insurance organization, qualified to do business in a State.

(B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

ESTABLISHMENT OF PLAN

SEC. 402. (a)(1) Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.

(2) For purposes of this title, the term "named fiduciary" means a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary (A) by a person who is an employer or employee organization with respect to the plan or (B) by such an employer and such an employee organization acting jointly.

(b) Every employee benefit plan shall—

(1) provide a procedure for establishing and carrying out a funding policy and method consistent with the objectives of the plan and the requirements of this title,

(2) describe any procedure under the plan for the allocation of responsibilities for the operation and administration of the plan (including any procedure described in section 405(c)(1)),

(3) provide a procedure for amending such plan, and for identifying the persons who have authority to amend the plan, and

(4) specify the basis on which payments are made to and from the plan.

(c) Any employee benefit plan may provide—

(1) that any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and administrator);

(2) that a named fiduciary, or a fiduciary designated by a named fiduciary pursuant to a plan procedure described in section 405(c)(1), may employ one or more persons to render advice with regard to any responsibility such fiduciary has under the plan; or

(3) that a person who is a named fiduciary with respect to control or management of the assets of the plan may appoint an investment manager or managers to manage (including the power to acquire and dispose of) any assets of a plan.

ESTABLISHMENT OF TRUST

SEC. 403. (a) Except as provided in subsection (b), all assets of an employee benefit plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument described in section 402(a) or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—

(1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this title, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 402(c)(3).

(b) The requirements of subsection (a) of this section shall not apply—

(1) to any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a State;

(2) to any assets of such an insurance company or any assets of a plan which are held by such an insurance company;

(3) to a plan—

(i) some or all of the participants of which are employees described in section 401(c)(1) of the Internal Revenue Code of 1954; or

(ii) which consists of one or more individual retirement accounts described in section 408 of the Internal Revenue Code of 1954, to the extent that such plan's assets are held in one or more custodial accounts which qualify under section 401(f) or 408(h) of such Code, whichever is applicable;

(4) to a plan which the Secretary exempts from the requirement of subsection (a) and which is not subject to any of the following provisions of this Act—

(A) part 2 of this subtitle,

(B) part 3 of this subtitle, or

(C) title IV of this Act; or

(5) to a contract established and maintained under section 403(b) of the Internal Revenue Code of 1954 to the extent that the assets of the contract are held in one or more custodial accounts pursuant to section 403(b)(7) of such Code.

(c)(1) Except as provided in paragraph (2) or (3) or subsection (d), or under section 4042 and 4044 (relating to termination of insured plans), the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

(2)(A) In the case of a contribution which is made by an employer by a mistake of fact, paragraph (1) shall not prohibit the return of such contribution to the employer within one year after the payment of the contribution.

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(B) If a contribution is conditioned on qualification of the plan under section 401, 403(a), or 405(a) of the Internal Revenue Code of 1954, and if the plan does not qualify, then paragraph (1) shall not prohibit the return of such contribution to the employer within one year after the date of denial of qualification of the plan.

(C) If a contribution is conditioned upon the deductibility of the contribution under section 404 of the Internal Revenue Code of 1954, then, to the extent the deduction is disallowed, paragraph (1) shall not prohibit the return to the employer of such contribution (to the extent disallowed) within one year after the disallowance of the deduction.

(3) In the case of a contribution which would otherwise be an excess contribution (as defined in section 4972(b) of the Internal Revenue Code of 1954) paragraph (1) shall not prohibit a correcting distribution with respect to such contribution from the plan to the employer to the extent permitted in such section to avoid payment of an excise tax on excess contributions under such section.

(d)(1) Upon termination of a pension plan to which section 4021 does not apply at the time of termination and to which this part applies (other than a plan to which no employer contributions have been made) the assets of the plan shall be allocated in accordance with the provisions of section 4044 of this Act, except as otherwise provided in regulations of the Secretary.

(2) The assets of a welfare plan which terminates shall be distributed in accordance with the terms of the plan, except as otherwise provided in regulations of the Secretary.

FIDUCIARY DUTIES

SEC. 404. (a)(1) Subject to sections 403 (c) and (d), 4042, and 4044, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title.

(2) In the case of an eligible individual account plan (as defined in section 407(d)(3)), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 407(d)(4) and (5)).

(b) Except as authorized by the Secretary by regulation, no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States.

(c) In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over assets in his account, if a participant or beneficiary exercises con-

trol over the assets in his account (as determined under regulations of the Secretary)—

(1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and

(2) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

LIABILITY FOR BREACH BY CO-FIDUCIARY

SEC. 405. (a) In addition to any liability which he may have under any other provision of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

(1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

(2) if, by his failure to comply with section 404(a)(1) in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or

(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

(b)(1) Except as otherwise provided in subsection (d) and in section 403(a) (1) and (2), if the assets of a plan are held by two or more trustees—

(A) each shall use reasonable care to prevent a co-trustee from committing a breach; and

(B) they shall jointly manage and control the assets of the plan, except that nothing in this subparagraph (B) shall preclude any agreement, authorized by the trust instrument, allocating specific responsibilities, obligations, or duties among trustees, in which event a trustee to whom certain responsibilities, obligations, or duties have not been allocated shall not be liable by reason of this subparagraph (B) either individually or as a trustee for any loss resulting to the plan arising from the acts or omissions on the part of another trustee to whom such responsibilities, obligations, or duties have been allocated.

(2) Nothing in this subsection shall limit any liability that a fiduciary may have under subsection (a) or any other provision of this part.

(3)(A) In the case of a plan the assets of which are held in more than one trust, a trustee shall not be liable under paragraph (1) except with respect to an act or omission of a trustee of a trust of which he is a trustee.

(B) No trustee shall be liable under this subsection for following instructions referred to in section 403(a)(1).

(c)(1) The instrument under which a plan is maintained may expressly provide for procedures (A) for allocating fiduciary responsibilities (other than trustee responsibilities) among named fiduciaries, and (B) for named fiduciaries to designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan.

(2) If a plan expressly provides for a procedure described in paragraph (1), and pursuant to such procedure any fiduciary responsibility of a named fiduciary is allocated to any person, or a person is designated to carry out any such responsibility, then such named fiduciary

shall not be liable for an act or omission of such person in carrying out such responsibility except to the extent that—

(A) the named fiduciary violated section 404(a)(1)—

(i) with respect to such allocation or designation,

(ii) with respect to the establishment or implementation of the procedure under paragraph (1), or

(iii) in continuing the allocation or designation; or

(B) the named fiduciary would otherwise be liable in accordance with subsection (a).

(3) For purposes of this subsection, the term "trustee responsibility" means any responsibility provided in the plan's trust instrument (if any) to manage or control the assets of the plan, other than a power under the trust instrument of a named fiduciary to appoint an investment manager in accordance with section 402(c)(3).

(d)(1) If an investment manager or managers have been appointed under section 402(c)(3), then, notwithstanding subsections (a) (2) and (3) and subsection (b), no trustee shall be liable for the acts or omissions of such investment manager or managers, or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager.

(2) Nothing in this subsection shall relieve any trustee of any liability under this part for any act of such trustee.

PROHIBITED TRANSACTIONS

SEC. 406. (a) Except as provided in section 408:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a).

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 407(a).

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

(c) A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a party-in-interest placed

on the property within the 10-year period ending on the date of the transfer.

10 PERCENT LIMITATION WITH RESPECT TO ACQUISITION AND HOLDING OF EMPLOYER SECURITIES AND EMPLOYER REAL PROPERTY BY CERTAIN PLANS

SEC. 407. (a) Except as otherwise provided in this section and section 414:

(1) A plan may not acquire or hold—

(A) any employer security which is not a qualifying employer security, or

(B) any employer real property which is not qualifying employer real property.

(2) A plan may not acquire any qualifying employer security or qualifying employer real property, if immediately after such acquisition the aggregate fair market value of employer securities and employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

(3)(A) After December 31, 1984, a plan may not hold any qualifying employer securities or qualifying employer real property (or both) to the extent that the aggregate fair market value of such securities and property determined on December 31, 1984, exceeds 10 percent of the greater of—

(i) the fair market value of the assets of the plan, determined on December 31, 1984, or

(ii) the fair market value of the assets of the plan determined on January 1, 1975.

(B) Subparagraph (A) of this paragraph shall not apply to any plan which on any date after December 31, 1974; and before January 1, 1985, did not hold employer securities or employer real property (or both) the aggregate fair market value of which determined on such date exceeded 10 percent of the greater of

(i) the fair market value of the assets of the plan, determined on such date, or

(ii) the fair market value of the assets of the plan determined on January 1, 1975.

(4)(A) After December 31, 1979, a plan may not hold any employer securities or employer real property in excess of the amount specified in regulations under subparagraph (B). This subparagraph shall not apply to a plan after the earliest date after December 31, 1974, on which it complies with such regulations.

(B) Not later than December 31, 1976, the Secretary shall prescribe regulations which shall have the effect of requiring that a plan divest itself of 50 percent of the holdings of employer securities and employer real property which the plan would be required to divest before January 1, 1985, under paragraph (2) or subsection (c) (whichever is applicable).

(b)(1) Subsection (a) of this section shall not apply to any acquisition or holding of qualifying employer securities or qualifying employer real property by an eligible individual account plan.

(2) CROSS REFERENCES.—

(A) For exemption from diversification requirements for holding of qualifying employer securities and qualifying employer real property by eligible individual account plans, see section 404(a)(2).

(B) For exemption from prohibited transactions for certain acquisitions of qualifying employer securities and qualifying employer real property which are not in violation of 10 percent limitation, see section 408(e).

(C) For transitional rules respecting securities or real property subject to binding contracts in effect on June 30, 1974, see section 414(c).

(c)(1) A plan which makes the election, under paragraph (3) shall be treated as satisfying the requirement of subsection (a)(3) if and only if employer securities held on any date after December 31, 1974 and before January 1, 1985 have a fair market value, determined as of December 31, 1974, not in excess of 10 percent of the lesser of—

(A) the fair market value of the assets of the plan determined on such date (disregarding any portion of the fair market value of employer securities which is attributable to appreciation of such securities after December 31, 1974) but not less than the fair market value of plan assets on January 1, 1975, or

(B) an amount equal to the sum of (i) the total amount of the contributions to the plan received after December 31, 1974, and prior to such date, plus (ii) the fair market value of the assets of the plan, determined on January 1, 1975.

(2) For purposes of this subsection, in the case of an employer security held by a plan after January 1, 1975, the ownership of which is derived from ownership of employer securities held by the plan on January 1, 1975, or from the exercise of rights derived from such ownership, the value of such security held after January 1, 1975, shall be based on the value as of January 1, 1975, of the security from which ownership was derived. The Secretary shall prescribe regulations to carry out this paragraph.

(3) An election under this paragraph may not be made after December 31, 1975. Such an election shall be made in accordance with regulations prescribed by the Secretary, and shall be irrevocable. A plan may make an election under this paragraph only if on January 1, 1975, the plan holds no employer real property. After such election and before January 1, 1985 the plan may not acquire any employer real property.

(d) For purposes of this section—

(1) The term "employer security" means a security issued by an employer of employees covered by the plan, or by an affiliate of such employer. A contract to which section 408(b)(5) applies shall not be treated as a security for purposes of this section.

(2) The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan, or to an affiliate of such employer. For purposes of determining the time at which a plan acquires employer real property for purposes of this section, such property shall be deemed to be acquired by the plan on the date on which the plan acquires the property or on the date on which the lease to the employer (or affiliate) is entered into, whichever is later.

(3)(A) The term "eligible individual account plan" means an individual account plan which is (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on the date of enactment of this Act and which on such date invested primarily in qualifying employer securities. Such term excludes an individual retirement account or annuity described in section 408 of the Internal Revenue Code of 1954.

(B) Notwithstanding subparagraph (A), a plan shall be treated as an eligible individual account plan with respect to the acquisition or holding of qualifying employer real property or qualifying employer securities only if such plan explicitly provides for acquisition and holding of qualifying employer securities or qualifying employer real property (as the case may be). In the case of a plan in existence on the date of enactment of this Act, this subparagraph shall not take effect until January 1, 1976.

(4) The term "qualifying employer real property" means parcels of employer real property—

(A) if a substantial number of the parcels are dispersed geographically;

(B) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use;

(C) even if all of such real property is leased to one lessee (which may be an employer, or an affiliate of an employer); and

(D) if the acquisition and retention of such property comply with the provisions of this part (other than section 404(a)(1)(B) to the extent it requires diversification, and sections 404(a)(1)(C), 406, and subsection (a) of this section).

(5) The term "qualifying employer security" means an employer security which is stock or a marketable obligation (as defined in subsection (e)).

(6) The term "employee stock ownership plan" means an individual account plan—

(A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase both of which are qualified, under section 401 of the Internal Revenue Code of 1954, and which is designed to invest primarily in qualifying employee securities, and

(B) which meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

(7) A corporation is an affiliate of an employer if it is a member of any controlled group of corporations (as defined in section 1563(a) of the Internal Revenue Code of 1954, except that "applicable percentage" shall be substituted for "80 percent" wherever the latter percentage appears in such section) of which the employer who maintains the plan is a member. For purposes of the preceding sentence, the term "applicable percentage" means 50 percent, or such lower percentage as the Secretary may prescribe by regulation. A person other than a corporation shall be treated as an affiliate of an employer to the extent provided in regulations of the Secretary. An employer which is a person other than a corporation shall be treated as affiliated with another person to the extent provided by regulations of the Secretary. Regulations under this paragraph shall be prescribed only after consultation and coordination with the Secretary of the Treasury.

(8) The Secretary may prescribe regulations specifying the extent to which conversions, splits, the exercise of rights, and similar transactions are not treated as acquisitions.

(e) For purposes of subsection (d)(5), the term "marketable obligation" means a bond, debenture, note, or certificate, or other evidence of indebtedness (hereinafter in this subsection referred to as "obligation") if—

(1) such obligation is acquired—

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the plan than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and

Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the plan than the price paid currently for a substantial portion of the same issue by persons independent of the issuer;

(2) immediately following acquisition of such obligation—

(A) not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the plan, and

(B) at least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer; and

(3) immediately following acquisition of the obligation, not more than 25 percent of the assets of the plan is invested in obligations of the employer or an affiliate of the employer.

EXEMPTIONS FROM PROHIBITED TRANSACTIONS

SEC. 408. (a) The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any fiduciary or transaction, or class of fiduciaries or transactions, from all or part of the restrictions imposed by sections 406 and 407(a). Action under this subsection may be taken only after consultation and coordination with the Secretary of the Treasury. An exemption granted under this section shall not relieve a fiduciary from any other applicable provision of this Act. The Secretary may not grant an exemption under this subsection unless he finds that such exemption is—

(1) administratively feasible,

(2) in the interests of the plan and of its participants and beneficiaries, and

(3) protective of the rights of participants and beneficiaries of such plan.

Before granting an exemption under this subsection from section 406 (a) or 407(a), the Secretary shall publish notice in the Federal Register of the pendency of the exemption, shall require that adequate notice be given to interested persons, and shall afford interested persons opportunity to present views. The Secretary may not grant an exemption under this subsection from section 406(b) unless he affords an opportunity for a hearing and makes a determination on the record with respect to the findings required by paragraphs (1), (2), and (3) of this subsection.

(b) The prohibitions provided in section 406 shall not apply to any of the following transactions:

(1) Any loans made by the plan to parties in interest who are participants or beneficiaries of the plan if such loans (A) are available to all such participants and beneficiaries on a reasonably equivalent basis, (B) are not made available to highly compensated employees, officers, or shareholders in an amount greater than the amount made available to other employees, (C) are made in accordance with specific provisions regarding such loans set forth in the plan, (D) bear a reasonable rate of interest, and (E) are adequately secured.

(2) Contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.

(3) A loan to an employee stock ownership plan (as defined in section 407(d)(6)), if—

(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B) such loan is at an interest rate which is not in excess of a reasonable rate.

If the plan gives collateral to a party in interest for such loan, such collateral may consist only of qualifying employer securities (as defined in section 407(d)(5)).

(4) The investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if—

(A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

(B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliate thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment.

(5) Any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State, if the plan pays no more than adequate consideration, and if each such insurer or insurers is—

(A) the employer maintaining the plan, or

(B) a party in interest which is wholly owned (directly or indirectly) by the employer maintaining the plan, or by any person which is a party in interest with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are parties in interest (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan).

(6) The providing of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan, and if—

(A) such bank or similar financial institution has adopted adequate internal safeguards which assure that the providing of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and adherence to such guidelines would reasonably preclude such bank or similar financial institution from providing such ancillary service (i) in an excessive or unreasonable manner, and (ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans.

Such ancillary services shall not be provided at more than reasonable compensation.

(7) The exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary, but only if the plan receives no less than adequate consideration pursuant to such conversion.

(8) Any transaction between a plan and (i) a common or collective trust fund or pooled investment fund maintained by a party in interest which is a bank or trust company supervised by a State or Federal agency or (ii) a pooled investment fund of an insurance company qualified to do business in a State, if—

(A) the transaction is a sale or purchase of an interest in the fund,

(B) the bank, trust company, or insurance company receives not more than reasonable compensation, and

(C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan.

(9) The making by a fiduciary of a distribution of the assets of the plan in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of this Act (relating to allocation of assets).

(c) Nothing in section 406 shall be construed to prohibit any fiduciary from—

(1) receiving any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

(2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; except that no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred; or

(3) serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

(d) Section 407(b) and subsections (a), (b), (c), and (e) of this section shall not apply to any transaction in which a plan, directly or indirectly—

(1) lends any part of the corpus or income of the plan to;

(2) pays any compensation for personal services rendered to the plan to; or

(3) acquires for the plan any property from or sells any property to;

any person who is with respect to the plan an owner-employee (as defined in section 401(c)(3) of the Internal Revenue Code of 1954), a member of the family (as defined in section 267(c)(4) of such Code) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation. For purposes of this subsection a shareholder employee (as defined in section 1379 of the Internal

Revenue Code of 1954) and a participant or beneficiary of an individual retirement account, individual retirement annuity, or an individual retirement bond (as defined in section 408 or 409 of the Internal Revenue Code of 1954) and an employer or association of employers which establishes such an account or annuity under section 408(c) of such code shall be deemed to be an owner-employee.

(e) Sections 406 and 407 shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 407(d)(5)) or acquisition, sale or lease by a plan of qualifying employer real property (as defined in section 407(d)(4))—

(1) if such acquisition, sale, or lease is for adequate consideration (or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under Section 407(e)(1)),

(2) if no commission is charged with respect thereto, and

(3) if—

(A) the plan is an eligible individual account plan (as defined in section 407(d)(3)), or

(B) in the case of an acquisition or lease of qualifying employer real property by a plan which is not an eligible individual account plan, or of an acquisition of qualifying employer securities by such a plan, the lease or acquisition is not prohibited by section 407(a).

LIABILITY FOR BREACH OF FIDUCIARY DUTY

SEC. 409. (a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 411 of this Act.

(b) No fiduciary shall be liable with respect to a breach of fiduciary duty under this title if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

EXCULPATORY PROVISIONS; INSURANCE

SEC. 410. (a) Except as provided in sections 405(b)(1) and 405(d), any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy.

(b) Nothing in this subpart shall preclude—

(1) a plan from purchasing insurance for its fiduciaries or for itself to cover liability or losses occurring by reason of the act or omission of a fiduciary, if such insurance permits recourse by the insurer against the fiduciary in the case of a breach of a fiduciary obligation by such fiduciary;

(2) a fiduciary from purchasing insurance to cover liability under this part from and for his own account; or

(3) an employer or an employee organization from purchasing insurance to cover potential liability of one or more persons who serve in a fiduciary capacity with regard to an employee benefit plan.

PROHIBITION AGAINST CERTAIN PERSONS HOLDING CERTAIN POSITIONS

SEC. 411. (a) No person who has been convicted of, or has been imprisoned as a result of his conviction of, robbery, bribery, extortion, embezzlement, fraud, grand larceny, burglary, arson, a felony violation of Federal or State law involving substances defined in section 102(6) of the Comprehensive Drug Abuse Prevention and Control Act of 1970, murder, rape, kidnaping, perjury, assault with intent to kill, any crime described in section 9(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(a)(1)), a violation of any provision of this Act, a violation of section 302 of the Labor-Management Relations Act, 1947 (29 U.S.C. 186), a violation of chapter 63 of title 18, United States Code, a violation of section 874, 1027, 1503, 1505, 1506, 1510, 1951, or 1954 of title 18, United States Code, a violation of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 401), or conspiracy to commit any such crimes or attempt to commit any such crimes, or a crime in which any of the foregoing crimes is an element, shall serve or be permitted to serve—

(1) as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, or employee of any employee benefit plan, or

(2) as a consultant to any employee benefit plan,

during or for five years after such conviction or after the end of such imprisonment, whichever is the later, unless prior to the end of such five-year period, in the case of a person so convicted or imprisoned, (A) his citizenship rights, having been revoked as a result of such conviction, have been fully restored, or (B) the Board of Parole of the United States Department of Justice determines that such person's service in any capacity referred to in paragraph (1) or (2) would not be contrary to the purposes of this title. Prior to making any such determination the Board shall hold an administrative hearing and shall give notice of such proceeding by certified mail to the State, county, and Federal prosecuting officials in the jurisdiction or jurisdictions in which such person was convicted. The Board's determination in any such proceeding shall be final. No person shall knowingly permit any other person to serve in any capacity referred to in paragraph (1) or (2) in violation of this subsection. Notwithstanding the preceding provisions of this subsection, no corporation or partnership will be precluded from acting as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, or employee, of any employee benefit plan or as a consultant to any employee benefit plan without a notice, hearing, and determination by such Board of Parole that such service would be inconsistent with the intention of this section.

(b) Any person who intentionally violates this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.

(c) For the purposes of this section:

(1) A person shall be deemed to have been "convicted" and under the disability of "conviction" from the date of the judgment of the trial court or the date of the final sustaining of such judgment on appeal, whichever is the later event.

(2) The term "consultant" means any person who, for compensation, advises or represents an employee benefit plan or who provides other assistance to such plan, concerning the establishment or operation of such plan.

(3) A period of parole shall not be considered as part of a period of imprisonment.

BONDING

SEC. 412. (a) Every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan (hereafter in this section referred to as "plan official") shall be bonded as provided in this section; except that—

(1) where such plan is one under which the only assets from which benefits are paid are the general assets of a union or of an employer, the administrator, officers, and employees of such plan shall be exempt from the bonding requirements of this section, and

(2) no bond shall be required of a fiduciary (or of any director, officer, or employee of such fiduciary) if such fiduciary—

(A) is a corporation organized and doing business under the laws of the United States or of any State;

(B) is authorized under such laws to exercise trust powers or to conduct an insurance business;

(C) is subject to supervision or examination by Federal or State authority; and

(D) has at all times a combined capital and surplus in excess of such a minimum amount as may be established by regulations issued by the Secretary, which amount shall be at least $1,000,000. Paragraph (2) shall apply to a bank or other financial institution which is authorized to exercise trust powers and the deposits of which are not insured by the Federal Deposit Insurance Corporation, only if such bank or institution meets bonding or similar requirements under State law which the Secretary determines are at least equivalent to those imposed on banks by Federal law.

The amount of such bond shall be fixed at the beginning of each fiscal year of the plan. Such amount shall be not less than 10 per centum of the amount of funds handled. In no case shall such bond be less than $1,000 nor more than $500,000, except that the Secretary, after due notice and opportunity for hearing to all interested parties, and after consideration of the record, may prescribe an amount in excess of $500,000, subject to the 10 per centum limitation of the preceding sentence. For purposes of fixing the amount of such bond, the amount of funds handled shall be determined by the funds handled by the person, group, or class to be covered by such bond and by their predecessor or predecessors, if any, during the preceding reporting year, or if the plan has no preceding reporting year, the amount of funds to be handled during the current reporting year by such person, group, or class, estimated as provided in regulations of the Secretary. Such bond shall provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of the plan official, directly or through connivance with others. Any bond shall have as surety thereon a corporate surety company which is an acceptable surety on Federal bonds under authority granted by the Secretary of the Treasury pursuant to sections 6 through 13 of title 6, United States Code. Any bond shall be in a form or of a type approved by the Secretary, including individual bonds or schedule or blanket forms of bonds which cover a group or class.

(b) It shall be unlawful for any plan official to whom subsection (a) applies, to receive, handle, disburse, or otherwise exercise custody or control of any of the funds or other property of any employee benefit plan, without being bonded as required by subsection (a) and it shall be unlawful for any plan official of such plan, or any other person having authority to direct the performance of such functions, to permit such functions, or any of them, to be performed by any plan official, with respect to whom the requirements of subsection (a) have not been met.

(c) It shall be unlawful for any person to procure any bond required by subsection (a) from any surety or other company or through any agent or broker in whose business operations such plan or any party in interest in such plan has any control or significant financial interest, direct or indirect.

(d) Nothing in any other provision of law shall require any person, required to be bonded as provided in subsection (a) because he handles funds or other property of an employee benefit plan, to be bonded insofar as the handling by such person of the funds or other property of such plan is concerned.

(e) The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section including exempting a plan from the requirements of this section where he finds that (1) other bonding arrangements or (2) the overall financial condition of the plan would be adequate to protect the interests of the beneficiaries and participants. When, in the opinion of the Secretary, the administrator of a plan offers adequate evidence of the financial responsibility of the plan, or that other bonding arrangements would provide adequate protection of the beneficiaries and participants, he may exempt such plan from the requirements of this section.

LIMITATION ON ACTIONS

SEC. 413. (a) No action may be commenced under this title with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part, or with respect to a violation of this part, after the earlier of—

(1) six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation, or

(2) three years after the earliest date (A) on which the plaintiff had actual knowledge of the breach or violation, or (B) on which a report from which he could reasonably be expected to have obtained knowledge of such breach or violation was filed with the Secretary under this title;

except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such breach or violation.

EFFECTIVE DATE

SEC. 414. (a) Except as provided in subsections (b), (c), and (d), this part shall take effect on January 1, 1975.

(b) (1) The provisions of this part authorizing the Secretary to promulgate regulations shall take effect on the date of enactment of this Act.

(2) Upon application of a plan, the Secretary may postpone until not later than January 1, 1976, the applicability of any provision of sections 402, 403 (other than 403(c)), 405 (other than 405 (a) and (d)), and 410(a), as it applies to any plan in existence on the date of enactment of this Act if he determines such postponement is (A) necessary to amend the instrument establishing the plan under which the plan is maintained and (B) not adverse to the interest of participants and beneficiaries.

(3) This part shall take effect on the date of enactment of this Act with respect to a plan which terminates after June 30, 1974, and before January 1, 1975, and to which at the time of termination section 4021 applies.

(c) Section 406 and 407(a) (relating to prohibited transactions) shall not apply—

(1) until June 30, 1984, to a loan of money or other extension of credit between a plan and a party in interest under a binding contract in effect on July 1, 1974 (or pursuant to renewals of such a contract), if such loan or other extension of credit remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be, and if the execution of the contract, the making of the loan, or the extension of credit was not, at the time of such execution, making, or extension, a prohibited transaction (within the meaning of section 503(b) of the Internal Revenue Code of 1954 or the corresponding provisions of prior law);

(2) until June 30, 1984, to a lease or joint use of property involving the plan and a party in interest pursuant to a binding contract in effect on July 1, 1974 (or pursuant to renewals of such a contract), if such lease or joint use remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and if the execution of the contract was not, at the time of such execution, a prohibited transaction (within the meaning of section 503(b) of the Internal Revenue Code of 1954) or the corresponding provisions of prior law;

(3) until June 30, 1984, to the sale, exchange, or other disposition of property described in paragraph (2) between a plan and a party in interest if—

(A) in the case of a sale, exchange, or other disposition of the property by the plan to the party in interest, the plan receives an amount which is not less than the fair market value of the property at the time of such disposition; and

(B) in the case of the acquisition of the property by the plan, the plan pays an amount which is not in excess of the fair market value of the property at the time of such acquisition;

(4) Until June 30, 1977, to the provision of services, to which paragraphs (1), (2), and (3) do not apply between a plan and a party in interest—

(A) under a binding contract in effect on July 1, 1974 (or pursuant to renewals of such contract), or

(B) if the party in interest ordinarily and customarily furnished such services on June 30, 1974, if such provision of services remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and if such provision of services was not, at the time of such provision, a prohibited transaction (within the meaning of section 503(b) of the Internal Revenue Code of 1954) or the corresponding provisions of prior law; or

(5) the sale, exchange, or other disposition of property which is owned by a plan on June 30, 1974, and all times thereafter, to a party in interest, if such plan is required to dispose of such property in order to comply with the provisions of section 407(a) (relating to the prohibition against holding excess employer securities and employer real property), and if the plan receives not less than adequate consideration.

(d) Any election, or failure to elect, by a disqualified person under section 2003(c)(1)(B) of this Act shall be treated for purposes of this part (but not for purposes of section 514) as an act or omission occurring before the effective date of this part.

PART 5—ADMINISTRATION AND ENFORCEMENT

CRIMINAL PENALTIES

SEC. 501. Any person who willfully violates any provision of part 1 of this subtitle, or any regulation or order issued under any such provision, shall upon conviction be fined not more than $5,000 or imprisoned not more than one year, or both; except that in the case of such violation by a person not an individual, the fine imposed upon such person shall be a fine not exceeding $100,000.

CIVIL ENFORCEMENT

SEC. 502. (a) A civil action may be brought—

(1) by a participant or beneficiary—

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 409;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this title or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this title or the terms of the plan;

(4) by the Secretary, or by a participant, or beneficiary for appropriate relief in the case of a violation of 105(c);

(5) except as otherwise provided in subsection (b), by the Secretary (A) to enjoin any act or practice which violates any provision of this title, or (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this title; or

(6) by the Secretary to collect any civil penalty under subsection (i).

(b) In the case of a plan which is qualified under section 401(a), 403(a), or 405(a) of the Internal Revenue Code of 1954 (or with respect to which an application to so qualify has been filed and has not been finally determined) the Secretary may exercise his authority under subsection (a)(5) with respct to a violation of, or the enforcement of, parts 2 and 3 of this subtitle (relating to participation, vesting, and funding), only if—

(1) requested by the Secretary of the Treasury, or

(2) one or more participants, beneficiaries, or fiduciaries, of such plan request in writing (in such manner as the Secretary shall prescribe by regulation) that he exercise such authority on their behalf. In the case of such a request under this paragraph he may exercise such authority only if he determines that such violation affects, or such enforcement is necessary to protect, claims of participants or beneficiaries to benefits under the plan.

(c) Any administrator who fails or refuses to comply with a request for any information which such administrator is required by this title to furnish to a participant or beneficiary (unless such failure or refusal results from matters reasonably beyond the control of the administrator) by mailing the material requested to the last known address of the requesting participant or beneficiary within 30 days after such request may in the court's discretion be personally liable to such participant or beneficiary in the amount of up to $100 a day from the

date of such failure or refusal, and the court may in its discretion order such other relief as it deems proper.

(d)(1) An employee benefit plan may sue or be sued under this title as an entity. Service of summons, subpena, or other legal process of a court upon a trustee or an administrator of an employee benefit plan in his capacity as such shall constitute service upon the employee benefit plan. In a case where a plan has not designated in the summary plan description of the plan an individual as agent for the service of legal process, service upon the Secretary shall constitute such service. The Secretary, not later than 15 days after receipt of service under the preceding sentence, shall notify the administrator or any trustee of the plan of receipt of such service.

(2) Any money judgment under this title against an employee benefit plan shall be enforceable only against the plan as an entity and shall not be enforceable against any other person unless liability against such person is established in his individual capacity under this title.

(e)(1) Except for actions under subsection (a)(1)(B) of this section, the district courts of the United States shall have exclusive jurisdiction of civil actions under this title brought by the Secretary or by a participant, beneficiary, or fiduciary. State courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions under subsection (a)(1)(B) of this section.

(2) Where an action under this title is brought in a district court of the United States, it may be brought in the district where the plan is administered, where the breach took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

(f) The district courts of the United States shall have jurisdiction, without respect to the amount in controversy or the citizenship of the parties, to grant the relief provided for in subsection (a) of this section in any action.

(g) In any action under this title by a participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of action to either party.

(h) A copy of the complaint in any action under this title by a participant, beneficiary, or fiduciary (other than an action brought by one or more participants or beneficiaries under subsection (a)(1)(B) which is solely for the purpose of recovering benefits due such participants under the terms of the plan) shall be served upon the Secretary and the Secretary of the Treasury by certified mail. Either Secretary shall have the right in his discretion to intervene in any action, except that the Secretary of the Treasury may not intervene in any action under part 4 of this subtitle. If the Secretary brings an action under subsection (a) on behalf of a participant or beneficiary, he shall notify the Secretary of the Treasury.

(i) In the case of a transaction prohibited by section 406 by a party in interest with respect to a plan to which this part applies, the Secretary may assess a civil penalty against such party in interest. The amount of such penalty may not exceed 5 percent of the amount involved (as defined in section 4975(f)(4) of the Internal Revenue Code of 1954); except that if the transaction is not corrected (in such manner as the Secretary shall prescribe by regulation, which regulations shall be consistent with section 4975(f)(5) of such Code) within 90 days after notice from the Secretary (or such longer period as the Secretary may permit), such penalty may be in an amount not more than 100 percent of the amount involved. This subsection shall not

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apply to a transaction with respect to a plan described in section 4975 (e)(1) of such Code.

(j) In all civil actions under this title, attorneys appointed by the Secretary may represent the Secretary (except as provided in section 518(a) of title 28, United States Code), but all such litigation shall be subject to the direction and control of the Attorney General.

(k) Suits by an administrator, fiduciary, participant, or beneficiary of an employee benefit plan to review a final order of the Secretary, to restrain the Secretary from taking any action contrary to the provisions of this Act, or to compel him to take action required under this title, may be brought in the district court of the United States for the district where the plan has its principal office, or in the United States District Court for the District of Columbia.

CLAIMS PROCEDURE

SEC. 503. In accordance with regulations of the Secretary, every employee benefit plan shall—

(1) provide adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied, setting forth the specific reasons for such denial, written in a manner calculated to be understood by the participant, and

(2) afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim.

INVESTIGATIVE AUTHORITY

SEC. 504. (a) The Secretary shall have the power, in order to determine whether any person has violated or is about to violate any provision of this title or any regulation or order thereunder—

(1) to make an investigation, and in connection therewith to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Secretary under this title, and

(2) to enter such places, inspect such books and records and question such persons as he may deem necessary to enable him to determine the facts relative to such investigation, if he has reasonable cause to believe there may exist a violation of this title or any rule or regulation issued thereunder or if the entry is pursuant to an agreement with the plan.

The Secretary may make available to any person actually affected by any matter which is the subject of an investigation under this section, and to any department or agency of the United States, information concerning any matter which may be the subject of such investigation; except that any information obtained by the Secretary pursuant to section 6103(g) of the Internal Revenue Code of 1954 shall be made available only in accordance with regulations prescribed by the Secretary of the Treasury.

(b) The Secretary may not under the authority of this section require any plan to submit to the Secretary any books or records of the plan more than once in any 12 month period, unless the Secretary has reasonable cause to believe there may exist a violation of this title or any regulation or order thereunder.

(c) For the purposes of any investigation provided for in this title, the provisions of sections 9 and 10 (relating to the attendance of witnesses and the production of books, records, and documents) of the Federal Trade Commission Act (15 U.S.C. 49, 50) are hereby made applicable (without regard to any limitation in such sections respect-

ing persons, partnerships, banks, or common carriers) to the jurisdiction, powers, and duties of the Secretary or any officers designated by him. To the extent he considers appropriate, the Secretary may delegate his investigative functions under this section with respect to insured banks acting as fiduciaries of employee benefit plans to the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

REGULATIONS

SEC. 505. Subject to title III and section 109, the Secretary may prescribe such regulations as he finds necessary or appropriate to carry out the provisions of this title. Among other things, such regulations may define accounting, technical and trade terms used in such provisions; may prescribe forms; and may provide for the keeping of books and records, and for the inspection of such books and records (subject to section 504(a) and (b)).

OTHER AGENCIES AND DEPARTMENTS

SEC. 506. In order to avoid unnecessary expense and duplication of functions among Government agencies, the Secretary may make such arrangements or agreements for cooperation or mutual assistance in the performance of his functions under this title and the functions of any such agency as he may find to be practicable and consistent with law. The Secretary may utilize, on a reimbursable or other basis, the facilities or services of any department, agency, or establishment of the United States or of any State or political subdivision of a State, including the services of any of its employees, with the lawful consent of such department, agency, or establishment; and each department, agency, or establishment of the United States is authorized and directed to cooperate with the Secretary and, to the extent permitted by law, to provide such information and facilities as he may request for his assistance in the performance of his functions under this title. The Attorney General or his representative shall receive from the Secretary for appropriate action such evidence developed in the performance of his functions under this title as may be found to warrant consideration for criminal prosecution under the provisions of this title or other Federal law.

ADMINISTRATION

SEC. 507. (a) Subchapter II of chapter 5, and chapter 7, of title 5, United States Code (relating to administrative procedure), shall be applicable to this title.

(b) Section 5108 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(f) In addition to the number of positions authorized by subsection (a), the Secretary of Labor is authorized, without regard to any other provision of this section, to place 1 position in the Department of Labor in grade GS–18, and a total of 20 positions in the Department of Labor in grades GS–16 and 17."

(c) No employee of the Department of Labor or the Department of the Treasury shall administer or enforce this title or the Internal Revenue Code of 1954 with respect to any employee benefit plan under which he is a participant or beneficiary, any employee organization of which he is a member, or any employer organization in which he has an interest. This subsection does not apply to an employee benefit plan which covers only employees of the United States.

APPROPRIATIONS

SEC. 508. There are hereby authorized to be appropriated such sums as may be necessary to enable the Secretary to carry out his functions and duties under this Act.

SEPARABILITY PROVISIONS

SEC. 509. If any provision of this Act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of this Act, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

INTERFERENCE WITH RIGHTS PROTECTED UNDER ACT

SEC. 510. It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan, this title, section 3001, or the Welfare and Pension Plans Disclosure Act, or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan, this title, or the Welfare and Pension Plans Disclosure Act. It shall be unlawful for any person to discharge, fine, suspend, expel, or discriminate against any person because he has given information or has testified or is about to testify in any inquiry or proceeding relating to this Act or the Welfare and Pension Plans Disclosure Act. The provisions of section 502 shall be applicable in the enforcement of this section.

COERCIVE INTERFERENCE

SEC. 511. It shall be unlawful for any person through the use of fraud, force, violence, or threat of the use of force or violence, to restrain, coerce, intimidate, or attempt to restrain, coerce, or intimidate any participant or beneficiary for the purpose of interfering with or preventing the exercise of any right to which he is or may become entitled under the plan, this title, section 3001, or the Welfare and Pension Plans Disclosure Act. Any person who willfully violates this section shall be fined $10,000 or imprisoned for not more than one year, or both.

ADVISORY COUNCIL

SEC. 512. (a)(1) There is hereby established an Advisory Council on Employee Welfare and Pension Benefit Plans (hereinafter in this section referred to as the "Council") consisting of fifteen members appointed by the Secretary. Not more than eight members of the Council shall be members of the same political party.

(2) Members shall be persons qualified to appraise the programs instituted under this Act.

(3) Of the members appointed, three shall be representatives of employee organizations (at least one of whom shall be representative of any organization members of which are participants in a multiemployer plan); three shall be representatives of employers (at least one of whom shall be representative of employers maintaining or contributing to multiemployer plans); three representatives shall be appointed from the general public, one of whom shall be a person representing those receiving benefits from a pension plan; and there shall

be one representative each from the fields of insurance, corporate trust, actuarial counseling, investment counseling, investment management, and the accounting field.

(4) Members shall serve for terms of three years except that of those first appointed, five shall be appointed for terms of one year, five shall be appointed for terms of two years, and five shall be appointed for terms of three years. A member may be reappointed. A member appointed to fill a vacancy shall be appointed only for the remainder of such term. A majority of members shall constitute a quorum and action shall be taken only by a majority vote of those present and voting.

(b) It shall be the duty of the Council to advise the Secretary with respect to the carrying out of his functions under this Act and to submit to the Secretary recommendations with respect thereto. The Council shall meet at least four times each year and at such other times as the Secretary requests. In his annual report submitted pursuant to section 513(b), the Secretary shall include each recommendation which he has received from the Council during the preceding calendar year.

(c) The Secretary shall furnish to the Council an executive secretary and such secretarial, clerical, and other services as are deemed necessary to conduct its business. The Secretary may call upon other agencies of the Government for statistical data, reports, and other information which will assist the Council in the performance of its duties.

(d)(1) Members of the Council shall each be entitled to receive the daily equivalent of the annual rate of basic pay in effect for grade GS–18 of the General Schedule for each day (including travel time) during which they are engaged in the actual performance of duties vested in the Council.

(2) While away from their homes or regular places of business in the performance of services for Council, members of the Council shall be allowed travel expenses, including per diem in lieu of subsistence, in the same manner as persons employed intermittently in the Government service are allowed expenses under section 5703(b) of title 5 of the United States Code.

(e) Section 14(a) of the Federal Advisory Committee Act (relating to termination) shall not apply to the Council.

RESEARCH, STUDIES, AND ANNUAL REPORT

SEC. 513. (a)(1) The Secretary is authorized to undertake research and surveys and in connection therewith to collect, compile, analyze and publish data, information, and statistics relating to employee benefit plans, including retirement, deferred compensation, and welfare plans, and types of plans not subject to this Act.

(2) The Secretary is authorized and directed to undertake research studies relating to pension plans, including but not limited to (A) the effects of this title upon the provisions and costs of pension plans, (B) the role of private pensions in meeting the economic security needs of the Nation, and (C) the operation of private pension plans including types and levels of benefits, degree of reciprocity or portability, and financial and actuarial characteristics and practices, and methods of encouraging the growth of the private pension system.

(3) The Secretary may, as he deems appropriate or necessary, undertake other studies relating to employee benefit plans, the matters regulated by this title, and the enforcement procedures provided for under this title.

(4) The research, surveys, studies, and publications referred to in this subsection may be conducted directly, or indirectly through grant or contract arrangements.

(b) The Secretary shall submit annually a report to the Congress covering his administration of this title for the preceding year, and including (1) an explanation of any variances or extensions granted under section 110, 207, 303, or 304 and the projected date for terminating the variance; (2) the status of cases in enforcement status; (3) recommendations received from the Advisory Council during the preceding year; and (4) such information, data, research findings, studies, and recommendations for further legislation in connection with the matters covered by this title as he may find advisable.

(c) The Secretary is authorized and directed to cooperate with the Congress and its appropriate committees, subcommittees, and staff in supplying data and any other information, and personnel and services, required by the Congress in any study, examination, or report by the Congress relating to pension benefit plans established or maintained by States or their political subdivisions.

EFFECT ON OTHER LAWS

SEC. 514. (a) Except as provided in subsection (b) of this section, the provisions of this title and title IV shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b). This section shall take effect on January 1, 1975.

(b)(1) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975.

(2)(A) Except as provided in subparagraph (B), nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(B) Neither an employee benefit plan described in section 4(a), which is not exempt under section 4(b) (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(3) Nothing in this section shall be construed to prohibit use by the Secretary of services or facilities of a State agency as permitted under section 506 of this Act.

(4) Subsection (a) shall not apply to any generally applicable criminal law of a State.

(c) For purposes of this section:

(1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State. A law of the United States applicable only to the District of Columbia shall be treated as a State law rather than a law of the United States.

(2) The term "State" includes a State, any political subdivisions thereof, or any agency or instrumentality of either, which purports to regulate, directly or indirectly, the terms and conditions of employee benefit plans covered by this title.

(d) Nothing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 111 and 507(b)) or any rule or regulation issued under any such law.

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE RELATING TO RETIREMENT PLANS

SEC. 1001. AMENDMENT OF INTERNAL REVENUE CODE OF 1954.

Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

Subtitle A—Participation, Vesting, Funding, Administration, Etc.

PART 1—PARTICIPATION, VESTING, AND FUNDING

SEC. 1011. MINIMUM PARTICIPATION STANDARDS.

Part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus, plans, etc.) is amended by adding at the end thereof the following:

"Subpart B—Special Rules

"Sec. 410. Minimum participation standards.
"Sec. 411. Minimum vesting standards.
"Sec. 412. Minimum funding standards.
"Sec. 413. Collectively bargained plans.
"Sec. 414. Definitions and special rules.
"Sec. 415. Limitations on benefits and contributions under qualified plans.

"SEC. 410. MINIMUM PARTICIPATION STANDARDS.

"(a) PARTICIPATION.—

"(1) MINIMUM AGE AND SERVICE CONDITIONS.—

"(A) GENERAL RULE.—A trust shall not constitute a qualified trust under section 401(a) if the plan of which it is a part requires, as a condition of participation in the plan, that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of the following dates—

"(i) the date on which the employee attains the age of 25; or

"(ii) the date on which he completes 1 year of service.

"(B) SPECIAL RULES FOR CERTAIN PLANS.—

"(i) In the case of any plan which provides that after not more than 3 years of service each participant has a right to 100 percent of his accrued benefit under the plan which is nonforfeitable (within the meaning of section 411) at the time such benefit accrues, clause (ii) of subparagraph (A) shall be applied by substituting '3 years of service' for '1 year of service'.

"(ii) In the case of any plan maintained exclusively for employees of an educational institution (as defined in section 170(b)(1)(A)(ii)) by an employer which is exempt from tax under section 501(a) which provides that each participant having at least 1 year of service has a right to 100 percent of his accrued benefit under the plan which is nonforfeitable (within the meaning of section 411) at the time such benefit accrues, clause (i) of

subparagraph (A) shall be applied by substituting '30' for '25'. This clause shall not apply to any plan to which clause (i) applies.

"(2) MAXIMUM AGE CONDITIONS.—A trust shall not constitute a qualified trust under section 401(a) if the plan of which it is a part excludes from participation (on the basis of age) employees who have attained a specified age, unless—

"(A) the plan is a—

"(i) defined benefit plan, or

"(ii) target benefit plan (as defined under regulations prescribed by the Secretary or his delegate), and

"(B) such employees begin employment with the employer after they have attained a specified age which is not more than 5 years before the normal retirement age under the plan.

"(3) DEFINITION OF YEAR OF SERVICE.—

"(A) GENERAL RULE.—For purposes of this subsection, the term 'year of service' means a 12-month period during which the employee has not less than 1,000 hours of service. For purposes of this paragraph, computation of any 12-month period shall be made with reference to the date on which the employee's employment commenced, except that, under regulations prescribed by the Secretary of Labor, such computation may be made by reference to the first day of a plan year in the case of an employee who does not complete 1,000 hours of service during the 12-month period beginning on the date his employment commenced.

"(B) SEASONAL INDUSTRIES.—In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term 'year of service' shall be such period as may be determined under regulations prescribed by the Secretary of Labor.

"(C) HOURS OF SERVICE.—For purposes of this subsection, the term 'hour of service' means a time of service determined under regulations prescribed by the Secretary of Labor.

"(D) MARITIME INDUSTRIES.—For purposes of this subsection, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary of Labor may prescribe regulations to carry out this subparagraph.

"(4) TIME OF PARTICIPATION.—A plan shall be treated as not meeting the requirements of paragraph (1) unless it provides that any employee who has satisfied the minimum age and service requirements specified in such paragraph, and who is otherwise entitled to participate in the plan, commences participation in the plan no later than the earlier of—

"(A) the first day of the first plan year beginning after the date on which such employee satisfied such requirements, or

"(B) the date 6 months after the date on which he satisfied such requirements,

unless such employee was separated from the service before the date referred to in subparagraph (A) or (B), whichever is applicable.

"(5) BREAKS IN SERVICE.—

"(A) GENERAL RULE.—Except as otherwise provided in subparagraphs (B), (C), and (D), all years of service with the employer or employers maintaining the plan shall be taken into account in computing the period of service for purposes of paragraph (1).

"(B) EMPLOYEES UNDER 3-YEAR 100 PERCENT VESTING.—In the case of any employee who has any 1-year break in service (as defined in section 411(a)(6)(A)) under a plan to which the service requirements of clause (i) of paragraph (1)(B) apply, if such employee has not satisfied such requirements, service before such break shall not be required to be taken into account.

"(C) 1-YEAR BREAK IN SERVICE.—In computing an employee's period of service for purposes of subsection (a)(1) in the case of any participant who has any 1-year break in service (as defined in section 411(a)(6)(A)), service before such break shall not be required to be taken into account under the plan until he has completed a year of service (as defined in paragraph (3)) after his return.

"(D) NONVESTED PARTICIPANTS.—In the case of a participant who does not have any nonforfeitable right to an accrued benefit derived from employer contributions, years of service with the employer or employers maintaining the plan before a break in service shall not be required to be taken into account in computing the period of service for purposes of subsection (a)(1) if the number of consecutive 1-year breaks in service equals or exceeds the aggregate number of such years of service before such break. Such aggregate number of years of service before such break shall be deemed not to include any years of service not required to be taken into account under this subparagraph by reason of any prior break in service.

"(b) ELIGIBILITY.—

"(1) IN GENERAL.—A trust shall not constitute a qualified trust under section 401(a) unless the trust, or two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under section 401(a) which benefits either—

"(A) 70 percent or more of all employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees who have not satisfied the minimum age and service requirements, if any, prescribed by the plan as a condition of participation, or

"(B) such employees as qualify under a classification set up by the employer and found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, or highly compensated.

"(2) EXCLUSION OF CERTAIN EMPLOYEES.—For purposes of paragraph (1), there shall be excluded from consideration—

"(A) employees not included in the plan who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers,

"(B) in the case of a trust established or maintained pursuant to an agreement which the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with title II of the Railway Labor Act and one or more employers, all employees not covered by such agreement, and

"(C) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(b)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

Subparagraph (B) shall not apply in the case of a plan which provides contributions or benefits for employees whose principal duties are not customarily performed aboard aircraft in flight.

"(c) APPLICATION OF PARTICIPATION STANDARDS TO CERTAIN PLANS.—

"(1) The provisions of this section (other than paragraph (2) of this subsection) shall not apply to—

"(A) a governmental plan (within the meaning of section 414(d)),

"(B) a church plan (within the meaning of section 414(e)) with respect to which the election provided by subsection (d) of this section has not been made,

"(C) a plan which has not at any time after the date of the enactment of the Employee Retirement Income Security Act of 1974 provided for employer contributions, and

"(D) a plan established and maintained by a society, order, or association described in section 501(c)(8) or (9) if no part of the contributions to or under such plan are made by employers of participants in such plan.

"(2) A plan described in paragraph (1) shall be treated as meeting the requirements of this section, for purposes of section 401(a), if such plan meets the requirements of section 401(a)(3) as in effect on the day before the date of the enactment of this section.

"(d) ELECTION BY CHURCH TO HAVE PARTICIPATION, VESTING, FUNDING, ETC., PROVISIONS APPLY.—

"(1) IN GENERAL.—If the church or convention or association of churches which maintains any church plan makes an election under this subsection (in such form and manner as the Secretary or his delegate may by regulations prescribe), then the provisions of this title relating to participation, vesting, funding, etc. (as in effect from time to time) shall apply to such church plan as if such provisions did not contain an exclusion for church plans.

"(2) ELECTION IRREVOCABLE.—An election under this subsection with respect to any church plan shall be binding with respect to such plan, and, once made, shall be irrevocable."

SEC. 1012. MINIMUM VESTING STANDARDS.

(a) IN GENERAL.—Subpart B of part I of subchapter D of chapter 1 is amended by adding after section 410 the following new section:

"SEC. 411. MINIMUM VESTING STANDARDS.

"(a) GENERAL RULE.—A trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that an employee's right to his normal retirement benefit is nonforfeitable upon the attainment of normal retirement age (as defined in subsection (a)(8)) and in addition satisfies the requirements of paragraphs (1) and (2) of this subsection and the requirements of paragraph (2) of subsection (b), and in the case of a defined benefit plan, also satisfies the requirements of paragraph (1) of subsection (b).

"(1) EMPLOYEE CONTRIBUTIONS.—A plan satisfies the requirements of this paragraph if an employee's rights in his accrued benefit derived from his own contributions are nonforfeitable.

"(2) EMPLOYER CONTRIBUTIONS.—A plan satisfies the requirements of this paragraph if it satisfies the requirements of subparagraph (A), (B), or (C).

"(A) 10-YEAR VESTING.—A plan satisfies the requirements of this subparagraph if an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of his accrued benefit derived from employer contributions.

"(B) 5- TO 15-YEAR VESTING.—A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions which percentage is not less than the percentage determined under the following table:

"Years of service:	Nonforfeitable percentage
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100.

"(C) RULE OF 45.—

"(i) A plan satisfies the requirements of this subparagraph if an employee who is not separated from the service, who has completed at least 5 years of service, and with respect to whom the sum of his age and years of service equals or exceeds 45, has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions determined under the following table:

"If years of service equal or exceed—	and sum of age and service equals or exceeds—	then the nonforfeitable percentage is—
5	45	50
6	47	60
7	49	70
8	51	80
9	53	90
10	55	100.

"(ii) Notwithstanding clause (i), a plan shall not be treated as satisfying the requirements of this subparagraph unless any employee who has completed at least 10 years of service has a nonforfeitable right to not less than 50 percent of his accrued benefit derived from employer contributions and to not less than an additional 10 percent for each additional year of service thereafter.

"(3) CERTAIN PERMITTED FORFEITURES, SUSPENSIONS, ETC.—For purposes of this subsection—

"(A) FORFEITURE ON ACCOUNT OF DEATH.—A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that it is not payable if the participant dies (except in the case of a survivor annuity which is payable as provided in section 401(a)(11)).

"(B) SUSPENSION OF BENEFITS UPON REEMPLOYMENT OF RETIREE.—A right to an accrued benefit derived from employer

contributions shall not be treated as forfeitable solely because the plan provides that the payment of benefits is suspended for such period as the employee is employed, subsequent to the commencement of payment of such benefits—

"(i) in the case of a plan other than a multiemployer plan, by the employer who maintains the plan under which such benefits were being paid; and

"(ii) in the case of a multiemployer plan, in the same industry, the same trade or craft, and the same geographic area covered by the plan as when such benefits commenced.

The Secretary of Labor shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph, including regulations with respect to the meaning of the term 'employed'.

"(C) EFFECT OF RETROACTIVE PLAN AMENDMENTS.—A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because plan amendments may be given retroactive application as provided in section 412(c)(8).

"(D) WITHDRAWAL OF MANDATORY CONTRIBUTION.—

"(i) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that, in the case of a participant who does not have a nonforfeitable right to at least 50 percent of his accrued benefit derived from employer contributions, such accrued benefit may be forfeited on account of the withdrawal by the participant of any amount attributable to the benefit derived from mandatory contributions (as defined in subsection (c)(2)(C)) made by such participant.

"(ii) Clause (i) shall not apply to a plan unless the plan provides that any accrued benefit forfeited under a plan provision described in such clause shall be restored upon repayment by the participant of the full amount of the withdrawal described in such clause plus, in the case of a defined benefit plan, interest. Such interest shall be computed on such amount at the rate determined for purposes of subsection (c)(2)(C) on the date of such repayment (computed annually from the date of such withdrawal). In the case of a defined contribution plan, the plan provision required under this clause may provide that such repayment must be made before the participant has any one-year break in service commencing after the withdrawal.

"(iii) In the case of accrued benefits derived from employer contributions which accrued before the date of the enactment of the Employee Retirement Income Security Act of 1974, a right to such accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that an amount of such accrued benefit may be forfeited on account of the withdrawal by the participant of an amount attributable to the benefit derived from mandatory contributions (as defined in subsection (c)(2)(C)) made by such participant before the date of the enactment of the Act if such amount forfeited is proportional to such amount withdrawn. This clause shall not apply to any plan to which any mandatory contribution is made after the date of the enactment of such Act. The Secretary or

his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this clause.

"(iv) For purposes of this subparagraph, in the case of any class-year plan, a withdrawal of employee contributions shall be treated as a withdrawal of such contributions on a plan year by plan year basis in succeeding order of time.

"(v) For nonforfeitability where the employee has a nonforfeitable right to at least 50 percent of his accrued benefit, see section 401(a)(19).

"(4) SERVICE INCLUDED IN DETERMINATION OF NONFORFEITABLE PERCENTAGE.—In computing the period of service under the plan for purposes of determining the nonforfeitable percentage under paragraph (2), all of an employee's years of service with the employer or employers maintaining the plan shall be taken into account, except that the following may be disregarded:

"(A) years of service before age 22, except that in the case of a plan which does not satisfy subparagraph (A) or (B) of paragraph (2), the plan may not disregard any such year of service during which the employee was a participant;

"(B) years of service during a period for which the employee declined to contribute to a plan requiring employee contributions;

"(C) years of service with an employer during any period for which the employer did not maintain the plan or a predecessor plan (as defined under regulations prescribed by the Secretary or his delegate);

"(D) service not required to be taken into account under paragraph (6);

"(E) years of service before January 1, 1971, unless the employee has had at least 3 years of service after December 31, 1970; and

"(F) years of service before the first plan year to which this section applies, if such service would have been disregarded under the rules of the plan with regard to breaks in service as in effect on the applicable date.

"(5) YEAR OF SERVICE.—

"(A) GENERAL RULE.—For purposes of this subsection, except as provided in subparagraph (C), the term 'year of service' means a calendar year, plan year, or other 12-consecutive month period designated by the plan (and not prohibited under regulations prescribed by the Secretary of Labor) during which the participant has completed 1,000 hours of service.

"(B) HOURS OF SERVICE.—For purposes of this subsection, the term 'hours of service' has the meaning provided by section 410(a)(3)(C).

"(C) SEASONAL INDUSTRIES.—In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term 'year of service' shall be such period as may be determined under regulations prescribed by the Secretary of Labor.

"(D) MARITIME INDUSTRIES.—For purposes of this subsection, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary of Labor may prescribe regulations to carry out the purposes of this subparagraph.

"(6) BREAKS IN SERVICE.—

"(A) DEFINITION OF 1-YEAR BREAK IN SERVICE.—For purposes of this paragraph, the term '1-year break in service'

means a calendar year, plan year, or other 12-consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary of Labor) during which the participant has not completed more than 500 hours of service.

"(B) 1 YEAR OF SERVICE AFTER 1-YEAR BREAK IN SERVICE.—For purposes of paragraph (4), in the case of any employee who has any 1-year break in service, years of service before such break shall not be required to be taken into account until he has completed a year of service after his return.

"(C) 1-YEAR BREAK IN SERVICE UNDER DEFINED CONTRIBUTION PLAN.—For purposes of paragraph (4), in the case of any participant in a defined contribution plan, or an insured defined benefit plan which satisfies the requirements of subsection (b)(1)(F), who has any 1-year break in service, years of service after such break shall not be required to be taken into account for purposes of determining the nonforfeitable percentage of his accrued benefit derived from employer contributions which accrued before such break.

"(D) NONVESTED PARTICIPANTS.—For purposes of paragraph (4), in the case of a participant who, under the plan, does not have any nonforfeitable right to an accrued benefit derived from employer contributions, years of service before any 1-year break in service shall not be required to be taken into account if the number of consecutive 1-year breaks in service equals or exceeds the aggregate number of such years of service prior to such break. Such aggregate number of years of service before such break shall be deemed not to include any years of service not required to be taken into account under this subparagraph by reason of any prior break in service.

"(7) ACCRUED BENEFIT.—

"(A) IN GENERAL.—For purposes of this section, the term 'accrued benefit' means—

"(i) in the case of a defined benefit plan, the employee's accrued benefit determined under the plan and, except as provided in subsection (c)(3), expressed in the form of an annual benefit commencing at normal retirement age, or

"(ii) in the case of a plan which is not a defined benefit plan, the balance of the employee's account.

"(B) EFFECT OF CERTAIN DISTRIBUTIONS.—Notwithstanding paragraph (4), for purposes of determining the employee's accrued benefit under the plan, the plan may disregard service performed by the employee with respect to which he has received—

"(i) a distribution of the present value of his entire nonforfeitable benefit if such distribution was in an amount (not more than $1,750) permitted under regulations prescribed by the Secretary or his delegate, or

"(ii) a distribution of the present value of his nonforfeitable benefit attributable to such service which he elected to receive.

Clause (i) of this subparagraph shall apply only if such distribution was made on termination of the employee's participation in the plan. Clause (ii) of this subparagraph shall apply only if such distribution was made on termination of the employee's participation in the plan or under such other

circumstances as may be provided under regulations prescribed by the Secretary or his delegate.

"(C) REPAYMENT OF SUBPARAGRAPH (b) DISTRIBUTIONS.—For purposes of determining the employee's accrued benefit under a plan, the plan may not disregard service as provided in subparagraph (B) unless the plan provides an opportunity for the participant to repay the full amount of the distribution described in such subparagraph (B) with, in the case of a defined benefit plan, interest at the rate determined for purposes of subsection (c)(2)(C) and provides that upon such repayment the employee's accrued benefit shall be recomputed by taking into account service so disregarded. This subparagraph shall apply only in the case of a participant who—

"(i) received such a distribution in any plan year to which this section applies, which distribution was less than the present value of his accrued benefit,

"(ii) resumes employment covered under the plan, and

"(iii) repays the full amount of such distribution with, in the case of a defined benefit plan, interest at the rate determined for purposes of subsection (c)(2)(C).

In the case of a defined contribution plan, the plan provision required under this subparagraph may provide that such repayment must be made before the participant has any one-year break in service commencing after such withdrawal.

"(8) NORMAL RETIREMENT AGE.—For purposes of this section, the term 'normal retirement age' means the earlier of—

"(A) the time a plan participant attains normal retirement age under the plan, or

"(B) the later of—

"(i) the time a plan participant attains age 65, or

"(ii) the 10th anniversary of the time a plan participant commenced participation in the plan.

"(9) NORMAL RETIREMENT BENEFIT.—For purposes of this section, the term 'normal retirement benefit' means the greater of the early retirement benefit under the plan, or the benefit under the plan commencing at normal retirement age. The normal retirement benefit shall be determined without regard to—

"(A) medical benefits, and

"(B) disability benefits not in excess of the qualified disability benefit.

For purposes of this paragraph, a qualified disability benefit is a disability benefit provided by a plan which does not exceed the benefit which would be provided for the participant if he separated from the service at normal retirement age. For purposes of this paragraph, the early retirement benefit under a plan shall be determined without regard to any benefits commencing before benefits payable under title II of the Social Security Act become payable which—

"(i) do not exceed such social security benefits, and

"(ii) terminate when such social security benefits commence.

"(10) CHANGES IN VESTING SCHEDULE.—

"(A) GENERAL RULE.—A plan amendment changing any vesting schedule under the plan shall be treated as not satisfy-

ing the requirements of paragraph (2) if the nonforfeitable percentage of the accrued benefit derived from employer contributions (determined as of the later of the date such amendment is adopted, or the date such amendment becomes effective) of any employee who is a participant in the plan is less than such nonforfeitable percentage computed under the plan without regard to such amendment.

"(B) ELECTION OF FORMER SCHEDULE.—A plan amendment changing any vesting schedule under the plan shall be treated as not satisfying the requirements of paragraph (2) unless each participant having not less than 5 years of service is permitted to elect, within a reasonable period after the adoption of such amendment, to have his nonforfeitable percentage computed under the plan without regard to such amendment.

"(b) ACCRUED BENEFIT REQUIREMENTS.—

(1) GENERAL RULES.—

"(A) 3-PERCENT METHOD.—A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which each participant is entitled upon his separation from the service is not less than—

"(i) 3 percent of the normal retirement benefit to which he would be entitled if he commenced participation at the earliest possible entry age under the plan and served continuously until the earlier of age 65 or the normal retirement age specified under the plan, multiplied by

"(ii) the number of years (not in excess of 33⅓) of his participation in the plan.

In the case of a plan providing retirement benefits based on compensation during any period, the normal retirement benefit to which a participant would be entitled shall be determined as if he continued to earn annually the average rate of compensation which he earned during consecutive years of service, not in excess of 10, for which his compensation was the highest. For purposes of this subparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

"(B) 133⅓ PERCENT RULE.—A defined benefit plan satisfies the requirements of this paragraph for a particular plan year if under the plan the accrued benefit payable at the normal retirement age is equal to the normal retirement benefit and the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year is not more than 133⅓ percent of the annual rate at which he can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year. For purposes of this subparagraph—

"(i) any amendment to the plan which is in effect for the current year shall be treated as in effect for all other plan years;

"(ii) any change in an accrual rate which does not apply to any individual who is or could be a participant in the current year shall be disregarded;

"(iii) the fact that benefits under the plan may be payable to certain employees before normal retirement age shall be disregarded; and

"(iv) social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after the current year.

"(C) FRACTIONAL RULE.—A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which any participant is entitled upon his separation from the service is not less than a fraction of the annual benefit commencing at normal retirement age to which he would be entitled under the plan as in effect on the date of his separation if he continued to earn annually until normal retirement age the same rate of compensation upon which his normal retirement benefit would be computed under the plan, determined as if he had attained normal retirement age on the date on which any such determination is made (but taking into account no more than the 10 years of service immediately preceding his separation from service). Such fraction shall be a fraction, not exceeding 1, the numerator of which is the total number of his years of participation in the plan (as of the date of his separation from the service) and the denominator of which is the total number of years he would have participated in the plan if he separated from the service at the normal retirement age. For purposes of this subparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

"(D) ACCRUAL FOR SERVICE BEFORE EFFECTIVE DATE.—Subparagraphs (A), (B), and (C) shall not apply with respect to years of participation before the first plan year to which this section applies, but a defined benefit plan satisfies the requirements of this subparagraph with respect to such years of participation only if the accrued benefit of any participant with respect to such years of participation is not less than the greater of—

"(i) his accrued benefit determined under the plan, as in effect from time to time prior to the date of the enactment of the Employee Retirement Income Security Act of 1974, or

"(ii) an accrued benefit which is not less than one-half of the accrued benefit to which such participant would have been entitled if subparagraph (A), (B), or (C) applied with respect to such years of participation.

"(E) FIRST TWO YEARS OF SERVICE.—Notwithstanding subparagraphs (A), (B), and (C) of this paragraph, a plan shall not be treated as not satisfying the requirements of this paragraph solely because the accrual of benefits under the plan does not become effective until the employee has two continuous years of service. For purposes of this subparagraph, the term 'years of service' has the meaning provided by section 410(a)(3)(A).

"(F) CERTAIN INSURED DEFINED BENEFIT PLANS.—Notwithstanding subparagraphs (A), (B), and (C), a defined benefit

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plan satisfies the requirements of this paragraph if such plan—

"(i) is funded exclusively by the purchase of insurance contracts, and

"(ii) satisfies the requirements of paragraphs (2) and (3) of section 412(i) (relating to certain insurance contract plans),

but only if an employee's accrued benefit as of any applicable date is not less than the cash surrender value his insurance contracts would have on such applicable date if the requirements of paragraphs (4), (5), and (6) of section 412(i) were satisfied.

"(G) ACCRUED BENEFIT MAY NOT DECREASE ON ACCOUNT OF INCREASING AGE OR SERVICE.—Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if the participant's accrued benefit is reduced on account of any increase in his age or service. The preceding sentence shall not apply to benefits under the plan commencing before entitlement to benefits payable under title II of the Social Security Act which benefits under the plan—

"(i) do not exceed such social security benefits, and

"(ii) terminate when such social security benefits commence.

"(2) SEPARATE ACCOUNTING REQUIRED IN CERTAIN CASES.—A plan satisfies the requirements of this paragraph if—

"(A) in the case of a defined benefit plan, the plan requires separate accounting for the portion of each employee's accrued benefit derived from any voluntary employee contributions permitted under the plan; and

"(B) in the case of any plan which is not a defined benefit plan, the plan requires separate accounting for each employee's accrued benefit.

"(3) YEAR OF PARTICIPATION.—

"(A) DEFINITION.—For purposes of determining an employee's accrued benefit, the term 'year of participation' means a period of service (beginning at the earliest date on which the employee is a participant in the plan and which is included in a period of service required to be taken into account under section 410(a)(5)) as determined under regulations prescribed by the Secretary of Labor which provide for the calculation of such period on any reasonable and consistent basis.

"(B) LESS THAN FULL TIME SERVICE.—For purposes of this paragraph, except as provided in subparagraph (C), in the case of any employee whose customary employment is less than full time, the calculation of such employee's service on any basis which provides less than a ratable portion of the accrued benefit to which he would be entitled under the plan if his customary employment were full time shall not be treated as made on a reasonable and consistent basis.

"(C) LESS THAN 1,000 HOURS OF SERVICE DURING YEAR.—For purposes of this paragraph, in the case of any employee whose service is less than 1,000 hours during any calendar year, plan year or other 12-consecutive month period designated by the plan (and not prohibited under regulations prescribed by the Secretary of Labor) the calculation of his period of service shall not be treated as not made on a reasonable and consistent basis solely because such service is not taken into account.

"(D) SEASONAL INDUSTRIES.—In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term 'year of participation' shall be such period as determined under regulations prescribed by the Secretary of Labor.

"(E) MARITIME INDUSTRIES.—For purposes of this subsection, in the case of any maritime industry, 125 days of service shall be treated as a year of participation. The Secretary of Labor may prescribe regulations to carry out the purposes of this subparagraph.

"(c) ALLOCATION OF ACCRUED BENEFITS BETWEEN EMPLOYER AND EMPLOYEE CONTRIBUTIONS.—

"(1) ACCRUED BENEFIT DERIVED FROM EMPLOYER CONTRIBUTIONS.—For purposes of this section, an employee's accrued benefit derived from employer contributions as of any applicable date is the excess, if any, of the accrued benefit for such employee as of such applicable date over the accrued benefit derived from contributions made by such employee as of such date.

"(2) ACCRUED BENEFIT DERIVED FROM EMPLOYEE CONTRIBUTIONS.—

"(A) PLANS OTHER THAN DEFINED BENEFIT PLANS.—In the case of a plan other than a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is—

"(i) except as provided in clause (ii), the balance of the employee's separate account consisting only of his contributions and the income, expenses, gains, and losses attributable thereto, or

"(ii) if a separate account is not maintained with respect to an employee's contributions under such a plan, the amount which bears the same ratio to his total accrued benefit as the total amount of the employee's contributions (less withdrawals) bears to the sum of such contributions and the contributions made on his behalf by the employer (less withdrawals).

"(B) DEFINED BENEFIT PLANS.—

"(i) IN GENERAL.—In the case of a defined benefit plan providing an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the accrued benefit derived from contributions made by an employee as of any applicable date is the annual benefit equal to the employee's accumulated contributions multiplied by the appropriate conversion factor.

"(ii) APPROPRIATE CONVERSION FACTOR.—For purposes of clause (i), the term 'appropriate conversion factor' means the factor necessary to convert an amount equal to the accumulated contributions to a single life annuity (without ancillary benefits) commencing at normal retirement age and shall be 10 percent for a normal retirement age of 65 years. For other normal retirement ages the conversion factor shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

"(C) DEFINITION OF ACCUMULATED CONTRIBUTIONS.—For purposes of this subsection, the term 'accumulated contributions' means the total of—

"(i) all mandatory contributions made by the employee,

"(ii) interest (if any) under the plan to the end of the last plan year to which subsection (a)(2) does not apply (by reason of the applicable effective date), and

"(iii) interest on the sum of the amounts determined under clauses (i) and (ii) compounded annually at the rate of 5 percent per annum from the beginning of the first plan year to which subsection (a)(2) applies (by reason of the applicable effective date) to the date upon which the employee would attain normal retirement age.

For purposes of this subparagraph, the term 'mandatory contributions' means amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.

"(D) ADJUSTMENTS.—The Secretary or his delegate is authorized to adjust by regulation the conversion factor described in subparagraph (B), the rate of interest described in clause (iii) of subparagraph (C), or both, from time to time as he may deem necessary. The rate of interest shall bear the relationship to 5 percent which the Secretary or his delegate determines to be comparable to the relationship which the long-term money rates and investment yields for the last period of 10 calendar years ending at least 12 months before the beginning of the plan year bear to the long-term money rates and investment yields for the 10-calendar year period 1964 through 1973. No such adjustment shall be effective for a plan year beginning before the expiration of 1 year after such adjustment is determined and published.

"(E) LIMITATION.—The accrued benefit derived from employee contributions shall not exceed the greater of—

"(i) the employee's accrued benefit under the plan, or

"(ii) the accrued benefit derived from employee contributions determined as though the amounts calculated under clauses (ii) and (iii) of subparagraph (C) were zero.

"(3) ACTUARIAL ADJUSTMENT.—For purposes of this section, in the case of any defined benefit plan, if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age, or if the accrued benefit derived from contributions made by an employee is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the employee's accrued benefit, or the accrued benefits derived from contributions made by an employee, as the case may be, shall be the actuarial equivalent of such benefit or amount determined under paragraph (1) or (2).

"(d) SPECIAL RULES.—

"(1) COORDINATION WITH SECTION 401(a)(4).—A plan which satisfies the requirements of this section shall be treated as satisfying any vesting requirements resulting from the application of section 401(a)(4) unless—

"(A) there has been a pattern of abuse under the plan (such as a dismissal of employees before their accrued benefits become nonforfeitable) tending to discriminate in favor of employees who are officers, shareholders, or highly compensated, or

"(B) there have been, or there is reason to believe there will be, an accrual of benefits or forfeitures tending to discriminate in favor of employees who are officers, shareholders, or highly compensated.

"(2) PROHIBITED DISCRIMINATION.—Subsection (a) shall not apply to benefits which may not be provided for designated employees in the event of early termination of the plan under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by section 401(a)(4).

"(3) TERMINATION OR PARTIAL TERMINATION; DISCONTINUANCE OF CONTRIBUTIONS.—Notwithstanding the provisions of subsection (a), a trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that—

"(A) upon its termination or partial termination, or

"(B) in the case of a plan to which section 412 does not apply, upon complete discontinuance of contributions under the plan,

the rights of all affected employees to benefits accrued to the date of such termination, partial termination, or discontinuance, to the extent funded as of such date, or the amounts credited to the employees' accounts, are nonforfeitable. This paragraph shall not apply to benefits or contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by section 401(a)(4), may not be used for designated employees in the event of early termination of the plan.

"(4) CLASS YEAR PLANS.—The requirements of subsection (a)(2) shall be deemed to be satisfied in the case of a class year plan if such plan provides that 100 percent of each employee's right to or derived from the contributions of the employer on his behalf with respect to any plan year are nonforfeitable not later than the end of the 5th plan year following the plan year for which such contributions were made. For purposes of this section, the term 'class year plan' means a profit-sharing, stock bonus, or money purchase plan which provides for the separate nonforfeitability of employees' rights to or derived from the contributions for each plan year.

"(5) TREATMENT OF VOLUNTARY EMPLOYEE CONTRIBUTIONS.—In the case of a defined benefit plan which permits voluntary employee contributions, the portion of an employee's accrued benefit derived from such contributions shall be treated as an accrued benefit derived from employee contributions under a plan other than a defined benefit plan.

"(6) ACCRUED BENEFIT NOT TO BE DECREASED BY AMENDMENT.—A plan shall be treated as not satisfying the requirements of this section if the accrued benefit of a participant is decreased by an amendment of the plan, other than an amendment described in section 412(c)(8).

"(e) APPLICATION OF VESTING STANDARDS TO CERTAIN PLANS.—

"(1) The provisions of this section (other than paragraph (2)) shall not apply to—

"(A) a governmental plan (within the meaning of section 414(d)),

"(B) a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made,

"(C) a plan which has not, at any time after the date of the enactment of the Employee Retirement Income Security Act of 1974, provided for employer contributions, and

"(D) a plan established and maintained by a society, order, or association described in section 501(c) (8) or (9), if no part of the contributions to or under such plan are made by employers of participants in such plan.

"(2) A plan described in paragraph (1) shall be treated as meeting the requirements of this section, for purposes of section 401(a), if such plan meets the vesting requirements resulting from the application of sections 401(a)(4) and 401(a)(7) as in effect on the day before the date of the enactment of the Employee Retirement Income Security Act of 1974."

(b) COMPARABILITY OF PLANS.—Section 401(a) (relating to requirements for qualification) is amended by adding at the end of paragraph (5) the following: "For purposes of determining whether two or more plans of an employer satisfy the requirements of paragraph (4) when considered as a single plan, if the amount of contributions on behalf of the employees allowed as a deduction under section 404 for the taxable year with respect to such plans, taken together, bears a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, the plans shall not be considered discriminatory merely because the rights of employees to, or derived from, the employer contributions under the separate plans do not become nonforfeitable at the same rate. For the purposes of determining whether two or more plans of an employer satisfy the requirements of paragraph (4) when considered as a single plan, if the employees' rights to benefits under the separate plans do not become nonforfeitable at the same rate, but the levels of benefits provided by the separate plans satisfy the requirements of regulations prescribed by the Secretary or his delegate to take account of the differences in such rates, the plans shall not be considered discriminatory merely because of the difference in such rates."

(c) VARIATIONS FROM CERTAIN VESTING AND ACCRUED BENEFITS REQUIREMENTS.—In the case of any plan maintained on January 1, 1974, if, not later than 2 years after the date of the enactment of this Act, the plan administrator petitions the Secretary of Labor, the Secretary of Labor may prescribe an alternate method which shall be treated as satisfying the requirements of subsection (a)(2) of section 411 of the Internal Revenue Code of 1954, or of subsection (b)(1) (other than subparagraph (D) thereof) of such section 411, or of both such provisions for a period of not more than 4 years. The Secretary may prescribe such alternate method only when he finds that—

(1) the application of such requirements would increase the costs of the plan to such an extent that there would result a substantial risk to the voluntary continuation of the plan or a substantial curtailment of benefit levels or the levels of employees' compensation,

(2) the application of such requirements or discontinuance of the plan would be adverse to the interests of plan participants in the aggregate, and

(3) a waiver or extension of time granted under section 412(d) or (e) would be inadequate.

In the case of any plan with respect to which an alternate method has been prescribed under the preceding provisions of this subsection for a period of not more than 4 years, if, not later than 1 year before the expiration of such period, the plan administrator petitions the Secretary of Labor for an extension of such alternate method, and the Secretary makes the findings required by the preceding sentence, such alternate method may be extended for not more than 3 years.

SEC. 1013. MINIMUM FUNDING STANDARDS.

(a) IN GENERAL.—Subpart B of part I of subchapter D of chapter 1 is amended by adding after section 411 the following new section:

"SEC. 412. MINIMUM FUNDING STANDARDS

"(a) GENERAL RULE.—Except as provided in subsection (h), this section applies to a plan if, for any plan year beginning on or after the effective date of this section for such plan—

"(1) such plan included a trust which qualified (or was determined by the Secretary or his delegate to have qualified) under section 401(a), or

"(2) such plan satisfied (or was determined by the Secretary or his delegate to have satisfied) the requirements of section 403(a) or 405(a).

A plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency. For purposes of this section and section 4971, the term 'accumulated funding deficiency' means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this section applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years.

"(b) FUNDING STANDARD ACCOUNT.—

"(1) ACCOUNT REQUIRED.—Each plan to which this section applies shall establish and maintain a funding standard account. Such account shall be credited and charged solely as provided in this section.

"(2) CHARGES TO ACCOUNT.—For a plan year, the funding standard account shall be charged with the sum of—

"(A) the normal cost of the plan for the plan year,

"(B) the amounts necessary to amortize in equal annual installments (until fully amortized)—

"(i) in the case of a plan in existence on January 1, 1974, the unfunded past service liability under the plan on the first day of the first plan year to which this section applies, over a period of 40 plan years,

"(ii) in the case of a plan which comes into existence after January 1, 1974, the unfunded past service liability under the plan on the first day of the first plan year to which this section applies, over a period of 30 plan years (40 plan years in the case of a multiemployer plan),

"(iii) separately, with respect to each plan year, the net increase (if any) in unfunded past service liability under the plan arising from plan amendments adopted in such year, over a period of 30 plan years (40 plan years in the case of a multiemployer plan),

"(iv) separately, with respect to each plan year, the net experience loss (if any) under the plan, over a period of 15 plan years (20 plan years in the case of a multiemployer plan), and

"(v) separately, with respect to each plan year, the net loss (if any) resulting from changes in actuarial assumptions used under the plan, over a period of 30 plan years,

"(C) the amount necessary to amortize each waived funding deficiency (within the meaning of subsection (d)(3)) for each prior plan year in equal annual installments (until fully amortized) over a period of 15 plan years, and

"(D) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 5 plan years any amount credited to the funding standard account under paragraph (3)(D).

"(3) CREDITS TO ACCOUNT.—For a plan year, the funding standard account shall be credited with the sum of—

"(A) the amount considered contributed by the employer to or under the plan for the plan year,

"(B) the amount necessary to amortize in equal annual installments (until fully amortized)—

"(i) separately, with respect to each plan year, the net decrease (if any) in unfunded past service liability under the plan arising from plan amendments adopted in such year, over a period of 30 plan years (40 plan years in the case of a multiemployer plan),

"(ii) separately, with respect to each plan year, the net experience gain (if any) under the plan, over a period of 15 plan years (20 plan years in the case of a multiemployer plan), and

"(iii) separately, with respect to each plan year, the net gain (if any) resulting from changes in actuarial assumptions used under the plan, over a period of 30 plan years,

"(C) the amount of the waived funding deficiency (within the meaning of subsection (d)(3) for the plan year, and

"(D) in the case of a plan year for which the accumulated funding deficiency is determined under the funding standard account if such plan year follows a plan year for which such deficiency was determined under the alternative minimum funding standard, the excess (if any) of any debit balance in the funding standard account (determined without regard to this subparagraph) over any debit balance in the alternative minimum funding standard account.

"(4) COMBINING AND OFFSETTING AMOUNTS TO BE AMORTIZED.—Under regulations prescribed by the Secretary or his delegate, amounts required to be amortized under paragraph (2) or paragraph (3), as the case may be—

"(A) may be combined into one amount under such paragraph to be amortized over a period determined on the basis of the remaining amortization period for all items entering into such combined amount, and

"(B) may be offset against amounts required to be amortized under the other such paragraph, with the resulting amount to be amortized over a period determined on the basis of the remaining amortization periods for all items entering into whichever of the two amounts being offset is the greater.

"(5) INTEREST.—The funding standard account (and items therein) shall be charged or credited (as determined under regulations prescribed by the Secretary or his delegate) with interest at the appropriate rate consistent with the rate or rates of interest used under the plan to determine costs.

"(c) SPECIAL RULES.—

"(1) DETERMINATIONS TO BE MADE UNDER FUNDING METHOD.—For purposes of this section, normal costs, accrued liability, past service liabilities, and experience gains and losses shall be determined under the funding method used to determine costs under the plan.

"(2) VALUATION OF ASSETS.—

"(A) IN GENERAL.—For purposes of this section, the value of the plan's assets shall be determined on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under regulations prescribed by the Secretary or his delegate.

"(B) ELECTION WITH RESPECT TO BONDS.—The value of a bond or other evidence of indebtedness which is not in default as to principal or interest may, at the election of the plan administrator, be determined on an amortized basis running from initial cost at purchase to par value at maturity or earliest call date. Any election under this subparagraph shall be made at such time and in such manner as the Secretary or his delegate shall by regulations provide, shall apply to all such evidences of indebtedness, and may be revoked only with the consent of the Secretary or his delegate.

"(3) ACTUARIAL ASSUMPTIONS MUST BE REASONABLE.—For purposes of this section, all costs, liabilities, rates of interest, and other factors under the plan shall be determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer the actuary's best estimate of anticipated experience under the plan.

"(4) TREATMENT OF CERTAIN CHANGES AS EXPERIENCE GAIN OR LOSS.—For purposes of this section, if—

"(A) a change in benefits under the Social Security Act or in other retirement benefits created under Federal or State law, or

"(B) a change in the definition of the term 'wages' under section 3121, or a change in the amount of such wages taken into account under regulations prescribed for purposes of section 401(a)(5),

results in an increase or decrease in accrued liability under a plan, such increase or decrease shall be treated as an experience loss or gain.

"(5) CHANGE IN FUNDING METHOD OR IN PLAN YEAR REQUIRES APPROVAL.—If the funding method for a plan is changed, the new funding method shall become the funding method used to determine costs and liabilities under the plan only if the change is approved by the Secretary or his delegate. If the plan year for a plan is changed, the new plan year shall become the plan year for the plan only if the change is approved by the Secretary or his delegate.

"(6) FULL FUNDING.—If, as of the close of a plan year, a plan would (without regard to this paragraph) have an accumulated funding deficiency (determined without regard to the alternative minimum funding standard account permitted under subsection (g)) in excess of the full funding limitation—

"(A) the funding standard account shall be credited with the amount of such excess, and

"(B) all amounts described in paragraphs (2) (B), (C), and (D) and (3)(B) of subsection (b) which are required to be amortized shall be considered fully amortized for purposes of such paragraphs.

"(7) FULL FUNDING LIMITATION.—For purposes of paragraph

(6), the term 'full funding limitation' means the excess (if any) of—

"(A) the accrued liability (including normal cost) under the plan (determined under the entry age normal funding method if such accrued liability cannot be directly calculated under the funding method used for the plan), over

"(B) the lesser of the fair market value of the plan's assets or the value of such assets determined under paragraph (2).

"(8) CERTAIN RETROACTIVE PLAN AMENDMENTS.—For purposes of this section, any amendment applying to a plan year which—

"(A) is adopted after the close of such plan year but no later than 2 and one-half months after the close of the plan year (or, in the case of a multiemployer plan, no later than 2 years after the close of such plan year),

"(B) does not reduce the accrued benefit of any participant determined as of the beginning of the first plan year to which the amendment applies, and

"(C) does not reduce the accrued benefit of any participant determined as of the time of adoption except to the extent required by the circumstances,

shall, at the election of the plan administrator, be deemed to have been made on the first day of such plan year. No amendment described in this paragraph which reduces the accrued benefits of any participant shall take effect unless the plan administrator files a notice with the Secretary of Labor notifying him of such amendment and the Secretary of Labor has approved such amendment, or within 90 days after the date on which such notice was filed, failed to disapprove such amendment. No amendment described in this subsection shall be approved by the Secretary of Labor unless he determines that such amendment is necessary because of a substantial business hardship (as determined under subsection (d)(2)) and that a waiver under subsection (d)(1) is unavailable or inadequate.

"(9) 3-YEAR VALUATION.—For purposes of this section, a determination of experience gains and losses and a valuation of the plan's liability shall be made not less frequently than once every 3 years, except that such determination shall be made more frequently to the extent required in particular cases under regulations prescribed by the Secretary or his delegate.

"(10) TIME WHEN CERTAIN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, any contributions for a plan year made by an employer after the last day of such plan year, but not later than two and one-half months after such day, shall be deemed to have been made on such last day. For purposes of this paragraph, such two and one-half month period may be extended for not more than six months under regulations prescribed by the Secretary or his delegate.

"(d) VARIANCE FROM MINIMUM FUNDING STANDARD.—

"(1) WAIVER IN CASE OF SUBSTANTIAL BUSINESS HARDSHIP.—If a employer or in the case of a multiemployer plan, 10 percent or more of the number of employers contributing to or under the plan, are unable to satisfy the minimum funding standard for a plan year without substantial business hardship and if application of the standard would be adverse to the interests of plan participants in the aggregate, the Secretary or his delegate may waive the requirements of subsection (a) for such year with respect to all or any portion of the minimum funding standard other than the portion thereof determined under subsection (b)(2)(C). The Secretary or his delegate shall not waive the mini-

mum funding standard with respect to a plan for more than 5 of any 15 consecutive plan years.

"(2) DETERMINATION OF SUBSTANTIAL BUSINESS HARDSHIP.—For purposes of this section, the factors taken into account in determining substantial business hardship shall include (but shall not be limited to) whether or not—

"(A) the employer is operating at an economic loss,

"(B) there is substantial unemployment or underemployment in the trade or business and in the industry concerned,

"(C) the sales and profits of the industry concerned are depressed or declining, and

"(D) it is reasonable to expect that the plan will be continued only if the waiver is granted.

"(3) WAIVED FUNDING DEFICIENCY.—For purposes of this section, the term 'waived funding deficiency' means the portion of the minimum funding standard (determined without regard to subsection (b)(3)(C)) for a plan year waived by the Secretary or his delegate and not satisfied by employer contributions.

"(e) EXTENSION OF AMORTIZATION PERIODS.—The period of years required to amortize any unfunded liability (described in any clause of subsection (b)(2)(B)) of any plan may be extended by the Secretary of Labor for a period of time (not in excess of 10 years) if he determines that such extension would carry out the purposes of the Employee Retirement Income Security Act of 1974 and would provide adequate protection for participants under the plan and their beneficiaries and if he determines that the failure to permit such extension would—

"(1) result in—

"(A) a substantial risk to the voluntary continuation of the plan, or

"(B) a substantial curtailment of pension benefit levels or employee compensation, and

"(2) be adverse to the interests of plan participants in the aggregate.

"(f) BENEFITS MAY NOT BE INCREASED DURING WAIVER OR EXTENSION PERIOD.—

"(1) IN GENERAL.—No amendment of the plan which increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits become nonforfeitable under the plan shall be adopted if a waiver under subsection (d)(1) or an extension of time under subsection (e) is in effect with respect to the plan, or if a plan amendment described in subsection (c)(8) has been made at any time in the preceding 12 months (24 months for multiemployer plans). If a plan is amended in violation of the preceding sentence, any such waiver or extension of time shall not apply to any plan year ending on or after the date on which such amendment is adopted.

"(2) EXCEPTION.—Paragraph (1) shall not apply to any plan amendment which—

"(A) the Secretary of Labor determines to be reasonable and which provides for only de minimis increases in the liabilities of the plan,

"(B) only repeals an amendment described in subsection (c)(8), or

"(C) is required as a condition of qualification under this part.

"(g) ALTERNATIVE MINIMUM FUNDING STANDARD.—

"(1) IN GENERAL.—A plan which uses a funding method that requires contributions in all years not less than those required under the entry age normal funding method may maintain an alternative minimum funding standard account for any plan year. Such account shall be credited and charged solely as provided in this subsection.

"(2) CHARGES AND CREDITS TO ACCOUNT.—For a plan year the alternative minimum funding standard account shall be—

"(A) charged with the sum of—

"(i) the lesser of normal cost under the funding method used under the plan or normal cost determined under the unit credit method,

"(ii) the excess, if any, of the present value of accrued benefits under the plan over the fair market value of the assets, and

"(iii) an amount equal to the excess (if any) of credits to the alternative minimum standard account for all prior plan years over charges to such account for all such years, and

"(B) credited with the amount considered contributed by the employer to or under the plan for the plan year.

"(3) SPECIAL RULES.—The alternative minimum funding standard account (and items therein) shall be charged or credited with interest in the manner provided under subsection (b)(5) with respect to the funding standard account.

"(h) EXCEPTIONS.—This section shall not apply to—

"(1) any profit-sharing or stock bonus plan,

"(2) any insurance contract plan described in subsection (i),

"(3) any governmental plan (within the meaning of section 414(d)),

"(4) any church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made,

"(5) any plan which has not, at any time after the date of the enactment of the Employee Retirement Income Security Act of 1974, provided for employer contributions, or

"(6) any plan established and maintained by a society, order, or association described in section 501(c) (8) or (9), if no part of the contributions to or under such plan are made by employers of participants in such plan.

No plan described in paragraph (3), (4), or (6) shall be treated as a qualified plan for purposes of section 401(a) unless such plan meets the requirements of section 401(a)(7) as in effect on the day before the date of the enactment of the Employee Retirement Income Security Act of 1974.

"(i) CERTAIN INSURANCE CONTRACT PLANS.—A plan is described in this subsection if—

"(1) the plan is funded exclusively by the purchase of individual insurance contracts,

"(2) such contracts provide for level annual premium payments to be paid extending not later than the retirement age for each individual participating in the plan, and commencing with the date the individual became a participant in the plan (or, in the case of an increase in benefits, commencing at the time such increase becomes effective),

"(3) benefits provided by the plan are equal to the benefits provided under each contract at normal retirement age under the plan and are guaranteed by an insurance carrier (licensed under the laws of a State to do business with the plan) to the extent premiums have been paid,

"(4) premiums payable for the plan year, and all prior plan years, under such contracts have been paid before lapse or there is reinstatement of the policy,

"(5) no rights under such contracts have been subject to a security interest at any time during the plan year, and

"(6) no policy loans are outstanding at any time during the plan year.

A plan funded exclusively by the purchase of group insurance contracts which is determined under regulations prescribed by the Secretary or his delegate to have the same characteristics as contracts described in the preceding sentence shall be treated as a plan described in this subsection."

(b) EXCISE TAX ON FAILURE TO MEET MINIMUM FUNDING STANDARDS.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding at the end thereof the following new chapter:

"CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

"Sec. 4971. Taxes on failure to meet minimum funding standards.

"SEC. 4971. TAXES ON FAILURE TO MEET MINIMUM FUNDING STANDARDS.

"(a) INITIAL TAX.—For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 5 percent on the amount of the accumulated funding deficiency under the plan, determined as of the end of the plan year ending with or within such taxable year. The tax imposed by this subsection shall be paid by the employer responsible for contributing to or under the plan the amount described in section 412(b)(3)(A).

"(b) ADDITIONAL TAX.—In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the correction period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected. The tax imposed by this subsection shall be paid by the employer described in subsection (a).

"(c) DEFINITIONS.—For purposes of this section—

"(1) ACCUMULATED FUNDING DEFICIENCY.—The term 'accumulated funding deficiency' has the meaning given to such term by the last sentence of section 412(a).

"(2) CORRECT.—The term 'correct' means, with respect to an accumulated funding deficiency, the contribution, to or under the plan, of the amount necessary to reduce such accumulated funding deficiency as of the end of a plan year in which such deficiency arose to zero.

"(3) CORRECTION PERIOD.—The term 'correction period' means, with respect to an accumulated funding deficiency, the period beginning with the end of a plan year in which there is an accumulated funding deficiency and ending 90 days after the date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed by subsection (b), extended—

"(A) by any period in which a deficiency cannot be assessed under section 6213(a), and

"(B) by any other period which the Secretary or his delegate determines is reasonable and necessary to permit a reduction of the accumulated funding deficiency to zero under this section.

"(d) NOTIFICATION OF THE SECRETARY OF LABOR.—Before issuing a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary or his delegate shall notify the Secretary of Labor and provide him a reasonable opportunity (but not more than 60 days)—

"(1) to require the employer responsible for contributing to or under the plan to eliminate the accumulated funding deficiency, or

"(2) to comment on the imposition of such tax.

"(e) CROSS REFERENCES.—

"For disallowance of deduction for taxes paid under this section, see section 275.

"For liability for tax in case of an employer party to collective bargaining agreement, see section 413(b)(6).

"For provisions concerning notification of Secretary of Labor of imposition of tax under this section, waiver of the tax imposed by subsection (b), and other coordination between Secretary of the Treasury and Secretary of Labor with respect to compliance with this section, see section 3002(b) of title III of the Employee Retirement Income Security Act of 1974.".

(c) AMENDMENTS TO SECTION 404.—

(1) Paragraph (1) of section 404(a) (relating to deduction for employer contributions to pension trusts) is amended to read as follows:

"(1) PENSION TRUSTS.

"(A) IN GENERAL.—In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 501(a), in an amount determined as follows:

"(i) the amount necessary to satisfy the minimum funding standard provided by section 412(a) for plan years ending within or with such taxable year (or for any prior plan year), if such amount is greater than the amount determined under clause (ii) or (iii) (whichever is applicable with respect to the plan),

"(ii) the amount necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Secretary or his delegate, but if such remaining unfunded cost with respect to any 3 individuals is more than 50 percent of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years.

"(iii) an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Secretary or his delegate, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount necessary to amortize such credits in equal annual payments (until fully amortized) over 10 years, as determined under regulations prescribed by the Secretary or his delegate.

In determining the amount deductible in such year under the foregoing limitations the funding method and the actuarial assumptions used shall be those used for such year under

section 412, and the maximum amount deductible for such year shall be an amount equal to the full funding limitation for such year determined under section 412.

"(B) SPECIAL RULE IN CASE OF CERTAIN AMENDMENTS.—In the case of a plan which the Secretary of Labor finds to be collectively bargained which makes an election under this subparagraph (in such manner and at such time as may be provided under regulations prescribed by the Secretary or his delegate), if the full funding limitation determined under section 412(c)(7) for such year is zero, if as a result of any plan amendment applying to such plan year, the amount determined under section 412(c)(7)(B) exceeds the amount determined under section 412(c)(7)(A), and if the funding method and the actuarial assumptions used are those used for such year under section 412, the maximum amount deductible in such year under the limitations of this paragraph shall be an amount equal to the lesser of—

"(i) the full funding limitation for such year determined by applying section 412(c)(7) but increasing the amount referred to in subparagraph (A) thereof by the decrease in the present value of all unamortized liabilities resulting from such amendment, or

"(ii) the normal cost under the plan reduced by the amount necessary to amortize in equal annual installments over 10 years (until fully amortized) the decrease described in clause (i).

In the case of any election under this subparagraph, the amount deductible under the limitations of this paragraph with respect to any of the plan years following the plan year for which such election was made shall be determined as provided under such regulations as may be prescribed by the Secretary or his delegate to carry out the purposes of this subparagraph.

"(C) CERTAIN COLLECTIVELY-BARGAINED PLANS.—In the case of a plan which the Secretary of Labor finds to be collectively bargained, established or maintained by an employer doing business in not less than 40 States and engaged in the trade or business of furnishing or selling services described in section 167(l)(3)(A)(iii), with respect to which the rates have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof, and in the case of any employer which is a member of a controlled group with such employer, subparagraph (B) shall be applied by substituting for the words 'plan amendment' the words 'plan amendment or increase in benefits payable under title II of the Social Security Act'. For purposes of this subparagraph, the term 'controlled group' has the meaning provided by section 1563(a), determined without regard to section 1563(a)(4) and (e)(3)(C).

"(D) CARRYOVER.—Any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year under the foregoing limitations."

(2) Paragraph (6) of section 404(a) (relating to taxpayers on accrual basis) is amended to read as follows:

"(6) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of paragraphs (1), (2), and (3), a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

(3) Paragraph (7) of section 404(a) (relating to limit on deductions) is amended to read as follows:

"(7) LIMIT ON DEDUCTIONS.—If amounts are deductible under paragraphs (1) and (3), or (2) and (3), or (1), (2), and (3), in connection with two or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed the greater of 25 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries of the trusts or plans, or the amount of contributions made to or under the trusts or plans to the extent such contributions do not exceed the amount of employer contributions necessary to satisfy the minimum funding standard provided by section 412 for the plan year which ends with or within such taxable year (or for any prior plan year). In addition, any amount paid into such trust or under such annuity plans in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this paragraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this paragraph shall not exceed 25 percent of the compensation otherwise paid or accrued during such taxable years to the beneficiaries under the trusts or plans. This paragraph shall not have the effect of reducing the amount otherwise deductible under paragraphs (1), (2), and (3), if no employee is a beneficiary under more than one trust or a trust and an annuity plan."

(d) ALTERNATIVE AMORTIZATION METHOD FOR CERTAIN MULTIEMPLOYER PLANS.—

(1) GENERAL RULE.—In the case of any multiemployer plan (as defined in section 414(f) of the Internal Revenue Code of 1954) to which section 412 of such Code applies, if—

(A) on January 1, 1974, the contributions under the plan were based on a percentage of pay,

(B) the actuarial assumptions with respect to pay are reasonably related to past and projected experience, and

(C) the rates of interest under the plan are determined on the basis of reasonable actuarial assumptions,

the plan may elect (in such manner and at such time as may be provided under regulations prescribed by the Secretary of the Treasury or his delegate) to fund the unfunded past service liability under the plan existing as of the date 12 months following the first date on which such section 412 first applies to the plan by charging the funding standard account with an equal annual percentage of the aggregate pay of all participants in the plan in lieu of the level dollar charges to such account required under clauses (i), (ii), and (iii) of section 412(b)(2)(B) of such Code and section 302(b)(2)(B)(i), (ii), and (iii) of this Act.

(2) LIMITATION.—In the case of a plan which makes an election under paragraph (1), the aggregate of the charges required under such paragraph for a plan year shall not be less than the interest

on the unfunded past service liabilities described in clauses (i), (ii), and (iii) of section 412(b)(2)(B) of the Internal Revenue Code of 1954.

SEC. 1014. COLLECTIVELY BARGAINED PLANS, ETC.

Subpart B of part I of subchapter D of chapter 1 (relating to special rules) is amended by inserting after section 412 the following new section:

"SEC. 413. COLLECTIVELY BARGAINED PLANS, ETC.

"(a) APPLICATION OF SUBSECTION (b).—Subsection (b) applies to—

"(1) a plan maintained pursuant to an agreement which the Secretary of Labor finds to be a collective-bargaining agreement between employee representatives and one or more employers, and

"(2) each trust which is a part of such plan.

"(b) GENERAL RULE.—If this subsection applies to a plan, notwithstanding any other provision of this title—

"(1) PARTICIPATION.—Section 410 shall be applied as if all employees of each of the employers who are parties to the collective-bargaining agreement and who are subject to the same benefit computation formula under the plan were employed by a single employer.

"(2) DISCRIMINATION, ETC.—Sections 401(a)(4) and 411(d)(3) shall be applied as if all participants who are subject to the same benefit computation formula and who are employed by employers who are parties to the collective bargaining agreement were employed by a single employer.

"(3) EXCLUSIVE BENEFIT.—For purposes of section 401(a), in determining whether the plan of an employer is for the exclusive benefit of his employees and their beneficiaries, all plan participants shall be considered to be his employees.

"(4) VESTING.—Section 411 (other than subsection (d)(3)) shall be applied as if all employers who have been parties to the collective-bargaining agreement constituted a single employer, except that the application of any rules with respect to breaks in service shall be made under regulations prescribed by the Secretary of Labor.

"(5) FUNDING.—The minimum funding standard provided by section 412 shall be determined as if all participants in the plan were employed by a single employer.

"(6) LIABILITY FOR FUNDING TAX.—For a plan year the liability under section 4971 of each employer who is a party to the collective bargaining agreement shall be determined in a reasonable manner not inconsistent with regulations prescribed by the Secretary or his delegate—

"(A) first on the basis of their respective delinquencies in meeting required employer contributions under the plan, and

"(B) then on the basis of their respective liabilities for contributions under the plan.

"(7) DEDUCTION LIMITATIONS.—Each applicable limitation provided by section 404(a) shall be determined as if all participants in the plan were employed by a single employer. The amounts contributed to or under the plan by each employer who is a party to the agreement, for the portion of his taxable year which is included within such a plan year, shall be considered not to exceed such a limitation if the anticipated employer contributions for such plan year (determined in a manner consistent with the manner in which actual employer contributions for such plan year are determined) do not exceed such limitation. If such anticipated contributions exceed such a limitation, the portion of each such employer's contributions which is not deductible under section

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404 shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

"(8) EMPLOYEES OF LABOR UNIONS.—For purposes of this subsection, employees of employee representatives shall be treated as employees of an employer described in subsection (a)(1) if such representatives meet the requirements of sections 401(a)(4) and 410 with respect to such employees.

"(c) PLANS MAINTAINED BY MORE THAN ONE EMPLOYER.—In the case of a plan maintained by more than one employer—

"(1) PARTICIPATION.—Section 410(a) shall be applied as if all employees of each of the employers who maintain the plan were employed by a single employer.

"(2) EXCLUSIVE BENEFIT.—For purposes of section 401(a), in determining whether the plan of an employer is for the exclusive benefit of his employees and their beneficiaries all plan participants shall be considered to be his employees.

"(3) VESTING.—Section 411 shall be applied as if all employers who maintain the plan constituted a single employer, except that the application of any rules with respect to breaks in service shall be made under regulations prescribed by the Secretary of Labor.

"(4) FUNDING.—The minimum funding standard provided by section 412 shall be determined as if all participants in the plan were employed by a single employer.

"(5) LIABILITY FOR FUNDING TAX.—For a plan year the liability under section 4971 of each employer who maintains the plan shall be determined in a reasonable manner not inconsistent with regulations prescribed by the Secretary or his delegate—

"(A) first on the basis of their respective delinquencies in meeting required employer contributions under the plan, and

"(B) then on the basis of their respective liabilities for contributions under the plan.

"(6) DEDUCTION LIMITATIONS.—Each applicable limitation provided by section 404(a) shall be determined as if all participants in the plan were employed by a single employer. The amounts contributed to or under the plan by each employer who maintains the plan, for the portion of this taxable year which is included within such a plan year, shall be considered not to exceed such a limitation if the anticipated employer contributions for such plan year (determined in a reasonable manner not inconsistent with regulations prescribed by the Secretary or his delegate) do not exceed such limitation. If such anticipated contributions exceed such a limitation, the portion of each such employer's contributions which is not deductible under section 404 shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

Allocations of amounts under paragraphs (4), (5), and (6), among the employers maintaining the plan, shall not be inconsistent with regulations prescribed for this purpose by the Secretary or his delegate."

SEC. 1015. DEFINITIONS AND SPECIAL RULES.

Subpart B of part I of subchapter D of chapter 1 is amended by inserting after section 413 the following new section:

"SEC. 414. DEFINITIONS AND SPECIAL RULES.

"(a) SERVICE FOR PREDECESSOR EMPLOYER.—For purposes of this part—

"(1) in any case in which the employer maintains a plan of a predecessor employer, service for such predecessor shall be treated as service for the employer, and

"(2) in any case in which the employer maintains a plan which is not the plan maintained by a predecessor employer, service for such predecessor shall, to the extent provided in regulations prescribed by the Secretary or his delegate, be treated as service for the employer.

"(b) EMPLOYEES OF CONTROLLED GROUP OF CORPORATIONS.—For purposes of sections 401, 410, 411, and 415, all employees of all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(a)(4) and (e)(3)(C)) shall be treated as employed by a single employer. With respect to a plan adopted by more than one such corporation, the minimum funding standard of section 412, the tax imposed by section 4971, and the applicable limitations provided by section 404(a) shall be determined as if all such employers were a single employer, and allocated to each employer in accordance with regulations prescribed by the Secretary or his delegate.

"(c) EMPLOYEES OF PARTNERSHIPS, PROPRIETORSHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—For purposes of sections 401, 410, 411, and 415, under regulations prescribed by the Secretary or his delegate, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer. The regulations prescribed under this subsection shall be based on principles similar to the principles which apply in the case of subsection (b).

"(d) GOVERNMENTAL PLAN.—For purposes of this part, the term 'governmental plan' means a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term 'governmental plan' also includes any plan to which the Railroad Retirement Act of 1935 or 1937 applies and which is financed by contributions required under that Act and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669).

"(e) CHURCH PLAN.—

"(1) IN GENERAL.—For purposes of this part the term 'church plan' means—

"(A) a plan established and maintained for its employees by a church or by a convention or association of churches which is exempt from tax under section 501, or

"(B) a plan described in paragraph (3).

"(2) CERTAIN UNRELATED BUSINESS OR MULTIEMPLOYER PLANS.—The term 'church plan' does not include a plan—

"(A) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513), or

"(B) which is a plan maintained by more than one employer, if one or more of the employers in the plan is not a church (or a convention or association of churches) which is exempt from tax under section 501.

"(3) SPECIAL TEMPORARY RULE FOR CERTAIN CHURCH AGENCIES UNDER CHURCH PLAN.—

"(A) Notwithstanding the provisions of paragraph (2)(B), a plan in existence on January 1, 1974, shall be

treated as a church plan if it is established and maintained by a church or convention or association of churches and one or more agencies of such church (or convention or association) for the employees of such church (or convention or association) and the employees of one or more agencies of such church (or convention or association), and if such church (or convention or association) and each such agency is exempt from tax under section 501.

"(B) Subparagraph (A) shall not apply to any plan maintained for employees of an agency with respect to which the plan was not maintained on January 1, 1974.

"(C) Subparagraph (A) shall not apply with respect to any plan for any plan year beginning after December 31, 1982.

"(f) MULTIEMPLOYER PLAN.—

"(1) IN GENERAL.—For purposes of this part, the term 'multiemployer plan' means a plan—

"(A) to which more than one employer is required to contribute,

"(B) which is maintained pursuant to a collective-bargaining agreement between employee representatives and more than one employer,

"(C) under which the amount of contributions made under the plan for a plan year by each employer making such contributions is less than 50 percent of the aggregate amount of contributions made under the plan for that plan year by all employers making such contributions,

"(D) under which benefits are payable with respect to each participant without regard to the cessation of contributions by the employer who employed that participant except to the extent that such benefits accrued as a result of service with the employer before such employer was required to contribute to such plan, and

"(E) which satisfies such other requirements as the Secretary of Labor may by regulations prescribe.

"(2) SPECIAL RULES.—For purposes of this subsection—

"(A) If a plan is a multiemployer plan within the meaning of paragraph (1) for any plan year, subparagraph (C) of paragraph (1) shall be applied by substituting '75 percent' for '50 percent' for each subsequent plan year until the first plan year following a plan year in which the plan had one employer who made contributions of 75 percent or more of the aggregate amount of contributions made under the plan for that plan year by all employers making such contributions.

"(B) All corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(e)(3)(C)) shall be deemed to be one employer.

"(g) PLAN ADMINISTRATOR.—For purposes of this part, the term 'plan administrator' means—

"(1) the person specifically so designated by the terms of the instrument under which the plan is operated;

"(2) in the absence of a designation referred to in paragraph (1)—

"(A) in the case of a plan maintained by a single employer, such employer,

"(B) in the case of a plan maintained by two or more employers or jointly by one or more employers and one or

more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who maintained the plan, or

"(C) in any case to which subparagraph (A) or (B) does not apply, such other person as the Secretary or his delegate may by regulation, prescribe.

"(h) TAX TREATMENT OF CERTAIN CONTRIBUTIONS.—

"(1) IN GENERAL.—Effective with respect to taxable years beginning after December 31, 1973, for purposes of this title, any amount contributed—

"(A) to an employees' trust described in section 401(a), or

"(B) under a plan described in section 403(a) or 405(a), shall not be treated as having been made by the employer if it is designated as an employee contribution.

"(2) DESIGNATION BY UNITS OF GOVERNMENT.—For purposes of paragraph (1), in the case of any plan established by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions.

"(i) DEFINED CONTRIBUTION PLAN.—For purposes of this part, the term 'defined contribution plan' means a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

"(j) DEFINED BENEFIT PLAN.—For purposes of this part, the term 'defined benefit plan' means any plan which is not a defined contribution plan.

"(k) CERTAIN PLANS.—A defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall—

"(1) for purposes of section 410 (relating to minimum participation standards), be treated as a defined contribution plan,

"(2) for purposes of sections 411(a)(7)(A) (relating to minimum vesting standards) and 415 (relating to limitations on benefits and contributions under qualified plans), be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan, and

"(3) for purposes of section 4975 (relating to tax on prohibited transactions), be treated as a defined benefit plan.

"(l) MERGERS AND CONSOLIDATIONS OF PLANS OR TRANSFERS OF PLAN ASSETS.—A trust which forms a part of a plan shall not constitute a qualified trust under section 401 and a plan shall be treated as not described in section 403(a) or 405 unless in the case of any merger or consolidation of the plan with, or in the case of any transfer of assets or liabilities of such plan to, any other trust plan after the date of the enactment of the Employee Retirement Income Security Act of 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). This paragraph

shall apply in the case of a multiemployer plan only to the extent determined by the Pension Benefit Guaranty Corporation."

SEC. 1016. CONFORMING AND CLERICAL AMENDMENTS.

(a) CONFORMING AMENDMENTS.—

(1) Section 275(a) (relating to denial of deduction for certain taxes) is amended by adding at the end thereof the following new paragraph:

"(6) Taxes imposed by chapter 42 and chapter 43."

(2) Section 401(a) (relating to requirements for qualification) is amended—

(A) by striking out paragraph (3) and inserting in lieu thereof:

"(3) if the plan of which such trust is a part satisfies the requirements of section 410 (relating to minimum participation standards); and",

(B) by striking out "paragraph (3)(B) or (4)" in paragraph (5) and inserting in lieu thereof "paragraph (4) or section 410(b) (without regard to paragraph (1)(A) thereof)", and

(C) by striking out paragraph (7) and inserting in lieu thereof:

"(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards)."

(3) Section 404(a)(2) (relating to deduction for contributions of an employer to an employee's annuity plan) is amended by striking out "and (8)," and inserting in lieu thereof "(8), (11), (12), (13), (14), and (15)".

(4) Section 406(b)(1) (relating to certain employees of foreign subsidiaries) is amended by striking out "paragraphs (3)(B) and (4) of section 401(a)" and inserting in lieu thereof "section 401(a)(4) and section 410(b) (without regard to paragraph (1)(A) thereof)".

(5) Section 407(b)(1) (relating to certain employees of domestic subsidiaries engaged in business outside the United States) is amended by striking out "paragraph (3)(B) and (4) of section 401(a)" and inserting in lieu thereof "section 401(a)(4) and section 410(b) (without regard to paragraph (1)(A) thereof)".

(6) Section 805(d)(1)(C) (relating to definition of pension plan reserves) is amended by striking out "and (8)" and inserting in lieu thereof "(8), (11), (12), (13), (14), and (15)".

(7) Section 6161(b)(1) (relating to extensions of time for paying tax) is amended by striking out "or 42" and inserting in lieu thereof "42 or 43". The second sentence of section 6161(b) is amended by striking out "or 42" and inserting in lieu thereof ", 42, or chapter 43".

(8) Section 6201(d) (relating to assessment authority) is amended by striking out "and chapter 42" and inserting in lieu thereof ", chapter 42, and chapter 43".

(9) Section 6211 (defining deficiency) is amended—

(A) by striking out so much of subsection (a) as precedes paragraph (1) thereof and inserting in lieu thereof the following:

"(a) IN GENERAL.—For purposes of this title in the case of income, estate, and gift taxes imposed by subtitles A and B and excise taxes imposed by chapters 42 and 43, the term 'deficiency' means the amount

by which the tax imposed by subtitle A or B, or chapter 42 or 43, exceeds the excess of—"; and

(B) by striking out "chapter 42" in subsection (b)(2) and inserting in lieu thereof "chapter 42 or 43".

(10) Section 6212 (relating to notice of deficiency) is amended—

(A) by striking out "chapter 42" in subsection (a) and inserting in lieu thereof "chapter 42 or 43",

(B) by striking out "or chapter 42" in subsection (b)(1) and inserting in lieu thereof "chapter 42, or chapter 43",

(C) by striking out "chapter 42, and this chapter" in subsection (b)(1) and inserting in lieu thereof "chapter 42, chapter 43, and this chapter", and

(D) by striking out "of the same decedent," in subsection (c) and inserting in lieu thereof "of the same decedent, of chapter 43 tax for the same taxable years,".

(11) Section 6213 (relating to restrictions applicable to deficiencies and petition to Tax Court) is amended—

(A) by striking out "or chapter 42" in subsection (a) and inserting in lieu thereof ", chapter 42 or 43",

(B) by striking out the heading of subsection (e) and inserting in lieu thereof:

"(e) SUSPENSION OF FILING PERIOD FOR CERTAIN EXCISE TAXES.—",

(C) by striking out "or 4945 (relating to taxes on taxable expenditures)" in subsection (e) and inserting in lieu thereof "4945 (relating to taxes on taxable expenditures), 4971 (relating to excise taxes on failure to meet minimum funding standard), 4975 (relating to excise taxes on prohibited transactions)"; and

(D) by striking out "or 4945(h)(2)" in subsection (e) and inserting in lieu thereof ", 4945(i)(2), 4971(c)(3), or 4975(f)(4),".

(12) Section 6214 (relating to determinations by Tax Court) is amended—

(A) by amending the heading of subsection (c) to read as follows:

"(c) TAXES IMPOSED BY SECTION 507 OR CHAPTER 42 OR 43.—",

(B) by inserting after "chapter 42" each place it appears in subsection (c) "or 43"; and

(C) by striking out "chapter 42" in subsection (d) and inserting in lieu thereof "chapter 42 or 43".

(13) Section 6344(a)(1) (relating to cross references) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 43".

(14) Section 6501(e)(3) (relating to limitations on assessment and collection) is amended by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 43".

(15) Section 6503 (relating to suspension of running of period of limitations) is amended—

(A) by striking out "chapter 42 taxes)" in subsection (a)(1) and inserting in lieu thereof "certain excise taxes)", and

(B) by inserting after "section 507" in subsection (h) "or section 4971 or section 4975", and by striking out "or 4945(h)(2)" in subsection (h) and inserting in lieu thereof "4945(i)(2), 4971(c)(3), or 4975(f)(4)".

(16) Section 6512 (relating to limitations in case of petition to Tax Court) is amended by striking out "chapter 42" each place it appears therein and inserting in lieu thereof "chapter 42 or 43".

(17) Section 6601(d) (relating to interest on underpayment,

nonpayment, or extensions of time for payment of tax) is amended by—

(A) striking out in the heading thereof "CHAPTER 42" and inserting in lieu thereof "CHAPTER 42 OR 43", and

(B) striking out "chapter 42" and inserting in lieu thereof "certain excise".

(18) Section 6653(c)(1) (relating to income, estate, gift, and chapter 42 taxes) is amended by striking out "chapter 42" each place it appears therein (including the heading) and inserting in lieu thereof "certain excise".

(19) Section 6659(b) (relating to applicable rules) is amended by striking out "chapter 42" and inserting in lieu thereof "certain excise".

(20) Section 6676(b) (relating to failure to supply identifying numbers) is amended by striking out "chapter 42" and inserting in lieu thereof "and certain excise".

(21) Section 6677(b) (relating to failure to file information returns with respect to certain foreign trusts) is amended by striking out "chapter 42" and inserting in lieu thereof "and certain excise".

(22) Section 6679(b) (relating to failure to file returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock) is amended by striking out "chapter 42" and inserting in lieu thereof "and certain excise".

(23) Section 6682(b) (relating to false information with respect to withholding allowances based on itemized deductions) is amended by striking out "chapter 42" and inserting in lieu thereof "and certain excise".

(24) The heading of section 6861 (relating to jeopardy assessments of income, estate, and gift taxes) is amended by striking out "and gift taxes.", and inserting in lieu thereof ", gift, and certain excise taxes.".

(25) Section 6862 (relating to jeopardy assessment of taxes other than income, estate, and gift taxes) is amended—

(A) by striking out "and Gift Taxes.", in the heading and inserting in lieu thereof ", Gift, and Certain Excise Taxes.",

(B) by striking out "and gift tax)" in subsection (a) and inserting in lieu thereof "gift tax, and certain excise taxes)".

(26) Section 7422 (relating to civil actions for refund) is amended—

(A) by striking out "chapter 42" and inserting in lieu thereof "chapter 42 or 43" in subsection (e),

(B) by striking out "CHAPTER 42" in the heading of subsection (g) and inserting in lieu thereof "CHAPTER 42 or 43",

(C) by striking out "or 4945" in subsection (g)(1) and inserting in lieu thereof "4945, 4971, or 4975",

(D) by striking out "section 4945(a) (relating to initial taxes on taxable expenditures)" in subsection (g)(1) and inserting in lieu thereof "section 4945(a) (relating to initial taxes on taxable expenditures), 4971(a) (relating to initial tax on failure to meet minimum funding standard), 4975(a) (relating to initial tax on prohibited transactions)",

(E) by striking out "or section 4945(b) (relating to additional taxes on taxable expenditures)" in subsection (g)(1) and inserting in lieu thereof "section 4945(b) (relating to additional taxes on taxable expenditures), section 4971(b) (relating to additional tax on failure to meet minimum fund-

ing standard), or section 4975(b) (relating to additional tax on prohibited transactions)", and

(F) by striking out "or 4945" in paragraphs (2) and (3) of subsection (g) and inserting in lieu thereof "4945, 4971, or 4975".

(27) Section 6204(b) (relating to supplemental assessments) is amended by striking out "and gift taxes" and inserting in lieu thereof "gift, and certain excise taxes".

(b) CLERICAL AMENDMENTS.—

(1) Part I of subchapter D of chapter 1 is amended by inserting after the heading and before the table of sections the following:

"Subpart A. General rule.
"Subpart B. Special rules.

"Subpart A—General Rule".

(2) The table of chapters for subtitle D is amended by adding at the end thereof the following new item:

"CHAPTER 43. Qualified pension, etc., plans."

(3) The table of sections for subchapter B of chapter 68 is amended by striking out the item relating to the section captioned "Assessable penalties with respect to information required to be furnished under section 7654" and inserting in lieu thereof:

"Sec. 6688. Assessable penalties with respect to information required to be furnished under section 7654."

(4) Subchapter B of chapter 68 is amended by striking out the heading of the section immediately preceding section 6689 and inserting in lieu thereof:

"SEC. 6688. ASSESSABLE PENALTIES WITH RESPECT TO INFORMATION REQUIRED TO BE FURNISHED UNDER SECTION 7654."

(5) The table of sections for part II of subchapter A of chapter 70 is amended by striking out "and gift taxes" in the items relating to sections 6861 and 6862 and inserting in lieu thereof "gift, and certain excise taxes".

SEC. 1017. EFFECTIVE DATES AND TRANSITIONAL RULES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this part shall apply for plan years beginning after the date of the enactment of this Act.

(b) EXISTING PLANS.—Except as otherwise provided in subsections (c) through (h), in the case of a plan in existence on January 1, 1974, the amendments made by this part shall apply for plan years beginning after December 31, 1975.

(c) EXISTING PLANS UNDER COLLECTIVE BARGAINING AGREEMENTS.—

(1) APPLICATION OF VESTING RULES TO CERTAIN PLAN PROVISIONS.—

(A) WAIVER OF APPLICATION.—In the case of a plan maintained on January 1, 1974, pursuant to one or more agreements which the Secretary of Labor finds to be collective bargaining agreements between employee representatives and one or more employers, during the special temporary waiver period the plan shall not be treated as not meeting the requirements of section 411(b) (1) or (2) of the Internal Revenue Code of

1954 solely by reason of a supplementary or special plan provision (within the meaning of subparagraph (D)).

(B) SPECIAL TEMPORARY WAIVER PERIOD.—For purposes of this paragraph, the term "special temporary waiver period" means plan years beginning after December 31, 1975, and before the earlier of—

(i) the date on which the last of the collective bargaining agreements relating to the plan terminates (determined without regard to any extension thereof agreed to after the date of the enactment of this Act), or

(ii) January 1, 1981.

For purposes of clause (i), any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement contained in this Act shall not be treated as a termination of such collective bargaining agreement.

(C) DETERMINATION BY SECRETARY OF LABOR REQUIRED.—Subparagraph (A) shall not apply unless the Secretary of Labor determines that the participation and vesting rules in effect on the date of the enactment of this Act are not less favorable to the employees, in the aggregate, than the rules provided under sections 410 and 411 of the Internal Revenue Code of 1954.

(D) SUPPLEMENTARY OR SPECIAL PLAN PROVISIONS.—For purposes of this paragraph, the term "supplementary or special plan provision" means any plan provision which—

(i) provides supplementary benefits, not in excess of one-third of the basic benefit, in the form of an annuity for the life of the participant, or

(ii) provides that, under a contractual agreement based on medical evidence as to the effects of working in an adverse environment for an extended period of time, a participant having 25 years of service is to be treated as having 30 years of service.

(2) APPLICATION OF FUNDING RULES.—

(A) IN GENERAL.—In the case of a plan maintained on January 1, 1974, pursuant to one or more agreements which the Secretary of Labor finds to be collective bargaining agreements between employee representatives and one or more employers, section 412 of the Internal Revenue Code of 1954, and other amendments made by this part to the extent such amendments relate to such section 412, shall not apply during the special temporary waiver period (as defined in paragraph (1)(B)).

(B) WAIVER OF UNDERFUNDING.—In the case of a plan maintained on January 1, 1974, pursuant to one or more agreements which the Secretary of Labor finds to be collective bargaining agreements between employee representatives and one or more employers, if by reason of subparagraph (A) the requirements of section 401(a)(7) of the Internal Revenue Code of 1954 apply without regard to the amendment of such section 401(a)(7) by section 1016(a)(2)(C) of this Act, the plan shall not be treated as not meeting such requirements solely by reason of the application of the amendments made by sections 1011 and 1012 of this Act or related amendments made by this part.

(C) LABOR ORGANIZATION CONVENTIONS.—In the case of a plan maintained by a labor organization, which is exempt from tax under section 501(c)(5) of the Internal Revenue

Code of 1954, exclusively for the benefit of its employees and their beneficiaries, section 412 of such Code and other amendments made by this part to the extent such amendments relate to such section 412, shall be applied by substituting for the term "December 31, 1975" in subsection (b), the earlier of—

(i) the date on which the second convention of such labor organization held after the date of the enactment of this Act ends, or

(ii) December 31, 1980,

but in no event shall a date earlier than the later of December 31, 1975, or the date determined under subparagraph (A) or (B) be substituted.

(d) EXISTING PLANS MAY ELECT NEW PROVISIONS.—In the case of a plan in existence on January 1, 1974, the provisions of the Internal Revenue Code of 1954 relating to participation, vesting, funding, and form of benefit (as in effect from time to time) shall apply in the case of the plan year (which begins after the date of the enactment of this Act but before the applicable effective date determined under subsection (b) or (c)) selected by the plan administrator and to all subsequent plan years, if the plan administrator elects (in such manner and at such time as the Secretary of the Treasury or his delegate shall by regulations prescribe) to have such provisions so apply. Any election made under this subsection, once made, shall be irrevocable.

(e) CERTAIN DEFINITIONS AND SPECIAL RULES.—Section 414 of the Internal Revenue Code of 1954 (other than subsections (b) and (c) of such section 414), as added by section 1015(a) of this Act, shall take effect on the date of the enactment of this Act.

(f) TRANSITIONAL RULES WITH RESPECT TO BREAKS IN SERVICE.—

(1) PARTICIPATION.—In the case of a plan to which section 410 of the Internal Revenue Code of 1954 applies, if any plan amendment with respect to breaks in service (which amendment is made or becomes effective after January 1, 1974, and before the date on which such section 410 first becomes effective with respect to such plan) provides that any employee's participation in the plan would commence at any date later than the later of—

(A) the date on which his participation would commence under the break in service rules of section 410(a)(5) of such Code, or

(B) the date on which his participation would commence under the plan as in effect on January 1, 1974,

such plan shall not constitute a plan described in section 403(a) or 405(a) of such Code and a trust forming a part of such plan shall not constitute a qualified trust under section 401(a) of such Code.

(2) VESTING.—In the case of a plan to which section 411 of the Internal Revenue Code of 1954 applies, if any plan amendment with respect to breaks in service (which amendment is made or becomes effective after January 1, 1974, and before the date on which such section 411 first becomes effective with respect to such plan) provides that the nonforfeitable benefit derived from employer contributions to which any employee would be entitled is less than the lesser of the nonforfeitable benefit derived from employer contributions to which he would be entitled under—

(A) the break in service rules of section 411(a)(6) of such Code, or

(B) the plan as in effect on January 1, 1974,

such plan shall not constitute a plan described in section 403(a) or 405(a) of such Code and a trust forming a part of such plan shall not constitute a qualified trust under section 401(a) of such Code. Subparagraph (B) shall not apply if the break in service rules under the plan would have been in violation of any law or rule of law in effect on January 1, 1974.

(g) 3-YEAR DELAY FOR CERTAIN PROVISIONS.—Subparagraphs (B) and (C) of section 404(a)(1) shall apply only in the case of plan years beginning on or after 3 years after the date of the enactment of this Act.

(h)(1) Except as provided in paragraph (2), section 413 of the Internal Revenue Code of 1954 shall apply to plan years beginning after December 31, 1953.

(2)(A) For plan years beginning before the applicable effective date of section 410 of such Code, the provisions of paragraphs (1) and (8) of subsection (b) of such section 413 shall be applied by substituting "401(a)(3)" for "410".

(B) For plan years beginning before the applicable effective date of section 411 of such Code, the provisions of subsection (b)(2) of such section 413 shall be applied by substituting "401(a)(7)" for "411(d)(3)".

(C)(i) The provisions of subsection (b)(4) of such section 413 shall not apply to plan years beginning before the applicable effective date of section 411 of such Code.

(ii) The provisions of subsection (b)(5) (other than the second sentence thereof) of such section 413 shall not apply to plan years beginning before the applicable effective date of section 412 of such Code.

PART 2—CERTAIN OTHER PROVISIONS RELATING TO QUALIFIED RETIREMENT PLANS

SEC. 1021. ADDITIONAL PLAN REQUIREMENTS.

(a) JOINT AND SURVIVOR ANNUITY REQUIREMENT.—

(1) IN GENERAL.—Effective with respect to plan years beginning after December 31, 1975, section 401(a) (relating to requirements for qualification) is amended by inserting after paragraph (10) the following new paragraph:

"(11)(A) A trust shall not constitute a qualified trust under this section if the plan of which such trust is a part provides for the payment of benefits in the form of an annuity unless such plan provides for the payment of annuity benefits in a form having the effect of a qualified joint and survivor annuity.

"(B) Notwithstanding the provisions of subparagraph (A), in the case of a plan which provides for the payment of benefits before the normal retirement age (as defined in section 411(a)(8)), the plan is not required to provide for the payment of annuity benefits in a form having the effect of a qualified joint and survivor annuity during the period beginning on the date on which the employee enters into the plan as a participant and ending on the later of—

"(i) the date the employee reaches the earliest retirement age under the plan, or

"(ii) the first day of the 120th month beginning before the date on which the employee reaches normal retirement age.

"(C) A plan described in subparagraph (B) does not meet the requirements of subparagraph (A) unless, under the plan, a participant has a reasonable period during which he may elect the qualified joint and survivor annuity form with respect to the period beginning on the date on which the period described in subparagraph (B) ends and ending on the date on which he reaches normal retirement age (as defined in section 411(a)(8)) if he continues his employment during that period. A plan does not meet the requirements of this subparagraph unless, in the case of such an election, the payments under the survivor annuity are not less than the payments which would have been made under the

joint annuity to which the participant would have been entitled if he made an election described in this subparagraph immediately prior to his retirement and if his retirement had occurred on the day before his death and within the period within which an election can be made.

"(D) A plan shall not be treated as not satisfying the requirements of this paragraph solely because the spouse of the participant is not entitled to receive a survivor annuity (whether or not an election described in subparagraph (C) has been made under subparagraph (C)) unless the participant and his spouse have been married throughout the 1-year period ending on the date of such participant's death.

"(E) A plan shall not be treated as satisfying the requirements of this paragraph unless, under the plan, each participant has a reasonable period (as described by the Secretary or his delegate by regulations) before the annuity starting date during which he may elect in writing (after having received a written explanation of the terms and conditions of the joint and survivor annuity and the effect of an election under this subparagraph) not to take such joint and survivor annuity.

"(F) A plan shall not be treated as not satisfying the requirements of this paragraph solely because under the plan there is a provision that any election described in subparagraph (C) or (E), and any revocation of any such election, does not become effective (or ceases to be effective) if the participant dies within a period (not in excess of 2 years) beginning on the date of such election or revocation, as the case may be. The preceding sentence does not apply unless the plan provision described in the preceding sentence also provides that such an election or revocation will be given effect in any case in which—

"(i) the participant dies from accidental causes,

"(ii) a failure to give effect to the election or revocation would deprive the participant's survivor of a survivor annuity, and

"(iii) such election or revocation is made before such accident occurred.

"(G) For purposes of this paragraph—

"(i) the term 'annuity starting date' means the first day of the first period for which an amount is received as an annuity (whether by reason of retirement or by reason of disability),

"(ii) the term 'earliest retirement age' means the earliest date on which, under the plan, the participant could elect to receive retirement benefits, and

"(iii) the term 'qualified joint and survivor annuity' means an annuity for the life of the participant with a survivor annuity for the life of his spouse which is not less than one-half of, or greater than, the amount of the annuity payable during the joint lives of the participant and his spouse and which is the actuarial equivalent of a single life annuity for the life of the participant.

For purposes of this paragraph, a plan may take into account in any equitable manner (as determined by the Secretary or his delegate) any increased costs resulting from providing joint and survivor annuity benefits.

"(H) This paragraph shall apply only if—

"(i) the annuity starting date did not occur before the effective date of this paragraph, and

"(ii) the participant was an active participant in the plan on or after such effective date."

(2) CERTAIN ADDITIONAL REQUIREMENTS APPLY ONLY TO PLANS TO WHICH VESTING REQUIREMENTS APPLY.—Section 401(a) (relating to requirements for qualification) is amended by adding at the end thereof the following new sentence: "Paragraphs (11), (12), (13), (14), (15), and (19) shall apply only in the case of a plan to which section 411 (relating to minimum vesting standards) applies without regard to subsection (e)(2) of such section."

(b) REQUIREMENTS IN CASE OF MERGERS AND CONSOLIDATIONS OF PLANS OR TRANSFERS OF PLAN ASSETS.—Effective with respect to plan years beginning after December 31, 1975, section 401(a) is amended by inserting after paragraph (11) the following new paragraph:

"(12) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that in the case of any merger or consolidation with, or transfer of assets or liabilities to, any other plan after the date of the enactment of the Employee Retirement Income Security Act of 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). This paragraph shall apply in the case of a multiemployer plan only to the extent determined by the Pension Benefit Guaranty Corporation."

(c) RETIREMENT BENEFITS MAY NOT BE ASSIGNED OR ALIENATED.—Section 401(a) is amended by inserting after paragraph (12) the following new paragraph:

"(13) A trust shall not constitute a qualified trust under thi section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated. For purposes of the preceding sentence, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 (relating to tax on prohibited transactions) by reason of section 4975 (d)(1). This paragraph shall take effect on January 1, 1976 and shall not apply to assignments which were irrevocable on the date of the enactment of the Employee Retirement Income Security Act of 1974."

(d) REQUIREMENT THAT PAYMENT OF BENEFITS BEGIN NOT LATER THAN WHEN THE PARTICIPANT ATTAINS AGE 65 OR HAS COMPLETED 10 YEARS OF PARTICIPATION.—Section 401(a) is amended by inserting after paragraph (13) the following new paragraph:

"(14) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, unless the participant otherwise elects, the payment of benefits under the plan to the participant will begin not later than the 60th day after the latest of the close of the plan year in which—

"(A) the date on which the participant attains the earlier of age 65 or the normal retirement age specified under the plan,

"(B) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or

"(C) the participant terminates his service with the employer.

In the case of a plan which provides for the payment of an early retirement benefit, a trust forming a part of such plan shall not constitute a qualified trust under this section unless a participant who satisfied the service requirements for such early retirement benefit, but separated from the service (with any nonforfeitable right to an accrued benefit) before satisfying the age requirement for such early retirement benefit, is entitled upon satisfaction of such age requirement to receive a benefit not less than the benefit to which he would be entitled at the normal retirement age, actuarially, reduced under regulations prescribed by the Secretary or his delegate."

(e) REQUIREMENT THAT PLAN BENEFITS ARE NOT DECREASED BY CERTAIN SOCIAL SECURITY INCREASES.—Section 401(a) is amended by inserting after paragraph (14) the following new paragraph:

"(15) a trust shall not constitute a qualified trust under this section unless under the plan of which such trust is a part—

"(A) in the case of a participant or beneficiary who is receiving benefits under such plan, or

"(B) in the case of a participant who is separated from the service and who has nonforfeitable rights to benefits,

such benefits are not decreased by reason of any increase in the benefit levels payable under title II of the Social Security Act or any increase in the wage base under such title II, if such increase takes place after the date of the enactment of the Employee Retirement Income Security Act of 1974 or (if later) the earlier of the date of first receipt of such benefits or the date of such separation, as the case may be."

(f) REQUIREMENT OF NONFORFEITABILITY IN CASE OF CERTAIN WITHDRAWALS.—Section 401(a) is amended by inserting after paragraph (18) the following new paragraph:

"(19) A trust shall not constitute a qualified trust under this section if under the plan of which such trust is a part any part of a participant's accrued benefit derived from employer contributions (whether or not otherwise nonforfeitable), is forfeitable solely because of withdrawal by such participant of any amount attributable to the benefit derived from contributions made by such participant. The preceding sentence shall not apply to the accrued benefit of any participant unless, at the time of such withdrawal, such participant has a nonforfeitable right to at least 50 percent of such accrued benefit (as determined under section 411). The first sentence of this paragraph shall not apply to the extent that an accrued benefit is permitted to be forfeited in accordance with section 411(a)(3)(D)(iii) (relating to proportional forfeitures of benefits accrued before enactment of the Employee Retirement Income Security Act of 1974, in the event of withdrawal of certain mandatory contributions)."

SEC. 1022. MISCELLANEOUS PROVISIONS.

(a) REQUIREMENT THAT PLAN NOT BE DISCRIMINATORY.—Section 401(a)(4) (disqualifying discriminatory plans) is amended to read as follows:

"(4) If the contributions or the benefits provided under the plan do not discriminate in favor of employees who are—

"(A) officers,

"(B) shareholders, or

"(C) highly compensated.

For purposes of this paragraph, there shall be excluded from consideration employees described in section 410(b)(2)(A) and (C)."

(b) AMENDMENTS RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—

(1) AMENDMENT OF SECTION (401)(a)(10).—So much of subparagraph (A) of section 401(a)(10) as precedes clause (i) thereof is amended to read as follows:

"(A) paragraph (3), the first and second sentences of paragraph (5), and section 410 shall not apply, but—".

(2) AMENDMENT OF SECTION (401)(d)(3).—Section 401(d)(3) (relating to additional requirements for qualification of trusts and and plans benefiting owner-employees) is amended to read as follows:

"(3)(A) The plan benefits each employee having 3 or more years of service (within the meaning of section 410(a)(3)).

"(B) For purposes of subparagraph (A), the term 'employee' does not include—

"(i) any employee included in a unit of employees covered by a collective-bargaining agreement described in section 410(b)(2)(A), and

"(ii) any employee who is a nonresident alien individual described in section 410(b)(2)(C)."

(c) PERSONS OTHER THAN BANKS MAY BE TRUSTEES OF TRUSTS BENEFITTING OWNER-EMPLOYEES.—

(1) The first sentence of section 401(d)(1) is amended to read as follows: "In the case of a trust which is created on or after October 10, 1962, or which was created before such date but is not exempt from tax under section 501(a) as an organization described in subsection (a) on the day before such date, the assets thereof are held by a bank or other person who demonstrates to the satisfaction of the Secretary or his delegate that the manner in which he will administer the trust will be consistent with the requirements of this section. A trust shall not be disqualified under this paragraph merely because a person (including the employer) other than the trustee or custodian so administering the trust may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments (including reinvestments, disposals, and exchanges) or by disapproving proposed investments (including reinvestments, disposals, or exchanges)."

(2) The second sentence of section 401(d)(1) is amended by striking out "the date of the enactment of this subsection" and inserting in lieu thereof "October 10, 1962,".

(d) CERTAIN CUSTODIAL ACCOUNTS.—Effective as of January 1, 1974, subsection (f) of section 401 (relating to certain custodial accounts) is amended to read as follows:

"(f) CERTAIN CUSTODIAL ACCOUNTS AND ANNUITY CONTRACTS.—For purposes of this title, a custodial account or an annuity contract shall be treated as a qualified trust under this section if—

"(1) the custodial account or annuity contract would, except for the fact that it is not a trust, constitute a qualified trust under this section, and

"(2) in the case of a custodial account the assets thereof are held by a bank (as defined in subsection (d)(1)) or another person who demonstrates, to the satisfaction of the Secretary or his delegate, that the manner in which he will hold the assets will be consistent with the requirements of this section.

For purposes of this title, in the case of a custodial account or annuity contract treated as a qualified trust under this section by reason of this subsection, the person holding the assets of such account or holding such contract shall be treated as the trustee thereof."

(e) CUSTODIAL ACCOUNTS FOR REGULATED INVESTMENT COMPANY STOCK.—Effective as of January 1, 1974, section 403(b) (relating to taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school) is amended by adding at the end thereof the following new paragraph:

"(7) CUSTODIAL ACCOUNTS FOR REGULATED INVESTMENT COMPANY STOCK.—

"(A) AMOUNTS PAID TREATED AS CONTRIBUTIONS.—For purposes of this title, amounts paid by an employer described in paragraph (1)(A) to a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as amounts contributed by him for an annuity contract for his employee if the amounts are paid to provide a retirement benefit for that employee and are to be invested in regulated investment company stock to be held in that custodial account.

"(B) ACCOUNT TREATED AS PLAN.—For purposes of this title, a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as an organization described in section 401(a) solely for purposes of subchapter F and subtitle F with respect to amounts received by it (and income from investment thereof).

"(C) REGULATED INVESTMENT COMPANY.—For purposes of this paragraph, the term 'regulated investment company' means a domestic corporation which is a regulated investment company within the meaning of section 851(a), and which issues only redeemable stock."

(f) INSURED CREDIT UNIONS.—Effective as of January 1, 1974, the last sentence of section 401(d)(1) is amended by striking out "section 581," and inserting in lieu thereof "section 581, an insured credit union (within the meaning of section 101(6) of the Federal Credit Union Act),".

(g) PUBLIC INSPECTION OF CERTAIN INFORMATION WITH RESPECT TO PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.—

(1) AMENDMENT OF SECTION 6104(a).—Paragraph (1) of section 6104(a) (relating to public inspection of applications for tax exemption) is amended—

(A) by redesignating subparagraph (B) as subparagraph (D) and by inserting after subparagraph (A) the following new subparagraphs:

"(B) PENSION, ETC., PLANS.—The following shall be open to public inspection at such times and in such places as the Secretary or his delegate may prescribe:

"(i) any application filed with respect to the qualification of a pension, profit-sharing, or stock bonus plan

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under section 401(a), 403(a), or 405(a), an individual retirement account described in section 408(a), or an individual retirement annuity described in section 408(b),

"(ii) any application filed with respect to the exemption from tax under section 501(a) of an organization forming part of a plan or account referred to in clause (i),

"(iii) any papers submitted in support of an application referred to in clause (i) or (ii), and

"(iv) any letter or other document issued by the Internal Revenue Service and dealing with the qualification referred to in clause (i) or the exemption from tax referred to in clause (ii).

Except in the case of a plan participant, this subparagraph shall not apply to any plan referred to in clause (i) having not more than 25 participants.

"(C) CERTAIN NAMES AND COMPENSATION NOT TO BE OPENED TO PUBLIC INSPECTION.—In the case of any application, document, or other papers, referred to in subparagraph (B), information from which the compensation (including deferred compensation) of any individual may be ascertained shall not be open to public inspection under subparagraph (B)."

(B) The heading of subparagraph (A) of section 6104(a)(1) is amended to read as follows:

"(A) ORGANIZATIONS DESCRIBED IN SECTION 501.—".

(C) The heading of subparagraph (D) of section 6104(a)(1) as redesignated by subparagraph (A) of this paragraph is amended to read as follows:

"(D) WITHHOLDING OF CERTAIN OTHER INFORMATION.—".

(D) Subparagraph (D) of section 6104(a)(1) (as so redesignated) is amended by striking out "subparagraph (A)" each place it appears and inserting in lieu thereof "subparagraph (A) or (B)".

(2) AMENDMENT OF SECTION 6104(a)(2).—Subparagraph (A) of section 6104(a)(2) is amended by adding at the end thereof "any application referred to in subparagraph (B) of subsection (a)(1) of this section, and".

(3) AMENDMENT OF SECTION 6104(b).—Section 6104(b) (relating to inspection of annual information returns) is amended by striking out "and 6056" and inserting in lieu thereof "6956, and 6058".

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to applications filed (or documents issued) after the date of enactment of this Act.

(h) PUBLICITY OF RETURNS.—Effective on the date of the enactment of this Act, section 6103 (relating to publicity of returns and disclosure of information as to persons filing income tax returns) is amended by adding at the end thereof a new subsection (g) to read as follows:

"(g) DISCLOSURE OF INFORMATION WITH RESPECT TO DEFERRED COMPENSATION PLANS.—The Secretary or his delegate is authorized to furnish—

"(1) returns with respect to any tax imposed by this title or information with respect to such returns to the proper officers and employees of the Department of Labor and the Pension Benefit

Guaranty Corporation for purposes of administration of Titles I and IV of the Employee Retirement Income Security Act of 1974, and

"(2) registration statements (as described in section 6057) and information with respect to such statements to the proper officers and employees of the Department of Health, Education, and Welfare for purposes of administration of section 1131 of the Social Security Act."

(i) CERTAIN PUERTO RICAN PENSION, ETC., PLANS TO BE EXEMPT FROM TAX UNDER SECTION 501(a).—

(1) GENERAL RULE.—Effective for taxable years beginning after December 31, 1973, for purposes of section 501(a) of the Internal Revenue Code of 1954 (relating to exemption from tax), any trust forming part of a pension, profit-sharing, or stock bonus plan all of the participants of which are residents of the Commonwealth of Puerto Rico shall be treated as an organization described in section 401(a) of such Code if such trust—

(A) forms part of a pension, profit-sharing, or stock bonus plan, and

(B) is exempt from income tax under the laws of the Commonwealth of Puerto Rico.

(2) ELECTION TO HAVE PROVISIONS OF, AND AMENDMENTS MADE BY, TITLE II OF THIS ACT APPLY.—

(A) If the administrator of a pension, profit-sharing, or stock bonus plan which is created or organized in Puerto Rico elects, at such time and in such manner as the Secretary of the Treasury may require, to have the provisions of this paragraph apply, for plan years beginning after the date of election any trust forming a part of such plan shall be treated as a trust created or organized in the United States for purposes of section 401(a) of the Internal Revenue Code of 1954.

(B) An election under subparagraph (A), once made, is irrevocable.

(C) This paragraph applies to plan years beginning after the date of enactment of this Act.

(D) The source of any distributions made under a plan which makes an election under this paragraph to participants and beneficiaries residing outside of the United States shall be determined, for purposes of subchapter N of chapter 1 of the Internal Revenue Code of 1954, by the Secretary of the Treasury in accordance with regulations prescribed by him. For purposes of this subparagraph the United States means the United States as defined in section 7701(a)(9) of the Internal Revenue Code of 1954.

(j) YEAR OF DEDUCTION FOR CERTAIN EMPLOYER CONTRIBUTIONS FOR SEVERANCE PAYMENTS REQUIRED BY FOREIGN LAW.—Effective for taxable years beginning after December 31, 1973, if—

(1) an employer is engaged in a trade or business in a foreign country,

(2) such employer is required by the laws of that country to make payments, based on periods of service, to its employees or their beneficiaries after the employees' retirement, death, or other separation from the service, and

(3) such employer establishes a trust (whether organized

within or outside the United States) for the purpose of funding the payments required by such law,

then, in determining for purposes of paragraph (5) of section 404(a) of the Internal Revenue Code of 1954 the taxable year in which any contribution to or under the plan is includible in the gross income of the nonresident alien employees of such employer, such paragraph (5) shall be treated as not requiring that separate accounts be maintained for such nonresident alien employees.

(k) RECEIPTS FOR EMPLOYEES.—Section 6051 (relating to receipts for employees) is amended by inserting after "exemption," in subsection (a) the following: "or every employer engaged in a trade or business who pays remuneration for services performed by an employee, including the cash value of such remuneration paid in any medium other than cash,".

SEC. 1023. RETROACTIVE CHANGES IN PLAN.

Section 401(b) (relating to certain retroactive changes in plan) is amended to read as follows:

"(b) CERTAIN RETROACTIVE CHANGES IN PLAN.—A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the requirements of subsection (a) for the period beginning with the date on which it was put into effect, or for the period beginning with the earlier of the date on which there was adopted or put into effect any amendment which caused the plan to fail to satisfy such requirements, and ending with the time prescribed by law for filing the return of the employer for his taxable year in which such plan or amendment was adopted (including extensions thereof) or such later time as the Secretary or his delegate may designate, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes for the whole of such period."

SEC. 1024. EFFECTIVE DATES.

Except as otherwise provided in section 1021, the amendments made by section 1021 shall apply to plan years to which part I applies. Except as otherwise provided in section 1022, the amendments made by section 1022 shall apply to plan years to which part I applies. Section 1023 shall take effect on the date of the enactment of this Act.

PART 3—REGISTRATION AND INFORMATION

SEC. 1031. REGISTRATION AND INFORMATION.

(a) ANNUAL REGISTRATION AND INFORMATION RETURNS.—Part III of subchapter A of chapter 61 (relating to information returns) is amended by adding at the end thereof the following new subpart:

"SUBPART E—REGISTRATION OF AND INFORMATION CONCERNING PENSION, ETC., PLANS

"Sec. 6057. Annual registration, etc.
"Sec. 6058. Information required in connection with certain plans of deferred compensation.
"Sec. 6059. Periodic report by actuary.

"SEC. 6057. ANNUAL REGISTRATION, ETC.

"(a) ANNUAL REGISTRATION.—

"(1) GENERAL RULE.—Within such period after the end of a plan year as the Secretary or his delegate may by regulations prescribe, the plan administrator (within the meaning of section 414(g)) of each plan to which the vesting standards of section 203 of part 2 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 applies for such plan year shall file a registration statement with the Secretary or his delegate.

"(2) CONTENTS.—The registration statement required by paragraph (1) shall set forth—

"(A) the name of the plan,

"(B) the name and address of the plan administrator,

"(C) the name and taxpayer identifying number of each participant in the plan—

"(i) who, during such plan year, separated from the service covered by the plan,

"(ii) who is entitled to a deferred vested benefit under the plan as of the end of such plan year, and

"(iii) with respect to whom retirement benefits were not paid under the plan during such plan year,

"(D) the nature, amount, and form of the deferred vested benefit to which such participant is entitled, and

"(E) such other information as the Secretary or his delegate may require.

At the time he files the registration statement under this subsection, the plan administrator shall furnish evidence satisfactory to the Secretary or his delegate that he has complied with the requirement contained in subsection (e).

"(b) NOTIFICATION OF CHANGE IN STATUS.—Any plan administrator required to register under subsection (a) shall also notify the Secretary or his delegate, at such time as may be prescribed by regulations, of—

"(1) any change in the name of the plan,

"(2) any change in the name or address of the plan administrator,

"(3) the termination of the plan, or

"(4) the merger or consolidation of the plan with any other plan or its division into two or more plans.

"(c) VOLUNTARY REPORTS.—To the extent provided in regulations prescribed by the Secretary or his delegate, the Secretary or his delegate may receive from—

"(1) any plan to which subsection (a) applies, and

"(2) any other plan (including any governmental plan or church plan (within the meaning of section 414)),

such information (including information relating to plan years beginning before January 1, 1974) as the plan administrator may wish to file with respect to the deferred vested benefit rights of any participant separated from the service covered by the plan during any plan year.

"(d) TRANSMISSION OF INFORMATION TO SECRETARY OF HEALTH, EDUCATION, AND WELFARE.—The Secretary or his delegate shall transmit copies of any statements, notifications, reports, or other information obtained by him under this section to the Secretary of Health, Education, and Welfare.

"(e) INDIVIDUAL STATEMENT TO PARTICIPANT.—Each plan administrator required to file a registration statement under subsection (a) shall, before the expiration of the time prescribed for the filing of such registration statement, also furnish to each participant described in subsection (a)(2)(C) an individual statement setting forth the information with respect to such participant required to be contained in such registration statement.

"(f) REGULATIONS.—

"(1) IN GENERAL.—The Secretary, after consultation with the Secretary of Health, Education, and Welfare, may prescribe such regulations as may be necessary to carry out the provisions of this section.

"(2) PLANS TO WHICH MORE THAN ONE EMPLOYER CONTRIBUTES.—This section shall apply to any plan to which more than one

employer is required to contribute only to the extent provided in regulations prescribed under this subsection.

"(g) CROSS REFERENCES.—

"For provisions relating to penalties for failure to register or furnish statements required by this section, see section 6652(e) and section 6690.

"For coordination between Department of the Treasury and the Department of Labor with regard to administration of this section, see section 3004 of the Employee Retirement Income Security Act of 1974.

"SEC. 6058. INFORMATION REQUIRED IN CONNECTION WITH CERTAIN PLANS OF DEFERRED COMPENSATION.

"(a) IN GENERAL.—Every employer who maintains a pension, annuity, stock bonus, profit-sharing, or other funded plan of deferred compensation described in part I of subchapter D of chapter 1, or the plan administrator (within the meaning of section 414(g)) of the plan, shall file an annual return stating such information as the Secretary or his delegate may by regulations prescribe with respect to the qualification, financial condition, and operations of the plan; except that, in the discretion of the Secretary or his delegate, the employer may be relieved from stating in its return any information which is reported in other returns.

"(b) ACTUARIAL STATEMENT IN CASE OF MERGERS, ETC.—Not less than 30 days before a merger, consolidation, or transfer of assets or liabilities of a plan described in subsection (a) to another plan, the plan administrator (within the meaning of section 414(g)) shall file an actuarial statement of valuation evidencing compliance with the requirements of section 401(a)(12).

"(c) EMPLOYER.—For purposes of this section, the term 'employer' includes a person described in section 401(c)(4) and an individual who establishes an individual retirement account or annuity described in section 408.

"(d) CROSS REFERENCES.—

"For provisions relating to penalties for failure to file a return required by this section, see section 6652(f).

"For coordination between the Department of the Treasury and the Department of Labor with respect to the information required under this section, see section 3004 of title III of the Employee Retirement Income Security Act of 1974.".

(b) SANCTIONS.—

(1) FAILURE TO FILE REGISTRATION STATEMENTS OR NOTIFICATION OF CHANGE IN STATUS.—

(A) Section 6652 (relating to failure to file certain information returns) is amended by redesignating subsection (e) as subsection (g) and by inserting after subsection (d) the following new subsections:

"(e) ANNUAL REGISTRATION AND OTHER NOTIFICATION BY PENSION PLAN.—

"(1) REGISTRATION.—In the case of any failure to file a registration statement required under section 6057(a) (relating to annual registration of certain plans) which includes all participants required to be included in such statement, on the date prescribed therefor (determined without regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary or his delegate and in the same manner as tax) by the person failing so to file, an amount equal to $1 for each participant with respect to whom there is a failure to file, multiplied by the number of days during which such failure continues, but the total amount imposed under this paragraph on any person for any failure to file with respect to any plan year shall not exceed $5,000.

"(2) NOTIFICATION OF CHANGE OF STATUS.—In the case of failure to file a notification required under section 6057(b) (relating to notification of change of status) on the date prescribed therefor (determined without regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary or his delegate and in the same manner as tax) by the person failing so to file, $1 for each day during which such failure continues, but the total amounts imposed under this paragraph on any person for failure to file any notification shall not exceed $1,000.

"(f) INFORMATION REQUIRED IN CONNECTION WITH CERTAIN PLANS OF DEFERRED COMPENSATION.—In the case of failure to file a return or statement required under section 6058 (relating to information required in connection with certain plans of deferred compensation) or 6047 (relating to information relating to certain trusts and annuity and bond purchase plans) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary or his delegate and in the same manner as tax) by the person failing so to file, $10 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file any return shall not exceed $5,000."

(B) (i) The section heading for section 6652 is amended by adding ", Registration Statements, etc." before the period at the end thereof.

(ii) The item relating to section 6652 in the table of contents for subchapter A of chapter 68 is amended by adding ", registration statements, etc." before the period of the end thereof.

(2) FAILURE TO FURNISH STATEMENT TO PARTICIPANT.—

(A) Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6690. FRAUDULENT STATEMENT OR FAILURE TO FURNISH STATEMENT TO PLAN PARTICIPANT.

"Any person required under section 6057(e) to furnish a statement to a participant who willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a statement in the manner, at the time, and showing the information required under section 6057(e), or regulations prescribed thereunder, shall for each such act, or for each such failure, be subject to a penalty under this subchapter of $50, which shall be assessed and collected in the same manner as the tax on employers imposed by section 3111."

(B) The table of sections for such subchapter B is amended by adding at the end thereof the following new item:

"Sec. 6690. Fraudulent statement or failure to furnish statement to plan participant."

(c) CLERICAL AMENDMENTS.—

(1) The table of subparts for such part III is amended by adding at the end thereof the following:

"Subpart E. Registration of and information concerning pension, etc., plans."

(2) Section 6033(c) (relating to cross references) is amended by adding at the end thereof the following:

"For provisions relating to information required in connection with certain plans of deferred compensation, see section 6058."

(3) Subsection (d) of section 6047 (relating to information with respect to certain trusts and annuity and bond purchase plans) is amended to read as follows:

"(d) CROSS REFERENCES.—

"(1) For provisions relating to penalties for failure to file a return required by this section, see section 6652(f).

"(2) For criminal penalty for furnishing fraudulent information, see section 7207."

SEC. 1032. DUTIES OF SECRETARY OF HEALTH, EDUCATION, AND WELFARE.

Title XI of the Social Security Act (relating to general provisions) is amended by adding at the end of part A thereof the following new section:

"NOTIFICATION OF SOCIAL SECURITY CLAIMANT WITH RESPECT TO DEFERRED VESTED BENEFITS

"SEC. 1131. (a) Whenever—

"(1) the Secretary makes a finding of fact and a decision as to—

"(A) the entitlement of any individual to monthly benefits under section 202, 223, or 228,

"(B) the entitlement of any individual to a lump-sum death payment payable under section 202(i) on account of the death of any person to whom such individual is related by blood, marriage, or adoption, or

"(C) the entitlement under section 226 of any individual to hospital insurance benefits under part A of title XVIII, or

"(2) the Secretary is requested to do so—

"(A) by any individual with respect to whom the Secretary holds information obtained under section 6057 of the Internal Revenue Code of 1954, or

"(B) in the case of the death of the individual referred to in subparagraph (A), by the individual who would be entitled to payment under section 204(d) of this Act.

he shall transmit to the individual referred to in paragraph (1) or the individual making the request under paragraph (2) any information, as reported by the employer, regarding any deferred vested benefit transmitted to the Secretary pursuant to such section 6057 with respect to the individual referred to in paragraph (1) or (2)(A) or the person on whose wages and self-employment income entitlement (or claim of entitlement) is based.

"(b)(1) For purposes of section 201(g)(1), expenses incurred in the administration of subsection (a) shall be deemed to be expenses incurred for the administration of title II.

"(2) There are hereby authorized to be appropriated to the Federal Old-Age and Survivors Insurance Trust Fund for each fiscal year (commencing with the fiscal year ending June 30, 1974) such sums as the Secretary deems necessary on account of additional administrative expenses resulting from the enactment of the provisions of subsection (a)."

SEC. 1033. REPORTS BY ACTUARIES.

(a) REPORTS BY ACTUARIES.—Subpart E of part III of subchapter A of chapter 61 (relating to registration of and information concerning pension, etc., plans) as added by section 1031(a) of this Act, is amended by adding at the end thereof the following new section:

"SEC. 6059. PERIODIC REPORT OF ACTUARY.

"(a) GENERAL RULE.—The actuarial report described in subsection (b) shall be filed by the plan administrator (as defined in section

414(g) of each defined benefit plan to which section 412 applies, for the first plan year for which section 412 applies to the plan and for each third plan year thereafter (or more frequently if the Secretary or his delegate determines that more frequent reports are necessary).

"(b) ACTUARIAL REPORT.—The actuarial report of a plan required by subsection (a) shall be prepared and signed by an enrolled actuary (within the meaning of section 7701(a)(35)) and shall contain—

"(1) a description of the funding method and actuarial assumptions used to determine costs under the plan,

"(2) a certification of the contribution necessary to reduce the accumulated funding deficiency (as defined in section 412(a)) to zero,

"(3) a statement—

"(A) that to the best of his knowledge the report is complete and accurate, and

"(B) the requirements of section 412(c) (relating to reasonable actuarial assumptions) have been complied with,

"(4) such other information as may be necessary to fully and fairly disclose the actuarial position of the plan, and

"(5) such other information regarding the plan as the Secretary or his delegate may by regulations require.

"(c) TIME AND MANNER OF FILING.—The actuarial report and statement required by this section shall be filed at the time and in the manner provided by regulations prescribed by the Secretary or his delegate.

"(d) CROSS REFERENCE.—

"For coordination between the Department of the Treasury and the Department of Labor with respect to the report required to be filed under this section, see section 3004 of title III of the Employee Retirement Income Security Act of 1974.".

(b) ASSESSABLE PENALTIES.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6692. FAILURE TO FILE ACTUARIAL REPORT.

"The plan administrator (as defined in section 414(g)) of each defined benefit plan to which section 412 applies who fails to file the report required by section 6059 at the time and in the manner required by section 6059, shall pay a penalty of $1,000 for each such failure unless it is shown that such failure is due to reasonable cause."

(c) CONSOLIDATION OF ACTUARIAL REPORTS.—The Secretary of the Treasury and the Secretary of Labor shall take such steps as may be necessary to assure coordination to the maximum extent feasible between the actuarial reports required by section 6059 of the Internal Revenue Code of 1954 and by section 103(d) of title I of the Employee Retirement Income Security Act of 1974.

(d) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following new item:

"Sec. 6692. Failure to file actuarial report.".

SEC. 1034. EFFECTIVE DATES.

This part shall take effect upon the date of the enactment of this Act; except that—

(1) the requirements of section 6059 of the Internal Revenue Code of 1954 shall apply only with respect to plan years to which part I of this title applies,

(2) the requirements of section 6057 of such Code shall apply only with respect to plan years beginning after December 31, 1975,

(3) the requirements of section 6058(a) of such Code shall apply only with respect to plan years beginning after the date of the enactment of this Act, and

(4) the amendments made by section 1032 shall take effect on January 1, 1978.

PART 4—DECLARATORY JUDGMENTS RELATING TO QUALIFICATION OF CERTAIN RETIREMENT PLANS

SEC. 1041. TAX COURT PROCEDURE.

(a) IN GENERAL.—Subchapter C of chapter 76 (relating to the Tax Court, is amended by adding at the end thereof the following new part:

"PART IV—DECLARATORY JUDGMENTS RELATING TO QUALIFICATION OF CERTAIN RETIREMENT PLANS

"Sec. 7476. Declaratory judgments.

"SEC. 7476. DECLARATORY JUDGMENTS.

"(a) CREATION OF REMEDY.—In a case of actual controversy involving—

"(1) a determination by the Secretary or his delegate with respect to the initial qualification or continuing qualification of a retirement plan under subchapter D of chapter 1, or

"(2) a failure by the Secretary or his delegate to make a determination with respect to—

"(A) such initial qualification, or

"(B) such continuing qualification if the controversy arises from a plan amendment or plan termination,

upon the filing of an appropriate pleading, the United States Tax Court may make a declaration with respect to such initial qualification or continuing qualification. Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

"(b) LIMITATIONS.—

"(1) PETITIONER.—A pleading may be filed under this section only by a petitioner who is the employer, the plan administrator, an employee who has qualified under regulations prescribed by the Secretary or his delegate as an interested party for purposes of pursuing administrative remedies within the Internal Revenue Service, or the Pension Benefit Guaranty Corporation.

"(2) NOTICE.—For purposes of this section, the filing of a pleading by any petitioner may be held by the Tax Court to be premature, unless the petitioner establishes to the satisfaction of the court that he has complied with the requirements prescribed by regulations of the Secretary or his delegate with respect to notice to other interested parties of the filing of the request for a determination referred to in subsection (a).

"(3) EXHAUSTION OF ADMINISTRATIVE REMEDIES.—The Tax Court shall not issue a declaratory judgment or decree under this section in any proceeding unless it determines that the petitioner has exhausted administrative remedies available to him within the Internal Revenue Service. A petitioner shall not be deemed to have exhausted his administrative remedies with respect to a failure by the Secretary or his delegate to make a determination with respect to initial qualification or continuing qualification of a retirement plan before the expiration of 270 days after the request for such determination was made.

"(4) PLAN PUT INTO EFFECT.—No proceeding may be maintained under this section unless the plan (and, in the case of a controversy involving the continuing qualification of the plan because of an amendment to the plan, the amendment) with respect to which a decision of the Tax Court is sought has been put into effect before the filing of the pleading. A plan or amendment shall not be treated as not being in effect merely because under the plan the funds contributed to the plan may be refunded if the plan (or the plan as so amended) is found to be not qualified.

"(5) TIME FOR BRINGING ACTION.—If the Secretary or his delegate sends by certified or registered mail notice of his determination with respect to the qualification of the plan to the persons referred to in paragraph (1) (or, in the case of employees referred to in paragraph (1), to any individual designated under regulations prescribed by the Secretary or his delegate as a representative of such employee), no proceeding may be initiated under this section by any person unless the pleading is filed before the ninety-first day after the day after such notice is mailed to such person (or to his designated representative, in the case of an employee).

"(c) COMMISSIONERS.—The chief judge of the Tax Court may assign proceedings under this section to be heard by the commissioners of the court, and the court may authorize a commissioner to make the decision of the court with respect to such proceeding, subject to such conditions and review as the court may by rule provide.

"(d) RETIREMENT PLAN.—For purposes of this section, the term 'retirement plan' means—

"(1) a pension, profit-sharing, or stock bonus plan described in section 401(a) or a trust which is part of such a plan,

"(2) an annuity plan described in section 403(a), or

"(3) a bond purchase plan described in section 405(a).

"(e) CROSS REFERENCE.—

"For provisions concerning intervention by Pension Benefit Guaranty Corporation and Secretary of Labor in actions brought under this section and right of Pension Benefit Guaranty Corporation to bring action, see section 3001(c) of subtitle A of title III of the Employee Retirement Income Security Act of 1974."

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) FEE FOR FILING PETITION.—Section 7451 (relating to fee for filing petition) is amended by striking out "deficiency" and inserting in lieu thereof "deficiency or for a declaratory judgment under part IV of this subchapter".

(2) DATE OF DECISION.—Section 7459(c) (relating to date of decision) is amended by inserting before the period at the end of the first sentence the following: "or, in the case of a declaratory judgment proceeding under part IV of this subchapter, the date of the court's order entering the decision".

(3) VENUE FOR APPEAL OF DECISION.—

(A) Section 7482(b)(1) (relating to venue) is amended by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or" and by inserting after subparagraph (B) the following new subparagraph:

"(C) in the case of a person seeking a declaratory decision under section 7476, the principal place of business, or principal office or agency of the employer."

(B) Section 7482(b)(1) is further amended—

(i) by striking out "neither subparagraph (A) nor (B) applies" and inserting in lieu thereof "subparagraph (A), (B), and (C) do not apply"; and

(ii) by inserting before the period at the end of the last sentence thereof the following: "or as of the time the petition seeking a declaratory decision under section 7476 was filed with the Tax Court".

(c) CLERICAL AMENDMENT.—The table of parts for subchapter C of chapter 76 (relating to the Tax Court) is amended by adding at the end thereof the following new item:

"PART IV. Declaratory judgments relating to qualification of certain retirement plans.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to pleadings filed more than 1 year after the date of the enactment of this Act.

PART 5—INTERNAL REVENUE SERVICE

SEC. 1051. ESTABLISHMENT OF OFFICE.

(a) IN GENERAL.—Section 7802 (relating to Commissioner of Internal Revenue) is amended to read as follows:

"SEC. 7802. COMMISSIONER OF INTERNAL REVENUE; ASSISTANT COMMISSIONER (EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS).

"(a) COMMISSIONER OF INTERNAL REVENUE.—There shall be in the Department of the Treasury a Commissioner of Internal Revenue, who shall be appointed by the President, by and with the advice and consent of the Senate. The Commissioner of Internal Revenue shall have such duties and powers as may be prescribed by the Secretary.

"(b) ASSISTANT COMMISSIONER FOR EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS.—There is established within the Internal Revenue Service an office to be known as the 'Office of Employee Plans and Exempt Organizations' to be under the supervision and direction of an Assistant Commissioner of Internal Revenue. As head of the Office, the Assistant Commissioner shall be responsible for carrying out such functions as the Secretary or his delegate may prescribe with respect to organizations exempt from tax under section 501(a) and with respect to plans to which part I of subchapter D of chapter 1 applies (and with respect to organizations designed to be exempt under such section and plans designed to be plans to which such part applies)."

(b) SALARIES.—

(1) ASSISTANT COMMISSIONER.—Section 5109 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(c) The position held by the employee appointed under section 7802(b) of the Internal Revenue Code of 1954 is classified at GS–18, and is in addition to the number of positions authorized by section 5108(a) of this title."

(2) CLASSIFICATION OF POSITIONS AT GS–16 AND 17.—Section 5108 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(e) In addition to the number of positions authorized by subsection (a), the Commissioner of Internal Revenue is authorized, without regard to any other provision of this section, to place a total of 20 positions in the Internal Revenue Service in GS–16 and 17.".

(c) CLERICAL AMENDMENTS.—The item relating to section 7802 in the table of sections for subchapter A of chapter 80 is amended to read as follows:

"Sec. 7802. Commissioner of Internal Revenue; Assistant Commissioner (Employee Plans and Exempt Organizations)."

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 90th day after the date of the enactment of this Act.

SEC. 1052. AUTHORIZATION OF APPROPRIATIONS.

There is authorized to be appropriated to the Department of the Treasury for the purpose of carrying out all functions of the Office of Employee Plans and Exempt Organizations for each fiscal year beginning after June 30, 1974, an amount equal to the sum of—

(1) so much of the collections from the taxes imposed under section 4940 of such Code (relating to excise tax based on investment income) as would have been collected if the rate of tax under such section was 2 percent during the second preceding fiscal year, and

(2) the greater of—

(A) an amount equal to the amount described in paragraph (1), or

(B) $30,000,000.

Subtitle B—Other Amendments to the Internal Revenue Code Relating to Retirement Plans

SEC. 2001. CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS AND SHAREHOLDER-EMPLOYEES.

(a) INCREASE IN MAXIMUM AMOUNT DEDUCTIBLE FOR SELF-EMPLOYED INDIVIDUALS.—

(1) Paragraph (1) of section 404(e) (relating to special limitations for self-employed individuals) is amended—

(A) by striking out "$2,500, or 10 percent" and inserting in lieu thereof "$7,500, or 15 percent", and

(B) by striking out "subject to the provisions of paragraph (2)" and inserting in lieu thereof "subject to paragraphs (2) and (4)".

(2) Paragraph (2)(A) of section 404(e) is amended by striking out "shall not exceed $2,500, or 10 percent" and inserting in lieu thereof "shall (subject to paragraph (4)) not exceed $7,500, or 15 percent".

(3) Section 404(e) is amended by adding at the end thereof the following new paragraph:

"(4) LIMITATIONS CANNOT BE LOWER THAN $750 OR 100 PERCENT OF EARNED INCOME.—The limitations under paragraphs (1) and (2)(A) for any employee shall not be less than the lesser of—

"(A) $750, or

"(B) 100 percent of the earned income derived by such employee from the trades or businesses taken into account for purposes of paragraph (1) or (2)(A) as the case may be.".

(b) INCREASE IN MAXIMUM AMOUNT DEDUCTIBLE FOR SHAREHOLDER-EMPLOYEES.—Paragraph (1) of section 1379(b) (relating to taxability of shareholder-employees) is amended—

(1) by striking out "10 percent" in subparagraph (A) and inserting in lieu thereof "15 percent", and

(2) by striking out "$2,500" in subparagraph (B) and inserting in lieu thereof "$7,500".

(c) ONLY FIRST $100,000 of ANNUAL COMPENSATION TO BE TAKEN INTO ACCOUNT.—Subsection (a) of section 401 (relating to requirements for qualification) is amended by inserting after paragraph (16) the following new paragraph:

"(17) In the case of a plan which provides contributions or benefits for employees some or all of whom are employees within the meaning of subsection (c)(1), or are shareholder-employees within the meaning of section 1379(d), only if the annual compen-

sation of each employee taken into account under the plan does not exceed the first $100,000 of such compensation."

(d) DEFINED BENEFIT PLANS FOR SELF-EMPLOYED INDIVIDUALS.—

(1) Subsection (a) of section 401 is amended by inserting after paragraph (17) the following new paragraph:

"(18) In the case of a trust which is part of a plan providing a defined benefit for employees some or all of whom are employees within the meaning of subsection (c)(1), or are shareholder-employees within the meaning of section 1379(d), only if such plan satisfies the requirements of subsection (j)."

(2) Section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) DEFINED BENEFIT PLANS PROVIDING BENEFITS FOR SELF-EMPLOYED INDIVIDUALS AND SHAREHOLDER-EMPLOYEES.—

"(1) IN GENERAL.—A defined benefit plan satisfies the requirements of this subsection only if the basic benefit accruing under the plan for each plan year of participation by an employee within the meaning of subsection (c)(1) (or a shareholder-employee) is permissible under regulations prescribed by the Secretary or his delegate under this subsection to insure that there will be reasonable comparability (assuming level funding) between the maximum retirement benefits which may be provided with favorable tax treatment under this title for such employees under—

"(A) defined contribution plans,

"(B) defined benefit plans, and

"(C) a combination of defined contribution plans and defined benefit plans.

"(2) GUIDELINES FOR REGULATIONS.—The regulations prescribed under this subsection shall provide that a plan does not satisfy the requirements of this subsection if, under the plan, the basic benefit of any employee within the meaning of subsection (c)(1) (or a shareholder-employee) may exceed the sum of the products for each plan year of participation of—

"(A) his annual compensation (not in excess of $50,000) for such year, and

"(B) the applicable percentage determined under paragraph (3).

"(3) APPLICABLE PERCENTAGE.—

"(A) TABLE.—For purposes of paragraph (2), the applicable percentage for any individual for any plan year shall be based on the percentage shown on the following table opposite his age when his current period of participation in the plan began.

"Age when participation began:	Applicable percentage
30 or less	6.5
35	5.4
40	4.4
45	3.6
50	3.0
55	2.5
60 or over	2.0

"(B) ADDITIONAL REQUIREMENTS.—The regulations prescribed under this subsection shall include provisions—

"(i) for applicable percentages for ages between any two ages shown on the table,

"(ii) for adjusting the applicable percentages in the case of plans providing benefits other than a basic benefit,

"(iii) that any increase in the rate of accrual, and any increase in the compensation base which may be taken into account, shall, with respect only to such increase, begin a new period of participation in the plan, and

"(iv) when appropriate, in the case of periods beginning after December 31, 1977, for adjustments in the applicable percentages based on changes in prevailing interest and mortality rates occurring after 1973.

"(4) CERTAIN CONTRIBUTIONS AND BENEFITS MAY NOT BE TAKEN INTO ACCOUNT.—A defined benefit plan which provides contributions or benefits for owner-employees does not satisfy the requirements of this subsection unless such plan meets the requirements of subsection (a)(4) without taking into account contributions or benefits under chapter 2 (relating to tax on self-employment income), chapter 21 (relating to Federal Insurance Contributions Act), title II of the Social Security Act, or any other Federal or State law.

"(5) DEFINITIONS.—For purposes of this subsection—

"(A) BASIC BENEFIT.—The term 'basic benefit' means a benefit in the form of a straight life annuity commencing at the later of—

"(i) age 65, or

"(ii) the day 5 years after the day the participant's current period of participation began

under a plan which provides no ancillary benefits and to which employees do not contribute.

"(B) SHAREHOLDER-EMPLOYEE.—The term 'shareholder-employee' has the same meaning as when used in section 1379(d).

"(C) COMPENSATION.—The term 'compensation' means—

"(i) in the case of an employee within the meaning of subsection (c)(1), the earned income of such individual, or

"(ii) in the case of a shareholder-employee, the compensation received or accrued by the individual from the electing small business corporation.

"(6) SPECIAL RULES.—Section 404(e) (relating to special limitations for self-employed individuals) and section 1379(b) (relating to taxability of shareholder-employee beneficiaries) do not apply to a trust to which this subsection applies.".

(e) REPEAL OF EXISTING TAX TREATMENT OF EXCESS CONTRIBUTIONS.—

(1) The last sentence of section 401(d)(5) is amended to read as follows: "Subparagraphs (A) and (B) do not apply to contributions described in subsection (e)."

(2) Paragraph (8) of section 401(d) is repealed.

(3) Subsection (e) of section 401 is amended to read as follows:

"(e) CONTRIBUTIONS FOR PREMIUMS ON ANNUITY, ETC., CONTRACTS.—A contribution by the employer on behalf of an owner-employee is described in this subsection if—

"(1) under the plan such contribution is required to be applied (directly or through a trustee) to pay premiums or other consideration for one or more annuity, endowment, or life insurance contracts on the life of such owner-employee issued under the plan,

"(2) the amount of such contribution exceeds the amount deductible under section 404 with respect to contributions made by the employer on behalf of such owner-employee under the plan, and

"(3) the amount of such contribution does not exceed the average of the amounts which were deductible under section 404 with

respect to contributions made by the employer on behalf of such owner-employee under the plan (or which would have been deductible if such section had been in effect) for the first three taxable years (A) preceding the year in which the last such annuity, endowment, or life insurance contract was issued under the plan, and (B) in which such owner-employee derived earned income from the trade or business with respect to which the plan is established, or for so many of such taxable years as such owner-employee was engaged in such trade or business and derived earned income therefrom.

In the case of any individual on whose behalf contributions described in paragraph (1) are made under more than one plan as an owner-employee during any taxable year, the preceding sentence does not apply if the amount of such contributions under all such plans for all such years exceeds $7,500. Any contribution which is described in this subsection shall, for purposes of section 4972(b), be taken into account as a contribution made by such owner-employee as an employee to the extent that the amount of such contribution is not deductible under section 404 for the taxable year, but only for the purpose of applying section 4972(b) to other contributions made by such owner-employee as an employee."

(4) Clause (ii) of section 401(a)(10)(A) is amended by striking out "subsection (e)(3)(A)" and inserting in lieu thereof "subsection (e)".

(5) Subparagraph (A) of section 72(m)(5)(A) is amended—

(A) by inserting "and" at the end of clause (i),

(B) by striking out the comma at the end of clause (ii) and the word "and" following that comma, and inserting in lieu thereof a period, and

(C) by striking out clause (iii).

(f) TAX ON EXCESS CONTRIBUTIONS.—

(1) Chapter 43 (relating to qualified pension, etc., plans) is amended by inserting after section 4971 the following new section:

"SEC. 4972. TAX ON EXCESS CONTRIBUTIONS FOR SELF-EMPLOYED INDIVIDUALS.

"(a) TAX IMPOSED.—In the case of a plan which provides contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1), there is imposed, for each taxable year of the employer who maintains such plan, a tax in an amount equal to 6 percent of the amount of the excess contributions under the plan (determined as of the close of the taxable year). The tax imposed by this subsection shall be paid by the employer who maintains the plan. This section applies only to plans which include a trust described in section 401(a), which are described in section 403(a), or which are described in section 405(a).

"(b) EXCESS CONTRIBUTIONS.—

"(1) IN GENERAL.—For purposes of this section, the term 'excess contributions' means the sum of the amounts (if any) determined under paragraphs (2), (3), and (4), reduced by the sum of the correcting distributions (as defined in paragraph (5)) made in all prior taxable years beginning after December 31, 1975. For purposes of this subsection the amount of any contribution which is allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

"(2) CONTRIBUTIONS BY OWNER-EMPLOYEES.—The amount determined under this paragraph, in the case of a plan which provides contributions or benefits for employees some or all of whom are

owner-employees (within the meaning of section 401(c)(3)), is the sum of—

"(A) the excess (if any) of—

"(i) the amount contributed under the plan by each owner-employee (as an employee) for the taxable year, over

"(ii) the amount permitted to be contributed by each owner-employee (as an employee) for such year, and

"(B) the amount determined under this paragraph for the preceding taxable year of the employer,

reduced by the excess (if any) of the amount described in subparagraph (A)(ii) over the amount described in subparagraph (A)(i).

"(3) DEFINED BENEFIT PLANS.—The amount determined under this paragraph, in the case of a defined benefit plan, is the amount contributed under the plan by the employer during the taxable year or any prior taxable year beginning after December 31, 1975, if—

"(A) as of the close of the taxable year, the full funding limitation of the plan (determined under section 412(c)(7)) is zero, and

"(B) such amount has not been deductible for the taxable year or any prior taxable year.

"(4) DEFINED CONTRIBUTION PLANS.—The amount determined under this paragraph, in the case of a plan other than a defined benefit plan, is the portion of the amounts contributed under the plan by the employer during the taxable year and each prior taxable year beginning after December 31, 1975, which has not been deductible for the taxable year or any prior taxable year.

"(5) CORRECTING DISTRIBUTION.—For purposes of this subsection the term 'correcting distribution' means—

"(A) in the case of a contribution made by an owner-employee as an employee, regardless of the type of plan, the amount determined under paragraph (2) distributed to the owner-employee who contributed such amount,

"(B) in the case of a defined benefit plan, the amount determined under paragraph (3) which is distributed from the plan to the employer, and

"(C) in the case of a defined contribution plan, the amount determined under paragraph (4) which is distributed from the plan to the employer or to the employee to the account of whom the amount described was contributed.

"(c) AMOUNT PERMITTED TO BE CONTRIBUTED BY OWNER-EMPLOYEE.—For purposes of subsection (b)(2), the amount permitted to be contributed under a plan by an owner-employee (as an employee) for any taxable year is the smallest of the following:

"(1) $2,500,

"(2) 10 percent of the earned income (as defined in section 401(c)(2)) for such taxable year derived by such owner-employee from the trade or business with respect to which the plan is established, or

"(3) the amount of the contribution which would be contributed by the owner-employee (as an employee) if such contribution were made at the rate of contributions permitted to be made by employees other than owner-employees.

In any case in which there are no employees other than owner-employees, the amount determined under the preceding sentence shall be zero.

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"(d) CROSS REFERENCE.—

"For disallowance of deduction for taxes paid under this section, see section 275.".

(2) CLERICAL AMENDMENT.—The table of sections for chapter 43 is amended by inserting after the item relating to section 4971 the following new item:

"Sec. 4972. Tax on excess contributions for self-employed individuals.".

(g) PREMATURE DISTRIBUTIONS TO OWNER-EMPLOYEES.—

(1) IN GENERAL.—Subparagraph (B) of section 72(m)(5) (relating to penalties applicable to certain amounts received by owner-employees) is amended to read as follows:

"(B) If a person receives an amount to which this paragraph applies, his tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of the amount so received which is includible in his gross income for such taxable year."

(2) CONFORMING AMENDMENTS.—

(A) Subparagraphs (C), (D), and (E) of section 72(m)(5) are repealed.

(B) The second sentence of section 46(a)(3) and the second sentence of section 50A(a)(3), as each is amended by section 2005(c)(4) of this Act, are each amended by inserting after "tax preferences)," the following: "section 72(m)(5)(B) (relating to 10 percent tax on premature distributions to owner-employees),".

(C) The third sentence of section 901(a), as amended by section 2005(c)(5) of this Act, is amended by striking out "tax preferences)," and inserting in lieu thereof "tax preferences), against the tax imposed for the taxable year under section 72(m)(5)(B) (relating to 10 percent tax on premature distributions to owner-employees),".

(D) Subparagraph (A) of section 56(a)(2) and paragraph (1) of section 56(c), as each is amended by section 2005(c)(7) of this Act, are each amended by striking out "402(e)" and inserting in lieu thereof "72(m)(5)(B), 402(e)".

(E) Section 404(a)(2) *is amended by striking out* "(16)" and inserting in lieu thereof "(16), (17), (18)".

(F) Clause (ii) of section 404(a)(9)(B) is amended to read as follows:

"(ii) without regard to the second sentence of paragraph (3); and".

(h) WITHDRAWAL OF EMPLOYEE CONTRIBUTIONS OF OWNER-EMPLOYEES.—

(1) Section 401(d)(4)(B) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended by inserting "in excess of contributions made by an owner-employee as an employee" after "benefits".

(2) Paragraph (1) of section 72(m) (relating to certain amounts received before annuity starting date) is repealed.

(3). Section 72(m)(5)(A)(i) is amended by striking out "(whether or not paid by him)" and inserting in lieu thereof the following: "(other than contributions made by him as an owner-employee)".

(i) EFFECTIVE DATES.—

(1) The amendments made by subsections (a) and (b) apply to taxable years beginning after December 31, 1973.

(2) The amendments made by subsection (c) apply to—
(A) taxable years beginning after December 31, 1975, and
(B) any other taxable years beginning after December 31, 1973, for which contributions were made under the plan in excess of the amounts permitted to be made under sections 404(e) and 1379(b) as in effect on the day before the date of the enactment of this Act.

(3) The amendments made by subsection (d) apply to taxable years beginning after December 31, 1975.

(4) The amendments made by subsections (e) and (f) apply to contributions made in taxable years beginning after December 31, 1975.

(5) The amendments made by subsection (g) apply to distributions made in taxable years beginning after December 31, 1975.

(6) The amendments made by subsection (h) apply to taxable years ending after the date of enactment of this Act.

SEC. 2002. DEDUCTION FOR RETIREMENT SAVINGS.

(a) ALLOWANCE OF DEDUCTION.—

(1) IN GENERAL.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 219 as 220 and by inserting after section 218 the following new section:

"SEC. 219. RETIREMENT SAVINGS.

"(a) DEDUCTION ALLOWED.—In the case of an individual, there is allowed as a deduction amounts paid in cash during the taxable year by or on behalf of such individual for his benefit—

"(1) to an individual retirement account described in section 408(a),

"(2) for an individual retirement annuity described in section 408(b), or

"(3) for a retirement bond described in section 409 (but only if the bond is not redeemed within 12 months of the date of its issuance).

For purposes of this title, any amount paid by an employer to such a retirement account or for such a retirement annuity or retirement bond constitutes payment of compensation to the employee (other than a self-employed individual who is an employee within the meaning of section 401(c)(1) includible in his gross income, whether or not a deduction for such payment is allowable under this section to the employee after the application of subsection (b).

"(b) LIMITATIONS AND RESTRICTIONS.—

"(1) MAXIMUM DEDUCTION.—The amount allowable as a deduction under subsection (a) to an individual for any taxable year may not exceed an amount equal to 15 percent of the compensation includible in his gross income for such taxable year, or $1,500, whichever is less.

"(2) COVERED BY CERTAIN OTHER PLANS.—No deduction is allowed under subsection (a) for an individual for the taxable year if for any part of such year—

"(A) he was an active participant in—

"(i) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(ii) an annuity plan described in section 403(a),

"(iii) a qualified bond purchase plan described in section 405(a), or

"(iv) a plan established for its employees by the United States, by a State or political division thereof, or

by an agency or instrumentality of any of the foregoing, or

"(B) amounts were contributed by his employer for an annuity contract described in section 403(b) (whether or not his rights in such contract are nonforfeitable).

"(3) CONTRIBUTIONS AFTER AGE 70½.—No deduction is allowed under subsection (a) with respect to any payment described in subsection (a) which is made during the taxable year of an individual who has attained age 70½ before the close of such taxable year.

"(4) RECONTRIBUTED AMOUNTS.—No deduction is allowed under this section with respect to a rollover contribution described in section 402(a)(5), 403(a)(4), 408(d)(3), or 409(b)(3)(C).

"(5) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction is allowed under subsection (a) for that portion of the amounts paid under the contract for the taxable year properly allocable, under regulations prescribed by the Secretary or his delegate, to the cost of life insurance.

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) COMPENSATION.—For purposes of this section, the term 'compensation' includes earned income as defined in section 401(c)(2).

"(2) MARRIED INDIVIDUALS.—The maximum deduction under subsection (b)(1) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.".

(2) DEDUCTION ALLOWED IN ARRIVING AT ADJUSTED GROSS INCOME.—Section 62 (defining adjusted gross income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) RETIREMENT SAVINGS.—The deduction allowed by section 219 (relating to deduction of certain retirement savings).".

(b) INDIVIDUAL RETIREMENT ACCOUNTS.—Subpart A of part I of subchapter D of chapter 1 (relating to retirement plans) is amended by adding at the end thereof the following new section:

"SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

"(a) INDIVIDUAL RETIREMENT ACCOUNT.—For purposes of this section, the term 'individual retirement account' means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

"(1) Except in the case of a rollover contribution described in subsection (d)(3) in section 402(a)(5), 403(a)(4), or 409(b)(3)(C), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year in excess of $1,500 on behalf of any individual.

"(2) The trustee is a bank (as defined in section 401(d)(1)) or such other person who demonstrates to the satisfaction of the Secretary or his delegate that the manner in which such other person will administer the trust will be consistent with the requirements of this section.

"(3) No part of the trust funds will be invested in life insurance contracts.

"(4) The interest of an individual in the balance in his account is nonforfeitable.

"(5) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.

"(6) The entire interest of an individual for whose benefit the trust is maintained will be distributed to him not later than the close of his taxable year in which he attains age 70½, or will be distributed, commencing before the close of such taxable year, in accordance with regulations prescribed by the Secretary or his delegate, over—

"(A) the life of such individual or the lives of such individual and his spouse, or

"(B) a period not extending beyond the life expectancy of such individual or the life expectancy of such individual and his spouse.

"(7) If an individual for whose benefit the trust is maintained dies before his entire interest has been distributed to him, or if distribution has been commenced as provided in paragraph (6) to his surviving spouse and such surviving spouse dies before the entire interest has been distributed to such spouse, the entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of the surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which annuity will be immediately distributed to such beneficiary or beneficiaries. The preceding sentence does not apply if distributions over a term certain commenced before the death of the individual for whose benefit the trust was maintained and the term certain is for a period permitted under paragraph (6).

"(b) INDIVIDUAL RETIREMENT ANNUITY.—For purposes of this section, the term 'individual retirement annuity' means an annuity contract, or an endowment contract (as determined under regulations prescribed by the Secretary or his delegate), issued by an insurance company which meets the following requirements:

"(1) The contract is not transferable by the owner.

"(2) The annual premium under the contract will not exceed $1,500 and any refund of premiums will be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits.

"(3) The entire interest of the owner will be distributed to him not later than the close of his taxable year in which he attains age 70½, or will be distributed, in accordance with regulations prescribed by the Secretary or his delegate, over—

"(A) the life of such owner or the lives of such owner and his spouse, or

"(B) a period not extending beyond the life expectancy of such owner or the life expectancy of such owner and his spouse.

"(4) If the owner dies before his entire interest has been distributed to him, or if distribution has been commenced as provided in paragraph (3) to his surviving spouse and such surviving spouse dies before the entire interest has been distributed to such spouse, the entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of the surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such bene-

ficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which annuity will be immediately distributed to such beneficiary or beneficiaries. The preceding sentence shall have no application if distributions over a term certain commenced before the death of the owner and the term certain is for a period permitted under paragraph (3).

"(5) The entire interest of the owner is nonforfeitable.

Such term does not include such an annuity contract for any taxable year of the owner in which it is disqualified on the application of subsection (e) or for any subsequent taxable year. For purposes of this subsection, no contract shall be treated as an endowment contract if it matures later than the taxable year in which the individual in whose name such contract is purchased attains age 70½; if it is not for the exclusive benefit of the individual in whose name it is purchased or his beneficiaries; or if the aggregate annual premiums under all such contracts purchased in the name of such individual for any taxable year exceed $1,500.

"(c) ACCOUNTS ESTABLISHED BY EMPLOYERS AND CERTAIN ASSOCIATIONS OF EMPLOYEES.—A trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries, or by an association of employees (which may include employees within the meaning of section 401(c)(1)) for the exclusive benefit of its members or their beneficiaries, shall be treated as an individual retirement account (described in subsection (a)), but only if the written governing instrument creating the trust meets the following requirements:

"(1) The trust satisfies the requirements of paragraphs (1) through (7) of subsection (a).

"(2) There is a separate accounting for the interest of each employee or member.

The assets of the trust may be held in a common fund for the account of all individuals who have an interest in the trust.

"(d) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, any amount paid or distributed out of an individual retirement account or under an individual retirement annuity shall be included in gross income by the payee or distributee, as the case may be, for the taxable year in which the payment or distribution is received. The basis of any person in such an account or annuity is zero.

"(2) DISTRIBUTIONS OF ANNUITY CONTRACTS.—Paragraph (1) does not apply to any annuity contract which meets the requirements of paragraphs (1), (3), (4), and (5) of subsection (b) and which is distributed from an individual retirement account. Section 72 applies to any such annuity contract, and for purposes of section 72 the investment in such contract is zero.

"(3) ROLLOVER CONTRIBUTION.—An amount is described in this paragraph as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

"(A) IN GENERAL.—Paragraph (1) does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if—

"(i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) or retirement bond

for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution; or

"(ii) the entire amount received (including money and any other property) represents the entire amount in the account or the entire value of the annuity and no amount in the account and no part of the value of the annuity is attributable to any source other than a rollover contribution from an employees' trust described in section 401(a) which is exempt from tax under section 501(a) (other than a trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan), or an annuity plan described in section 403(a) (other than a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan) and any earnings on such sums and the entire amount thereof is paid into another such trust (for the benefit of such individual) or annuity plan not later than the 60th day on which he receives the payment or distribution.

"(B) LIMITATION.—This paragraph does not apply to any amount described in subparagraph (A)(i) received by an individual from an individual retirement account or individual retirement annuity if at any time during the 3-year period ending on the day of such receipt such individual received any other amount described in that subparagraph from an individual retirement account, individual retirement annuity, or a retirement bond which was not includible in his gross income because of the application of this paragraph.

"(4) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Paragraph (1) does not apply to the distribution of any contribution paid during a taxable year to an individual retirement account or for an individual retirement annuity to the extent that such contribution exceeds the amount allowable as a deduction under section 219 if—

"(A) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such individual's return for such taxable year,

"(B) no deduction is allowed under section 219 with respect to such excess contribution, and

"(C) such distribution is accompanied by the amount of net income attributable to such excess contribution.

Any net income described in subparagraph (C) shall be included in the gross income of the individual for the taxable year in which received.

"(5) TRANSFER OF ACCOUNT INCIDENT TO DIVORCE.—The transfer of an individual's interest in an individual retirement account, individual retirement annuity, or retirement bond to his former spouse under a divorce decree or under a written instrument incident to such divorce is not to be considered a taxable transfer made by such individual notwithstanding any other provision of this subtitle, and such interest at the time of the transfer is to be treated as an individual retirement account of such spouse, and not of such individual. Thereafter such account, annuity, or bond for purposes of this subtitle is to be treated as maintained for the benefit of such spouse.

"(e) TAX TREATMENT OF ACCOUNTS AND ANNUITIES.—

"(1) EXEMPTION FROM TAX.—Any individual retirement account is exempt from taxation under this subtitle unless such account has ceased to be an individual retirement account by reason of paragraph (2) or (3). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc. organizations).

"(2) LOSS OF EXEMPTION OF ACCOUNT WHERE EMPLOYEE ENGAGES IN PROHIBITED TRANSACTION.—

"(A) IN GENERAL.—If, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year. For purposes of this paragraph—

"(i) the individual for whose benefit any account was established is treated as the creator of such account, and

"(ii) the separate account for any individual within an individual retirement account maintained by an employer or association of employees is treated as a separate individual retirement account.

"(B) ACCOUNT TREATED AS DISTRIBUTING ALL ITS ASSETS.—In any case in which any account ceases to be an individual retirement account by reason of subparagraph (A) as of the first day of any taxable year, paragraph (1) of subsection (d) applies as if there were a distribution on such first day in an amount equal to the fair market value (on such first day) of all assets in the account (on such first day).

"(3) EFFECT OF BORROWING ON ANNUITY CONTRACT.—If during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day.

"(4) EFFECT OF PLEDGING ACCOUNT AS SECURITY.—If, during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual.

"(5) PURCHASE OF ENDOWMENT CONTRACT BY INDIVIDUAL RETIREMENT ACCOUNT.—If the assets of an individual retirement account or any part of such assets are used to purchase an endowment contract for the benefit of the individual for whose benefit the account is established—

"(A) to the extent that the amount of the assets involved in the purchase are not attributable to the purchase of life insurance, the purchase is treated as a rollover contribution described in subsection (d)(3), and

"(B) to the extent that the amount of the assets involved in the purchase are attributable to the purchase of life, health, accident, or other insurance, such amounts are treated as distributed to that individual (but the provisions of subsection (f) do not apply).

"(6) COMMINGLING INDIVIDUAL RETIREMENT ACCOUNT AMOUNTS IN CERTAIN COMMON TRUST FUNDS AND COMMON INVESTMENT FUNDS.—Any common trust fund or common investment fund of

individual retirement account assets which is exempt from taxation under this subtitle does not cease to be exempt on account of the participation or inclusion of assets of a trust exempt from taxation under section 501(a) which is described in section 401(a).

"(f) ADDITIONAL TAX ON CERTAIN AMOUNTS INCLUDED IN GROSS INCOME BEFORE AGE 59½—

"(1) EARLY DISTRIBUTIONS FROM AN INDIVIDUAL RETIREMENT ACCOUNT, ETC.—If a distribution from an individual retirement account or under an individual retirement annuity to the individual for whose benefit such account or annuity was established is made before such individual attains age 59½, his tax under this chapter for the taxable year in which such distribution is received shall be increased by an amount equal to 10 percent of the amount of the distribution which is includible in his gross income for such taxable year.

"(2) DISQUALIFICATION CASES.—If an amount is includible in gross income for a taxable year under subsection (e) and the taxpayer has not attained age 59½ before the beginning of such taxable year, his tax under this chapter for such taxable year shall be increased by an amount equal to 10 percent of such amount so required to be included in his gross income.

"(3) DISABILITY CASES.—Paragraphs (1) and (2) do not apply if the amount paid or distributed, or the disqualification of the account or annuity under subsection (e), is attributable to the taxpayer becoming disabled within the meaning of section 72(m)(7).

"(g) COMMUNITY PROPERTY LAWS.—This section shall be applied without regard to any community property laws.

"(h) CUSTODIAL ACCOUNTS.—For purposes of this section, a custodial account shall be treated as a trust if the assets of such account are held by a bank (as defined in section 401(d)(1)) or another person who demonstrates, to the satisfaction of the Secretary or his delegate, that the manner in which he will administer the account will be consistent with the requirements of this section, and if the custodial account would, except for the fact that it is not a trust, constitute an individual retirement account described in subsection (a). For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

"(i) REPORTS.—The trustee of an individual retirement account and the issuer of an endowment contract described in subsection (b) or an individual retirement annuity shall make such reports regarding such account, contract, or annuity to the Secretary or his delegate and to the individuals for whom the account, contract, or annuity is, or is to be, maintained with respect to contributions, distributions, and such other matters as the Secretary or his delegate may require under regulations. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by those regulations.

"(j) CROSS REFERENCES.—

"(1) For tax on excess contributions in individual retirement accounts or annuities, see section 4973.

"(2) For tax on certain accumulations in individual retirement accounts or annuities, see section 4974."

(c) RETIREMENT BONDS.—Subpart A of part I of subchapter D of chapter 1 (relating to retirement plans) is amended by inserting after section 408 the following new section:

"SEC. 409. RETIREMENT BONDS.

"(a) RETIREMENT BOND.—For purposes of this section and section 219(a), the term 'retirement bond' means a bond issued under the

Second Liberty Bond Act, as amended, which by its terms, or by regulations prescribed by the Secretary or his delegate under such Act—

"(1) provides for payment of interest, or investment yield, only on redemption;

"(2) provides that no interest, or investment yield, is payable if the bond is redeemed within 12 months after the date of its issuance;

"(3) provides that it ceases to bear interest, or provide investment yield on the earlier of—

"(A) the date on which the individual in whose name it is purchased (hereinafter in this section referred to as the 'registered owner') attains age 70½; or

"(B) 5 years after the date on which the registered owner dies, but not later than the date on which he would have attained the age 70½ had he lived;

"(4) provides that, except in the case of a rollover contribution described in subsection (b)(3)(C) or in section 402(a)(5), 403(a)(4), or 408(d)(3) the registered owner may not contribute for the purchase of such bonds in excess of $1,500 in any taxable year; and

"(5) is not transferable.

"(b) INCOME TAX TREATMENT OF BONDS.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, on the redemption of a retirement bond the entire proceeds shall be included in the gross income of the taxpayer entitled to the proceeds on redemption. If the registered owner has not tendered it for redemption before the close of the taxable year in which he attains age 70½, such individual shall include in his gross income for such taxable year the amount of proceeds he would have received if the bond had been redeemed at age 70½. The provisions of section 72 (relating to annuities) and section 1232 (relating to bonds and other evidences of indebtedness) shall not apply to a retirement bond.

"(2) BASIS.—The basis of a retirement bond is zero.

"(3) EXCEPTIONS.—

"(A) REDEMPTION WITHIN 12 MONTHS.—If a retirement bond is redeemed within 12 months after the date of its issuance, the proceeds are excluded from gross income if no deduction is allowed under section 219 on account of the purchase of such bond.

"(B) REDEMPTION AFTER AGE 70½.—If a retirement bond is redeemed after the close of the taxable year in which the registered owner attains age 70½, the proceeds from the redemption of the bond are excluded from the gross income of the registered owner to the extent that such proceeds were includible in his gross income for such taxable year.

"(C) ROLLOVER INTO AN INDIVIDUAL RETIREMENT ACCOUNT OR ANNUITY OR A QUALIFIED PLAN.—If a retirement bond is redeemed at any time before the close of the taxable year in which the registered owner attains age 70½, and the registered owner transfers the entire amount of the proceeds from the redemption of the bond to an individual retirement account described in section 408(a) or to an individual retirement annuity described in section 408(b) (other than an endowment contract) which is maintained for the benefit of the registered owner of the bond, or to an employees' trust described in section 401(a) which is exempt from tax under section 501(a), or an annuity plan described in section 403(a)

for the benefit of the registered owner, on or before the 60th day after the day on which he received the proceeds of such redemption, then the proceeds shall be excluded from gross income and the transfer shall be treated as a rollover contribution described in section 403(d)(3). This subparagraph does not apply in the case of a transfer to such an employees' trust or such an annuity plan unless no part of the value of such proceeds is attributable to any source other than a rollover contribution from such an employees' trust or annuity plan (other than an annuity plan or a trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan).

"(c) ADDITIONAL TAX ON CERTAIN REDEMPTIONS BEFORE AGE 59½.—

"(1) EARLY REDEMPTION OF BOND.—If a retirement bond is redeemed by the registered owner before he attains age 59½, his tax under this chapter for the taxable year in which the bond is redeemed shall be increased by an amount equal to 10 percent of the amount of the proceeds of the redemption includible in his gross income for the taxable year.

"(2) DISABILITY CASES.—Paragraph (1) does not apply for any taxable year during which the retirement bond is redeemed if, for that taxable year, the registered owner is disabled within the meaning of section 72(m)(7).

"(3) REDEMPTION WITHIN ONE YEAR.—Paragraph (1) does not apply if the registered owner tenders the bond for redemption within 12 months after the date of its issuance.".

(d) EXCISE TAX ON EXCESS CONTRIBUTIONS.—Chapter 43 (relating to qualified pension, etc., plans) is amended by inserting after section 4972 the following new section:

"SEC. 4973. TAX ON EXCESS CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ACCOUNTS, CERTAIN SECTION 403(b) CONTRACTS, CERTAIN INDIVIDUAL RETIREMENT ANNUITIES, AND CERTAIN RETIREMENT BONDS.

"(a) TAX IMPOSED.—In the case of—

"(1) an individual retirement account (within the meaning of section 408(a)),

"(2) an individual retirement annuity (within the meaning of section 408(b)), a custodial account treated as an annuity contract under section 403(b)(7)(A) (relating to custodial accounts for regulated investment company stock), or

"(3) a retirement bond (within the meaning of section 409),

established for the benefit of any individual, there is imposed for each taxable year a tax in an amount equal to 6 percent of the amount of the excess contributions to such individual's accounts, annuities, or bonds (determined as of the close of the taxable year). The amount of such tax for any taxable year shall not exceed 6 percent of the value of the account, annuity, or bond (determined as of the close of the taxable year). In the case of an endowment contract described in section 408(b), the tax imposed by this section does not apply to any amount allocable to life, health, accident, or other insurance under such contract. The tax imposed by this subsection shall be paid by such individual.

"(b) EXCESS CONTRIBUTIONS.—For purposes of this section, in the case of individual retirement accounts, individual retirement annuities, or bonds, the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to the accounts or for the annuities or bonds (other than a rollover contribution described in section 402(a)(5), 403(a)(4), 408(d)(3)), or 409(b)(3)(C), over

"(B) the amount allowable as a deduction under section 219 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by the excess (if any) of the maximum amount allowable as a deduction under section 219 for the taxable year over the amount contributed to the accounts or for the annuities or bonds for the taxable year and reduced by the sum of the distributions out of the account (for all prior taxable years) which were included in the gross income of the payee under section 408(d)(1). For purposes of this paragraph, any contribution which is distributed out of the individual retirement account, individual retirement annuity, or bond in a distribution to which section 408(d)(4) applies shall be treated as an amount not contributed.

"(c) SECTION 403(b) CONTRACTS.—For purposes of this section, in the case of a custodial account referred to in subsection (a)(3), the term 'excess contributions' means the sum of—

"(1) the excess (if any) of the amount contributed for the taxable year to such account, over the lesser of the amount excludable from gross income under section 403(b) or the amount permitted to be contributed under the limitations contained in section 415 (or under whichever such section is applicable, if only one is applicable), and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by—

"(A) the excess (if any) of the lesser of (i) the amount excludable from gross income under section 403(b) or (ii) the amount permitted to be contributed under the limitations contained in section 415 over the amount contributed to the account for the taxable year (or under whichever such section is applicable, if only one is applicable), and

"(B) the sum of the distributions out of the account (for all prior taxable years) which are included in gross income under section 72(e)."

(e) EXCISE TAX ON EXCESSIVE ACCUMULATIONS.—Chapter 43 is amended by inserting after section 4973 the following new section:

"SEC. 4974. EXCISE TAX ON CERTAIN ACCUMULATIONS IN INDIVIDUAL RETIREMENT ACCOUNTS OR ANNUITIES.

"(a) IMPOSITION OF TAX.—If, in the case of an individual retirement account or individual retirement annuity, the amount distributed during the taxable year of the payee is less than the minimum amount required to be distributed under section 408(a)(6) or (7), or 408(b)(3) or (4) during such year, there is imposed a tax equal to 50 percent of the amount by which the minimum amount required to be distributed during such year exceeds the amount actually distributed during the year. The tax imposed by this section shall be paid by such payee.

"(b) REGULATIONS.—For purposes of this section, the minimum amount required to be distributed during a taxable year under section 408(a)(6) or (7) or 408(b)(3) or (4) shall be determined under regulations prescribed by the Secretary or his delegate.".

(f) PENALTY FOR FAILURE TO PROVIDE REPORTS ON INDIVIDUAL RETIREMENT ACCOUNTS.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6693. FAILURE TO PROVIDE REPORTS ON INDIVIDUAL RETIREMENT ACCOUNTS OR ANNUITIES.

"(a) The person required by section 408(i) to file a report regarding an individual retirement account or individual retirement annuity at the time and in the manner required by section 408(i) shall pay a penalty of $10 for each failure unless it is shown that such failure is due to reasonable cause.

"(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) does not apply to the assessment or collection of any penalty imposed by subsection (a).".

(g) CONFORMING AMENDMENTS.—

(1) Section 37(c)(1) (defining retirement income) is amended—

(A) by striking out "and" at the end of subparagraph (D),

(B) by adding at the end of subparagraph (E) the following: "retirement bonds described in section 409, and", and

(C) by adding at the end thereof the following new paragraph:

"(F) an individual retirement account described in section 408(a) or an individual retirement annuity described in section 408(b), or".

(2) The second sentence of section 46(a)(3) and the second sentence of section 50A(a)(3), as each is amended by sections 2001(g)(2)(B) and 2005(c)(4) of this Act, are each amended by inserting after "owner-employees)," the following: "section 408(e) (relating to additional tax on income from certain retirement accounts),".

(3) The third sentence of section 901(a), as amended by section 2005(c)(5) of this Act, is amended by inserting "against the tax imposed for the taxable year by section 408(f) (relating to additional tax on income from certain retirement accounts)," before "against the tax imposed by section 531".

(4) Subparagraph (A) of section 56(a)(2) and paragraph (1) of section 56(c) are each amended by striking out "531" and inserting in lieu thereof "408(f), 531,".

(5) Section 402(a) (relating to taxability of beneficiary of exempt trust), as amended by section 2005(c)(2) of this Act, is amended by inserting after paragraph (5) the following new paragraph:

"(5) ROLLOVER AMOUNTS.—In the case of an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if—

"(A) the balance to the credit of an employee is paid to him on one or more distributions which constitute a lump sum distribution within the meaning of subsection (e)(4)(A) (determined without reference to subsection (e)(4)(B)),

"(B)(i) the employee transfers all the property he receives in such distribution to an individual retirement account described in section 408(a), an individual retirement annuity described in section 408(b) (other than an endowment contract), or a retirement bond described in section 409, on or before the 60th day after the day on which he received such property, to the extent the fair market value of such property exceeds the amount referred to in subsection (e)(4)(D)(i), or

"(ii) the employee transfers all the property he receives in such distribution to an employees' trust described in section 401(a) which is exempt from tax under section 501(a),

or to an annuity plan described in section 403(a) on or before the 60th day after the day on which he received such property, to the extent the fair market value of such property exceeds the amount referred to in subsection (e)(4)(D)(i), and

"(C) the amount so transferred consists of the property (other than money) distributed, to the extent that the fair market value of such property does not exceed the amount required to be transferred pursuant to subparagraph (B),

then such distributions are not includible in gross income for the year in which paid. For purposes of this title, a transfer described in subparagraph (B)(i) shall be treated as a rollover contribution as described in section 408(d)(3). Subparagraph (B)(ii) does not apply in the case of a transfer to an employees' trust, or annuity plan if any part of the lump sum distribution described in subparagraph (A) is attributable to a trust forming part of a plan under which the employee was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan."

(6) Section 403(a) (relating to taxation of employee annuities) is amended by adding after paragraph (3) the following new paragraph:

"(4) ROLLOVER AMOUNTS.—In the case of an employee annuity described in 403(a), if—

"(A) the balance to the credit of an employee is paid to him in one or more distributions which constitute a lump sum distribution within the meaning of section 402(e)(4)(A) determined without reference to section 402(e)(4)(B),

"(B)(i) the employee transfers all the property he receives in such distribution to an individual account described in section 408(a), an individual retirement annuity described in section 408(b) (other than an endowment contract), or a retirement bond described in section 409, on or before the 60th day after the day on which he received such property to the extent the fair market value of such property exceeds the amount referred to in section 402(e)(4)(D)(i), or

"(ii) the employee transfers all the property he receives in such distribution to an employees' trust described in section 401(a) which is exempt from tax under section 501(a), or to an annuity plan described in subsection (a) on or before the 60th day after the day on which he received such property to the extent the fair market value of such property exceeds the amount referred to in section 402(e)(4)(D)(i), and

"(C) the amount so transferred consists of the property distributed to the extent that the fair market value of such property does not exceed the amount required to be transferred pursuant to subparagraph (B),

then such distribution is not includible in gross income for the year in which paid. For purposes of this title, a transfer described in subparagraph (B)(i) shall be treated as a rollover contribution described in section 408(d)(3).

Subparagraph (B)(ii) does not apply in the case of a transfer to an employees' trust, or annuity plan if any part of the lump sum distribution described in subparagraph (A) is attributable to an annuity plan under which the employee was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan.".

(7) Section 3401(a)(12) (relating to exemption from collection of income tax at source on certain wages) is amended by adding at the end thereof the following new subparagraph:

"(D) for a payment described in section 219(a) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to a deduction under such section for payment; or".

(8) Section 6047 (relating to information relating to certain trusts and annuity and bond purchase plans) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) OTHER PROGRAMS.—To the extent provided by regulations prescribed by the Secretary or his delegate, the provisions of this section apply with respect to any payment described in section 219(a) and to transactions of any trust described in section 408(a) or under an individual retirement annuity described in section 408(b).".

(9) Section 805(d)(1) (relating to definition of pension plan reserves) is amended by striking out "or" at the end of subparagraph (C), by striking out "foregoing." at the end of subparagraph (D) and inserting in lieu thereof "foregoing; or", and by adding at the end thereof the following new subparagraph:

"(E) purchased under contracts entered into with trusts which (at the time the contracts were entered into) were individual retirement accounts described in section 408(a) or under contracts entered into with individual retirement annuities described in section 408(b)."

(10) Section 72 (relating to annuities) is amended—

(A) by inserting after "501(a)" in subsection (m)(4)(A) ", an individual retirement amount described in section 408(a), an individual retirement annuity described in section 408(b)".

(B) by striking out at the end of subsection (m)(6) "401(c)(3)" and inserting in lieu thereof "401(c)(3) and includes an individual for whose benefit an individual retirement account or annuity described in section 408 (a) or (b) is maintained".

(11) Section 801(g)(7) (relating to basis of assets held for qualified pension plan contracts) is amended by striking out "or (D)" and inserting in lieu thereof "(D), or (E)".

(h) CLERICAL AMENDMENTS.—

(1) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out the item relating to section 219 and inserting in lieu thereof the following:

"Sec. 219. Retirement savings.
"Sec. 220. Cross references.".

(2) The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by adding at the end thereof the following:

"Sec. 408. Individual retirement accounts.
"Sec. 409. Retirement bonds.".

(3) The table of sections for chapter 43 is amended by inserting after the item relating to section 4972 the following new items:

"Sec. 4973. Tax on excess contributions to individual retirement accounts, certain 403(b) contracts, certain individual retirement annuities, and certain retirement bonds.
"Sec. 4974. Tax on certain accumulations in individual retirement accounts.
"Sec. 4975. Tax on prohibited transactions.".

(4) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following new item:

"Sec. 6693. Failure to provide reports on individual retirement accounts or annuities.".

(i) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (b), and (c) apply to taxable years beginning after December 31, 1974.

(2) The amendments made by subsections (d) through (h) except subsection (g)(5) and (6) shall take effect on January 1, 1975.

(3) The amendments made by subsection (g)(5) and (6) shall apply on and after the date of enactment of this Act with respect to contributions to an employees' trust described in section 401(a) of the Internal Revenue Code of 1954 which is exempt from tax under section 501(a) of such Code or an annuity plan described in section 403(a) of such Code.

SEC. 2003. PROHIBITED TRANSACTIONS.

(a) EXCISE TAX ON PROHIBITED TRANSACTIONS.—Chapter 43 (relating to qualified pension, etc., plans) is amended by adding after section 4974 the following new section:

"SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

"(a) INITIAL TAXES ON DISQUALIFIED PERSON.—There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 5 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

"(b) ADDITIONAL TAXES ON DISQUALIFIED PERSON.—In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the correction period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

"(c) PROHIBITED TRANSACTION.—

"(1) GENERAL RULE.—For purposes of this section, the term 'prohibited transaction' means any direct or indirect—

"(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

"(B) lending of money or other extension of credit between a plan and a disqualified person;

"(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

"(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

"(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

"(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

"(2) SPECIAL EXEMPTION.—The Secretary or his delegate shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction,

orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary or his delegate may not grant an exemption under this paragraph unless he finds that such exemption is—

"(A) administratively feasible,

"(B) in the interests of the plan and of its participants and beneficiaries, and

"(C) protective of the rights of participants and beneficiaries of the plan.

Before granting an exemption under this paragraph, the Secretary or his delegate shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary or his delegate affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary or his delegate may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

"(3) SPECIAL RULE FOR INDIVIDUAL RETIREMENT ACCOUNTS.—An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt for the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

"(d) EXEMPTIONS.—The prohibitions provided in subsection (c) shall not apply to—

"(1) any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan—

"(A) is available to all such participants or beneficiaries on a reasonably equivalent basis,

"(B) is not made available to highly compensated employees, officers, or shareholders in an amount greater than the amount made available to other employees,

"(C) is made in accordance with specific provisions regarding such loans set forth in the plan,

"(D) bears a reasonable rate of interest, and

"(E) is adequately secured;

"(2) any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor;

"(3) any loan to an employee stock ownership plan (as defined in subsection (e)(7)), if—

"(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

"(B) such loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));

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"(4) the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if—

"(A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

"(B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;

"(5) any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is—

"(A) the employer maintaining the plan, or

"(B) a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan);

"(6) the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if—

"(A) such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

"(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary or his delegate after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service—

"(i) in an excessive or unreasonable manner, and

"(ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;

"(7) the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary or his delegate, but only if the plan receives no less than adequate consideration pursuant to such conversion;

"(8) any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised by a State or

Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if—

"(A) the transaction is a sale or purchase of an interest in the fund,

"(B) the bank, trust company, or insurance company receives not more than reasonable compensation, and

"(C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;

"(9) receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

"(10) receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;

"(11) service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;

"(12) the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets); or

"(13) any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction).

The exemptions provided by this subsection (other than paragraphs (9) and (12) shall not apply to any transaction with respect to a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)) in which a plan directly or indirectly lends any part of the corpus or income of the plan to, pays any compensation for personal services rendered to the plan to, or acquires for the plan any property from or sells any property to, any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation. For purposes of the preceding sentence, a shareholder-employee (as defined in section 1379), a participant or beneficiary of an individual retirement account, individual retirement annuity, on an individual retirement bond (as defined in section 408 or 409), and an employer or association of employees which establishes such an account or annuity under section 408(c) shall be deemed to be an owner-employee.

"(e) DEFINITIONS.—

"(1) PLAN.—For purposes of this section, the term 'plan' means a trust described in section 401(a) which forms a part of a plan,

or a plan described in section 403(a) or 405(a), which trust or plan is exempt from tax under section 501(a), an individual retirement account described in section 408(a) or an individual retirement annuity described in section 408(b) or a retirement bond described in section 409 (or a trust, plan, account, annuity, or bond which, at any time, has been determined by the Secretary or his delegate to be such a trust, plan, account, or bond).

"(2) DISQUALIFIED PERSON.—For purposes of this section, the term 'disqualified person' means a person who is—

"(A) a fiduciary;

"(B) a person providing services to the plan;

"(C) an employer any of whose employees are covered by the plan;

"(D) an employee organization any of whose members are covered by the plan;

"(E) an owner, direct or indirect, of 50 percent or more of—

"(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,

"(ii) the capital interest or the profits interest of a partnership, or

"(iii) the beneficial interest of a trust or unincorporated enterprise,

which is an employer or an employee organization described in subparagraph (C) or (D);

"(F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);

"(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—

"(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

"(ii) the capital interest or profits interest of such partnership, or

"(iii) the beneficial interest of such trust or estate, is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

"(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or

"(I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).

"(3) FIDUCIARY.—For purposes of this section, the term 'fiduciary' means any person who—

"(A) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

"(B) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

"(C) has any discretionary authority or discretionary responsibility in the administration of such plan.

Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.

"(4) STOCKHOLDINGS.—For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

"(5) PARTNERSHIPS; TRUSTS.—For purposes of paragraphs (2)(E)(ii) and (iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

"(6) MEMBER OF FAMILY.—For purposes of paragraph (2)(F), the family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.

"(7) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' means a defined contribution plan—

"(A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and

"(B) which is otherwise defined in regulations prescribed by the Secretary or his delegate.

"(8) QUALIFYING EMPLOYER SECURITY.—The term 'qualifying employer security' means an employer security which is—

"(A) stock or otherwise an equity security, or

"(B) a bond, debenture, note, or certificate or other evidence of indebtedness which is described in paragraphs (1), (2), and (3) of section 503(e).

If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company's investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its investment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.

"(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) JOINT AND SEVERAL LIABILITY.—If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.

"(2) TAXABLE PERIOD.—The term 'taxable period' means, with respect to any prohibited transaction, the period beginning with

the date on which the prohibited transaction occurs and ending on the earlier of—

"(A) the date of mailing of a notice of deficiency pursuant to section 6212, with respect to the tax imposed by subsection (a), or

"(B) the date on which correction of the prohibited transaction is completed.

"(3) SALE OR EXCHANGE; ENCUMBERED PROPERTY.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

"(4) AMOUNT INVOLVED.—The term 'amount involved' means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value—

"(A) in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and

"(B) in the case of the tax imposed by subsection (b), shall be the highest fair market value during the correction period.

"(5) CORRECTION.—The terms 'correction' and 'correct' mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards.

"(6) CORRECTION PERIOD.—The term 'correction period' means, with respect to a prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending 90 days after the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (b) under section 6212, extended by—

"(A) any period in which a deficiency cannot be assessed under section 6213(a), and

"(B) any other period which the Secretary or his delegate determines is reasonable and necessary to bring about the correction of the prohibited transaction.

"(g) APPLICATION OF SECTION.—This section shall not apply—

"(1) in the case of a plan to which a guaranteed benefit policy (as defined in section 401(b)(2)(B) of the Employee Retirement Income Security Act of 1974) is issued, to any assets of the insurance company, insurance service, or insurance organization merely because of its issuance of such policy;

"(2) to a governmental plan (within the meaning of section 414(d)); or

"(3) to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.

In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.

"(h) NOTIFICATION OF SECRETARY OF LABOR.—Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary or his delegate shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

"(i) CROSS REFERENCE.—

"For provisions concerning coordination procedures between Secretary of Labor and Secretary of Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.".

(b) AMENDMENT OF SECTION 503.—Section 503 (relating to requirements for exemption) is amended—

(1) by striking out "or (18)" in subsection (a)(1)(A),

(2) by amending subsection (a)(1)(B) by inserting "which is referred to in section 4975(g) (2) or (3)" after "described in section 401(a)",

(3) by striking out "or section 401" in subsection (a)(2) and inserting in lieu thereof "or paragraph (1)(B)",

(4) by striking out "or section 401" in subsection (c) and inserting in lieu thereof "or subsection (a)(1)(B)", and

(5) by striking out subsection (g).

(c) EFFECTIVE DATE AND SAVINGS PROVISIONS.—

(1)(A) The amendments made by this section shall take effect on January 1, 1975.

(B) If, before the amendments made by this section take effect, an organization described in section 401(a) of the Internal Revenue Code of 1954 is denied exemption under section 501(a) of such Code by reason of section 503 of such Code, the denial of such exemption shall not apply if the disqualified person elects (in such manner and at such time as the Secretary or his delegate shall by regulations prescribe) to pay, with respect to the prohibited transaction (within the meaning of section 503 (b) or (g)) which resulted in such denial of exemption, a tax in the amount and in the manner provided with respect to the tax imposed under section 4975 of such Code. An election made under this subparagraph, once made, shall be irrevocable. The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph.

(2) Section 4975 of the Internal Revenue Code of 1954 (relating to tax on prohibited transactions) shall not apply to—

(A) a loan of money or other extension of credit between a plan and a disqualified person under a binding contract in effect on July 1, 1974 (or pursuant to renewals of such a contract), until June 30, 1984, if such loan or other extension of credit remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be, and if the execution of the contract, the making of the loan, or the extension of credit was not, at the time of such execution, making, or extension, a prohibited transaction (within the meaning of section 503(b) of such Code or the corresponding provisions of prior law);

(B) a lease or joint use of property involving the plan and a disqualified person pursuant to a binding contract in effect on July 1, 1974 (or pursuant to renewals of such a contract), until June 30, 1984, if such lease or joint use remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and if the execution of the contract was not, at the time of such execution, a prohibited

transaction (within the meaning of section 503(b) of such Code) or the corresponding provisions of prior law;

(C) the sale, exchange, or other disposition of property described in subparagraph (B) between a plan and a disqualified person before June 30, 1984, if—

(i) in the case of a sale, exchange, or other disposition of the property by the plan to the disqualified person, the plan receives an amount which is not less than the fair market value of the property at the time of such disposition; and

(ii) in the case of the acquisition of the property by the plan, the plan pays an amount which is not in excess of the fair market value of the property at the time of such acquisition;

(D) Until June 30, 1977, the provision of services to which subparagraphs (A), (B), and (C) do not apply between a plan and a disqualified person (i) under a binding contract in effect on July 1, 1974 (or pursuant to renewals of such contract), or (ii) if the disqualified person ordinarily and customarily furnished such services on June 30, 1974, if such provision of services remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and if the provision of services was not, at the time of such provision, a prohibited transaction (within the meaning of section 503(b) of such Code) or the corresponding provisions of prior law; or

(E) the sale, exchange, or other disposition of property which is owned by a plan on June 30, 1974, and all times thereafter, to a disqualified person, if such plan is required to dispose of such property in order to comply with the provisions of section 407(a)(2)(A) (relating to the prohibition against holding excess employer securities and employer real property) of the Employee Retirement Income Security Act of 1974, and if the plan receives not less than adequate consideration.

For the purposes of this paragraph, the term "disqualified person" has the meaning provided by section 4975(e)(2) of the Internal Revenue Code of 1954.

SEC. 2004. LIMITATIONS ON BENEFITS AND CONTRIBUTIONS.

(a) PLAN REQUIREMENTS.—

(1) Section 401(a) (relating to requirements for qualification) is amended by inserting after paragraph (15) the following new paragraph:

"(16) A trust shall not constitute a qualified trust under this section if the plan of which such trust is a part provides for benefits or contributions which exceed the limitations of section 415."

(2) Subpart B of part I of subchapter D of chapter 1 is amended by inserting after section 414 the following new section:

"SEC. 415. LIMITATIONS ON BENEFITS AND CONTRIBUTION UNDER QUALIFIED PLANS.

"(a) GENERAL RULE.—

"(1) TRUSTS.—A trust which is a part of a pension, profit-sharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if—

"(A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceed the limitation of subsection (b),

"(B) in the case of a defined contribution plan, contributions and other additions under the plan with respect to any

participant for any taxable year exceed the limitation of subsection (c), or

"(C) in any case in which an individual is a participant in both a defined benefit plan and a defined contribution plan maintained by the employer, the trust has been disqualified under subsection (g).

"(2) SECTION APPLIES TO CERTAIN ANNUITIES AND ACCOUNTS.—in the case of—

"(A) an employee annuity plan described in section 403(a),

"(B) an annuity contract described in section 403(b),

"(C) an individual retirement account described in section 408(a),

"(D) an individual retirement annuity described in section 408(b),

"(E) a plan described in section 405(a), or

"(F) a retirement bond described in section 409,

such contract, annuity plan, account, annuity, plan, or bond shall not be considered to be described in section 403(a), 403(b), 405(a), 408(a), 408(b), or 409, as the case may be, unless it satisfies the requirements of subparagraph (A) or subparagraph (B) of paragraph (1), whichever is appropriate, and has not been disqualified under subsection (g). In the case of an annuity contract described in section 403(b), the preceding sentence shall apply only to the portion of the annuity contract which exceeds the limitation of subsection (b) or the limitation of subsection (c), whichever is appropriate, and the amount of the contribution for such portion shall reduce the exclusion allowance as provided in section 403(b)(2).

"(b) LIMITATION FOR DEFINED BENEFIT PLANS.—

"(1) IN GENERAL.—Benefits with respect to a participant exceed the limitation of this subsection if, when expressed as an annual benefit (within the meaning of paragraph (2)), such annual benefit is greater than the lesser of—

"(A) $75,000, or

"(B) 100 percent of the participant's average compensation for his high 3 years.

"(2) ANNUAL BENEFIT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'annual benefit' means a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in sections 402(a)(5), 403(a)(4), 408(d)(3), and 409(b)(3)(C) are made.

"(B) ADJUSTMENT FOR CERTAIN OTHER FORMS OF BENEFIT.—If the benefit under the plan is payable in any form other than the form described in subparagraph (A), or if the employees contribute to the plan or make rollover contributions (as defined in sections 402(a)(5), 403(a)(4), 408(d)(3) and 409(b)(3)(C)), the determinations as to whether the limitation described in paragraph (1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary or his delegate, by adjusting such benefit so that it is equivalent to the benefit described in subparagraph (A). For purposes of this subparagraph, any ancillary benefit which is not directly related to retirement income benefits shall not be taken into account; and that portion of any joint and survivor annuity which constitutes a qualified joint and

survivor annuity (as defined in section 401(a)(11)(H)(iii)) shall not be taken into account.

"(C) ADJUSTMENT TO $75,000 LIMIT WHERE BENEFIT BEGINS BEFORE AGE 55.—If the retirement income benefit under the plan begins before age 55, the determination as to whether the $75,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary or his delegate, by adjusting such benefit so that it is equivalent to such a benefit beginning at age 55.

"(3) AVERAGE COMPENSATION FOR HIGH 3 YEARS.—For purposes of paragraph (1), a participant's high 3 years shall be the period of consecutive calendar years (not more than 3) during which the participant both was an active participant in the plan and had the greatest aggregate compensation from the employer. In the case of an employee within the meaning of section 401(c)(1), the preceding sentence shall be applied by substituting for 'compensation from the employer' the following: 'the participant's earned income (within the meaning of section 401(c)(2) but determined without regard to any exclusion under section 911)'.

"(4) TOTAL ANNUAL BENEFITS NOT IN EXCESS OF $10,000.—Notwithstanding the preceding provisions of this subsection, the benefits payable with respect to a participant under any defined benefit plan shall be deemed not to exceed the limitation of this subsection if—

"(A) the retirement benefits payable with respect to such participant under such plan and under all other defined benefit plans of the employer do not exceed $10,000 for the plan year, or for any prior plan year, and

"(B) the employer has not at any time maintained a defined contribution plan in which the participant participated.

"(5) REDUCTION FOR SERVICE LESS THAN 10 YEARS.—In the case of an employee who has less than 10 years of service with the employer, the limitation referred to in paragraph (1), and the limitation referred to in paragraph (4), shall be the limitation determined under such paragraph (without regard to this paragraph), multiplied by a fraction, the numerator of which is the number of years (or part thereof) of service with the employer and the denominator of which is 10.

"(6) COMPUTATION OF BENEFITS AND CONTRIBUTIONS.—The computation of—

"(A) benefits under a defined contribution plan, for purposes of section 401(a)(4),

"(B) contributions made on behalf of a participant in a defined benefit plan, for purposes of section 401(a)(4), and

"(C) contributions and benefits provided for a participant in a plan described in section 414(k), for purposes of this section

shall not be made on a basis inconsistent with regulations prescribed by the Secretary or his delegate.

"(c) LIMITATION FOR DEFINED CONTRIBUTION PLANS.—

"(1) IN GENERAL.—Contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of

paragraph (2)) to the participant's account, such annual addition is greater than the lesser of—

"(A) $25,000, or

"(B) 25 percent of the participant's compensation.

"(2) ANNUAL ADDITION.—For purposes of paragraph (1), the term 'annual addition' means the sum for any year of—

"(A) employer contributions,

"(B) the lesser of—

"(i) the amount of the employee contributions in excess of 6 percent of his compensation, or

"(ii) one-half of the employee contributions, and

"(C) forfeitures.

For the purposes of this paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(a)(5), 403(a)(4), 408(d)(3), and 409(b)(3)(C)).

"(3) PARTICIPANT'S COMPENSATION.—For purposes of paragraph (1), the term 'participant's compensation' means the compensation of the participant from the employer for the year. In the case of an employee within the meaning of section 401(c)(1), the preceding sentence shall be applied by substituting for 'compensation of the participant from the employer' the following: 'the participant's earned income (within the meaning of section 401(c)(2) but determined without regard to any exclusion under section 911)'.

"(4) SPECIAL ELECTION FOR SECTION 403(b) CONTRACTS PURCHASED BY EDUCATIONAL INSTITUTIONS, HOSPITALS, AND HOME HEALTH SERVICE AGENCIES.—

"(A) In the case of amounts contributed for an annuity contract described in section 403(b) for the year in which occurs a participant's separation from the service with an educational institution, a hospital, or a home health service agency, at the election of the participant there is substituted for the amount specified in paragraph (1)(B) the amount of the exclusion allowance which would be determined under section 403(b)(2) (without regard to this section) for the participant's taxable year in which such separation occurs if the participant's years of service were computed only by taking into account his service for the employer during the period of years (not exceeding ten) ending on the date of such separation.

"(B) In the case of amounts contributed for an annuity contract described in section 403(b) for any year in the case of a participant who is an employee of an educational institution, a hospital, or a home health service agency, at the election of the participant there is substituted for the amount specified in paragraph (1)(B) the least of—

"(i) 25 percent of the participant's includible compensation (as defined in section 403(b)(3)) plus $4,000,

"(ii) the amount of the exclusion allowance determined for the year under section 403(b)(2), or

"(iii) $15,000.

"(C) In the case of amounts contributed for an annuity contract described in section 403(b) for any year for a participant who is an employee of an educational institution, a hospital, or a home health service agency, at the election of the participant the provisions of section 403(b)(2)(A) shall not apply.

"(D)(i) The provisions of this paragraph apply only if the participant elects its application at the time and in the manner provided under regulations prescribed by the Secretary or his delegate. Not more than one election may be made under subparagraph (A) by any participant. A participant who elects to have the provisions of subparagraph (A), (B), or (C) of this paragraph apply to him may not elect to have any other subparagraph of this paragraph apply to him. Any election made under this paragraph is irrevocable.

"(ii) For purposes of this paragraph the term 'educational institution' means an educational institution as defined in section 151(e)(4).

"(iii) For purposes of this paragraph the term 'home health service agency' means an organization described in subsection 501(c)(3) which is exempt from tax under section 501(a) and which has been determined by the Secretary of Health, Education, and Welfare to be a home health agency (as defined in section 1861(o) of the Social Security Act).

"(d) COST-OF-LIVING ADJUSTMENTS.—

"(1) IN GENERAL.—The Secretary or his delegate shall adjust annually—

"(A) the $75,000 amount in subsection (b)(1)(A),

"(B) the $25,000 amount in subsection (c)(1)(A), and

"(C) in the case of a participant who is separated from service, the amount taken into account under subsection (b)(1)(B),

for increases in the cost of living in accordance with regulations prescribed by the Secretary or his delegate. Such regulations shall provide for adjustment procedures which are similar to the procedures used to adjust primary insurance amounts under section 215(i)(2)(A) of the Social Security Act.

"(2) BASE PERIODS.—The base period taken into account—

"(A) for purposes of subparagraphs (A) and (B) of paragraph (1) is the calendar quarter beginning October 1, 1974, and

"(B) for purposes of subparagraph (C) of paragraph (1) is the last calendar quarter of the calendar year before the calendar year in which the participant is separated from service.

"(e) LIMITATION IN CASE OF DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN FOR SAME EMPLOYEE.—

"(1) IN GENERAL.—In any case in which an individual is a participant in both a defined benefit plan and a defined contribution plan maintained by the same employer, the sum of the defined benefit plan fraction and the defined contribution plan fraction for any year may not exceed 1.4.

"(2) DEFINED BENEFIT PLAN FRACTION.—For purposes of this subsection, the defined benefit plan fraction for any year is a fraction—

"(A) the numerator of which is the projected annual benefit of the participant under the plan (determined as of the close of the year), and

"(B) the denominator of which is the projected annual benefit of the participant under the plan (determined as of the close of the year) if the plan provided the maximum benefit allowable under subsection (b).

"(3) DEFINED CONTRIBUTION PLAN FRACTION.—For purposes of this subsection, the defined contribution plan fraction for any year is a fraction—

"(A) the numerator of which is the sum of the annual additions to the participant's account as of the close of the year, and

"(B) the denominator of which is the sum of the maximum amount of annual additions to such account which could have been made under subsection (c) for such year and for each prior year of service with the employer.

"(4) SPECIAL TRANSITION RULES FOR DEFINED CONTRIBUTION FRACTION.—In applying paragraph (3) with respect to years beginning before January 1, 1976—

"(A) the aggregate amount taken into account under paragraph (3)(A) may not exceed the aggregate amount taken into account under paragraph (3)(B), and

"(B) the amount taken into account under subsection (c)(2)(B)(i) for any year concerned is an amount equal to—

"(i) the excess of the aggregate amount of employee contributions for all years beginning before January 1, 1976, during which the employee was an active participant of the plan, over 10 percent of the employee's aggregate compensation for all such years, multiplied by

"(ii) a fraction the numerator of which is 1 and the denominator of which is the number of years beginning before January 1, 1976, during which the employee was an active participant in the plan.

Employee contributions made on or after October 2, 1973, shall be taken into account under subparagraph (B) of the preceding sentence only to the extent that the amount of such contributions does not exceed the maximum amount of contributions permissible under the plan as in effect on October 2, 1973.

"(5) SPECIAL RULES FOR SECTIONS 403(b) and 408.—For purposes of this subsection, any annuity contract described in section 403(b) (except in the case of a participant who has elected under subsection (c)(4)(D) to have the provisions of subsection (c)(4)(C) apply), any individual retirement account described in section 408(a), any individual retirement annuity described in section 408(b), and any retirement bond described in section 409, for the benefit of a participant shall be treated as a defined contribution plan maintained by each employer with respect to which the participant has the control required under subsection (b) or (c) of section 414 (as modified by subsection (h)). In the case of any annuity contract described in section 403(b), the amount of the contribution disqualified by reason of subsection (g) shall reduce the exclusion allowance as provided in section 403(b)(2).

"(f) COMBINING OF PLANS.—

"(1) IN GENERAL.—For purposes of applying the limitations of subsections (b), (c), and (e)—

"(A) all defined benefit plans (whether or not terminated) of an employer are to be treated as one defined benefit plan, and

"(B) all defined contribution plans (whether or not terminated) of an employer are to be treated as one defined contribution plan.

"(2) ANNUAL COMPENSATION TAKEN INTO ACCOUNT FOR DEFINED BENEFIT PLANS.—If the employer has more than one defined benefit plan—

"(A) subsection (b)(1)(B) shall be applied separately with respect to each such plan, but

"(B) in applying subsection (b)(1)(B) to the aggregate of such defined benefit plans for purposes of this subsection, the high 3 years of compensation taken into account shall be the period of consecutive calendar years (not more than 3) during which the individual had the greatest aggregate compensation from the employer.

"(g) AGGREGATION OF PLANS.—The Secretary or his delegate, in applying the provisions of this section to benefits or contributions under more than one plan maintained by the same employer, and to any trusts, contracts, accounts, or bonds referred to in subsection (a)(2), with respect to which the participant has the control required under section 414(b) or (c), as modified by subsection (h), shall, under regulations prescribed by the Secretary or his delegate, disqualify one or more trusts, plans, contracts, accounts, or bonds, or any combination thereof until such benefits or contributions do not exceed the limitations contained in this section. In addition to taking into account such other factors as may be necessary to carry out the purposes of subsections (e) and (f), the regulations prescribed under this paragraph shall provide that no plan which has been terminated shall be disqualified until all other trusts, plans, contracts, accounts, or bonds have been disqualified.

"(h) 50 PERCENT CONTROL.—For purposes of applying subsections (b) and (c) of section 414 to this section, the phrase 'more than 50 percent' shall be substituted for the phrase 'at least 80 percent' each place it appears in section 1563(a)(1).

"(i) RECORDS NOT AVAILABLE FOR PAST PERIODS.—Where for the period before January 1, 1976, or (if later) the first day of the first plan year of the plan, the records necessary for the application of this section are not available, the Secretary or his delegate may by regulations prescribe alternative methods for determining the amounts to be taken into account for such period.

"(j) REGULATIONS; DEFINITION OF YEAR.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section, including, but not limited to, regulations defining the term 'year' for purposes of any provision of this section.

"(k) SPECIAL RULES.—

"(1) DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN.—For purposes of this title, the term 'defined contribution plan' or 'defined benefit plan' means a defined contribution plan (within the meaning of section 414(i)) or a defined benefit plan (within the meaning of section 414(j)), whichever applies, which is—

"(A) a plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a),

"(C) a qualified bond purchase plan described in section 405(a),

"(D) an annuity a contract described in section 403(b),

"(E) an individual retirement account described in section 408(a),

"(F) an individual retirement annuity described in section 408(b), or

"(G) an individual retirement bond described in section 409.".

(3) SPECIAL RULE FOR CERTAIN PLANS IN EFFECT ON DATE OF ENACTMENT.—In any case in which, on the date of enactment of this Act, an individual is a participant in both a defined benefit

plan and a defined contribution plan maintained by the same employer, and the sum of the defined benefit plan fraction and the defined contribution plan fraction for the year during which such date occurs exceeds 1.4, the sum of such fractions may continue to exceed 1.4 if—

(A) the defined benefit plan fraction is not increased, by amendment of the plan or otherwise, after the date of enactment of this Act, and

(B) no contributions are made under the defined contribution plan after such date.

A trust which is part of a pension, profit-sharing, or stock bonus plan described in the preceding sentence shall not be treated as not constituting a qualified trust under section 401(a) of the Internal Revenue Code of 1954 on account of the provisions of section 415(e) of such Code, as long as it is described in the preceding sentence of this subsection.

(b) LIMIT ON EMPLOYER DEDUCTIONS.—The second sentence of section 404(a)(3)(A) (relating to limits on deductible contributions) is amended by striking out "beneficiaries under the plan." and inserting in lieu thereof "beneficiaries under the plan, but the amount so deductible under this sentence in any one succeeding taxable year together with the amount so deductible under the first sentence of this subparagraph shall not exceed 25 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan.".

(c) CERTAIN ANNUITY AND BOND PURCHASE PLANS.—

(1) Section 404(a)(2) (relating to the general rule for deduction for employee annuities) is amended by striking out "(15)" and inserting in lieu thereof "(15), (16), and (19)" and by striking out "(a)(9) and (10)" and inserting in lieu thereof "(a)(9), (10), (17), and (18)".

(2) Section 405(a)(1) (relating to requirements for qualified bond purchase plans) is amended by striking out "and (8)," and inserting in lieu thereof "(8), (16), and (19)".

(3) Section 805(d)(1)(C) (relating to pension plan reserves) is amended by striking out "and (15)" and inserting in lieu thereof "(15), (16), and (19)".

(4) Section 403(b)(2) (relating to exclusion allowance) is amended to read as follows:

"(2) EXCLUSION ALLOWANCE.—

"(A) IN GENERAL.—For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of—

"(i) the amount determined by multiplying 20 percent of his includible compensation by the number of years of service, over

"(ii) the aggregate of the amounts contributed by the employer for annuity contracts and excludible from the gross income of the employee for any prior taxable year.

"(B) ELECTION TO HAVE ALLOWANCE DETERMINED UNDER SECTION 415 RULES.—In the case of an employee who makes an election under section 415(c)(4)(D) to have the provisions of section 415(c)(4)(C) (relating to special rule for section 403(b) contracts purchased by educational institutions, hospitals, and home health service agencies) apply, the exclusion allowance for any such employee for the taxable year is the amount which could be contributed (under section 415) by his employer under a plan described in section 403(a) if the

annuity contract for the benefit of such employee were treated as a defined contribution plan maintained by the employer.".

(d) EFFECTIVE DATE.—

(1) GENERAL RULE.—The amendments made by this section shall apply to years beginning after December 31, 1975. The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out the provisions of this paragraph.

(2) TRANSITION RULE FOR DEFINED BENEFIT PLANS.—In the case of an individual who was an active participant in a defined benefit plan before October 3, 1973, if—

(A) the annual benefit (within the meaning of section 415(b)(2) of the Internal Revenue Code of 1954) payable to such participant on retirement does not exceed 100 percent of his annual rate of compensation on the earlier of (i) October 2, 1973, or (ii) the date on which he separated from the service of the employer,

(B) such annual benefit is no greater than the annual benefit which would have been payable to such participant on retirement if (i) all the terms and conditions of such plan in existence on such date had remained in existence until such retirement, and (ii) his compensation taken into account for any period after October 2, 1973, had not exceeded his annual rate of compensation on such date, and

(C) in the case of a participant who separated from the service of the employer prior to October 2, 1973, such annual benefit is no greater than his vested accrued benefit as of the date he separated from the service,

then such annual benefit shall be treated as not exceeding the limitation of subsection (b) of section 415 of the Internal Revenue Code of 1954.

SEC. 2005. TAXATION OF CERTAIN LUMP SUM DISTRIBUTIONS.

(a) TREATMENT OF TOTAL DISTRIBUTIONS.—Section 402(e) (relating to certain plan terminations) is amended to read as follows:

"(e) TAX ON LUMP SUM DISTRIBUTIONS.—

(1) IMPOSITION OF SEPARATE TAX ON LUMP SUM DISTRIBUTIONS.—

"(A) SEPARATE TAX.—There is hereby imposed a tax (in the amount determined under subparagraph (B)) on the ordinary income portion of a lump sum distribution.

"(B) AMOUNT OF TAX.—The amount of tax imposed by subparagraph (A) for any taxable year shall be an amount equal to the amount of the initial separate tax for such taxable year multiplied by a fraction, the numerator of which is the ordinary income portion of the lump sum distribution for the taxable year and the denominator of which is the total taxable amount of such distribution for such year.

"(C) INITIAL SEPARATE TAX.—The initial separate tax for any taxable year is an amount equal to 10 times the tax which would be imposed by subsection (c) of section 1 if the recipient were an individual referred to in such subsection and the taxable income were an amount equal to one-tenth of the excess of—

"(i) the total taxable amount of the lump sum distribution for the taxable year, over

"(ii) the minimum distribution allowance.

"(D) MINIMUM DISTRIBUTION ALLOWANCE.—For purposes of this paragraph, the minimum distribution allowance for the taxable year is an amount equal to—

"(i) the lesser of $10,000 or one-half of the total taxable amount of the lump sum distribution for the taxable year, reduced (but not below zero) by

"(ii) 20 percent of the amount (if any) by which such total taxable amount exceeds $20,000.

"(E) LIABILITY FOR TAX.—The recipient shall be liable for the tax imposed by this paragraph.

"(2) MULTIPLE DISTRIBUTIONS AND DISTRIBUTIONS OF ANNUITY CONTRACTS.—In the case of any recipient of a lump sum distribution for the taxable year with respect to whom during the 6-taxable-year period ending on the last day of the taxable year there has been one or more other lump sum distributions after December 31, 1973, or if the distribution (or any part thereof) is an annuity contract, in computing the tax imposed by paragraph (1)(A), the total taxable amounts of all such distributions during such 6-taxable-year period shall be aggregated, but the amount of tax so computed shall be reduced (but not below zero) by the sum of—

"(A) the amount of the tax imposed by paragraph (1)(A) paid with respect to such other distributions, plus

"(B) that portion of the tax on the aggregated total taxable amounts which is attributable to annuity contracts.

For purposes of this paragraph, a beneficiary of a trust to which a lump sum distribution is made shall be treated as the recipient of such distribution if the beneficiary is an employee (including an employee within the meaning of section 401(c)(1)) with respect to the plan under which the distribution is made or if the beneficiary is treated as the owner of such trust for purposes of subpart E of part I of subchapter J. In the case of the distribution of an annuity contract, the taxable amount of such distribution shall be deemed to be the current actuarial value of the contract, determined on the date of such distribution. In the case of a lump sum distribution with respect to any individual which is made only to two or more trusts, the tax imposed by paragraph (1)(A) shall be computed as if such distribution was made to a single trust, but the liability for such tax shall be apportioned among such trusts according to the relative amounts received by each. The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph.

"(3) ALLOWANCE OF DEDUCTION.—The ordinary income portion of a lump sum distribution for the taxable year shall be allowed as a deduction from gross income for such taxable year, but only to the extent included in the taxpayer's gross income for such taxable year.

"(4) DEFINITIONS AND SPECIAL RULES.—

"(A) LUMP SUM DISTRIBUTION.—For purposes of this section and section 403, the term 'lump sum distribution' means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

"(i) on account of the employee's death,

"(ii) after the employee attains age 59½,

"(iii) on account of the employee's separation from the service, or

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"(iv) after the employee has become disabled (within the meaning of section 72(m)(7))

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Clause (iii) of this subparagraph shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and clause (iv) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this subparagraph, a distribution of an annuity contract from a trust or annuity plan referred to in the first sentence of this subparagraph shall be treated as a lump sum distribution. For purposes of this subparagraph, a distribution to two or more trusts shall be treated as a distribution to one recipient.

"(B) ELECTION OF LUMP SUM TREATMENT.—For purposes of this section and section 403, no amount which is not an annuity contract may be treated as a lump sum distribution under subparagraph (A) unless the taxpayer elects for the taxable year to have all such amounts received during such year so treated at the time and in the manner provided under regulations prescribed by the Secretary or his delegate. Not more than one election may be made under this subparagraph with respect to any individual after such individual has attained age 59½. No election may be made under this subparagraph by any taxpayer other than an individual, an estate, or a trust. In the case of a lump sum distribution made with respect to an employee to two or more trusts, the election under this subparagraph shall be made by the personal representative of the employee.

"(C) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under subparagraph (A)—

"(i) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

"(ii) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

"(D) TOTAL TAXABLE AMOUNT.—For purposes of this section and section 403, the term 'total taxable amount' means, with respect to a lump sum distribution, the amount of such distribution which exceeds the sum of—

"(i) the amounts considered contributed by the employee (determined by applying section 72(f)), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not includible in gross income, and

"(ii) the net unrealized appreciation attributable to that part of the distribution which consists of the securities of the employer corporation so distributed.

"(E) ORDINARY INCOME PORTION.—For purposes of this section, the term 'ordinary income portion' means, with

respect to a lump sum distribution, so much of the total taxable amount of such distribution as is equal to the product of such total taxable amount multiplied by a fraction—

"(i) the numerator of which is the number of calendar years of active participation by the employee in such plan after December 31, 1973, and

"(ii) the denominator of which is the number of calendar years of active participation by the employee in such plan.

"(F) EMPLOYEE.—For purposes of this subsection and subsection (a)(2), except as otherwise provided in subparagraph (A), the term 'employee' includes an individual who is an employee within the meaning of section 401(c)(1) and the employer of such individual is the person treated as his employer under section 401(c)(4).

"(G) COMMUNITY PROPERTY LAWS.—The provisions of this subsection, other than paragraph (3), shall be applied without regard to community property laws.

"(H) MINIMUM PERIOD OF SERVICE.—For purposes of this subsection (but not for purposes of subsection (a)(2) or section 403(a)(2)(A)), no amount distributed to an employee from or under a plan may be treated as a lump sum distributed under subparagraph (A) unless he has been a participant in the plan for 5 or more taxable years before the taxable year in which such amounts are distributed.

"(I) AMOUNTS SUBJECT TO PENALTY.—This subsection shall not apply to amounts described in clause (ii) of subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

"(J) UNREALIZED APPRECIATION OF EMPLOYER SECURITIES.—In the case of any distribution including securities of the employer corporation which, without regard to the requirement of subparagraph (H), would be treated as a lump sum distribution under subparagraph (A), there shall be excluded from gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation so distributed. In the case of any such distribution or any lump sum distribution including securities of the employer corporation, the amount of net unrealized appreciation of such securities and the resulting adjustments to the basis of such securities shall be determined under regulations prescribed by the Secretary or his delegate.

"(K) SECURITIES.—For purposes of this subsection, the terms 'securities' and 'securities of the employer corporation' have the respective meanings provided by subsection (a)(3)."

(b) PHASEOUT OF CAPITAL GAINS TREATMENT.—

(1) IN GENERAL.—Section 402(a)(2) (relating to capital gains treatment for certain distributions) is amended to read as follows:

"(2) CAPITAL GAINS TREATMENT FOR PORTION OF LUMP SUM DISTRIBUTIONS.—In the case of an employee trust described in section 401(a), which is exempt from tax under section 501(a), so much of the total taxable amount (as defined in subparagraph (D) of subsection (e)(4)) of a lump sum distribution as is equal to the product of such total taxable amount multiplied by a fraction—

"(A) the numerator of which is the number of calendar years of active participation by the employee in such plan before January 1, 1974, and

"(B) the denominator of which is the number of calendar years of active participation by the employee in such plan, shall be treated as a gain from the sale or exchange of a capital asset held for more than 6 months. For purposes of computing the fraction described in this paragraph and the fraction under subsection (e)(4)(E), the Secretary or his delegate may prescribe regulations under which plan years may be used in lieu of calendar years. For purposes of this paragraph, in the case of an individual who is an employee without regard to section 401(c)(1), determination of whether or not any distribution is a lump sum distribution shall be made without regard to the requirement that an election be made under subsection (e)(4)(B), but no distribution to any taxpayer other than an individual, estate, or trust may be treated as a lump sum distribution under this paragraph."

(2) AMENDMENT OF SECTION 403.—That part of paragraph (2) of section 403(a) which follows clause (ii) of subparagraph (A) thereof is amended to read as follows:

"(iii) a lump sum distribution (as defined in section 402(e)(4)(A)) is paid to the recipient,

so much of the total taxable amount (as defined in section 402(e)(4)(D)) of such distribution as is equal to the product of such total taxable amount multiplied by the fraction described in section 402(a)(2) shall be treated as a gain from the sale or exchange of a capital asset held for more than 6 months. For purposes of this paragraph, in the case of an individual who is an employee without regard to section 401(c)(1), determination of whether or not any distribution is a lump sum distribution shall be made without regard to the requirement that an election be made under subsection (e)(4)(B) of section 402, but no distribution to any taxpayer other than an individual, estate, or trust may be treated as a lump sum distribution under this paragraph.

"(B) CROSS REFERENCE.—

"For imposition of separate tax on ordinary income portion of lump sum distribution, see section 402(e).".

(c) CONFORMING AMENDMENTS.—

(1) Subparagraph (C) of section 402(a)(3) is repealed.

(2) Paragraph (5) (as in effect on December 31, 1973) of section 402(a) is repealed.

(3) Section 72 is amended by striking out subsection (n) thereof and by redesignating subsections (o) and (p) as (n) and (o), respectively.

(4) The second sentence of section 46(a)(3) and the second sentence of section 50A(a)(3) are each amended by inserting after "tax preferences)," the following: "section 402(e) (relating to tax on lump sum distributions),".

(5) The third sentence of section 901(a) is amended by inserting "against the tax imposed by section 402(e) (relating to tax on lump sum distributions)," before "against the tax imposed by section 531".

(6) Subsection 1304(b)(2) (relating to special rules) is amended by striking out paragraph (2) and by redesignating paragraphs (3), (4), (5), and (6) as paragraphs (2), (3), (4), and (5), respectively.

(7) Subparagraph (A) of section 56(a)(2) and paragraph (1) of section 56(c) are each amended by inserting before "531" the following: "402(e),".

(8) Sections 871(b)(1) and 877(b) are each amended by inserting ", 402(e)(1)," after "section 1".

(9) Section 62 (defining adjusted gross income), is amended by inserting after paragraph (10) the following new paragraph:

"(11) CERTAIN PORTION OF LUMP-SUM DISTRIBUTIONS FROM PENSION PLANS TAXED UNDER SECTION 402(e).—The deduction allowed by section 402(e)(3)."

(10) Section 122(b)(2) (relating to consideration for the contract) is amended by striking out "72(o)" and inserting "72(n)".

(11) Section 405(e) (relating to capital gains treatment and limitation of tax not to apply to bonds distributed by trusts) is amended by striking out "Section 72(n) and section 402(a)(2)" and inserting "Subsections (a)(2) and (e) of section 402".

(12) Section 406(c) (relating to termination of status as deemed employee, etc.) is amended by striking out "section 72(n), section 402(a)(2)" and inserting "subsections (a)(2) and (e) of section 402".

(13) Section 407(c) (relating to termination of status as deemed employee, etc.) is amended by striking out "section 72(n), section 402(a)(2)" and inserting "subsections (a)(2) and (e) of section 402".

(14) Section 1348(b)(1) (relating to earned income) is amended by striking out "72(n), 402(a)(2)" and inserting "402(a)(2), 402(e)".

(15) Section 101(b)(2)(B) is amended by striking out "total distributions payable (as defined in section 402(a)(3)) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death" and inserting in lieu thereof "a lump sum distribution (as defined in section 402(e)(4))".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply only with respect to distributions or payments made after December 31, 1973, in taxable years beginning after such date.

SEC. 2006. SALARY REDUCTION REGULATIONS.

(a) INCLUSION OF CERTAIN CONTRIBUTIONS IN INCOME.—Except in the case of plans or arrangements in existence on June 27, 1974, a contribution made before January 1, 1977, to an employees' trust described in section 401(a), 403(a), or 405(a) of the Internal Revenue Code of 1954 which is exempt from tax under section 501(a) of such Code, or under an arrangement which, but for the fact that it was not in existence on June 27, 1974, would be an arrangement described in subsection (b)(2) of this section, shall be treated as a contribution made by an employee if the contribution is made under an arrangement under which the contribution will be made only if the employee elects to receive a reduction in his compensation or to forego an increase in his compensation.

(b) ADMINISTRATION IN THE CASE OF CERTAIN QUALIFIED PENSION OR PROFIT-SHARING PLANS, ETC., IN EXISTENCE ON JUNE 27, 1974.—No salary reduction regulations may be issued by the Secretary of the Treasury in final form before January 1, 1977, with respect to an arrangement which was in existence on June 27, 1974, and which, on that date—

(1) provided for contributions to an employees' trust described in section 401(a), 403(a), or 405(a) of the Internal Revenue Code of 1954 which is exempt from tax under section 501(a) of such Code, or

(2) was maintained as part of an arrangement under which an

employee was permitted to elect to receive part of his compensation in one or more alternative forms if one of such forms results in the inclusion of amounts in income under the Internal Revenue Code of 1954.

(c) ADMINISTRATION OF LAW WITH RESPECT TO CERTAIN PLANS.—

(1) ADMINISTRATION IN THE CASE OF PLANS DESCRIBED IN SUBSECTION (b).—Until salary reduction regulations have been issued in final form, the law with respect to plans or arrangements described in subsection (b) shall be administered—

(A) without regard to the proposed salary reduction regulations (37 FR 25938) and without regard to any other proposed salary reduction regulations, and

(B) in the manner in which such law was administered before January 1, 1972.

(2) ADMINISTRATION IN THE CASE OF QUALIFIED PROFIT-SHARING PLANS.—In the case of plans or arrangements described in subsection (b), in applying this section to the tax treatment of contributions to qualified profit-sharing plans where the contributed amounts are distributable only after a period of deferral, the law shall be administered in a manner consistent with—

(A) Revenue Ruling 56–497 (1956—2 C.B. 284),

(B) Revenue Ruling 63–180 (1963—2 C.B. 189), and

(C) Revenue Ruling 68–89 (1968—1 C.B. 402).

(d) LIMITATION ON RETROACTIVITY OF FINAL REGULATIONS.—In the case of any salary reduction regulations which become final after December 31, 1976—

(1) for purposes of chapter 1 of the Internal Revenue Code of 1954 (relating to normal taxes and surtaxes), such regulations shall not apply before January 1, 1977; and

(2) for purposes of chapter 21 of such Code (relating to Federal Insurance Contributions Act) and for purposes of chapter 24 of such Code (relating to collection of income tax at source on wages), such regulations shall not apply before the day on which such regulations are issued in final form.

(e) SALARY REDUCTION REGULATIONS DEFINED.—For purposes of this section, the term "salary reduction regulations" means regulations dealing with the includibility in gross income (at the time of contribution) of amounts contributed to a plan which includes a trust that qualifies under section 401(a), or a plan described in section 403(a) or 405(a), including plans or arrangements described in subsection (b)(2), if the contribution is made under an arrangement under which the contribution will be made only if the employee elects to receive a reduction in his compensation or to forego an increase in his compensation, or under an arrangement under which the employee is permitted to elect to receive part of his compensation in one or more alternative forms (if one of such forms results in the inclusion of amounts in income under the Internal Revenue Code of 1954).

SEC. 2007. RULES FOR CERTAIN NEGOTIATED PLANS.

(a) TREATMENT OF CERTAIN PARTICIPANTS IN THE PLAN.—Section 404(c) (relating to certain negotiated plans) is amended by inserting after the first sentence the following new sentences: "For purposes of this chapter and subtitle B, in the case of any individual who before July 1, 1974, was a participant in a plan described in the preceding sentence—

"(A) such individual, if he is or was an employee within the meaning of section 401(c)(1), shall be treated (with respect to service covered by the plan) as being an employee other than an employee within the meaning of section 401(c)(1) and as being an employee of a participating employer under the plan,

"(B) earnings derived from service covered by the plan shall be treated as not being earned income within the meaning of section 401(c)(2), and

"(C) such individual shall be treated as an employee of a participating employer under the plan with respect to service before July 1, 1975, covered by the plan.

Section 277 (relating to deductions incurred by certain membership organizations in transactions with members) does not apply to any trust described in this subsection.".

(b) OTHER AMENDMENTS TO SECTION 404(c)(1).—

(1) Paragraph (1) of the first sentence of section 404(c) is amended by striking out "and pensions" and inserting in lieu thereof "or pensions".

(2) The last sentence of section 404(c) is amended by striking out "This subsection" and inserting in lieu thereof "The first and third sentences of this subsection".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending on or after June 30, 1972.

SEC. 2008. CERTAIN ARMED FORCES SURVIVOR ANNUITIES.

(a) IN GENERAL.—Section 122(a) (relating to certain reduced uniformed services retired pay) is amended to read as follows:

"(a) GENERAL RULE.—In the case of a member or former member of the uniformed services of the United States, gross income does not include the amount of any reduction in his retired or retainer pay pursuant to the provisions of chapter 73 of title 10, United States Code.".

(b) TECHNICAL AMENDMENTS.—

(1) Section 122(b)(2) is amended by striking out "section 1438" in subparagraph (B) and inserting in lieu thereof "section 1438 or 1452(d)".

(2) Section 72(o) is amended by inserting after "Plan" in the heading of such section "or Survivor Benefit Plan".

(3) Section 101(b)(2)(D) is amended by striking out "if the individual who made the election under such chapter" and inserting in lieu thereof "if the member or former member of the uniformed services by reason of whose death such annuity is payable".

(4) Section 2039(c) is amended by striking out "section 1438" in the last sentence and inserting in lieu thereof "section 1438 or 1452(d)".

(c) EFFECTIVE DATES.—The amendments made by this section apply to taxable years ending on or after September 21, 1972. The amendments made by paragraphs (3) and (4) of subsection (b) apply with respect to individuals dying on or after such date.

TITLE III—JURISDICTION, ADMINISTRATION, ENFORCEMENT; JOINT PENSION TASK FORCE, ETC.

Subtitle A—Jurisdiction, Administration, and Enforcement

PROCEDURES IN CONNECTION WITH THE ISSUANCE OF CERTAIN DETERMINATION LETTERS BY THE SECRETARY OF THE TREASURY

SEC. 3001. (a) Before issuing an advance determination of whether a pension, profit-sharing, or stock bonus plan, a trust which is a part of such a plan, or an annuity or bond purchase plan meets the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, the Secretary of the Treasury shall require the person applying for the determination to provide, in addition to any material and information necessary for such determination, such other material and information as may reasonably be made available at the time such application is made as the Secretary of Labor may require under title I of this Act for the administration of that title. The Secretary of the Treasury shall also require that the applicant provide evidence satisfactory to the Secretary that the applicant has notified each employee who qualifies as an interested party (within the meaning of regulations prescribed under section 7476(b)(1) of such Code (relating to declaratory judgments in connection with the qualification of certain retirement plans)) of the application for a determination.

(b)(1) Whenever an application is made to the Secretary of the Treasury for a determination of whether a pension, profit-sharing, or stock bonus plan, a trust which is a part of such a plan, or an annuity or bond purchase plan meets the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, the Secretary shall upon request afford an opportunity to comment on the application at any time within 45 days after receipt thereof to—

(A) any employee or class of employee qualifying as an interested party within the meaning of the regulations referred to in subsection (a).

(B) the Secretary of Labor, and

(C) the Pension Benefit Guaranty Corporation.

(2) The Secretary of Labor may not request an opportunity to comment upon such an application unless he has been requested in writing to do so by the Pension Benefit Guaranty Corporation or by the lesser of—

(A) 10 employees, or

(B) 10 percent of the employees

who qualify as interested parties within the meaning of the regulations referred to in subsection (a). Upon receiving such a request, the Secretary of Labor shall furnish a copy of the request to the Secretary of the Treasury within 5 days (excluding Saturdays, Sundays, and legal public holidays (as set forth in section 6103 of title 5, United States Code)).

(3) Upon receiving such a request from the Secretary of Labor, the Secretary of the Treasury shall furnish to the Secretary of Labor such information held by the Secretary of the Treasury relating to the application as the Secretary of Labor may request.

(4) The Secretary of Labor shall, within 30 days after receiving a request from the Pension Benefit Guaranty Corporation or from the

necessary number of employees who qualify as interested parties, notify the Secretary of the Treasury, the Pension Benefit Guaranty Corporation, and such employees with respect to whether he is going to comment on the application to which the request relates and with respect to any matters raised in such request on which he is not going to comment. If the Secretary of Labor indicates in the notice required under the preceding sentence that he is not going to comment on all or part of the matters raised in such request, the Secretary of the Treasury shall afford the corporation, and such employees, an opportunity to comment on the application with respect to any matter on which the Secretary of Labor has declined to comment.

(c) The Pension Benefit Guaranty Corporation and, upon petition of a group of employees referred to in subsection (b) (2), the Secretary of Labor, may intervene in any action brought for declaratory judgment under section 7476 of the Internal Revenue Code of 1954 in accordance with the provisions of such section. The Pension Benefit Guaranty Corporation is permitted to bring an action under such section 7476 under such rules as may be prescribed by the United States Tax Court.

(d) If the Secretary of the Treasury determines that a plan or trust to which this section applies meets the applicable requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 and issues a determination letter to the applicant, the Secretary shall notify the Secretary of Labor of his determination and furnish such information and material relating to the application and determination held by the Secretary of the Treasury as the Secretary of Labor may request for the proper administration of title I of this Act. The Secretary of Labor shall accept the determination of the Secretary of the Treasury as prima facie evidence of initial compliance by the plan with the standards of parts 2, 3, and 4 of subtitle B of title I of this Act. If an application for such a determination is withdrawn, or if the Secretary of the Treasury issues a determination that the plan or trust does not meet the requirements of such part I, the Secretary shall notify the Secretary of Labor of the withdrawal or determination.

(e) This section does not apply with respect to an application for any plan received by the Secretary of the Treasury before the date on which section 410 of the Internal Revenue Code of 1954 applies to the plan, or on which such section will apply if the plan is determined by the Secretary to be a qualified plan.

PROCEDURES WITH RESPECT TO CONTINUED COMPLIANCE WITH REQUIREMENTS RELATING TO PARTICIPATION, VESTING, AND FUNDING STANDARDS

SEC. 3002. (a) In carrying out the provisions of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 with respect to whether a plan or a trust meets the requirements of section 410 (a) or 411 of such Code (relating to minimum participation standards and minimum vesting standards, respectively), the Secretary of the Treasury shall notify the Secretary of Labor when the Secretary of the Treasury issues a preliminary notice of intent to disqualify related to the plan or trust or, if earlier, at the time of commencing any proceeding to determine whether the plan or trust satisfies such requirements. Unless the Secretary of the Treasury finds that the collection of a tax imposed under the Internal Revenue Code of 1954 is in jeopardy, the Secretary of the Treasury shall not issue a determination that the plan or trust does not satisfy the requirements of such section until

the expiration of a period of 60 days after the date on which he notifies the Secretary of Labor of such review. The Secretary of the Treasury, in his discretion, may extend the 60-day period referred to in the preceding sentence if he determines that such an extension would enable the Secretary of Labor to obtain compliance with such requirements by the plan within the extension period. Except as otherwise provided in this Act, the Secretary of Labor shall not generally apply part 2 of title I of this Act to any plan or trust subject to sections 410(a) and 411 of such Code, but shall refer alleged general violations of the vesting or participation standards to the Secretary of the Treasury. (The preceding sentence shall not apply to matters relating to individuals benefits.)

(b) Unless the Secretary of the Treasury finds that the collection of a tax is in jeopardy, in carrying out the provisions of section 4971 of the Internal Revenue Code of 1954 (relating to taxes on the failure to meet minimum funding standards), the Secretary of the Treasury shall notify the Secretary of Labor before sending a notice of deficiency with respect to any tax imposed under that section on an employer. and, in accordance with the provisions of subsection (d) of that section, afford the Secretary of Labor an opportunity to comment on the imposition of the tax in the case. The Secretary of the Treasury may waive the imposition of the tax imposed under section 4971(b) of such Code in appropriate cases. Upon receiving a written request from the Secretary of Labor or from the Pension Benefit Guaranty Corporation, the Secretary of the Treasury shall cause an investigation to be commenced expeditiously with respect to whether the tax imposed under section 4971 of such Code should be applied with respect to any employer to which the request relates. The Secretary of the Treasury and the Secretary of Labor shall consult with each other from time to time with respect to the provisions of section 412 of the Internal Revenue Code of 1954 (relating to minimum funding standards) and with respect to the funding standards applicable under title I of this Act in order to coordinate the rules applicable under such standards.

(c) Regulations prescribed by the Secretary of the Treasury under sections 410(a), 411, and 412 of the Internal Revenue Code of 1954 (relating to minimum participation standards, minimum vesting standards, and minimum funding standards, respectively) shall also apply to the minimum participation, vesting, and funding standards set forth in parts 2 and 3 of subtitle B of title I of this Act. Except as otherwise expressly provided in this Act, the Secretary of Labor shall not prescribe other regulations under such parts, or apply the regulations prescribed by the Secretary of the Treasury under sections 410(a), 411, 412 of the Internal Revenue Code of 1954 and applicable to the minimum participation, vesting, and funding standards under such parts in a manner inconsistent with the way such regulations apply under sections 410(a), 411, and 412 of such Code.

(d) The Secretary of Labor and the Pension Benefit Guaranty Corporation, before filing briefs in any case involving the construction or application of minimum participation standards, minimum vesting standards, or minimum funding standards under title I of this Act, shall afford the Secretary of the Treasury a reasonable opportunity to review any such brief. The Secretary of the Treasury shall have the right to intervene in any such case.

PROCEDURES IN CONNECTION WITH PROHIBITED TRANSACTIONS

SEC. 3003. (a) Unless the Secretary of the Treasury finds that the collection of a tax is in jeopardy, in carrying out the provisions of section 4975 of the Internal Revenue Code of 1954 (relating to tax on prohibited transactions) the Secretary of the Treasury shall, in accordance with the provisions of subsection (h) of such section, notify the Secretary of Labor before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b) of such section, and, in accordance with the provisions of subsection (h) of such section, afford the Secretary an opportunity to comment on the imposition of the tax in any case. The Secretary of the Treasury shall have authority to waive the imposition of the tax imposed under section 4975(b) in appropriate cases. Upon receiving a written request from the Secretary of Labor or from the Pension Benefit Guaranty Corporation, the Secretary of the Treasury shall cause an investigation to be carried out with respect to whether the tax imposed by section 4975 of such Code should be applied to any person referred to in the request.

(b) The Secretary of the Treasury and the Secretary of Labor shall consult with each other from time to time with respect to the provisions of section 4975 of the Internal Revenue Code of 1954 (relating to tax on prohibited transactions) and with respect to the provisions of title I of this Act relating to prohibited transactions and exemptions therefrom in order to coordinate the rules applicable under such standards.

(c) Whenever the Secretary of Labor obtains information indicating that a party-in-interest or disqualified person is violating section 406 of this Act, he shall transmit such information to the Secretary of the Treasury.

COORDINATION BETWEEN THE DEPARTMENT OF THE TREASURY AND THE DEPARTMENT OF LABOR

SEC. 3004. (a) Whenever in this Act or in any provision of law amended by this Act the Secretary of the Treasury and the Secretary of Labor are required to carry out provisions relating to the same subject matter (as determined by them) they shall consult with each other and shall develop rules, regulations, practices, and forms which, to the extent appropriate for the efficient administration of such provisions, are designed to reduce duplication of effort, duplication of reporting, conflicting or overlapping requirements, and the burden of compliance with such provisions by plan administrators, employers, and participants and beneficiaries.

(b) In order to avoid unnecessary expense and duplication of functions among Government agencies, the Secretary of the Treasury and the Secretary of Labor may make such arrangements or agreements for cooperation or mutual assistance in the performance of their functions under this Act, and the functions of any such agency as they find to be practicable and consistent with law. The Secretary of the Treasury and the Secretary of Labor may utilize, on a reimbursable or other basis, the facilities or services, of any department, agency, or establishment of the United States or of any State or political subdivision of a State, including the services, of any of its employees, with the lawful consent of such department, agency, or establishment; and each department, agency, or establishment of the United States is authorized and

directed to cooperate with the Secretary of the Treasury and the Secretary of Labor and, to the extent permitted by law, to provide such information and facilities as they may request for their assistance in the performance of their functions under this Act. The Attorney General or his representative shall receive from the Secretary of the Treasury and the Secretary of Labor for appropriate action such evidence developed in the performance of their functions under this Act as may be found to warrant consideration for criminal prosecution under the provisions of this title or other Federal law.

Subtitle B—Joint Pension Task Force; Studies

PART 1—JOINT PENSION TASK FORCE

ESTABLISHMENT

SEC. 3021. The staffs of the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives, the Joint Committee on Internal Revenue Taxation, and the Committee on Finance and the Committee on Labor and Public Welfare of the Senate shall carry out the duties assigned under this title to the Joint Pension Task Force. By agreement among the chairmen of such Committees, the Joint Pension Task Force shall be furnished with office space, clerical personnel, and such supplies and equipment as may be necessary for the Joint Pension Task Force to carry out its duties under this title.

DUTIES

SEC. 3022. (a) The Joint Pension Task Force shall, within 24 months after the date of enactment of this Act, make a full study and review of—

(1) the effect of the requirements of section 411 of the Internal Revenue Code of 1954 and of section 203 of this Act to determine the extent of discrimination, if any, among employees in various age groups resulting from the application of such requirements;

(2) means of providing for the portability of pension rights among different pension plans;

(3) the appropriate treatment under title IV of this Act (relating to termination insurance) of plans established and maintained by small employers;

(4) the effects and desirability of the Federal preemption of State and local law with respect to matters relating to pension and similar plans; and

(5) such other matter as any of the committees referred to in section 3021 may refer to it.

(b) The Joint Pension Task Force shall report the results of its study and review to each of the committees referred to in section 3021.

PART 2—OTHER STUDIES

CONGRESSIONAL STUDY

SEC. 3031. (a) The Committee on Education and Labor and the Committee on Ways and Means of the House of Representatives and the Committee on Finance and the Committee on Labor and Public Welfare of the Senate shall study retirement plans established and maintained or financed (directly or indirectly) by the Government of

the United States, by any State (including the District of Columbia) or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. Such study shall include an analysis of—

(1) the adequacy of existing levels of participation, vesting, and financing arrangements,

(2) existing fiduciary standards, and

(3) the necessity for Federal legislation and standards with respect to such plans.

In determining whether any such plan is adequately financed, each committee shall consider the necessity for minimum funding standards, as well as the taxing power of the government maintaining the plan.

(b) Not later than December 31, 1976, the Committee on Education and Labor and the Committee on Ways and Means shall each submit to the House of Representatives the results of the studies conducted under this section, together with such recommendations as they deem appropriate. The Committee on Finance and the Committee on Labor and Public Welfare shall each submit to the Senate the results of the studies conducted under this section together with such recommendations as they deem appropriate not later than such date.

PROTECTION FOR EMPLOYEES UNDER FEDERAL PROCUREMENT, CONSTRUCTION, AND RESEARCH CONTRACTS AND GRANTS

SEC. 3032. (a) The Secretary of Labor shall, during the 2-year period beginning on the date of the enactment of this Act, conduct a full and complete study and investigation of the steps necessary to be taken to insure that professional, scientific, and technical personnel and others working in associated occupations employed under Federal procurement, construction, or research contracts or grants will, to the extent feasible, be protected against forfeitures of pension or retirement rights or benefits, otherwise provided, as a consequence of job transfers or loss of employment resulting from terminations or modifications of Federal contracts, grants, or procurement policies. The Secretary of Labor shall report the results of his study and investigation to the Congress within 2 years after the date of the enactment of this Act. The Secretary of Labor is authorized, to the extent provided by law, to obtain the services of private research institutions and such other persons by contract or other arrangement as he determines necessary in carrying out the provisions of this section.

(b) In the course of conducting the study and investigation described in subsection (a), and in developing the regulations referred to in subsection (c), the Secretary of Labor shall consult—

(1) with appropriate professional societies, business organizations, and labor organizations, and

(2) with the heads of interested Federal departments and agencies.

(c) Within 1 year after the date on which he submits his report to the Congress under subsection (a), the Secretary of Labor shall, if he determines it to be feasible, develop regulations which will provide the protection of pension and retirement rights and benefits referred to in subsection (a).

(d)(1) Any regulations developed pursuant to subsection (c) shall take effect if, and only if—

(A) the Secretary of Labor, not later than the day which is 3 years after the date of the enactment of this Act, delivers a copy of such regulations to the House of Representatives and a copy to the Senate, and

(B) before the close of the 120-day period which begins on the day on which the copies of such regulations are delivered to the House of Representatives and to the Senate, neither the House of Representatives nor the Senate adopts, by an affirmative vote of a majority of those present and voting in that House, a resolution of disapproval.

(2) For purposes of this subsection, the term "resolution of disapproval" means only a resolution of either House of Congress, the matter after the resolving clause of which is as follows: "That the —— does not favor the taking effect of the regulations transmitted to the Congress by the Secretary of Labor on ——", the first blank space therein being filled with the name of the resolving House and the second blank space therein being filled with the day and year.

(3) A resolution of disapproval in the House of Representatives shall be referred to the Committee on Education and Labor. A resolution of disapproval in the Senate shall be referred to the Committee on Labor and Public Welfare.

(4)(A) If the committee to which a resolution of disapproval has been referred has not reported it at the end of 7 calendar days after its introduction, it is in order to move either to discharge the committee from further consideration of the resolution or to discharge the committee from further consideration of any other resolution of disapproval which has been referred to the committee.

(B) A motion to discharge may be made only by an individual favoring the resolution, is highly privileged (except that it may not be made after the committee has reported a resolution of disapproval), and debate thereon shall be limited to not more than 1 hour, to be divided equally between those favoring and those opposing the resolution. An amendment to the motion is not in order, and it is not in order to move to reconsider the vote by which the motion is agreed to or disagreed to.

(C) If the motion to discharge is agreed to or disagreed to, the motion may not be renewed, nor may another motion to discharge the committee be made with respect to any other resolution of disapproval.

(5)(A) When the committee has reported, or has been discharged from further consideration of, a resolution of disapproval, it is at any time thereafter in order (even though a previous motion to the same effect has been disagreed to) to move to proceed to the consideration of the resolution. The motion is highly privileged and is not debatable. An amendment to the motion is not in order, and it is not in order to move to reconsider the vote by which the motion is agreed to or disagreed to.

(B) Debate on the resolution of disapproval shall be limited to not more than 10 hours, which shall be divided equally between those favoring and those opposing the resolution. A motion further to limit debate is not debatable. An amendment to, or motion to recommit, the resolution is not in order, and it is not in order to move to reconsider the vote by which the resolution is agreed to or disagreed to.

(6)(A) Motions to postpone, made with respect to the discharge from committee or the consideration of a resolution of disapproval, and motions to proceed to the consideration of other business, shall be decided without debate.

(B) Appeals from the decisions of the Chair relating to the application of the rules of the House of Representatives or the Senate, as the case may be, to the procedure relating to any resolution of disapproval shall be decided without debate.

(7) Whenever the Secretary of Labor transmits copies of the regulations to the Congress, a copy of such regulations shall be delivered to

each House of Congress on the same day and shall be delivered to the Clerk of the House of Representatives if the House is not in session and to the Secretary of the Senate if the Senate is not in session.

(8) The 120 day period referred to in paragraph (1) shall be computed by excluding—

(A) the days on which either House is not in session because of an adjournment of more than 3 days to a day certain or an adjournment of the Congress sine die, and

(B) any Saturday and Sunday, not excluded under subparagraph (A), when either House is not in session.

(9) This subsection is enacted by the Congress—

(A) as an exercise of the rulemaking power of the House of Representatives and the Senate, respectively, and as such they are deemed a part of the rules of each House, respectively, but applicable only with respect to the procedure to be followed in that House in the case of resolutions of disapproval described in paragraph (2); and they supersede other rules only to the extent that they are inconsistent therewith; and

(B) with full recognition of the constitutional right of either House to change the rules (so far as relating to the procedures of that House) at any time, in the same manner and to the same extent as in the case of any other rule of that House.

Subtitle C—Enrollment of Actuaries

ESTABLISHMENT OF JOINT BOARD FOR THE ENROLLMENT OF ACTUARIES

SEC. 3041. The Secretary of Labor and the Secretary of the Treasury shall, not later than the last day of the first calendar month beginning after the date of the enactment of this Act, establish a Joint Board for the Enrollment of Actuaries (hereinafter in this part referred to as the "Joint Board").

ENROLLMENT BY JOINT BOARD

SEC. 3042. (a) The Joint Board shall, by regulations, establish reasonable standards and qualifications for persons performing actuarial services with respect to plans in which this Act applies and, upon application by any individual, shall enroll such individual if the Joint Board finds that such individual satisfies such standards and qualifications. With respect to individuals applying for enrollment before January 1, 1976, such standards and qualifications shall include a requirement for an appropriate period of responsible actuarial experience relating to pension plans. With respect to individuals applying for enrollment on or after January 1, 1976, such standards and qualifications shall include—

(1) education and training in actuarial mathematics and methodology, as evidenced by—

(A) a degree in actuarial mathematics or its equivalent from an accredited college or university,

(B) successful completion of an examination in actuarial mathematics and methodology to be given by the Joint Board, or

(C) successful completion of other actuarial examinations deemed adequate by the Joint Board, and

(2) an appropriate period of responsible actuarial experience.

Notwithstanding the preceding provisions of this subsection, the Joint Board may provide for the temporary enrollment for the period end-

ing on January 1, 1976, of actuaries under such interim standards as it deems adequate.

(b) The Joint Board may, after notice and an opportunity for a hearing, suspend or terminate the enrollment of an individual under this section if the Joint Board finds that such individual—

(1) has failed to discharge his duties under this Act, or

(2) does not satisfy the requirements for enrollment as in effect at the time of his enrollment.

The Joint Board may also, after notice and opportunity for hearing, suspend or terminate the temporary enrollment of an individual who fails to discharge his duties under this Act or who does not satisfy the interim enrollment standards.

AMENDMENT OF INTERNAL REVENUE CODE

SEC. 3043. Section 7701(a) of the Internal Revenue Code of 1954 (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(35) ENROLLED ACTUARY.—The term 'enrolled actuary' means a person who is enrolled by the Joint Board for the Enrollment of Actuaries established under subtitle C of the title III of the Employee Retirement Income Security Act of 1974."

TITLE IV—PLAN TERMINATION INSURANCE

Subtitle A—Pension Benefit Guaranty Corporation

DEFINITIONS

SEC. 4001. (a) For purposes of this title, the term—

(1) "administrator" means the person or persons described in paragraph (16) of section 3 of this Act;

(2) "substantial employer" means for any plan year an employer (treating employers who are members of the same affiliated group, within the meaning of section 1563(a) of the Internal Revenue Code of 1954, determined without regard to section 1563(a)(4) and (e)(3)(C) of such Code, as one employer) who has made contributions to or under a plan under which more than one employer makes contributions for each of—

(A) the two immediately preceding plan years, or

(B) the second and third preceding plan years,

equaling or exceeding 10 percent of all employer contributions paid to or under that plan for each such year;

(3) "multiemployer plan" means a multiemployer plan as defined in section 414(f) of the Internal Revenue Code of 1954 (as added by this Act but without regard to whether such section is in effect on the date of enactment of this Act);

(4) "corporation", except where the context clearly requires otherwise, means the Pension Benefit Guaranty Corporation established under section 4002;

(5) "fund" means the appropriate fund established under section 4005;

(6) "basic benefits" means benefits guaranteed under section 4022 other than under section 4022(c); and

(7) "non-basic benefits" means benefits guaranteed under section 4022(c).

(b) An individual who owns the entire interest in an unincorporated trade or business is treated as his own employer, and a partnership is treated as the employer of each partner who is an employee within the meaning of section 401(c)(1) of the Internal Revenue Code of 1954. For purposes of this title, under regulations prescribed by the corporation, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such trades and businesses as a single employer. The regulations prescribed under the preceding sentence shall be consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under section 414(c) of the Internal Revenue Code of 1954.

PENSION BENEFIT GUARANTY CORPORATION

SEC. 4002. (a) There is established within the Department of Labor a body corporate to be known as the Pension Benefit Guaranty Corporation. In carrying out its functions under this title, the corporation shall be administered by the chairman of the board of directors in accordance with policies established by the board. The purposes of this title, which are to be carried out by the corporation, are—

(1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,

(2) to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which this title applies, and

(3) to maintain premiums established by the corporation under section 4006 at the lowest level consistent with carrying out its obligations under this title.

(b) To carry out the purposes of this title, the corporation has the powers conferred on a nonprofit corporation under the District of Columbia Nonprofit Corporation Act and, in addition to any specific power granted to the corporation elsewhere in this title or under that Act, the corporation has the power—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any court, State or Federal;

(2) to adopt, alter, and use a corporate seal, which shall be judicially noticed;

(3) to adopt, amend, and repeal, by the board of directors, bylaws, rules, and regulations relating to the conduct of its business and the exercise of all other rights and powers granted to it by this Act;

(4) to conduct its business (including the carrying on of operations and the maintenance of offices) and to exercise all other rights and powers granted to it by this Act in any State or other jurisdiction without regard to qualification, licensing, or other requirements imposed by law in such State or other jurisdiction;

(5) to lease, purchase, accept gifts or donations of, or otherwise to acquire, to own, hold, improve, use, or otherwise deal in or with, and to sell, convey, mortgage, pledge, lease, exchange, or otherwise dispose of, any property, real, personal, or mixed, or any interest therein wherever situated;

(6) to appoint and fix the compensation of such officers, attorneys, employees, and agents as may be required, to determine their qualifications, to define their duties, and, to the extent desired by the corporation, require bonds for them and fix the penalty

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thereof, and to appoint and fix the compensation of experts and consultants in accordance with the provisions of section 3109 of title 5, United States Code;

(7) to utilize the personnel and facilities of any other agency or department of the United States Government, with or without reimbursement, with the consent of the head of such agency or department; and

(8) to enter into contracts, to execute instruments, to incur liabilities, and to do any and all other acts and things as may be necessary or incidental to the conduct of its business and the exercise of all other rights and powers granted to the corporation by this Act.

(c) Section 5108 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(g) In addition to the number of positions authorized by subsection (a), the Pension Benefit Guaranty Corporation is authorized, without regard to any other provision of this section, to place one position in the corporation at GS-18 and a total of 10 positions in the corporation at GS-16 and 17.".

(d) The board of directors of the corporation consists of the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Commerce. Members of the board shall serve without compensation, but shall be reimbursed for travel, subsistence, and other necessary expenses incurred in the performance of their duties as members of the board. The Secretary of Labor is the chairman of the board of directors.

(e) The board of directors shall meet at the call of its chairman, or as otherwise provided by the bylaws of the corporation.

(f) As soon as practicable, but not later than 180 days after the date of enactment of this Act, the board of directors shall adopt initial bylaws and rules relating to the conduct of the business of the corporation. Thereafter, the board of directors may alter, supplement, or repeal any existing bylaw or rule, and may adopt additional bylaws and rules from time to time as may be necessary. The chairman of the board shall cause a copy of the bylaws of the corporation to be published in the Federal Register not less often than once each year.

(g) (1) The corporation, its property, its franchise, capital, reserves, surplus, and its income (including, but not limited to, any income of any fund established under section 4005), shall be exempt from all taxation now or hereafter imposed by any State or local taxing authority, except that any real property and any tangible personal property (other than cash and securities) of the corporation shall be subject to State and local taxation to the same extent according to its value as other real and tangible personal property is taxed.

(2) The receipts and disbursements of the corporation in the discharge of its functions shall not be included in the totals of the budget of the United States Government and shall be exempt from any general limitations imposed by statute on budget outlays of the United States. Except as explicitly provided in this title, the United States is not liable for any obligation or liability incurred by the corporation.

(3) Section 101 of the Government Corporation Control Act (31 U.S.C. 846) is amended by inserting before the period a semicolon and the following: "and Pension Benefit Guaranty Corporation".

(h) (1) There is established an advisory committee to the corporation, for the purpose of advising the corporation as to its policies and procedures relating to (A) the appointment of trustees in termination proceedings, (B) investment of moneys, (C) whether plans being terminated should be liquidated immediately or continued in operation under a trustee, and (D) such other issues as the corporation may

request from time to time. The advisory committee may also recommend persons for appointment as trustees in termination proceedings, make recommendations with respect to the investment of moneys in the funds, and advise the corporation as to whether a plan subject to being terminated should be liquidated immediately or continued in operation under a trustee.

(2) The advisory committee consists of seven members appointed, from among individuals recommended by the board of directors, by the President. Of the seven members, two shall represent the interests of employee organizations, two shall represent the interests of employers who maintain pension plans, and three shall represent the interests of the general public. The President shall designate one member as chairman at the time of the appointment of that member.

(3) Members shall serve for terms of 3 years each, except that, of the members first appointed, one of the members representing the interests of employee organizations, one of the members representing the interests of employers, and one of the members representing the interests of the general public shall be appointed for terms of 2 years each, one of the members representing the interests of the general public shall be appointed for a term of 1 year, and the other members shall be appointed to full 3-year terms. The advisory committee shall meet at least six times each year and at such other times as may be determined by the chairman or requested by any three members of the advisory committee.

(4) Members shall be chosen on the basis of their experience with employee organizations, with employers who maintain pension plans, with the administration of pension plans, or otherwise on account of outstanding demonstrated ability in related fields. Of the members serving on the advisory committee at any time, no more than four shall be affiliated with the same political party.

(5) An individual appointed to fill a vacancy occurring other than by the expiration of a term of office shall be appointed only for the unexpired term of the member he succeeds. Any vacancy occurring in the office of a member of the advisory committee shall be filled in the manner in which that office was originally filled.

(6) The advisory committee shall appoint and fix the compensation of such employees as it determines necessary to discharge its duties, including experts and consultants in accordance with the provisions of section 3109 of title 5, United States Code. The corporation shall furnish to the advisory committee such professional, secretarial, and other services as the committee may request.

(7) Members of the advisory committee shall, for each day (including traveltime) during which they are attending meetings or conferences of the committee or otherwise engaged in the business of the committee, be compensated at a rate fixed by the corporation which is not in excess of the daily equivalent of the annual rate of basic pay in effect for grade GS–18 of the General Schedule, and while away from their homes or regular places of business they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 5703 of title 5, United States Code.

(8) The Federal Advisory Committee Act does not apply to the advisory committee established by this subsection.

INVESTIGATORY AUTHORITY; COOPERATION WITH OTHER AGENCIES; CIVIL ACTIONS

SEC. 4003. (a) The corporation may make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of this title or any rule or regulation thereunder, and may require or permit any person to file with it a

statement in writing, under oath or otherwise as the corporation shall determine, as to all the facts and circumstances concerning the matter to be investigated.

(b) For the purpose of any such investigation, or any other proceeding under this title, any member of the board of directors of the corporation, or any officer designated by the chairman, may administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the corporation deems relevant or material to the inquiry.

(c) In case of contumacy by, or refusal to obey a subpena issued to, any person, the corporation may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. The court may issue an order requiring such person to appear before the corporation, or member or officer designated by the corporation, and to produce records or to give testimony related to the matter under investigation or in question. Any failure to obey such order of the court may be punished by the court as a contempt thereof. All process in any such case may be served in the judicial district in which such person is an inhabitant or may be found.

(d) In order to avoid unnecessary expense and duplication of functions among government agencies, the corporation may make such arrangements or agreements for cooperation or mutual assistance in the performance of its functions under this title as is practicable and consistent with law. The corporation may utilize the facilities or services of any department, agency, or establishment of the United States or of any State or political subdivision of a State, including the services of any of its employees, with the lawful consent of such department, agency, or establishment. The head of each department, agency, or establishment of the United States shall cooperate with the corporation and, to the extent permitted by law, provide such information and facilities as it may request for its assistance in the performance of its functions under this title. The Attorney General or his representative shall receive from the corporation for appropriate action such evidence developed in the performance of its functions under this title as may be found to warrant consideration for criminal prosecution under the provisions of this or any other Federal law.

(e)(1) Civil actions may be brought by the corporation for appropriate relief, legal or equitable or both, to redress violations of the provisions of this title.

(2) Except as otherwise provided in this title, where such an action is brought in a district court of the United States, it may be brought in the district where the plan is administered, where the violation took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

(3) The district courts of the United States shall have jurisdiction of actions brought by the corporation under this title without regard to the amount in controversy in any such action.

(4) Upon application by the corporation to a court of the United States for expedited handling of any case in which the corporation is a party, it is the duty of that court to assign such case for hearing at the earliest practical date and to cause such case to be in every way expedited.

(5) In any action brought under this title, whether to collect premiums, penalties, and interest under section 4007 or for any other

purpose, the court may award to the corporation all or a portion of the costs of litigation incurred by the corporation in connection with such action.

(f) Any participant, beneficiary, plan administrator, or employee adversely affected by any action of the corporation, or by a receiver or trustee appointed by the corporation, with respect to a plan in which such participant, beneficiary, plan administrator or employer has an interest, may bring an action against the corporation, receiver, or trustee in the appropriate court. For purposes of this subsection the term "appropriate court" means the United States district court before which proceedings under section 4041 or 4042 of this title are being conducted, or if no such proceedings are being conducted the United States district court for the district in which the plan has its principal office, or the United States district court for the District of Columbia. The district courts of the United States have jurisdiction of actions brought under this subsection without regard to the amount in controversy.

TEMPORARY AUTHORITY FOR INITIAL PERIOD

SEC. 4004. (a) Notwithstanding anything to the contrary in this title, the corporation may, upon receipt of notice that a plan is to be terminated or upon making a determination described in section 4042, appoint a receiver whose powers shall take effect immediately. The receiver shall assume control of such plan and its assets, protecting the interests of all interested persons during subsequent proceedings.

(b)(1) Within a reasonable time, not exceeding 20 days, after the appointment of a receiver under subsection (a), the corporation shall apply to an appropriate United States district court for a decree approving such appointment. The court to which application is made shall issue a decree approving such appointment unless it determines that such approval would not be in the best interests of the participants and beneficiaries of the plan.

(2) If the court to which application is made under paragraph (1) dismisses the application with prejudice, or if the corporation fails to apply for a decree under paragraph (1) within 20 days after the appointment of the receiver, the receiver shall transfer all assets and records of the plan held by him to the plan administrator within 3 business days after such dismissal or the expiration of the 20 day period. The receiver shall not be liable to the plan or to any other person for his acts as receiver other than for willful misconduct, or for conduct in violation of the provisions of part 4 of subpart B of title I of this Act (except to the extent that the provisions of section 4042(d)(1)(A) provide otherwise).

(c) The corporation is authorized, as an alternative to appointing a receiver under subsection (a), to direct a plan administrator to apply to a district court of the United States for the appointment of a receiver to assume control of the plan and its assets for the purpose of protecting the interests of all interested persons until the plan can be terminated under the provisions of this title.

(d) A receiver appointed under this section has the powers of a trustee under section 4042(d)(1)(A) and (B), and shall report to the corporation and the court on the plan from time to time as required by either the corporation or the court. As soon as practicable after his appointment, a receiver appointed under this section shall determine whether the assets of the plan are sufficient to discharge when due all obligations of the plan with respect to benefits guaranteed under this title in accordance with the requirements of section 4044. If the determination of the receiver is approved by the corporation and the court, the receiver shall proceed as if he were a trustee appointed under section 4042.

(e) A receiver may not be appointed under this section more than 270 days after the date of enactment of this Act.

(f) In addition to its other powers under this title, for only the first 270 days after the date of enactment of this Act the corporation may—

(1) contract for printing without regard to the provisions of chapter 5 of title 44, United States Code,

(2) waive any notice required under this title if the corporation finds that a waiver is necessary or appropriate,

(3) extend the 90-day period referred to in section 4041(a) for an additional 90 days without the agreement of the plan administrator and without application to a court as required under section 4041(d), and

(4) waive the application of the provisions of sections 4062, 4063, and 4064 to, or reduce the liability imposed under such sections on, any employer with respect to a plan terminating during that 270 day period if the corporation determines that such waiver or reduction is necessary to avoid unreasonable hardship in any case in which the employer was not able, as a practical matter, to continue the plan.

ESTABLISHMENT OF PENSION BENEFIT GUARANTY FUNDS

SEC. 4005. (a) There are established on the books of the Treasury of the United States four revolving funds to be used by the corporation in carrying out its duties under this title. One of the funds shall be used in connection with benefits guaranteed under sections 4022 and 4023 (but not non-basic benefits) with respect to plans other than multiemployer plans, one of the funds shall be used with respect to such benefits guaranteed under such sections (other than non-basic benefits) for multiemployer plans, one of the funds shall be used with respect to non-basic benefits, if any are guaranteed by the corporation under section 4022, for plans which are not multiemployer plans, and the remaining fund shall be used with respect to non-basic benefits, if any are guaranteed by the corporation under section 4022, for multiemployer plans. Whenever in this title reference is made to the term "fund" the reference shall be considered to refer to the appropriate fund established under this subsection.

(b)(1) Each fund established under this section shall be credited with the appropriate portion of—

(A) funds borrowed under subsection (c),

(B) premiums, penalties, interest, and charges collected under this title,

(C) the value of the assets of a plan administered under section 4042 by a trustee to the extent that they exceed the liabilities of such plan,

(D) the amount of any employer liability payments under subtitle D, to the extent that such payments exceed liabilities of the plan (taking into account all other plan assets),

(E) earnings on investments of the fund or on assets credited to the fund under this subsection, and

(F) receipts from any other operations under this title.

(2) Subject to the provisions of subsection (a), each fund shall be available—

(A) for making such payments as the corporation determines are necessary to pay benefits guaranteed under section 4022,

(B) for making such payments as the corporation determines are necessary under section 4023,

(C) to purchase assets from a plan being terminated by the corporation when the corporation determines such purchase will best protect the interests of the corporation, participants in the plan being terminated, and other insured plans,

(D) to repay to the Secretary of the Treasury such sums as may be borrowed (together with interest thereon) under subsection (c), and

(E) to pay the operational and administrative expenses of the corporation, including reimbursement of the expenses incurred by the Department of the Treasury in maintaining the funds, and the Comptroller General in auditing the corporation.

(3) Whenever the corporation determines that the moneys of any fund are in excess of current needs, it may request the investment of such amounts as it determines advisable by the Secretary of the Treasury in obligations issued or guaranteed by the United States but, until all borrowings under subsection (c) have been repaid, the obligations in which such excess moneys are invested may not yield a rate of return in excess of the rate of interest payable on such borrowings.

(c) The corporation is authorized to issue to the Secretary of the Treasury notes or other obligations in an aggregate amount of not to exceed $100,000,000, in such forms and denominations, bearing such maturities, and subject to such terms and conditions as may be prescribed by the Secretary of the Treasury. Such notes or other obligations shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities during the month preceding the issuance of such notes or other obligations of the corporation. The Secretary of the Treasury is authorized and directed to purchase any notes or other obligations issued by the corporation under this subsection, and for that purpose he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act, as amended, are extended to include any purchase of such notes and obligations. The Secretary of the Treasury may at any time sell any of the notes or other obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such notes or other obligations shall be treated as public debt transactions of the United States.

PREMIUM RATES

SEC. 4006. (a)(1) The corporation shall prescribe such insurance premium rates and such coverage schedules for the application of those rates as may be necessary to provide sufficient revenue to the fund for the corporation to carry out its functions under this title. The premium rates charged by the corporation for any period shall be uniform for all plans, other than multiemployer plans insured by the corporation, with respect to basic benefits guaranteed by it under section 4022, and shall be uniform for all multiemployer plans with respect to basic benefits guaranteed by it under such section. The premium rates charged by the corporation for any period for non-basic benefits guaranteed by it shall be uniform by category of non-basic benefit guaranteed, shall be based on the risk insured in each category, and shall reflect the experience of the corporation (including reasonably anticipated experience) in guaranteeing such benefits.

(2) The corporation shall maintain separate coverage schedules for—

(A) basic benefits guaranteed by it under section 4022 for—

(i) plans which are multiemployer plans, and

(ii) plans which are not multiemployer plans,

(B) employers insured under section 4023 against liability under subtitle D of this title, and

(C) non-basic benefits.

Except as provided in paragraph (3), the corporation may revise such schedules whenever it determines that revised rates are necessary, but a revised schedule described in subparagraph (A) shall apply only to plan years beginning more than 30 days after the date on which the Congress approves such revised schedule by a concurrent resolution.

(3) Except as provided in paragraph (4), the rate for all plans for benefits guaranteed under section 4022 (other than non-basic benefits) with respect to plan years ending no more than 35 months after the effective date of this title is —

(A) in the case of each plan which is not a multiemployer plan, an amount equal to one dollar for each individual who is a participant in such plan at any time during the plan year; and

(B) in the case of a multiemployer plan, an amount equal to fifty cents for each individual who is a participant in such plan at any time during such plan year.

The rate applicable under this paragraph to any plan the plan year of which does not begin on the date of enactment of this Act is a fraction of the rate described in the preceding sentence, the numerator of which is the number of months which end before the date on which the new plan year commences and the denominator of which is 12. The corporation is authorized to prescribe regulations under which the rate described in subparagraph (B) will not apply to the same participant in any multiemployer plan more than once for any plan year.

(4) Upon notification filed with the corporation not less than 60 days after the date on which the corporation publishes the rates applicable under paragraph (5), at the election of a plan the rate applicable to that plan with respect to the second full plan year to which this section applies beginning after the date of enactment of this Act shall be the greater of —

(A) an alternative rate determined under paragraph (5), or

(B) one-half of the rate applicable to the plan under paragraph (3).

In the case of a multiemployer plan, the rate prescribed by this paragraph (at the election of a plan) for the second full plan year is also the applicable rate for plan years succeeding the second full plan year and ending before the full plan year first commencing after December 31, 1977.

(5) In carrying out its authority under paragraph (1) to establish premium rates and bases for basic benefits guaranteed under section 4022 the corporation shall establish such rates and bases in coverage schedules for plan years beginning 24 months or more after the date of enactment of this Act in accordance with the provisions of this paragraph. The corporation shall publish the rate schedules first applicable under this paragraph in the Federal Register not later than 270 days after the date of enactment of this Act.

(A) The corporation may establish annual premiums composed of—

(i) a rate applicable to the excess, if any, of the present value of the basic benefits of the plan which are guaranteed over the value of the assets of the plan, not in excess of 0.1 percent for plans which are not multiemployer plans and not in excess of 0.025 percent for multiemployer plans, and

(ii) an additional charge based on the rate applicable to the present value of the basic benefits of the plan which are guaranteed, determined separately for multiemployer plans and for plans which are not multiemployer plans.

The rate for the additional charge referred to in clause (ii) shall be set by the corporation for every year at a level (determined separately for multiemployer plans and for plans which are not multiemployer plans) which the corporation estimates will yield total revenue approximately equal to the total revenue to be derived by the corporation from the premiums referred to in clause (i) of this subparagraph.

(B) The corporation may establish annual premiums based on—

(i) the number of participants in a plan, but such premium rates shall not exceed the rates described in paragraph (3),

(ii) unfunded basic benefits guaranteed under this title, but such premium rates shall not exceed the limitations applicable under subparagraph (A)(i), or

(iii) total guaranteed basic benefits, but such premium rates may not exceed the rates determined under subparagraph (A)(ii).

If the corporation uses 2 or more of the rate bases described in this subparagraph, the premium rates shall be designed to produce approximately equal amounts of aggregate premium revenue from each of the rate bases used.

(6) The corporation shall by regulation define the terms "value of the assets" and "present value of the benefits of the plan which are guaranteed" in a manner consistent with the purposes of this title and the provisions of this section.

(b)(1) In order to place a revised coverage schedule (other than a schedule described in subsection (a)(2) (B) or (C) in effect, the corporation shall transmit the proposed schedule, its proposed effective date, and the reasons for its proposal to the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives, and to the Committee on Finance and the Committee on Labor and Public Welfare of the Senate.

(2) The succeeding paragraphs of this subsection are enacted by Congress as an exercise of the rulemaking power of the Senate and the House of Representatives, respectively, and as such they shall be deemed a part of the rules of each House, respectively, but applicable only with respect to the procedure to be followed in that House in the case of resolutions described in paragraph (3). They shall supersede other rules only to the extent that they are inconsistent therewith. They are enacted with full recognition of the constitutional right of either House to change the rules (so far as relating to the procedure of that House) at any time, in the same manner and to the same extent as in the case of any rule of that House.

(3) For the purpose of the succeeding paragraphs of this subsection, "resolution" means only a concurrent resolution, the matter after the resolving clause of which is as follows: "That the Congress favors the proposed revised coverage schedule transmitted to Congress by the Pension Benefit Guaranty Corporation on ———.", the blank space therein being filled with the date on which the corporation's message proposing the rate was delivered.

(4) A resolution shall be referred to the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives and to the Committee on Finance and the Committee on Labor and Public Welfare of the Senate.

(5) If a committee to which has been referred a resolution has not reported it before the expiration of 10 calendar days after its introduction, it shall then (but not before) be in order to move to discharge the committee from further consideration of that resolution, or to discharge the committee from further consideration of any other

resolution with respect to the proposed adjustment which has been referred to the committee. The motion to discharge may be made only by a person favoring the resolution, shall be highly privileged (except that it may not be made after the committee has reported a resolution with respect to the same proposed rate), and debate thereon shall be limited to not more than 1 hour, to be divided equally between those favoring and those opposing the resolution. An amendment to the motion is not in order, and it is not in order to move to reconsider the vote by which the motion is agreed to or disagreed to. If the motion to discharge is agreed to or disagreed to, the motion may not be renewed, nor may another motion to discharge the committee be made with respect to any other resolution with respect to the same proposed rate.

(6) When a committee has reported, or has been discharged from further consideration of a resolution, it is at any time thereafter in order (even though a previous motion to the same effect has been disagreed to) to move to proceed to the consideration of the resolution. The motion is highly privileged and is not debatable. An amendment to the motion is not in order, and it is not in order to move to reconsider the vote by which the motion is agreed to or disagreed to. Debate on the resolution shall be limited to not more than 10 hours, which shall be divided equally between those favoring and those opposing the resolution. A motion further to limit debate is not debatable. An amendment to, or motion to recommit, the resolution is not in order, and it is not in order to move to reconsider the vote by which the resolution is agreed to or disagreed to.

(7) Motions to postpone, made with respect to the discharge from committee, or the consideration of, a resolution and motions to proceed to the consideration of other business shall be decided without debate. Appeals from the decisions of the Chair relating to the application of the rules of the Senate or the House of Representatives, as the case may be, to the procedure relating to a resolution shall be decided without debate.

PAYMENT OF PREMIUMS

SEC. 4007. (a) The plan administrator of each plan shall pay the premiums imposed by the corporation under this title with respect to that plan when they are due. Any employer obtaining contingent liability coverage under section 4023 shall pay the premiums imposed by the corporation under that section when due. Premiums under this title are payable at the time, and on an estimated, advance, or other basis, as determined by the corporation. Premiums imposed by this title on the date of enactment (applicable to that portion of any plan year during which such date occurs) are due within 30 days after such date. Premiums imposed by this title on the first plan year commencing after the date of enactment of this Act are due within 30 days after such plan year commences. Premiums shall continue to accrue until a plan's assets are distributed pursuant to a termination procedure, or until a trustee is appointed pursuant to section 4042, whichever is earlier.

(b) If any basic benefit premium is not paid when it is due the corporation is authorized to assess a late payment charge of not more than 100 percent of the premium payment which was not timely paid. The preceding sentence shall not apply to any payment of premium made within 60 days after the date on which payment is due, if before such date, the plan administrator obtains a waiver from the corporation based upon a showing of substantial hardship arising

from the timely payment of the premium. The corporation is authorized to grant a waiver under this subsection upon application made by the plan administrator, but the corporation may not grant a waiver if it appears that the plan administrator will be unable to pay the premium within 60 days after the date on which it is due. If any premium is not paid by the last date prescribed for a payment, interest on the amount of such premium at the rate imposed under section 6601(a) of the Internal Revenue Code of 1954 (relating to interest on underpayment, nonpayment, or extensions of time for payment of tax) shall be paid for the period from such last date to the date paid.

(c) If any plan administrator fails to pay a premium when due, the corporation is authorized to bring a civil action in any district court of the United States within the jurisdiction of which the plan assets are located, the plan is administered, or in which a defendant resides or is found for the recovery of the amount of the premium penalty, and interest, and process may be served in any other district. The district courts of the United States shall have jurisdiction over actions brought under this subsection by the corporation without regard to the amount in controversy.

(d) The corporation shall not cease to guarantee basic benefits on account of the failure of a plan administrator to pay any premium when due.

REPORT BY THE CORPORATION

SEC. 4008. As soon as practicable after the close of each fiscal year the corporation shall transmit to the President and the Congress a report relative to the conduct of its business under this title for that fiscal year. The report shall include financial statements setting forth the finances of the corporation at the end of such fiscal year and the result of its operations (including the source and application of its funds) for the fiscal year and shall include an actuarial evaluation of the expected operations and status of the funds established under section 4005 for the next five years (including a detailed statement of the actuarial assumptions and methods used in making such evaluation).

PORTABILITY ASSISTANCE

SEC. 4009. The corporation shall provide advice and assistance to individuals with respect to evaluating the economic desirability of establishing individual retirement accounts or other forms of individual retirement savings for which a deduction is allowable under section 219 of the Internal Revenue Code of 1954 and with respect to evaluating the desirability, in particular cases, of transferring amounts representing an employee's interest in a qualified plan to such an account upon the employee's separation from service with an employer.

Subtitle B—Coverage

PLANS COVERED

SEC. 4021. (a) Except as provided in subsection (b), this section applies to any plan (including a successor plan) which, for a plan year—

(1) is an employee pension benefit plan (as defined in paragraph (2) of section 3 of this Act) established or maintained—

(A) by an employer engaged in commerce or in any industry or activity affecting commerce, or

(B) by any employee organization, or organization representing employees, engaged in commerce or in any industry or activity affecting commerce, or

(C) by both,

which has, in practice, met the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 (as in effect for the preceding 5 plan years of the plan) applicable to plans described in paragraph (2) for the preceding 5 plan years; or

(2) is, or has been determined by the Secretary of the Treasury to be, a plan described in section 401(a) of the Internal Revenue Code of 1954, or which meets, or has been determined by the Secretary of the Treasury to meet, the requirements of section 404(a)(2) of such Code.

For purposes of this title, a successor plan is considered to be a continuation of a predecessor plan. For this purpose, a successor plan is a plan which covers a group of employees which includes substantially the same employees as a previously established plan, and provides substantially the same benefits as that plan provided.

(b) This section does not apply to any plan—

(1) which is an individual account plan, as defined in paragraph (34) of section 3 of this Act,

(2) established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, or to which the Railroad Retirement Act of 1935 or 1937 applies and which is financed by contributions required under that Act,

(3) which is a church plan as defined in section 414(e) of the Internal Revenue Code of 1954, unless that plan has made an election under section 410(d) of such Code, and has notified the corporation in accordance with procedures prescribed by the corporation, that it wishes to have the provisions of this part apply to it,

(4)(A) established and maintained by a society, order, or association described in section 501(c)(8) or (9) of the Internal Revenue Code of 1954, if no part of the contributions to or under the plan is made by employers of participants in the plan, or

(B) of which a trust described in section 501(c)(18) of such Code is a part;

(5) which has not at any time after the date of enactment of this Act provided for employer contributions;

(6) which is unfunded and which is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;

(7) which is established and maintained outside of the United States primarily for the benefit of individuals substantially all of whom are nonresident aliens;

(8) which is maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by section 415 of the Internal Revenue Code of 1954 on plans to which that section applies, without regard to whether the plan is funded, and, to the extent that a separable part of a plan (as determined by the corporation) maintained by an employer is maintained for such purpose, that part shall be treated for purposes of this title, as a separate plan which is an excess benefit plan;

(9) which is established and maintained exclusively for substantial owners as defined in section 4022(b)(6);

(10) of an international organization which is exempt from taxation under the International Organizations Immunities Act;

(11) maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws;

(12) which is a defined benefit plan, to the extent that it is treated as an individual account plan under paragraph (35)(B) of section 3 of this Act; or

(13) established and maintained by a professional service employer which does not at any time after the date of enactment of this Act have more than 25 active participants in the plan.

(c)(1) For purposes of subsection (b)(1), the term "individual account plan" does not include a plan under which a fixed benefit is promised if the employer or his representative participated in the determination of that benefit.

(2) For purposes of this paragraph and for purposes of subsection (b)(13)—

(A) the term "professional service employer" means any proprietorship, partnership, corporation, or other association or organization (i) owned or controlled by professional individuals or by executors or administrators of professional individuals, (ii) the principal business of which is the performance of professional services, and

(B) the term "professional individuals" includes but is not limited to, physicians, dentists, chiropractors, osteopaths, optometrists, other licensed practitioners of the healing arts, attorneys at law, public accountants, public engineers, architects, draftsmen, actuaries, psychologists, social or physical scientists, and performing artists.

(3) In the case of a plan established and maintained by more than one professional service employer, the plan shall not be treated as a plan described in subsection (b)(13) if, at any time after the date of enactment of this Act the plan has more than 25 active participants.

BENEFITS GUARANTEED

SEC. 4022. (a) Subject to the limitations contained in subsection (b), the corporation shall guarantee the payment of all nonforfeitable benefits (other than benefits becoming nonforfeitable solely on account of the termination of a plan) under the terms of a plan which terminates at a time when section 4021 applies to it.

(b)(1) Except to the extent provided in paragraph (8)—

(A) no benefits provided by a plan which has been in effect for less than 60 months at the time the plan terminates shall be guaranteed under this section, and

(B) any increase in the amount of benefits under a plan resulting from a plan amendment which was made, or became effective, whichever is later, within 60 months before the date on which the plan terminates shall be disregarded.

(2) For purposes of this subsection, the time a successor plan (within the meaning of section 4021(a)) has been in effect includes the time a previously established plan (within the meaning of section 4021(a)) was in effect. For purposes of determining what benefits are guaranteed under this section in the case of a plan to which section 4021 does not apply on the day after the date of enactment of this Act, the 60 month period referred to in paragraph (1) shall be computed

beginning on the first date on which such section does apply to the plan.

(3) The amount of monthly benefits described in subsection (a) provided by a plan, which are guaranteed under this section with respect to a participant, shall not have an actuarial value which exceeds the actuarial value of a monthly benefit in the form of a life annuity commencing at age 65 equal to the lesser of—

(A) his average monthly gross income from his employer during the 5 consecutive calendar year period (or, if less, during the number of calendar years in such period in which he actively participates in the plan) during which his gross income from that employer was greater than during any other such period with that employer determined by dividing 1/12 of the sum of all such gross income by the number of such calendar years in which he had such gross income, or

(B) $750 multiplied by a fraction, the numerator of which is the contribution and benefit base (determined under section 230 of the Social Security Act) in effect at the time the plan terminates and the denominator of which is such contribution and benefit base in effect in calendar year 1974.

The provisions of this paragraph do not apply to non-basic benefits.

(4)(A) The actuarial value of a benefit, for purposes of this subsection, shall be determined in accordance with regulations prescribed by the corporation.

(B) For purposes of paragraph (3)—

(i) the term "gross income" means "earned income" within the meaning of section 911(b) of the Internal Revenue Code of 1954 (determined without regard to any community property laws),

(ii) in the case of a participant in a plan under which contributions are made by more than one employer, amounts received as gross income from any employer under that plan shall be aggregated with amounts received from any other employer under that plan during the same period, and

(iii) any non-basic benefit shall be disregarded.

(5) Notwithstanding paragraph (3), no person shall receive from the corporation for basic benefits with respect to a participant an amount, or amounts, with an actuarial value which exceeds a monthly benefit in the form of a life annuity commencing at age 65 equal to the amount determined under paragraph (3)(B) at the time of the last plan termination.

(6)(A) For purposes of this title, the term "substantial owner" means an individual who—

(i) owns the entire interest in an unincorporated trade or business,

(ii) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in such partnership, or

(iii) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of that corporation or all the stock of that corporation.

For purposes of clause (iii) the constructive ownership rules of section 1563(e) of the Internal Revenue Code of 1954 shall apply (determined without regard to section 1563(e)(3)(C)). For purposes of this title an individual is also treated as a substantial owner with respect to a plan if, at any time within the 60 months preceding the date on which the determination is made, he was a substantial owner under the plan.

(B) In the case of a participant in a plan under which benefits have not been increased by reason of any plan amendments and who is covered by the plan as a substantial owner, the amount of benefits guaranteed under this section shall not exceed the product of—

(i) a fraction (not to exceed 1) the numerator of which is the number of years the substantial owner was an active participant in the plan, and the denominator of which is 30, and

(ii) the amount of the substantial owner's monthly benefits guaranteed under subsection (a) (as limited under paragraph (3) of this subsection).

(C) In the case of a participant in a plan, other than a plan described in subparagraph (B), who is covered by the plan as a substantial owner, the amount of the benefit guaranteed under this section shall, under regulations prescribed by the corporation, treat each benefit increase attributable to a plan amendment as if it were provided under a new plan. The benefits guaranteed under this section with respect to all such amendments shall not exceed the amount which would be determined under subparagraph (B) if subparagraph (B) applied.

(7) (A) No benefits accrued under a plan after the date on which the Secretary of the Treasury issues notice that he has determined that any trust which is a part of a plan does not meet the requirements of section 401(a) of the Internal Revenue Code of 1954, or that the plan does not meet the requirements of section 404(a)(2) of such Code, are guaranteed under this section unless such determination is erroneous. This subparagraph does not apply if the Secretary subsequently issues a notice that such trust meets the requirements of section 401(a) of such Code or that the plan meets the requirements of section 404(a)(2) of such Code and if the Secretary determines that the trust or plan has taken action necessary to meet such requirements during the period between the issuance of the notice referred to in the preceding sentence and the issuance of the notice referred to in this sentence.

(B) No benefits accrued under a plan after the date on which an amendment of the plan is adopted which causes the Secretary of the Treasury to determine that any trust under the plan has ceased to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 or that the plan has ceased to meet the requirements of section 404(a)(2) of such Code, are guaranteed under this section unless such determination is erroneous. This subparagraph shall not apply if the amendment is revoked as of the date it was first effective or amended to comply with such requirements.

(8) Benefits described in paragraph (1) are guaranteed only to the extent of the greater of—

(A) 20 percent of the amount which, but for the fact that the plan or amendment has not been in effect for 60 months or more, would be guaranteed under this section, or

(B) $20 per month,

multiplied by the number of years (but not more than 5) the plan or amendment, as the case may be, has been in effect. In determining how many years a plan or amendment has been in effect for purposes of this paragraph, the first 12 months following the date on which the plan or amendment is made or first becomes effective (whichever is later) constitutes one year, and each consecutive period of 12 months thereafter constitutes an additional year. This paragraph does not apply to benefits payable under a plan unless the corporation finds substantial evidence that the plan was terminated for a reasonable business purpose and not for the purpose of obtaining the payment of benefits by the corporation under this title.

(c) The corporation is authorized to guarantee the payment of such other classes of benefits and to establish the terms and conditions under which such other classes of benefits are guaranteed as it determines to be appropriate.

CONTINGENT LIABILITY COVERAGE

SEC. 4023. (a) The corporation shall insure any employer who maintains or contributes to or under a plan to which section 4021 applies against the payment of any liability imposed on him under subtitle D of this title in the event of a termination of that plan. The corporation may develop arrangements with persons engaged in the business of providing insurance under which the insurance coverage described in the preceding sentence could be provided in whole or in part by such private insurers. In developing such arrangements the corporation shall devise a system under which risks are equitably distributed between the corporation and private insurers with respect to the classes of employers insured by each.

(b) The corporation is authorized to prescribe and collect in such manner as it determines to be appropriate premiums for insurance offered under subsection (a). If the corporation requires all employers to which this title applies to purchase coverage under this section, the provisions of section 4007 (b) and (c) apply to the collection of premiums under this section. The premiums shall be determined by the corporation and revised by it from time to time as may be necessary, and shall be chargeable at a rate sufficient to fund any payment by the corporation becoming necessary under such coverage.

(c) If the corporation is, in its determination, able to develop a satisfactory arrangement with private insurers, within 36 months after the date of enactment of this Act, to carry out the program of insurance authorized by this section in whole or in part, the corporation is authorized to require employers to elect coverage by such private insurance or by the corporation at such times and in such manner as the corporation determines necessary.

(d) No payment may be made by the corporation under any insurance provided by it under this section unless the premiums on such insurance have been paid by the employer and the insurance has been in effect (with respect to any benefit) for more than 60 months. The corporation is authorized to prescribe conditions under which no payment will be made by it under any insurance offered under this section without regard to whether premiums for such insurance have been paid.

(e) Nothing in this section precludes the purchase by the employer of insurance from any other person, or limits the circumstances under which that insurance is payable, or in any way limits the terms and conditions of such insurance, except that the corporation may prescribe as a condition precedent to the purchase of such insurance the payment of a reinsurance premium or other reasonable fee under this section determined by the corporation to be necessary to assure the liquidity and adequacy of any fund or funds established to carry out the provisions of this section.

(f) In carrying out its duties under subsection (a) to develop arrangements with private insurers the corporation shall consider as an alternative or as a supplement to private insurance the feasibility of using private industry guarantees, indemnities, or letters of credit.

Subtitle C—Terminations

TERMINATION BY PLAN ADMINISTRATOR

SEC. 4041. (a) Before the effective date of the termination of a plan, the plan administrator shall file a notice with the corporation that the plan is to be terminated on a proposed date (which may not be earlier than 10 days after the filing of the notice), and for a period of 90 days after the proposed termination date the plan administrator shall pay no amount pursuant to the termination procedure of the plan unless, before the expiration of such period, he receives a notice of sufficiency under subsection (b). Upon receiving such a notice, the plan administrator may proceed with the termination of the plan in a manner consistent with this subtitle.

(b) If the corporation determines that, after application of section 4044, the assets held under the plan are sufficient to discharge when due all obligations of the plan with respect to basic benefits, it shall notify the plan administrator of such determination as soon as practicable.

(c) If, within such 90-day period, the corporation finds that it is unable to determine that, if the assets of the plan are allocated in accordance with the provisions of section 4044, the assets held under the plan are sufficient to discharge when due all obligations of the plan with respect to basic benefits, it shall notify the plan administrator within such 90-day period of that finding. When the corporation issues a notice under this subsection, it shall commence proceedings in accordance with the provisions of section 4042. Upon receiving a notice under this subsection, the plan administrator shall refrain from taking any action under the proposed termination.

(d) The corporation and the plan administrator may agree to extend the 90-day period provided by this section by a written agreement signed by the corporation and the plan administrator before the expiration of the 90-day period, or the corporation may apply to an appropriate court (as defined in section 4042(g)) for an order extending the 90-day period provided by this section. The 90-day period shall be extended as provided in the agreement or in any court order obtained by the corporation. The 90-day period may be further extended by subsequent written agreements signed by the corporation and the plan administrator made before the expiration of a previously agreed upon extension of the 90-day period, or by subsequent order of the court. Any extension may be made upon such terms and conditions (including the payment of benefits) as are agreed upon by the corporation and the plan administrator or as specified in the court order.

(e) If, after the plan administrator has begun to terminate the plan as authorized by this section, the corporation or the plan administrator finds that the plan is unable, or will be unable, to pay basic benefits when due, the plan administrator shall notify the corporation of such finding as soon as practicable thereafter. If the corporation makes such a finding or concurs with the finding of the plan administrator, it shall institute appropriate proceedings under section 4042. The plan administrator terminating a plan shall furnish such reports to the corporation as it may require for purposes of its duties under this section.

(f) For purposes of subsection (a), a plan with respect to which basic benefits are guaranteed shall be treated as terminated upon the adoption of an amendment to such plan, if, after giving effect to such amendment, the plan is a plan described in section 4021(b)(1).

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(g) Notwithstanding any other provision of this title, a plan administrator or the corporation may petition the appropriate court for the appointment of a trustee in accordance with the provisions of section 4042 if the interests of the participants and beneficiaries would be better served by the appointment of the trustee.

TERMINATION BY CORPORATION

SEC. 4042. (a) The corporation may institute proceedings under this section to terminate a plan whenever it determines that—

(1) the plan has not met the minimum funding standard required under section 412 of the Internal Revenue Code of 1954, or has been notified by the Secretary of the Treasury that a notice of deficiency under section 6212 of such Code has been mailed with respect to the tax imposed under section 4971(a) of such Code,

(2) the plan is unable to pay benefits when due,

(3) the reportable event described in section 4043(b)(7) has occurred, or

(4) the possible long-run loss of the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated.

The corporation may prescribe a simplified procedure to follow in terminating small plans as long as that procedure includes substantial safeguards for the rights of the participants and beneficiaries under the plans, and for the employers who maintain such plans (including the requirement for a court decree under subsection (c)). The corporation is authorized to pool the assets of such small plans for purposes of administration and such other purposes, not inconsistent with its duties to the plan participants and the employer maintaining the plan under this title, as it determines to be required for the efficient administration of this title.

(b) Whenever the corporation makes a determination under subsection (a) with respect to a plan it may, upon notice to the plan, apply to the appropriate United States district court for the appointment of a trustee to administer the plan with respect to which the determination is made pending the issuance of a decree under subsection (c) ordering the termination of the plan. If within 3 business days after the filing of an application under this subsection, or such other period as the court may order, the administrator of the plan consents to the appointment of a trustee, or fails to show why a trustee should not be appointed, the court may grant the application and appoint a trustee to administer the plan in accordance with its terms until the corporation determines that the plan should be terminated or that termination is unnecessary. The corporation may request that it be appointed as trustee of a plan in any case.

(c) If the corporation has issued a notice under this section to a plan administrator and (whether or not a trustee has been appointed under subsection (b)) has determined that the plan should be terminated, it may, upon notice to the plan administrator, apply to the appropriate United States district court for a decree adjudicating that the plan must be terminated in order to protect the interests of the participants and to avoid any further deterioration of the financial condition of the plan or any further increase in the liability of the fund. If the trustee appointed under subsection (b) disagrees with the determination of the corporation under the preceding sentence he may intervene in the proceeding relating to the application for the decree, or make application for such decree himself. Upon granting a decree for which the corporation or trustee has applied under this

subsection the court shall authorize the trustee appointed under subsection (b) (or appoint a trustee if one has not been appointed under such subsection and authorize him) to terminate the plan in accordance with the provisions of this subtitle. If the corporation and the plan administrator agree that a plan should be terminated and agree to the appointment of a trustee without proceeding in accordance with the requirements of this subsection (other than this sentence) the trustee shall have the power described in subsection (d)(1) and, in addition to any other duties imposed on the trustee under law or by agreement between the corporation and the plan administrator, the trustee is subject to the duties described in subsection (d)(3). Whenever a trustee appointed under this title is operating a plan with discretion as to the date upon which final distribution of the assets is to be commenced, the trustee shall notify the corporation at least 10 days before the date on which he proposes to commence such distribution.

(d)(1)(A) A trustee appointed under subsection (b) shall have the power—

(i) to do any act authorized by the plan or this title to be done by the plan administrator or any trustee of the plan;

(ii) to require the transfer of all (or any part) of the assets and records of the plan to himself as trustee;

(iii) to invest any assets of the plan which he holds in accordance with the provisions of the plan, regulations of the corporation, and applicable rules of law;

(iv) to limit payment of benefits under the plan to basic benefits or to continue payment of some or all of the benefits which were being paid prior to his appointment; and

(v) to do such other acts as he deems necessary to continue operation of the plan without increasing the potential liability of the corporation, if such acts may be done under the provisions of the plan.

If the court to which application is made under subsection (c) dismisses the application with prejudice, or if the corporation fails to apply for a decree under subsection (c) within 30 days after the date on which the trustee is appointed under subsection (b), the trustee shall transfer all assets and records of the plan held by him to the plan administrator within 3 business days after such dismissal or the expiration of such 30-day period, and shall not be liable to the plan or any other person for his acts as trustee except for willful misconduct, or for conduct in violation of the provisions of part 4 of subtitle B of title I of this Act (except as provided in subsection (d)(1)(A)(v)). The 30-day period referred to in this subparagraph may be extended as provided by agreement between the plan administrator and the corporation or by court order obtained by the corporation.

(B) If the court to which an application is made under subsection (c) issues the decree requested in such application, in addition to the powers described in subparagraph (A), the trustee shall have the power—

(i) to pay benefits under the plan in accordance with the allocation requirements of section 4044;

(ii) to collect for the plan any amounts due the plan;

(iii) to receive any payment made by the corporation to the plan under this title;

(iv) to commence, prosecute, or defend on behalf of the plan any suit or proceeding involving the plan, except to the extent that the corporation is an adverse party in a suit or proceeding;

(v) to issue, publish, or file such notices, statements, and reports as may be required by the corporation or any order of the court;

(vi) to liquidate the plan assets;

(vii) to recover payments under section 4045(a); and

(viii) to do such other acts as may be necessary to comply with this title or any order of the court and to protect the interests of plan participants and beneficiaries.

(2) As soon as practicable after his appointment, the trustee shall give notice to interested parties of the institution of proceedings under this title to determine whether the plan should be terminated or to terminate the plan, whichever is applicable. For purposes of this paragraph, the term "interested party" means—

(A) the plan administrator,

(B) each participant in the plan and each beneficiary of a deceased participant, and

(C) each employer who may be subject to liability under section 4062, 4063, or 4064.

(3) Except to the extent inconsistent with the provisions of this Act, or as may be otherwise ordered by the court, a trustee appointed under this section shall be subject to the same duties as a trustee appointed under section 47 of the Bankruptcy Act, and shall be, with respect to the plan, a fiduciary within the meaning of paragraph (21) of section 3 of this Act and under section 4975(e) of the Internal Revenue Code of 1954 (except to the extent that the provisions of this title are inconsistent with the requirements applicable under part 4 of subtitle B of title I of this Act and of such section 4975).

(e) An application by the corporation under this section may be filed notwithstanding the pendency in the same or any other court of any bankruptcy, mortgage foreclosure, or equity receivership proceeding, or any proceeding to reorganize, conserve, or liquidate such plan or its property, or any proceeding to enforce a lien against property of the plan.

(f) Upon the filing of an application for the appointment of a trustee or the issuance of a decree under this section, the court to which an application is made shall have exclusive jurisdiction of the plan involved and its property wherever located with the powers, to the extent consistent with the purposes of this section, of a court of bankruptcy and of a court in a proceeding under chapter X of the Bankruptcy Act. Pending an adjudication under subsection (c) such court shall stay, and upon appointment by it of a trustee, as provided in this section such court shall continue the stay of, any pending bankruptcy, mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the plan or its property and any other suit against any receiver, conservator, or trustee of the plan or its property. Pending such adjudication and upon the appointment by it of such trustee, the court may stay any proceeding to enforce a lien against property of the plan or any other suit against the plan.

(g) An action under this subsection may be brought in the judicial district where the plan administrator resides or does business or where any asset of the plan is situated. A district court in which such action is brought may issue process with respect to such action in any other judicial district.

(h)(1) The amount of compensation paid to each trustee appointed under the provisions of this title shall require the prior approval of the corporation, and, in the case of a trustee appointed by a court, the consent of that court.

(2) Trustees shall appoint, retain, and compensate accountants, actuaries, and other professional service personnel in accordance with regulations prescribed by the corporation.

REPORTABLE EVENTS

SEC. 4043. (a) Within 30 days after the plan administrator knows or has reason to know that a reportable event described in subsection (b) has occurred, he shall notify the corporation that such event has occurred. The corporation is authorized to waive the requirement of the preceding sentence with respect to any or all reportable events with respect to any plan, and to require the notification to be made by including the event in the annual report made by the plan. Whenever an employer making contributions under a plan to which section 4021 applies knows or has reason to know that a reportable event has occurred he shall notify the plan administrator immediately.

(b) For purposes of this section a reportable event occurs—

(1) when the Secretary of the Treasury issues notice that a plan has ceased to be a plan described in section 4021(a)(2), or when the Secretary of Labor determines the plan is not in compliance with title I of this Act;

(2) when an amendment of the plan is adopted if, under the amendment, the benefit payable with respect to any participant may be decreased;

(3) when the number of active participants is less than 80 percent of the number of such participants at the beginning of the plan year, or is less than 75 percent of the number of such participants at the beginning of the previous plan year;

(4) when the Secretary of the Treasury determines that there has been a termination or partial termination of the plan within the meaning of section 411(d)(3) of the Internal Revenue Code of 1954, but the occurrence of such a termination or partial termination does not, by itself, constitute or require a termination of a plan under this title;

(5) when the plan fails to meet the minimum funding standards under section 412 of such Code (without regard to whether the plan is a plan described in section 4021(a)(2) of this Act) or under section 302 of this Act;

(6) when the plan is unable to pay benefits thereunder when due;

(7) when there is a distribution under the plan to a participant who is a substantial owner as defined in section 4022(b)(6) if—

(A) such distribution has a value of $10,000 or more;

(B) such distribution is not made by reason of the death of the participant; and

(C) immediately after the distribution, the plan has nonforfeitable benefits which are not funded;

(8) when a plan merges, consolidates, or transfers its assets under section 208 of this Act, or when an alternative method of compliance is prescribed by the Secretary of Labor under section 110 of this Act; or

(9) when any other event occurs which the corporation determines may be indicative of a need to terminate the plan.

For purposes of paragraph (7), all distributions to a participant within any 24-month period are treated as a single distribution.

(c) The Secretary of the Treasury shall notify the corporation—

(1) whenever a reportable event described in paragraph (1), (4), or (5) of subsection (b) occurs, or

(2) whenever any other event occurs which the Secretary of the Treasury believes indicates that the plan may not be sound.

(d) The Secretary of Labor shall notify the corporation—

(1) whenever a reportable event described in paragraph (1), (5), or (8) of subsection (b) occurs, or

(2) whenever any other event occurs which the Secretary of Labor believes indicates that the plan may not be sound.

ALLOCATION OF ASSETS

SEC. 4044. (a) In the case of the termination of a defined benefit plan, the plan administrator shall allocate the assets of the plan (available to provide benefits) among the participants and beneficiaries of the plan in the following order:

(1) First, to that portion of each individual's accured benefit which is derived from the participant's contributions to the plan which were not mandatory contributions.

(2) Second, to that portion of each individual's accrued benefit which is derived from the participant's mandatory contributions.

(3) Third, in the case of benefits payable as an annuity—

(A) in the case of the benefit of a participant or beneficiary which was in pay status as of the beginning of the 3-year period ending on the termination date of the plan, to each such benefit, based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least,

(B) in the case of a participant's or beneficiary's benefit (other than a benefit described in subparagraph (A)) which would have been in pay status as of the beginning of such 3-year period if the participant had retired prior to the beginning of the 3-year period and if his benefits had commenced (in the normal form of annuity under the plan) as of the beginning of such period, to each such benefit based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least.

For purposes of subparagraph (A), the lowest benefit in pay status during a 3-year period shall be considered the benefit in pay status for such period.

(4) Fourth—

(A) to all other benefits (if any) of individuals under the plan guaranteed under this title (determined without regard to section 4022(b)(5)), and

(B) to the additional benefits (if any) which would be determined under subparagraph (A) if section 4022(b)(6) did not apply.

For purposes of this paragraph, section 4021 shall be applied without regard to subsection (c) thereof.

(5) Fifth, to all other nonforfeitable benefits under the plan.

(6) Sixth, to all other benefits under the plan.

(b) For purposes of subsection (a)—

(1) The amount allocated under any paragraph of subsection (a) with respect to any benefit shall be properly adjusted for any allocation of assets with respect to that benefit under a prior paragraph of subsection (a).

(2) If the assets available for allocation under any paragraph of subsection (a) (other than paragraphs (5) and (6)) are insufficient to satisfy in full the benefits of all individuals which are

described in that paragraph, the assets shall be allocated pro rata among such individuals on the basis of the present value (as of the termination date) of their respective benefits described in that paragraph.

(3) This paragraph applies if the assets available for allocation under paragraph (5) of subsection (a) are not sufficient to satisfy in full the benefits of individuals described in that paragraph.

(A) If this paragraph applies, except as provided in subparagraph (B), the assets shall be allocated to the benefits of individuals described in such paragraph (5) on the basis of the benefits of individuals which would have been described in such paragraph (5) under the plan as in effect at the beginning of the 5-year period ending on the date of plan termination.

(B) If the assets available for allocation under subparagraph (A) are sufficient to satisfy in full the benefits described in such subparagraph (without regard to this subparagraph), then for purposes of subparagraph (A), benefits of individuals described in such subparagraph shall be determined on the basis of the plan as amended by the most recent plan amendment effective during such 5-year period under which the assets available for allocation are sufficient to satisfy in full the benefits of individuals described in subparagraph (A) and any assets remaining to be allocated under such subparagraph shall be allocated under subparagraph (A) on the basis of the plan as amended by the next succeeding plan amendment effective during such period.

(4) If the Secretary of the Treasury determines that the allocation made pursuant to this section (without regard to this paragraph) results in discrimination prohibited by section 401(a)(4) of the Internal Revenue Code of 1954 then, if required to prevent the disqualification of the plan (or any trust under the plan) under section 401(a), 403(a), or 405(a) of such Code, the assets allocated under subsections (a)(4)(B), (a)(5), and (a)(6) shall be reallocated to the extent necessary to avoid such discrimination.

(5) The term "mandatory contributions" means amounts contributed to the plan by a participant which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions. For this purpose, the total amount of mandatory contributions of a participant is the amount of such contributions reduced (but not below zero) by the sum of the amounts paid or distributed to him under the plan before its termination.

(6) A plan may establish subclasses and categories within the classes described in paragraphs (1) through (6) of subsection (a) in accordance with regulations prescribed by the corporation.

(c) Any increase or decrease in the value of the assets of a plan occurring during the period beginning on the later of (1) the date a trustee is appointed under section 4042(b) or (2) the date on which the plan is terminated is to be allocated between the plan and the corporation in the manner determined by the court (in the case of a court-appointed trustee) or as agreed upon by the corporation and the plan administrator in any other case. Any increase or decrease in the value of the assets of a plan occurring after the date on which the plan is terminated shall be credited to, or suffered by, the corporation.

(d)(1) Any residual assets of a plan may be distributed to the employer if—

(A) all liabilities of the plan to participants and their beneficiaries have been satisfied,

(B) the distribution does not contravene any provision of law, and

(C) the plan provides for such a distribution in these circumstances.

(2) Notwithstanding the provisions of paragraph (1), if any assets of the plan attributable to employee contributions, remain after all liabilities of the plan to participants and their beneficiaries have been satisfied, such assets shall be equitably distributed to the employees who made such contributions (or their beneficiaries) in accordance with their rate of contributions.

RECAPTURE OF CERTAIN PAYMENTS

SEC. 4045. (a) Except as provided in subsection (c), the trustee is authorized to recover for the benefit of a plan from a participant the recoverable amount (as defined in subsection (b)) of all payments from the plan to him which commenced within the 3-year period immediately preceding the time the plan is terminated.

(b) For purposes of subsection (a) the recoverable amount is the excess of the amount determined under paragraph (1) over the amount determined under paragraph (2).

(1) The amount determined under this paragraph is the sum of the amount of the actual payments received by the participant within the 3-year period.

(2) The amount determined under this paragraph is the sum of—

(A) the sum of the amount such participant would have received during each consecutive 12-month period within the 3 years if the participant received the benefit in the form described in paragraph (3),

(B) the sum for each of the consecutive 12-month periods of the lesser of—

(i) the excess, if any, of $10,000 over the benefit in the form described in paragraph (3), or

(ii) the excess of the actual payment, if any, over the benefit in the form described in paragraph (3), and

(C) the present value at the time of termination of the participant's future benefits guaranteed under this title as if the benefits commenced in the form described in paragraph (3).

(3) The form of benefit for purposes of this subsection shall be the monthly benefit the participant would have received during the consecutive 12-month period, if he had elected at the time of the first payment made during the 3-year period, to receive his interest in the plan as a monthly benefit in the form of a life annuity commencing at the time of such first payment.

(c)(1) In the event of a distribution described in section 4043(b)(7) the 3-year period referred to in subsection (b) shall not end sooner than the date on which the corporation is notified of the distribution.

(2) The trustee shall not recover any payment made from a plan after or on account of the death of a participant, or to a participant who is disabled (within the meaning of section 72(m)(7) of the Internal Revenue Code of 1954).

(3) The corporation is authorized to waive, in whole or in part, the recovery of any amount which the trustee is authorized to recover for the benefit of a plan under this section in any case in which it determines that substantial economic hardship would result to the participant or his beneficiaries from whom such amount is recoverable.

REPORTS TO TRUSTEE

SEC. 4046. The corporation and the plan administrator of any plan to be terminated under this subtitle shall furnish to the trustee such information as the corporation or the plan administrator has and, to the extent practicable, can obtain regarding—

(1) the amount of benefits payable with respect to each participant under a plan to be terminated,

(2) the amount of benefits guaranteed under section 4022 which are payable with respect to each participant in the plan,

(3) the present value, as of the time of termination, of the aggregate amount of benefits payable under section 4022 (determined without regard to section 4022(b)(5)),

(4) the fair market value of the assets of the plan at the time of termination,

(5) the computations under section 4044, and all actuarial assumptions under which the items described in paragraphs (1) through (4) were computed, and

(6) any other information with respect to the plan the trustee may require in order to terminate the plan.

RESTORATION OF PLANS

SEC. 4047. Whenever the corporation determines that a plan which is to be terminated, or which is in the process of being terminated, under this subtitle should not be terminated as a result of such circumstances as the corporation determines to be relevant, the corporation is authorized to cease any activities undertaken to terminate the plan, and to take whatever action is necessary and within its power to restore the plan to its status prior to the determination that the plan was to be terminated. In the case of a plan which has been terminated under section 4042 the corporation is authorized in any such case in which the corporation determines such action to be appropriate and consistent with its duties under this title, to take such action as may be necessary to restore the plan to its pretermination status, including, but not limited to, the transfer to the employer or a plan administrator of control of part or all of the remaining assets and liabilities of the plan.

DATE OF TERMINATION

SEC. 4048. For purposes of this title the date of termination is—

(1) in the case of a plan terminated in accordance with the provisions of section 4041, the date established by the plan administrator and agreed to by the corporation,

(2) in the case of a plan terminated in accordance with the provisions of section 4042, the date established by the corporation and agreed to by the plan administrator, or

(3) in the case of a plan terminated in accordance with the provisions of either section in any case in which no agreement is reached between the plan administrator and the corporation (or the trustee), the date established by the court.

Subtitle D—Liability

AMOUNTS PAYABLE BY THE CORPORATION

SEC. 4061. The corporation shall pay benefits under a plan terminated under this title subject to the limitations and requirements of subtitle B of this title. Amounts guaranteed by the corporation under section 4022 shall be paid by the corporation out of the appropriate fund.

LIABILITY OF EMPLOYER

SEC. 4062. (a) This section applies to any employer who maintained a plan (other than a multiemployer plan) at the time it was terminated, but does not apply—

(1) to an employer who maintained a plan with respect to which he paid the annual premium described in section 4006(a)(2)(B) for each of the 5 plan years immediately preceding the plan year during which the plan terminated unless the conditions imposed by the corporation on the payment of coverage under section 4023 do not permit such coverage to apply under the circumstances, or

(2) to the extent of any liability arising out of the insolvency of an insurance company with respect to an insurance contract.

(b) Any employer to which this section applies shall be liable to the corporation, in an amount equal to the lesser of—

(1) the excess of—

(A) the current value of the plan's benefits guaranteed under this title on the date of termination over

(B) the current value of the plan's assets allocable to such benefits on the date of termination, or

(2) 30 percent of the net worth of the employer determined as of a day, chosen by the corporation but not more than 120 days prior to the date of termination, computed without regard to any liability under this section.

(c) For purposes of subsection (b)(2) the net worth of an employer is—

(1) determined on whatever basis best reflects, in the determination of the corporation, the current status of the employer's operations and prospects at the time chosen for determining the net worth of the employer, and

(2) increased by the amount of any transfers of assets made by the employer determined by the corporation to be improper under the circumstances, including any such transfers which would be inappropriate under the Bankruptcy Act if the employer were the subject of a proceeding under that Act.

(d) For purposes of this section the following rules apply in the case of certain corporate reorganizations:

(1) If an employer ceases to exist by reason of a reorganization which involves a mere change in identity, form, or place of organization, however effected, a successor corporation resulting from such reorganization shall be treated as the employer to whom this section applies.

(2) If an employer ceases to exist by reason of a liquidation into a parent corporation, the parent corporation shall be treated as the employer to whom this section applies.

(3) If an employer ceases to exist by reason of a merger, consolidation, or division, the successor corporation or corporations shall be treated as the employer to whom this section applies.

(e) If an employer ceases operations at a facility in any location and, as a result of such cessation of operations, more than 20 percent of the total number of his employees who are participants under a plan established and maintained by him are separated from employment, the employer shall be treated with respect to that plan as if he were a substantial employer under a plan under which more than one employer makes contributions and the provisions of sections 4063, 4064, and 4065 shall apply.

LIABILITY OF SUBSTANTIAL EMPLOYER FOR WITHDRAWAL

SEC. 4063. (a) Except as provided in subsection (d), the plan administrator of a plan under which more than one employer makes contributions—

(1) shall notify the corporation of the withdrawal of a substantial employer from the plan, within 60 days after such withdrawal, and

(2) request that the corporation determine the liability of such employer under this subtitle with respect to such withdrawal.

The corporation shall, as soon as practicable thereafter, determine whether such employer is liable for any amount under this subtitle with respect to the withdrawal and notify such employer of such liability.

(b) Except as provided in subsection (c), an employer who withdraws from a plan to which section 4021 applies, during a plan year for which he was a substantial employer, and who is notified by the corporation as provided by subsection (a), shall be liable to the corporation in accordance with the provisions of section 4062 and this section. The amount of such employer's liability shall be computed on the basis of an amount determined by the corporation to be the amount described in section 4062 for the entire plan, as if the plan had been terminated by the corporation on the date of the employer's withdrawal, multiplied by a fraction—

(1) the numerator of which is the total amount required to be contributed to the plan by such employer for the last 5 years ending prior to the withdrawal, and

(2) the denominator of which is the total amount required to be contributed to the plan by all employers for such last 5 years.

In addition to and in lieu of the manner prescribed in the preceding sentence, the corporation may also determine the liability of each such employer on any other equitable basis prescribed by the corporation in regulations. Any amount collected by the corporation under this subsection shall be held in escrow subject to disposition in accordance with the provisions of paragraphs (2) and (3) of subsection (c).

(c)(1) In lieu of payment of his liability under this section the employer may be required to furnish a bond to the corporation in an amount not exceeding 150 percent of his liability to insure payment of his liability under this section. The bond shall have as surety thereon a corporate surety company which is an acceptable surety on Federal bonds under authority granted by the Secretary of the Treasury under sections 6 through 13 of title 6, United States Code. Any such bond shall be in a form or of a type approved by the Secretary including individual bonds or schedule or blanket forms of bonds which cover a group or class.

(2) If the plan is not terminated within the 5-year period commencing on the day of withdrawal, the liability of such employer is abated and any payment held in escrow shall be refunded without interest to the employer (or his bond cancelled) in accordance with bylaws or rules prescribed by the corporation.

(3) If the plan terminates within the 5-year period commencing on the day of withdrawal, the corporation shall—

(A) demand payment or realize on the bond and hold such amount in escrow for the benefit of the plan;

(B) treat any escrowed payments under this section as if they were plan assets and apply them in a manner consistent with this subtitle; and

(C) refund any amount to the employer which is not required to meet any obligation of the corporation with respect to the plan.

(d) The provisions of this subsection apply in the case of a withdrawal described in subsection (a), and the provisions of subsections (b) and (c) shall not apply, if the corporation determines that the procedure provided for under this subsection is consistent with the purposes of this section and section 4064 and is more appropriate in the particular case. Upon a showing by the plan administrator of a plan that the withdrawal from the plan by any employer or employers has resulted, or will result, in a significant reduction in the amount of aggregate contributions to or under the plan by employers, the corporation may—

(1) require the plan fund to be equitably allocated between those participants no longer working in covered service under the plan as a result of their employer's withdrawal, and those participants who remain in covered service under the plan;

(2) treat that portion of the plan funds allocable under paragraph (1) to participants no longer in covered service as a termination; and

(3) treat that portion of the plan fund allocable to participants remaining in covered service as a separate plan.

(e) The corporation is authorized to waive the application of the provisions of subsections (b), (c), and (d) of this section to any employer or plan administrator whenever it determines that there is an indemnity agreement in effect among all other employers under the plan which is adequate to satisfy the purposes of this section and of section 4064.

LIABILITY OF EMPLOYERS ON TERMINATION OF PLAN MAINTAINED BY MORE THAN ONE EMPLOYER

SEC. 4064. (a) This section applies to all employers who maintain a plan under which more than one employer makes contributions at the time such plan is terminated, or who, at any time within the 5 plan years preceding the date of termination, made contributions under the plan.

(b) The corporation shall determine the liability of each such employer in a manner consistent with section 4062 except that the amount of the liability determined under section 4062(b)(1) with respect to the entire plan shall be allocated to each employer by multiplying such amounts by a fraction—

(1) the numerator of which is the amount required to be contributed to the plan by each employer for the last 5 plan years ending prior to the termination, and

(2) the denominator of which is the total amount required to be contributed to the plan by all such employers for such last 5 years,

and the limitation described in section 4062(b)(2) shall be applied separately to each employer. The corporation may also determine the liability of each such employer on any other equitable basis prescribed by the corporation in regulations.

ANNUAL REPORT OF PLAN ADMINISTRATOR

SEC. 4065. For each plan year for which section 4021 applies to a plan, the plan administrator shall file with the corporation, on a form prescribed by the corporation, an annual report which identifies the plan and plan administrator and which includes—

(1) a copy of each notification required under section 4063 with respect to such year, and

(2) a statement disclosing whether any reportable event (described in section 4043(b)) occurred during the plan year.

The report shall be filed within 6 months after the close of the plan year to which it relates. The corporation shall cooperate with the Secretary of the Treasury and the Secretary of Labor in an endeavor to coordinate the timing and content, and possibly obtain the combination, of reports under this section with reports required to be made by plan administrators to such Secretaries.

ANNUAL NOTIFICATION TO SUBSTANTIAL EMPLOYERS

SEC. 4066. The plan administrator of each plan under which contributions are made by more than one employer shall notify, within 6 months after the close of each plan year, any employer making contributions under that plan who is described in section 4001(a)(2) that he is a substantial employer for that year.

RECOVERY OF EMPLOYER LIABILITY FOR PLAN TERMINATION

SEC. 4067. The corporation is authorized to make arrangements with employers who are liable under section 4062, 4063, or 4064 for payment of their liability, including arrangements for deferred payment on such terms and for such periods as the corporation deems equitable and appropriate.

LIEN FOR LIABILITY OF EMPLOYER

SEC. 4068. (a) If any employer or employers liable to the corporation under section 4062, 4063, or 4064 neglect or refuse to pay, after demand, the amount of such liability (including interest), there shall be a lien in favor of the corporation upon all property and rights to property, whether real or personal, belonging to such employer or employers.

(b) The lien imposed by subsection (a) arises on the date of termination of a plan, and continues until the liability imposed under section 4062, 4063, or 4064 is satisfied or becomes unenforceable by reason of lapse of time.

(c)(1) Except as otherwise provided under this section, the priority of the lien imposed under subsection (a) shall be determined in the same manner as under section 6323 of the Internal Revenue Code of 1954. Such section 6323 shall be applied by substituting "lien imposed by section 4068 of the Employee Retirement Income Security Act of 1974" for "lien imposed by section 6321"; "corporation" for "Secretary or his delegate"; "employer liability lien" for "tax lien"; "employer" for "taxpayer"; "lien arising under section 4068(a) of the Employee

Retirement Income Security Act of 1974" for "assessment of the tax"; and "payment of the loan value is made to the corporation" for "satisfaction of a levy pursuant to section 6332(b)"; each place such terms appear.

(2) In the case of bankruptcy or insolvency proceedings, the lien imposed under subsection (a) shall be treated in the same manner as a tax due and owing to the United States for purposes of the Bankruptcy Act or section 3466 of the Revised Statutes (31 U.S.C. 191).

(3) For purposes of applying section 6323(a) of the Internal Revenue Code of 1954 to determine the priority between the lien imposed under subsection (a) and a Federal tax lien, each lien shall be treated as a judgment lien arising as of the time notice of such lien is filed.

(4) For purposes of this subsection, notice of the lien imposed by subsection (a) shall be filed in the same manner as under section 6323 (f) and (g) of the Internal Revenue Code of 1954.

(d)(1) In any case where there has been a refusal or neglect to pay the liability imposed under section 4062, 4063, or 4064, the corporation may bring civil action in a district court of the United States to enforce the lien of the corporation under this section with respect to such liability or to subject any property, of whatever nature, of the employer, or in which he has any right, title, or interest to the payment of such liability.

(2) The liability imposed by section 4062, 4063, or 4064 may be collected by a proceeding in court if the proceeding is commenced within 6 years after the date upon which the plan was terminated or prior to the expiration of any period for collection agreed upon in writing by the corporation and the employer before the expiration of such 6-year period. The period of limitations provided under this paragraph shall be suspended for the period the assets of the employer are in the control or custody of any court of the United States, or of any State, or of the District of Columbia, and for 6 months thereafter, and for any period during which the employer is outside the United States if such period of absence is for a continuous period of at least 6 months.

(e) If the corporation determines, with the consent of the board of directors, that release of the lien or subordination of the lien to any other creditor of the employer or employers would not adversely affect the collection of the liability imposed under section 4062, 4063, or 4064, or that the amount realizable by the corporation from the property to which the lien attaches will ultimately be increased by such release or subordination, and that the ultimate collection of the liability will be facilitated by such release or subordination, the corporation may issue a certificate of release or subordination of the lien with respect to such property, or any part thereof.

Subtitle E—Amendments to Internal Revenue Code of 1954; Effective Dates

AMENDMENTS TO INTERNAL REVENUE CODE OF 1954

SEC. 4081. (a) Section 404 of the Internal Revenue Code of 1954 (relating to deduction for contributions of an employer to employees' trust or annuity plan in compensation under a deferred-payment plan) is amended by adding at the end thereof the following new subsection:

"(g) CERTAIN EMPLOYER LIABILITY PAYMENTS CONSIDERED AS CONTRIBUTIONS.—For purposes of this section any amount paid by an employer under section 4062, 4063, or 4064 of the Employee Retirement Income Security Act of 1974 shall be treated as a contribution to which this section applies by such employer to or under a stock bonus, pension, profit-sharing, or annuity plan.".

(b) Section 6511(d) of the Internal Revenue Code of 1954 (relating to special rules applicable to income taxes) is amended by adding at the end thereof the following new paragraph:

"(8) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO AMOUNTS INCLUDED IN INCOME SUBSEQUENTLY RECAPTURED UNDER QUALIFIED PLAN TERMINATION.—If the claim for credit or refund relates to an overpayment of tax imposed by subtitle A on account of the recapture, under section 4045 of the Employee Retirement Income Security Act of 1974, of amounts included in income for a prior taxable year, the 3-year period of limitation prescribed in subsection (a) shall be extended, for purposes of permitting a credit or refund of the amount of the recapture, until the date which occurs one year after the date on which such recaptured amount is paid by the taxpayer.".

EFFECTIVE DATE; SPECIAL RULES

SEC. 4082. (a) The provisions of this title take effect on the date of enactment of this Act.

(b) Notwithstanding the provisions of subsection (a), the corporation shall pay benefits guaranteed under this title with respect to any plan—

(1) which is not a multiemployer plan,

(2) which terminates after June 30, 1974, and before the date of enactment of this Act,

(3) to which section 4021 would apply if that section were effective beginning on July 1, 1974, and

(4) with respect to which a notice is filed with the Secretary of Labor and received by him not later than 10 days after the date of enactment of this Act, except that, for reasonable cause shown, such notice may be filed with the Secretary of Labor and received by him not later than October 31, 1974, stating that the plan is a plan described in paragraphs (1), (2), and (3).

The corporation shall not pay benefits guaranteed under this title with respect to a plan described in the preceding sentence unless the corporation finds substantial evidence that the plan was terminated for a reasonable business purpose and not for the purpose of obtaining the payment of benefits by the corporation under this title or for the purpose of avoiding the liability which might be imposed under subtitle D if the plan terminated on or after the date of enactment of this Act. The provisions of subtitle D do not apply in the case of such a plan which terminates before the date of enactment of this Act. For purposes of determining whether a plan is a plan described in paragraph (2), the provisions of section 4048 shall not apply, but the corporation shall make the determination on the basis of the date on which benefits ceased to accrue or on any other reasonable basis consistent with the purposes of this subsection.

(c)(1) Except as provided in paragraphs (2), (3), and (4), the corporation shall not pay benefits guaranteed under this title with respect to a multiemployer plan which terminates before January 1,

1978. Whenever the corporation exercises the authority granted under paragraph (2) or (3), the corporation shall notify the Committee on Education and Labor and the Committee on Ways and Means of the House of Representatives, and the Committee on Labor and Public Welfare and the Committee on Finance of the Senate.

(2) The corporation may, in its discretion, pay benefits guaranteed under this title with respect to a multiemployer plan which terminates after the date of enactment of this Act and before January 1, 1978, if—

(A) the plan was maintained during the 60 months immediately preceding the date on which the plan terminates, and

(B) the corporation determines that the payment by the corporation of benefits guaranteed under this title with respect to that plan will not jeopardize the payments the corporation anticipates it may be required to make in connection with benefits guaranteed under this title with respect to multiemployer plans which terminate after December 31, 1977.

(3) Notwithstanding any provision of section 4021 or 4022 which would prevent such payments, the corporation, in carrying out its authority under paragraph (2), may pay benefits guaranteed under this title with respect to a multiemployer plan described in paragraph (2) in any case in which those benefits would otherwise not be payable if—

(A) the plan has been in effect for at least 5 years,

(B) the plan has been in substantial compliance with the funding requirements for a qualified plan with respect to the employees and former employees in those employment units on the basis of which the participating employers have contributed to the plan for the preceding 5 years, and

(C) the participating employers and employee organization or organizations had no reasonable recourse other than termination.

(4) If the corporation determines, under paragraph (2) or (3), that it will pay benefits guaranteed under this title with respect to a multiemployer plan which terminates before January 1, 1978, the corporation—

(A) may establish requirements for the continuation of payments which commenced before January 2, 1974, with respect to retired participants under the plan,

(B) may not, notwithstanding any other provision of this title, make payments with respect to any participant under such a plan who, on January 1, 1974, was receiving payment of retirement benefits, in excess of the amounts and rates payable with respect to such participant on that date,

(C) may not make any payments with respect to benefits guaranteed under this title in connection with such a plan which are derived, directly or indirectly, from amounts borrowed under section 4005(c), and

(D) shall review from time to time payments made under the authority granted to it by paragraphs (2) and (3), and reduce or terminate such payments to the extent necessary to avoid jeopardizing the ability of the corporation to make payments of benefits guaranteed under this title in connection with multiemployer plans which terminate after December 31, 1977, without increasing premium rates for such plans.

APPROVED SEPTEMBER 2, 1974.

570-155 O - 75 - 15

House Report No. 93-298

1st Session

[Bracketed numerals indicate official report page numbers.]

TAX TREATMENT OF SURVIVOR BENEFIT PLANS OF THE UNIFORMED SERVICES

JUNE 20, 1973.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. MILLS of Arkansas, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 4200]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4200) to amend section 122 of the Internal Revenue Code of 1954, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

The amendments are as follows:

On page 2, line 2, strike out "(a)" and insert "(d)".

On page 2, line 11, insert "(c)" immediately after "2039".

On page 2, line 13, strike out "(a)" and insert "(d)".

I. SUMMARY

This bill makes several amendments to the Internal Revenue Code of 1954 which are designed to continue the same tax treatment for servicemen and former servicemen of the United States under the Survivor Benefit Plan (recently enacted in P.L. 92–425) as formerly was available for them under the Retired Serviceman's Family Protection Plan in the case of annuities for surviving spouses or certain child beneficiaries. Under the present tax law, a member or former member of the uniformed services of the United States who receives a reduced amount of retired or retainer pay because of his election to contribute to the program for survivor annuity benefits is not required to include in his gross income the amount of this reduction in his pay. However, the law governing these annuities has recently been changed by the new Survivor Benefit Plan to provide that survivor annuity benefits apply unless the retired serviceman elects not to participate. Your committee's bill conforms the existing tax treatment to this change in the election requirement under the new Survivor Benefit Plan. Thus,

[2] where a serviceman (or former serviceman) does not elect out of the new Survivor Benefit Plan and as a result receives reduced retired pay, the amount of the reduction is not taxed to him. Similar conforming amendments are also made to other provisions of the tax laws.

This bill is reported unanimously by your committee and the Treasury Department has indicated that it favors its enactment.

II. GENERAL STATEMENT

Until recently, a serviceman (or former serviceman) could provide survivor benefits for his dependents only by electing to participate in the Retired Serviceman's Family Protection Plan. If a retired serviceman made the election under this plan, he would receive a reduced amount of retired or retainer pay in order to finance survivor benefits for his dependents. Since this retirement program is not funded and for that reason is not a qualified pension plan under the tax laws (sec. 401(a) of the Code), a special rule was provided for retired servicemen participating in this program. This provision (sec. 122 of the Code) provides that in the case where a member (or former member) of the uniformed services of the United States makes an election to participate in the Retired Serviceman's Family Protection Plan, the amount of any reduction in his retired or retainer pay on account of his contribution to the plan would not be taxed to him.

Congress recently passed legislation (P.L. 92–425) which completely revised the program for survivor benefits for dependents of retired servicemen. Under this newly enacted Survivor Benefit Plan, the survivor benefits will be automatically provided and the retired or retainer pay of a serviceman is automatically reduced unless he elects not to participate in the plan.

Since present law is cast in terms of an election into the program and the new survivor benefit program is automatically provided unless a retired serviceman elects out of the program, your committee believes it is appropriate to make the necessary changes in the tax law so that under the new survivor benefit program the identical tax treatment will apply to servicemen (or former servicemen) receiving reduced retired or retainer pay as under the old program. Accordingly, your committee's bill provides that where a retired serviceman does not elect out of the new survivor benefit program and thus is automatically covered so that he receives reduced retired or retainer pay on account of his contribution to the program, the amount of the reduction is not to be taxed to him.

The bill also makes a similar conforming amendment in the provision allowing an exclusion of up to $5,000 paid to a survivor of a deceased serviceman who retired because of disability and died before attaining normal retirement age. In addition, the bill also conforms the estate and gift tax exclusions available under the present tax law for the value of survivor annuities under the new survivor benefit program.

The income tax amendments apply to taxable years ending on or after September 21, 1972, which is the date of enactment of the new Survivor Benefit Plan (P.L. 92–425), or in the case of the death benefit exclusion those who die on or after that date. The estate tax amendment applies to individuals dying on or after September 21, 1972.

[3] III. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

In compliance with clause 7 of rule XIII of the Rules of the House of Representatives, the following statement is made relative to the effect of the revenues of this bill. Your committee estimates that, since this bill continues the existing tax treatment for survivor benefit plans of the uniformed services, there will be no gain or loss in revenues. The Treasury Department agrees with this statement.

In compliance with clause 27(b) of the rule XI of the Rules of the House of Representatives, the following statement is made relative to the vote of the committee on the motion to report the bill. The bill was ordered reported unanimously, by voice vote.

House Report No. 93-533

1st Session

[Bracketed numerals indicate official report page numbers.]

EMPLOYEE BENEFIT SECURITY ACT OF 1973

OCTOBER 2, 1973.

Mr. PERKINS, from the Committee on Education and Labor, submitted the following

REPORT

together with

SUPPLEMENTAL, ADDITIONAL, AND INDIVIDUAL VIEWS

[To accompany H.R. 2]

The Committee on Education and Labor, to whom was referred the bill (H.R. 2) to revise the Welfare and Pension Plans Disclosure Act, having considered the same, report favorably thereon with an amendment and recommend that the bill, as amended, do pass. The amendment substitutes all after the enacting clause and inserts a substitute text which appears in italic type in the reported bill.

I. SYNOPSIS

The Employee Benefit Security Act as reported by the Committee is designed to remedy certain defects in the private retirement system which limit the effectiveness of the system in providing retirement income security. The primary purpose of the bill is the protection of individual pension rights, but the committee has been constrained to recognize the voluntary nature of private retirement plans. The relative improvements required by this Act have been weighed against the additional burdens to be placed on the system. While modest cost increases are to be anticipated when the Act becomes effective, the adverse impact of these increases have been minimized. Additionally, all of the provisions in the Act have been analysed on the basis of their projected costs in relation to the anticipated benefit to the employee participant. In broad outline, the bill is designed to:

(1) establish equitable standards of plan administration;

(2) mandate minimum standards of plan design with respect to the vesting of plan benefits;

[2] (3) require minimum standards of fiscal responsibility by requiring the amortization of unfunded liabilities;

(4) insure the vested portion of unfunded liabilities against the risk of premature plan termination; and

(5) promote a renewed expansion of private retirement plans and increase the number of participants receiving private retirement benefits.

Provision is made for the imposition of criminal penalties on those willfully violating their duties under the Act. The Labor Department is given primary authority to administer the provisions of the Act, but the Committee has placed the principal focus of the enforcement effort on anticipated civil litigation to be initiated by the Secretary of Labor as well as participants and beneficiaries.

II. Background

The private pension system is a relatively modern economic institution tracing its role as an important social and economic factor only from the mid 1940's. A variety of converging financial and social trends in our society have created a favorable environment for the growth and expansion of private deferred compensation schemes and retirement programs in general. As our economy has matured, an ever increasing number of employers have recognized their responsibility for the physical and economic welfare of their employees, even for the years beyond retirement. Its development parallels and is a response to the transition of the American life style from its rural agrarian antecedents into its present urbanized, wage earner society. The dynamic asset growth necessary to meet its responsibilities has placed the private pension system in a position to influence the level of savings, the operation of our capital markets, and the relative financial security of millions of consumers, three of the fundamental elements of our national economic security.

The growth of the private pension movement in the United States proceeded slowly until the years preceding World War II. As the full implications of the economic changes sweeping the nation were felt, American beliefs and attitudes regarding retirement security changed. The passage of the Railroad Retirement Act and the Social Security Act marked the turning point in American thinking, and dissatisfaction with those early governmental programs contributed to an accelerated interest in private retirement plans. The wage freezes imposed during World War II and the Korean conflict focused increased attention on the deferred component of compensation as a means of avoiding the freeze restrictions.

In 1947 a series of administrative proceedings and court decisions under the National Labor Relations Act of 1935 held that pensions were a form of remuneration for the purposes of that Act, and they accordingly became mandatory subjects of collective bargaining. (Inland Steel Company v. NLRB, 170 f.2d 247 (7th Cir. 1948), cert. denied, 336 U.S. 960 (1949)). In the same time period a Presidential fact finding commission in presenting its report on the steel industry labor dispute in 1949 stated that:

> We think all industry in the absence of adequate Government programs, owes an obligation to workers to provide for

[3] maintenance of the human body in the form of medical and similar benefits and full depreciation in the form of old age retirement—in the same way as it now does for plant and machinery.

In 1940, an estimated four million employees were covered by private pension plans; in 1950, the figure had increased to almost 10 million and in 1960 over 21 million were covered. Currently, over 30 million employees or almost one half of the private non-farm work force are covered by these plans. This phenomenal expansion of coverage has been matched by an even more startling accumulation of assets to back the benefit structure. Today, in excess of $150 billion in assets are held in reserve to pay benefits credited to private plan participants.

This rapid growth has constituted the basis for legislative efforts at both the federal and state levels to assure equitable and fair administration of all pension plans.

Various aspects of pension plans have been affected to some degree by most of the major labor legislation of the twentieth century, including the National Labor Relations Act (1935), the Labor Management Relations Act (1947), and the Labor Management Reporting and Disclosure Act (1959). However, not until 1958, with the enactment of the Welfare and Pension Plans Disclosure Act, was legislation effected which was specifically designed to exercise regulatory controls over pension and welfare funds. Based upon disclosure of malfeasance and improper activities by pension administrators, trustees, or fiduciaries, the Act was amended in 1962 to designate certain acts of conduct as federal crimes when they occurred in connection with welfare and pension plans. The amendments also conferred investigatory and various regulatory powers upon the Secretary over pension and welfare funds. In the decade since the amendments were enacted, experience has shown that, despite intermittent enforcement of the reporting requirements and the criminal provisions, the protection accomplished by statute has not been sufficient to accomplish Congressional intent.

The Existing Law

The growth and development of the private pension system in the past two decades has been substantial. Yet, regulation of the private system's scope and operation has been minimal and its effectiveness a matter of debate. The assets of private plans, estimated to be in excess of $150 billion, constitute the only large private accumulation of funds which have escaped the imprimatur of effective federal regulation.

At the federal level, there are essentially three federal statutes which, although accomplishing different purposes and vested within different federal departments for enforcement, are all compatible in their regulatory responsibilities. These are the Welfare and Pension Plans Disclosure Act (29 U.S.C. Sec. 301 et. seq.), the Labor Management Relations Act (29 U.S.C. Sec. 141, et. seq.) and the Internal Revenue Code I.R.C. of 1954, Secs. 401–404, 501–503).

A complete description of the federal regulation affecting the administration of private plans can be found in Interim Report of The Private Welfare and Pension Plan Study, 1971, Senate Report No. 92–634 of the 92d Congress 2d Session.

[4] After a comprehensive investigation of abuses in the administration and investment of private fund assets, Congress adopted the Welfare and Pension Plan Disclosure Act in 1958. The policy underlying enactment of this Act was purportedly to protect the interest of welfare and pension plan participants and beneficiaries through disclosure of information with respect to such plans. The essential requirement of the Act was that the plan administrator compile, file with the Secretary of Labor, and send to participants and their beneficiaries upon written request, a description and annual report of the plan. It was expected that the knowledge thus disseminated would enable participants to police their plans. The Act was amended in 1962 to make theft, embezzlement, bribery, and kickbacks federal crimes if they occur in connection with welfare and pension plans. The 1962 amendments also conferred limited investigatory and regulatory powers upon the Secretary of Labor, and required bonding of plan officials.

Experience in the decade since the passage of the above amendments has demonstrated the inadequacy of the Welfare and Pension Plans Disclosure Act in regulating the private pension system for the purpose of protecting rights and benefits due to workers. It is weak in its limited disclosure requirements and wholly lacking in substantive fiduciary standards. Its chief procedural weakness can be found in its reliance upon the initiative of the individual employee to police the management of his plan.

The Labor Management Relations Act, Sec. 302, provides the fundamental guidelines for the establishment and operation of pension funds administered jointly by an employer and a union. The Act is not intended to establish nor does it provide standards for the preservation of vested benefits, funding adequacy, security of investment, or fiduciary conduct.

Tax deduction benefits accruing to employers are prescribed by the Internal Revenue Code under which the employer is granted a deduction within certain limits for contributions made to a qualified plan, and the investment earnings on such plans are made tax-exempt. To attain "qualified status" under the Code, the plan must be (1) for the exclusive benefit of the participants; (2) for the purpose of distributing the corpus or income to the participants; (3) established in such a manner to make it impossible for the employer to use or divert funds before satisfying the plan's liabilities; and (4) not discriminate in favor of officers, stockholders, or highly-compensated or supervisory employees.

The Internal Revenue Code provides only limited safeguards for the security of anticipated benefit rights in private plans since its primary functions are designed to produce revenue and to prevent evasion of tax obligations. The essence of enforcement under the Code lies in the power of the Internal Revenue Service to grant or disallow qualified status to a pension plan, thus determining the availability of statutory tax advantages. The Internal Revenue Service jurisdiction and enforcement capabilities are solely to allow various tax advantages to accrue to employers who establish and maintain pension plans which can qualify for such tax benefit privileges.

In the absence of adequate federal standards, the participant is left to rely on the traditional equitable remedies of the common law of trusts. A few states, including New York, Washington, Wisconsin,

[5] Massachusetts, and California have codified existing trust principles and enacted legislation which requires in many instances a degree of disclosure similar to that required by federal statute.

The fact that statutory rules exist says little as to their efficacy in adjusting inequities that are visited upon plan participants, as evidenced by the hearings before this Committee. In almost every instance, participants lose their benefits not because of some violation of federal law, but rather because of the manner in which the plan is executed with respect to its contractual requirements of vesting or funding. Courts strictly interpret the plan indenture and are reluctant to apply concepts of equitable relief or to disregard technical document wording. Thus, under present law, accumulated pension credits can be lost even when separated employees are within a few months, or even days, of qualifying for retirement.

The proposed bill would, therefore, establish minimum standards of vesting, funding, and fiduciary and a system of compulsory benefit insurance to protect the security of pension rights.

As suggested by the President's Cabinet Committee Report of 1965; "As a matter of equity and fair treatment an employee covered by a pension plan is entitled, after a reasonable period of service, to protection of his future retirement benefit against any termination of his employment." Concern for loss of benefits by workers after long years of labor through circumstances beyond their control was similarly expressed by President Richard M. Nixon on December 8, 1971, when, in a message to the Congress he said, "When a pension plan is terminated, an employee participating in it can lose all or a part of the benefits which he has long been relying on, even if his plan is fully vested . . . even one worker whose retirement security is destroyed by the termination of a plan is one too many."

III. Major Issues

Although the need for legislative reform has been and continues to be widely acknowledged among all persons and sectors affected, federal mandation of essential improvements has been resisted due to the belief that such legislation might impede plan growth. However, the Committee's inquiries have revealed that the costs associated with the vesting and funding proposals in the Act are sufficiently modest as not to constitute a major impediment to plan growth. Additionally, any added cost attributable to the imposition of vesting and funding standards will innure directly to the benefit of the participants in each plan in the form of increased availability of benefits and added security.

The principal issues affecting the vital and basic needs for legislation involve consideration of the essential elements of pensions:

A. VESTING

One of the major private pension plan considerations centers around the concept of vesting. Vesting refers to the nonforfeitable right of interest which an employee participant acquires in the pension fund. The benefit credits may vest in the employee immediately, although in most cases participants do not become eligible for vesting of benefits until a stipulated age or period of service, or a combination of both, is attained.

[6] Upon compliance with the basic requirements of age or service, many plans will grant their participants vested rights to those benefits earned to that time. However, should employment terminate prior to such time, the employee will receive no benefits. Some pension plans, however, specify "graded" vesting formulas, whereby only a defined percentage of the accrued benefits earned will vest upon fulfillment of minimum requirements, and such percentage may increase periodically, as the employee continues in his employment and completes additional service.

Despite the recognized and acknowledged need for pension plans to provide for vesting of earned benefits, if pension promises are to be meaningful to workers, there is need for federal statutory requirements which will compel an employer to grant such vesting benefits. The difficulties and hardships resulting from non-existent or inadequate plan provisions for vesting of benefits have been vividly established by the Committee's studies and hearings.

It is noteworthy that in 1965, the President's Commission on Public Policy and Private Pensions, while acknowledging that there had been some improvement in private plans by increased adoption of vesting provisions, nonetheless found and recommended legislation to make minimum vesting provisions mandatory. That Commission concluded that ". . . the degree of retirement protection in private pension plans varies widely and in many cases remains quite inadequate." (President's Committee on Corporate Pension Funds and other Private Retirement and Welfare Programs, Public Policy and Private Pension Programs: A Report to the President on Private Employee Retirement Plans, January, 1965, p. 39).

The vesting concept recommended by the Cabinet Committee suggested preference for deferred graded vesting. It specifically favored a vesting formula under which 50 percent of an accrued pension would be vested in a plan participant upon completion of 15 years of service, with rights to full vesting of accrued pension credits to occur after 20 years of service. In general, although there has been some discernible progress to permit early vesting of benefits to employees, some employers incline to defer such vesting until the employee reaches a normal or early retirement eligibility formula. This is essentially based upon the belief that it will discourage and deter such employee from leaving the job before reaching retirement age.

Despite claims by opponents that progress made in pension plan provisions to provide vesting manifest movement toward an eventual voluntary vesting system, plans involving substantial numbers of workers which contain no vesting are still not uncommon. Opponents of mandatory vesting believe that compulsory vesting provisions will discourage development of new plans and impede flexibility and latitude in formulating employee benefits because of excessive costs that are certain to result. However, in the face of Committee findings relative to projected costs to plans for imposed vesting, indications are that the resistance of opponents to universal vesting is essentially structured upon extreme reluctance to submit to governmental regulatory measures concerning pension plan administration and operations. In its final analysis, the issue basically resolves itself into whether workers, after many years of labor, whose jobs terminate voluntarily or otherwise, should be denied benefits that have been placed for them in a fund for retirement purposes.

[7]

B. FUNDING

Another major issue in private pension plans relates to the adequacy of plan funding. "Funding" refers to the accumulation of sufficient assets in a pension plan to assure the availability of funds for payment of benefits due to the employees as such obligations arise. Today, funding of pension plans for the limited and specific purpose of qualifying for tax benefits permitted by law for contributions made is governed by statutory and regulatory requirements which are under the jurisdiction of the Internal Revenue Service (I.R.S. Code of 1954, Sections 401–404). The minimum funding rules (Treasury Regulations, Sections 1.401–404(c) (1963)) require an employer to make contributions to a pension fund, qualified by the Internal Revenue Service, of amounts at least equal to the pension liabilities being created currently, and the interest due upon those amounts of monies which reflect unfunded accrued liabilities. The inherent weakness of this required minimum funding is that the employer is not required under law to make payments toward the principal of the unfunded accrued liabilities. Without mandatory funding of past service liabilities, a pension plan may never be in a financial posture to meet its pension obligations to its employees.

The pension plan which offers full protection to its employees is one which is funded with accumulated assets which at least are equal to the accrued liabilities, and with a contribution rate sufficient to maintain that status at all times. However, since plans are revised and amended to provide new benefits which create new and different liabilities for the plan, opponents of compulsory funding argue that it is unrealistic to expect that plans maintain a full funding status at all times. The same opposition is voiced for new plans, which invariably assume a large unfunded liability at the outset of the plan, due to the granting of credit for past service by employees to the employer.

The ineffectiveness of funding requirements was acknowledged in the President's Cabinet Committee Report of 1965, when it concluded that ". . . the minimum standards for funding under present tax law do not assure adequate funding. The setting of standards for adequate funding therefore becomes an important public concern." (Public Policy and Private Pension Programs, 1965, pp. 50–51). The promise and commitment of a pension can be fulfilled only when funds are available to pay the employee participant what is owed to him. Without adequate funding, a promise of a pension may be illusory and empty.

C. FIDUCIARY RESPONSIBILITY AND DISCLOSURE

Another area of concern of the Subcommittee has involved the conduct of administration and operations of pension plans. Of particular interest has been the course of conduct in fund transactions, the degree of responsibility required of the fiduciaries, the types of persons who should be deemed pension "fiduciaries," and the standards of accountability they shall be governed by in the management and disposition of pension funds. The only current federal requirement is that the Secretary of Labor require fiduciaries, trustees, etc., to make disclosure of the provisions and financial operations of the pension plan under the Welfare and Pension Plans Disclosure Act.

[8] An important issue relates to the effectiveness of communication of plan contents to employees. Descriptions of plans furnished to employees should be presented in a manner that an average and reasonable worker participant can understand intelligently. It is grossly unfair to hold an employee accountable for acts which disqualify him from benefits, if he had no knowledge of these acts, or if these conditions were stated in a misleading or incomprehensible manner in plan booklets. Subcommittee findings were abundant in establishing that an average plan participant, even where he has been furnished an explanation of his plan provisions, often cannot comprehend them because of the technicalities and complexities of the language used.

IV. Committee Studies and Activities

The General Subcommittee on Labor, pursuant to House Resolution 225, 93d Congress, February 20, 1973 and a prior resolution from the 92d Congress, has conducted a comprehensive and exhaustive study of the private pension system in the United States, with particular emphasis on the impact which such plans have upon the workers covered. The Subcommittee's implementation of the House Resolutions has been a methodical collection and analysis of vital statistics and information from individual and group cases reflecting the internal administration and operations of private pension and welfare plans. An interim staff report was issued in April of 1972 and an in-depth analysis of the cost of vesting proposals was published in February of 1973. During February, March, April and May over twenty days were devoted by the Subcommittee to taking testimony on pension reform issues. These hearings were conducted in Washington, D.C., Pittsburgh, Pennsylvania, Waterbury, Connecticut, Chicago, Illinois, South Bend, Indiana, Seattle, Washington, Honolulu, Hawaii, and San Francisco, California.

Because of the Subcommittee's concern for the cost impact of mandated vesting requirements, an outside consultant, Dr. Howard Winklevoss, Associate Professor of Insurance at the Wharton School of Finance, was retained to prepare an analysis of the various vesting cost proposals. This analysis utilized the computer facilities of both the Wharton School and the House. The complete text of this analysis was published in February 1973.

V. Committee Action

The Committee endorses the concept of a comprehensive private pension reform program. It believes that expeditious enactment of H.R. 2 will institute a program which will achieve a strengthening of the role played by private retirement plans within the fabric of our economic and social structures. Its most important purpose will be to assure American workers that they may look forward, with anticipation, to a retirement with financial security and dignity, and without fear that this period of life will be lacking in the necessities to sustain them as human beings within our society. The enactment of progressive and effective pension legislation is also certain to increase stability within the framework of our nation's economy, since the tremendous resources and assets of the private pension plan system are an integral part of our economy. It will also serve to restore credibility and faith

[9] in the private pension plans designed for American working men and women, and this should serve to encourage rather than diminish efforts by management and industry to expand pension plan coverage and to improve benefits for workers.

The Committee believes that the legislative approach of establishing minimum standards and safeguards for private pensions is not only consistent with retention of the freedom of decision-making vital to pension plans, but in furtherance of the growth and development of the private pension system. At the same time, the Committee recognizes the absolute need that safeguards for plan participants be sufficiently adequate and effective to prevent the numerous inequities to workers under plans which have resulted in tragic hardship to so many.

The Bill reported by the Committee represents an effort to strike an appropriate balance between the interests of employers and labor organizations in maintaining flexibility in the design and operation of their pension programs, and the need of the workers for a level of protection which will adequately protect their rights and just expectations. In adopting this approach, the Committee believes it has designed a bill, which, like the National Labor Relations Act, the wage-hour laws and other labor standards laws, brings the workers' interests up to parity with those of employers. This legislation strikes an appropriate and equitable balance between two opposing schools of thought—those who advocate complete and stringent control of private pensions and those who oppose any form of government supervisory or regulatory control.

The Act does provide for coverage of public employee plans under Title I but excludes them from the other substantive provisions. The Committee is convinced that legislation seeking reform in the public sector must proceed with a thorough study of the effects of such proposals. There are literally thousands of public employee retirement systems operated by towns, counties, authorities and cities in addition to the state and Federal plans. Eligibility, vesting, and funding provisions are at least as diverse as those in the private sector with the added uniqueness added by the legislative process. For this reason the Committee is convinced that additional data and study is necessary before any attempt is made to address the issues of vesting and funding with respect to public plans.

The Committee on Education and Labor ordered H.R. 2 reported unanimously on September 25, 1932.

ESTIMATE OF COSTS

In accordance with clause 7 of Rule XIII the Committee estimates that the projected cost of administering this act will not exceed that amount currently being expended for the present act.

VI. Committee Views

POLICY OF "EMPLOYEE BENEFIT SECURITY ACT"

Underlying the provisions of this Act is a recognition of the necessity for a comprehensive legislative program dealing not only with

[10] malfeasance and maladministration in the plans, or the consequences of lack of adequate vesting, but also with the broad spectrum of questions such as adequacy of funding, plant shut downs and plan terminations, adequate communication to participants, and, in short, the establishment of certain minimum standards to which all private pension plans must conform if the private pension promise is to become real rather than illusory.

DEFINITIONS

The Committee has the following technical notes concerning definitions:

The definition of "employee" is intended to encompass any person who has the status of an "employee" under a collective bargaining agreement.

The exclusion of assets of investment companies regulated under the Investment Company Act of 1940 from the definition of "fund" is not intended to exclude participating shares in an investment company held by the fund.

With respect to the term "profit-sharing retirement plan", it is intended that stock bonus, thrift and savings or similar plans with retirement features be treated as the equivalent of profit-sharing retirement plans for purposes of this Act unless expressly indicated otherwise.

With respect to the term "normal service cost", it is intended that this definition be applied consistent with such cost methods recognized by the Internal Revenue Service unless there is an effort to avoid or evade the funding requirements of this Act.

With respect to the term "non-forfeitable right" or "vested right", it is not contemplated that vesting be required in benefits such as death benefits, disability benefits, or other forms of ancillary benefits provided by the plan. The plan may, of course, at its option, provide for vesting in such benefits.

With respect to "adequate consideration," it is intended that this term be read to include the fair market value of the use of leased property.

In formulating the definition of "multi-employer plan" the Committee was guided by the concept that such a plan, if sufficiently comprehensive in size or scope, would be unlikely to terminate because its existence did not depend on the economic fortunes of one employer or employer entity. The Committee recognized that certain single employer plans have characteristics similar to those of the multi-employer type described in the definition, but, on balance, it is believed that experience on plan terminations provides a reasonable basis for the distinction.

Title I—Disclosure and Fiduciary Standards

Title I represents a major departure from current law. First, by additions to and changes in the reporting requirements designed to disclose more significant information about plans and the transactions engaged in by those controlling plan operations and to provide specific data to participants and beneficiaries concerning the rights and benefits they are entitled to under the plans and the circumstances

[11] which may result in their not being entitled to benefits. Second, by the addition of a new section setting forth responsibilities and proscriptions applicable to persons occupying a fiduciary relationship to employee benefit plans, including a "prudent man" standard for evaluating the conduct of all fiduciaries, and by barring from responsible fiduciary provisions in such plans for a period of five years all persons convicted of certain listed criminal offenses.

REPORTING AND DISCLOSURE

The underlying theory of the Welfare and Pension Plans Disclosure Act to date has been that reporting of generalized information concerning plan operations to plan participants and beneficiaries and to the public in general would, by subjecting the dealings of persons controlling employee benefit plans to the light of public scrutiny, insure that the plan would be operated according to instructions and in the best interests of participants and beneficiaries. The Secretary's role in this scheme was minimal. Disclosure has been seen as a device to impart to employees sufficient information and data to enable them to know whether the plan was financially sound and being administered as intended. It was expected that the information disclosed would enable employees to police their plans. But experience has shown that the limited data available under the present Act is insufficient. Changes are therefore required to increase the information and data required in the reports both in scope and detail. Experience has also demonstrated a need for a more particularized form of reporting so that the individual participant knows exactly where he stands with respect to the plan—what benefits he may be entitled to, what circumstances may preclude him from obtaining benefits, what procedures he must follow to obtain benefits, and who are the persons to whom the management and investment of his plan funds have been entrusted. At the same time, the safeguarding effect of the fiduciary responsibility section will operate efficiently only if fiduciaries are aware that the details of their dealings will be open to inspection, and that individual participants and beneficiaries will be armed with enough information to enforce their own rights as well as the obligations owed by the fiduciary to the plan in general.

FIDUCIARY RESPONSIBILITY

A fiduciary is one who occupies a position of confidence or trust. As defined by the Act, a fiduciary is a person who exercises any power of control, management or disposition with respect to monies or other property of an employee benefit fund, or who has authority or responsibility to do so. It is not the intent of the Committee, however, that where the sole power of control, management or disposition with respect to plan funds rests with the participants themselves, as may be the case with respect to certain plans where the participant has the sole discretion over an individual account established in his name, that such participants shall be regarded as fiduciaries. The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts. The section was deemed necessary for several reasons.

[12] First, a number of plans are structured in such a way that it is unclear whether the traditional law of trusts is applicable. Predominantly, these are plans, such as insured plans, which do not use the trust form as their mode of funding. Administrators and others exercising control functions in such plans under the present Act are subject only to minimal restrictions and the applicability of present State law to employee benefit plans is sometimes unclear. Second, even where the funding mechanism of the plan is in the form of a trust, reliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries. This is because trust law had developed in the context of testamentary and inter vivos trusts (usually designed to pass designated property to an individual or small group of persons) with an attendant emphasis on carrying out the instructions of the settlor. Thus, if the settlor includes in the trust document an exculpatory clause under which the trustee is relieved from liability for certain actions which would otherwise constitute a breach of duty, or if the settler specifies that the trustee shall be allowed to make investments which might otherwise be considered imprudent, the trust law in many states will be interpreted to allow the deviation. In the absence of a fiduciary responsibility section in the present Act, courts applying trust law to employee benefit plans have allowed the same kinds of deviations, even though the typical employee benefit plan, covering hundreds or even thousands of participants, is quite different from the testamentary trust both in purpose and in nature.

Third, even assuming that the law of trusts is applicable, without detailed information about the plan, access to the courts, and without standards by which a participant can measure the fiduciary's conduct he is not equipped to safeguard either his own rights or the plan assets. Furthermore, a fiduciary standard embodied in Federal legislation is considered desirable because it will bring a measure of uniformity in an area where decisions under the same set of facts may differ from state to state. It is expected that courts will interpret the prudent man rule and other fiduciary standards bearing in mind the special nature and purposes of employee benefit plans intended to be effectuated by the Act.

Finally, it is evident that the operations of employee benefit plans are increasingly interstate. The uniformity of decision which the Act is designed to foster will help administrators, fiduciaries and participants to predict the legality of proposed actions without the necessity of reference to varying state laws.

It is to be noted that the definition of "employee benefit fund" excludes assets of an investment company regulated under the Investment Company Act of 1940 but any participating shares held by the employee benefit fund in an investment company are assets of the fund and subject to coverage under this section.

The Committee also has made provision for contributory plans to equitably distribute any surplus funds remaining on plan termination to the participants in accordance with their rate of contribution. This requirement is applicable only after plan assets have been used to satisfy all liabilities. The Committee believes it is unfair to permit the complete recapture by employers of surplus funds in terminated contributory plans, without regard to the fact that contributions by

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[13] the workers helped to generate the surplus. The Committee wishes to emphasize that while it is not passing judgment on any particular case now pending, it has concluded that equitable principles require that this particular subject be governed by a specific rule which reflects what the Committee regards as essential protection for the interests of workers in such plans.

The principles of fiduciary conduct are adopted from existing trust law, but with modifications appropriate for employee benefit plans. These salient principles place a twofold duty on every fiduciary: to act in his relationship to the plan's fund as a prudent man in a similar situation and under like conditions would act, and to act consistently with the principles of administering the trust for the exclusive purposes previously enumerated, and in accordance with the documents and instruments governing the fund unless they are inconsistent with the fiduciary principles of the section.

There follows a list of proscriptions which represent the most serious type of fiduciary misconduct which in one way or another has occurred in connection with some welfare or pension plans. While the magnitude of these improper practices is small in relation to the total number of plans in existence, the seriousness of the improper practices disclosed indicates the need for additional precautions to insure that these specific examples do not become general conditions. The list of proscriptions is intended to provide this essential protection.

Title II—Vesting

Section 201 provides that no pension plan shall require, as a condition for eligibility to participate, a period of service longer than one year or an age greater than 25, whichever occurs later; however, a plan which provides 100% immediate vesting upon entry into plan, may restrict participation to those who are 30 years of age or have three years of service, whichever occurs later.

Earlier eligibility standards were considered and appeared to impose an unwarranted additional cost on plans. Additionally, the Committee believes on the basis of substantial evidence presented that until age 25 a large portion of the work force is still transient and accounting for such employees would impose unduly burdensome and costly record-keeping requirements on plan administrators. The Committee believes that an age 25 entry standard approaches the norm for the majority of plans today.

The exception for plans which provide 100% full vesting upon plan entry is based on the fact that such plans, like the TIAA-CREF plan for college teachers, provide earlier vesting in larger amounts than provided under the bill, and requiring such plans to install earlier membership requirements would impose burdens well beyond the minimum standards approach intended by the Committee, and might compel such plans to sacrifice immediate full vesting on plan entry.

The Act presumes that promised pension benefits are in the form of a conditional deferred wage. While popular attention focuses on the deferred wage aspect of pensions, the Act recognizes that the pension promise is conditional upon completion of minimum periods of service. The imposition of equitable standards to limit the conditions precedent to receipt of pension rights will eliminate most of the situations where workers have lost out on their pensions.

[14] The alternative vesting standards provided for under the bill should impact individual participants on a roughly equivalent basis. The potential for manipulation by carefully shopping for the most stringent standard to limit the incidence of vesting is considered to be modest. In all cases some vesting will occur no later than 10 years after initial employment and full vesting will occur between the 10th and 15th year of employment.

The Committee has endorsed a major innovation which provides for retrospective credit in accrued benefits attributable to service rendered prior to the effective date of the vesting provisions.

Title III—Funding

The Committee believes that actuarially sound funding procedures are indispensable to effective implementation of the purposes of the Act. If employers never went out of business or terminated pension plans before they were completely funded, there would, no doubt, be no persuasive justification for funding standards aside from whatever tax considerations might be applicable. Nevertheless, employers do experience financial or economic difficulties or they undergo varying degrees of corporate reorganization, all of which can lead to premature termination of underfunded plans. A plan termination insurance program provides the essential safeguard to the rights of workers who are trapped by these unforeseen economic hazards but such a program cannot be made practical without being coupled to required standards of funding. To create a plan termination insurance program without appropriate funding standards would permit those who present the greatest risk in terms of exposure to benefit at the expense of employers who have developed conscientious funding programs. The funding standards contained in the Act are designed to lessen that unnecessary exposure by requiring every plan to be funded in a manner which will fully amortize unfunded liabilities.

The basic rights granted by the imposition of vesting standards are of real benefit to the participant only to the extent that adequate provision is made to pay the benefits when due. The vesting standards may be viewed as controlling the volume of the benefit promises made by the plan and the funding provisions as controlling the quality of those promises. The Act recognizes as a basic principle that defined benefit pension plans must be funded on some regular and current fashion. All current accruals of benefits based on current service are required to be paid for immediately. To the extent that a plan has offered benefits not based on current service, i.e. past service credit, the present value of such benefits is required to be amortized over a period of time not to exceed forty years, but over a shorter time period (not less than 30 years) if the average period remaining until retirement is very short.

Title IV—Plan Termination Insurance

Section 401.—Establishment and Applicability of Program

The bill reported by the Committee requires plan termination insurance to cover unfunded vested liabilities incurred prior to, as well as subsequent to, enactment of the Act, in order to prevent employees from being deprived of insurance protection for retirement credits earned before enactment.

[15] The Secretary may provide insurance to plans to cover unfunded vested liabilities of a plan not subject to the Act so long as there is compliance with the vesting, funding and other requirements of the Act and the plan pays the requisite assessments and premiums. This is intended to make insurance coverage under the Act available on a voluntary basis to plans not subject to the Act.

Section 403.—Assessments and premiums

The Committee adopted a provision which requires an initial three-year premium to be paid by the plan, as follows:

(a) For funded vested liabilities incurred after enactment—0.2 percentum of unfunded vested liabilities;

(b) For unfunded vested liabilities incurred prior to enactment—0.2 percentum of unfunded vested liabilities provided the plan was 75 percent funded during the five-year period preceding Act, or if the plan is less than five years old on date of enactment, and if it was reducing unfunded vested liabilities at rate of five percent each year;

(c) For unfunded vested liabilities incurred prior to Act, but where the funding tests above in (b) have not been met—more than .4 percentum and not less than 0.2 percentum of such unfunded vested liabilities;

(d) As to multi-employer plans, both as to unfunded vested liabilities incurred before or after Act—not to exceed 0.2 percentum of all such unfunded vested liabilities.

In order to minimize the risk of shifting to the reinsurance program substantially all unfunded liabilities created prior to enactment, it was believed essential to create two classes of risks for purposes of setting the premium rate. If the plan was being funded in an adequate fashion, i.e., was 75 percent funded or was amortizing unfunded vested liabilities at the rate of five percent each year, it was believed that such a plan was an acceptable risk and the .2 percentum premium rate was appropriate. In the event the plan did not meet the test of funding adequacy, as indicated, it falls in the category of being a higher risk and therefore, can be charged up to twice the amount of normal premium, but no more. Since multi-employer plans, as defined in the bill, have a much lower risk of plan termination, it was believed appropriate to continue charging the .2 percent premium regardless of when the unfunded vested liabilities were incurred.

Section 404.—Payment of Insurance

There are a variety of circumstances under which pension plans terminate. In some cases, the termination proceeds by stages. In other cases, it may happen fairly rapidly. In order to carry out the purpose of the reinsurance program while at the same time protecting the program from undue exposure owing to delays, manipulation, or unforeseen economic hazards following plan termination, the Secretary is provided with sufficient flexibility to determine the most appropriate procedure for winding up terminated plans and assuring effective implementation of the insurance program.

It is also required that plans furnish to the Secretary adequate prior notice of intent to terminate the plan. Persons responsible for giving such notice who fail to do so, or who terminate plans in order to circumvent or avoid the Act, are held personally liable for losses sustained by the insurance program.

[16] *Section 405.—Recovery*

The Committee recognizes that in order to provide adequate protection to employees against loss of vested benefits owing to premature plan termination, it is necessary for the insurance program to cover all forms of plan termination regardless of the circumstances giving rise to the termination. The Committee also recognized that some degree of employer liability was essential where the employer was not insolvent at the point of plan termination in order to preclude abuse by shifting the financial burden to the plan termination insurance program despite the fact that the employer had available funds to continue funding the plan.

One approach to this problem would be to require financially responsible employers to, in effect, act as self-insurers for the unfunded vested liabilities and those who are not financially responsible to obtain plan termination insurance. This approach, which is supported by precedent in the field of workmen's compensation, for example, was considered and rejected because of the potentially enormous liabilities involved. To require the Secretary to evaluate the financial capabilities of particular employers to assume such potentially enormous liabilities might have an adverse effect on the employer's competitive position and on his continued healthy growth.

Having determined that participation in the plan termination insurance program was essential for all plans, and that some degree of employer liability was necessary, the question of the degree of such liability becomes important. The Committee had concern that if the degree of liability was absolute to the extent of the employer's assets, it might drive some employers to the brink of bankruptcy, impose substantial economic hardship, or discourage the establishment of plans or the reasonable liberalization of benefits.

Accordingly, the Committee endorsed a formula of employer liability which requires the employer to reimburse the plan termination insurance program for the total amount of insurance paid, but in no event greater than 50% of employer's net worth at time of plan termination.

In addition, as a result of plan termination field hearings held by the Subcommittee, numerous instances were disclosed where acquiring companies that terminated pension plans failed to take over the liability for vested benefits owed to the employees of the predecessor company. Since this circumstance could also arise in connection with the reinsurance provision, it is necessary to strengthen the reinsurance provisions by requiring successors-in-interest to be liable for reimbursements owned by predecessor companies.

In order to make the liability of the employer for reimbursement of insurance paid meaningful, it was considered essential to provide a mechanism for enforcement of such liability through giving the government a lien on employer property for unpaid amounts due.

With respect to the Secretary's authority to treat portions of multiemployer plans as terminated for purposes of applying the plan termination insurance provisions, it should be noted that the contributing employers in such arrangements are free to arrange indemnification agreements among themselves in connection with the plan's application for insurance coverage under Title IV, so that employer liability for reimbursement of insurance paid under Title IV can be allocated under terms that the parties themselves have agreed to as equitable.

The enforcement provisions have been designed specifically to provide both the Secretary and participants and beneficiaries with broad remedies for redressing or preventing violations of the Act. The intent of the Committee is to provide the full range of legal and equitable remedies available in both state and federal courts and to remove jurisdictional and procedural obstacles which in the past appear to have hampered effective enforcement of fiduciary responsibilities under state law for recovery of benefits due to participants. For actions in federal courts, nationwide service of process is provided in order to remove a possible procedural obstacle to having all proper parties before the court.

Except where plans are not subject to this Act and in certain other enumerated circumstances, state law is preempted. Because of the interstate character of employee benefit plans, the Committee believes it essential to provide for a uniform source of law in the areas of vesting, funding, insurance and portability standards, for evaluation of fiduciary conduct, and for creating a single reporting and disclosure system in lieu of burdensome multiple reports. As indicated previously, however, the Act expressly authorizes cooperative arrangements with state agencies as well as other federal agencies, and provides that state laws regulating banking, insurance or securities remain unimpaired.

The Act makes it unlawful for any person to discharge, fine, suspend, expel, discipline or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of the plan or the Act, or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan or the Act.

The Act makes it a criminal offense for any person to use fraud, force, or violence or threats thereof to restrain, coerce, intimidate or attempt to restrain, coerce, intimidate any participant or beneficiary for the purpose of interfering with or preventing the exercise of any right to which he is or may become entitled under the plan, or the Act.

Although the instances of these occurrences are relatively small in number, the Committee has concluded that safeguards are required to preclude this type of abuse from being carried out and in order to completely secure the rights and expectations brought into being by this legislation.

VII. SECTION-BY-SECTION ANALYSIS

PURPOSES

The Employee Benefit Security Act is designed (1) to establish minimum standards of fiduciary conduct for Trustees, Administrators and others dealing with retirement plans, to provide for their enforcement through civil and criminal sanctions, to require adequate public disclosure of the plan's administrative and financial affairs, and (2) to improve the equitable character and soundness of private pension plans by requiring them to: (a) vest the accrued benefits of employees with significant periods of service with an employer, (b) meet minimum standards of funding and (c) guarantee the adequacy of the

[18] plan's assets against the risk of plan termination prior to completion of the normal funding cycle by insuring the unfunded portion of the benefits promised.

Section 2. Findings and declaration of policy

Section 3. Definitions:

1. Employee Welfare Benefit Plan
2. Employee Pension Benefit Plan
3. Employee Benefit Plan (or Plan)
4. Employee Organization
5. Employer
6. Employee
7. Participant
8. Beneficiary
9. Person
10. State
11. Commerce
12. Industry or Activity Affecting Commerce
13. Secretary
14. Party in interest
15. Relative
16. Administrator
17. Separate Account
18. Adequate Consideration
19. Nonforfeitable (Pension Benefit or Right)
20. Security
21. Fiduciary
22. Regular Retirement Benefit
23. Accrued Portion of the Regular Retirement Benefit
24. Regular Retirement Age
25. Vested Liabilities
26. Current Value
27. Present Value
28. Investment Company not a Fiduciary
29. Normal Service Cost
30. Present Value of an Annuity Certain
31. Accrued Liability
32. Multi-Employer Plan
33. Unfunded Accrued Liability
34. Advanced Funding Actuarial Cost Method (Actuarial Cost Method)

TITLE I—FIDUCIARY RESPONSIBILITY AND DISCLOSURE

Section 101. Coverage

Title I would cover all private employee benefit plans under Commerce Clause jurisdiction except:

1. Plans of the Federal government;
2. Plans required under workmen's compensation, unemployment compensation, and disability insurance laws;
3. Plans established or maintained outside the United States for the benefit of non-United States citizens;
4. Unfunded deferred compensation schemes of top executives.

Section 102. Duty of disclosure and reporting

The administrator of a pension or welfare plan would be required to publish to each participant or beneficiary a description of the plan as set forth in section 103 and a summary of the annual financial report as set forth in section 104. The report would be in such form and detail as the administrator finds necessary to disclose fully and fairly all pertinent facts.

Upon termination of a pension or welfare plan, the administrator would be required to file a special terminal report as prescribed by the Secretary of Labor.

Section 103. Description of the plan

Plan descriptions would be required to be published within 120 days after the establishment of a plan or within 120 days after a plan be-

[19] comes subject to this title, whichever is later. Amendments to plans would have to be published within 120 days, and descriptions would have to be republished at least every five years. The description would have to be comprehensive and written in a manner calculated to be understood by the average plan participant. Among other things it would have to include: the name and address of the administrator; the schedule of benefits; a description of the plan's vesting provisions; the source of the plan's financing; and the procedures to be followed in presenting claims for benefits as well as those for appealing claims which are denied.

Section 104. Annual reports

An annual financial report to the Secretary of Labor would be required by this section for all plans. Sec. 105 provides that the Secretary shall exempt plans with less than 26 and may exempt plans with less than 100 participants. Information required in the report would include:

An audit and opinion by an independent qualified public accountant (with exceptions for public plans and when financial statements are certified by a bank or insurance carrier);

An actuarial statement of valuation (where appropriate) accompanied by a certification from the actuary preparing the valuation;

The number of employees, benefits paid, and information fiduciaries, trustees and administrators and compensation paid them;

A summary financial statement of assets and liabilities;

A summary of receipts and disbursements;

A schedule of all assets listed by issuer;

A schedule of known party-in-interest transactions;

A schedule of loans which are in default and uncollectible;

A schedule of leases which are in default and uncollectible;

A bank or insurance carrier statement of assets and liabilities for common and collective trusts.

If some or all of the plan's assets are held in common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier, the bank or carrier would also be required to file a statement of assets and liabilities.

If some or all of the benefits under the plan are provided by an insurance carrier or other organization, such report would also have to include: The premium rate or subscription charge and the total premium or subscription charges paid to each carrier and the approximate number of persons covered by each class of benefits; the total premiums received, the approximate number of persons covered by each class of benefits, and the total claims paid by such carriers, or, if separate experience ratings are not kept, a statement as to the basis of a carrier's premium rate or a copy of the financial report of the carrier.

Section 105. Publication

The Secretary would be authorized to reject any report which after a hearing before him was found to be incomplete or to contain a qualified opinion by an accountant or an actuary.

A copy of the plan description and each annual report would have to be filed with the Secretary of Labor who would make them available for inspection in the public document room of the Department of

[20] Labor. The administrator would be required to make copies of the annual report and plan description as well as the bargaining agreement, and trust instrument creating the plan available for examination by any plan participant or beneficiary in the administrator's principal office, and in such other places as necessary to fully and fairly disclose all pertinent facts.

All pension and welfare plan participants would be furnished with a copy of the plan description initially and at the time of amendment, including:

A schedule of benefits;
Eligibility and vesting provisions;
Claim procedures and remedies;
Basis of financing;
Other relevant plan provisions affecting their rights and the annual report, including a summary financial statement of assets and receipts and disbursements, and the ratio of assets to value of nonforfeitable pension benefits.

Upon written request to the plan administrator, a participant could receive a copy of a statement as to his or her rights and the amount of any nonforfeitable benefit; and a copy of the plan, trust, bargaining agreement or other document. All newly vested would receive notification at the time their benefits became nonforfeitable. These copies would be furnished at the cost of reproduction.

Upon termination, all pension plan participants would receive a statement showing his or her benefits, indicating when and how they may be claimed, and including any other information affecting their rights.

A statement of a pension plan participant's right to deferred vested benefits from former pension plans would be furnished upon request to the Social Security Administration and when action is taken on the participant's Social Security account. To assure timely filings and payment of vested benefits, the address and identity of all plans would be kept up-to-date.

Section 106. Disclosure of benefit rights to participants

The administrator is required to inform each participant when his benefits become nonforfeitable. Upon written request of any participant or beneficiary, the administrator is required to disclose the rights of that participant.

Violation of the provisions dealing with the retention of records subjects a person to a fine of up to $5,000 and/or imprisonment of up to two years. Violations of the provisions of 111(b)(2) (dealing with prohibited transactions) would subject a person to a fine of up to $10,000 and/or up to five years' imprisonment.

This section would give the Secretary of Labor authority to investigate any plan. He would be given authority to demand sufficient information as he may deem necessary to enable him to conduct his investigations.

Plan participants, beneficiaries, or the Secretary of Labor on behalf of the participants and beneficiaries would be allowed to bring civil actions to redress breaches of a fiduciary's responsibility or to remove a fiduciary who has failed to carry out his duties. The Secretary would also be empowered to bring an action to enjoin any act or practice

[21] which appears to him to violate the title. Civil actions brought by a participant or beneficiary may be brought in any court, State or Federal. However, the Secretary would have the right to intervene in a case and remove it to a Federal district court. In any actions by a participant or beneficiary, the court could, at its discretion, allow reasonable attorneys' fees and costs of action to either party. Class actions shall be brought where requirements for class actions could be met.

Section 107.

All reports filed with the Secretary shall be public information.

Section 108.

Detailed records must be retained for six years.

Section 109.

Proven reliance upon a regulation or written interpretation by the Secretary of Labor would constitute a defense in a criminal or civil proceeding under certain sections of the act.

Section 110.

Every person subject to the fiduciary provisions of the act would have to be bonded.

Section 111. Fiduciary responsibility

This section would deem every employee benefit fund to be a trust held for the exclusive purpose of providing benefits to participants and their beneficiaries as well as defraying reasonable administrative expenses. Each plan would have to be in writing.

A fiduciary is defined in section 3 (29) as anyone who exercises any power of control, management or disposition with regard to a fund's assets or who has authority to do so or who has authority or responsibility in the plan's administration. Fiduciaries would be required to discharge their duties with respect to the fund ". . . solely in the interest of the participants and with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

A fiduciary would also have to diversify the investments, except in the case of profit-sharing, stock bonus, or thrift and savings plans, so as to minimize the risk of large losses unless under the circumstances it is prudent not to do so and in accordance with the documents and instruments governing the fund.

A fiduciary would be specifically prohibited from making the following transactions:

Dealing with such fund for his own account . . .

Acting in any transaction involving the fund on behalf of a party adverse to the interests of the plan or participants . . .

Receiving personal consideration from any party dealing with the fund in connection with a transaction involving the fund . . .

Transferring property to any party in interest for less than adequate consideration . . .

Permitting the acquisition of property from any party in interest for more than adequate consideration.

[22] *Section 112. Pension plan termination*

An equitable priority distribution of assets would be provided upon plan termination. Assets not previously allocated to individual accounts would have to be distributed according to the following priorities:

(a) Contributions by employees would be returned;

(b) Those presently receiving benefits and those who could voluntarily elect to receive benefits;

(c) Those other than in (b)—to the extent of their vested benefits;

(d) All others, including the non-vested benefits of those in (c).

Benefit increases within the five years prior to plan termination would trigger an allocation based on the prior benefit formula, any remaining assets being distributed on the basis of increases in the more recent benefit formulas:

(e) Investment income attributable to employee contributions would be distributed pro rata to the employees' accounts.

(f) Any benefit liabilities incurred as a result of plan termination would be given last priority.

(g) Any remaining assets would be returned to the employer if the plan so provides; otherwise, they would be distributed pro ratably to the employees.

Section 113.

Certain persons convicted of crimes may not serve as officers, administrators, trustees, or paid consultants.

Section 114.

A 15-member Advisory Council on Employee Welfare and Pension Benefit Plans would be established.

Section 115.

The Welfare and Pension Plans Disclosure Act would be repealed upon the effective date of the act, which would be six months after enactment.

TITLE II—VESTING AND ELIGIBILITY REQUIREMENTS

Section 201. Coverage

Title II would cover all private pension benefit plans including profit-sharing plans which provide benefits after retirement, except:

1. Federal, State and local plans;

2. Keogh plans benefiting the self-employed and owner-employees;

3. Plans established or maintained outside the United States for the benefit of workers who are not United States citizens;

4. Executive deferred compensation plans; and

5. Secondary plans providing class year vesting.

Section 202. Eligibility requirements

No plan, after the effective date of this title, would be allowed to require as a condition for eligibility to participate in it an age greater than 25 or a period of service longer than one year (three years for plans which provide for immediate 100% vesting or for crediting of

[23] all pre-participation service for benefit purposes), whichever is the later. Existing plans would be permitted to retain their eligibility requirements for three years or until they are amended, whichever is sooner.

Section 203. Nonforfeitable benefits

Every pension plan would be given a choice of one of three vesting rules:

1. Ten-Year Service Rule (100% vested at 10 years of covered service);
2. Graded Fifteen-Year Service Rule (30% vested at eight years of covered service, such percentage increasing by 10% each year until 100% is reached after 15 years of covered service);
3. Rule of 45 (50% vested when age plus covered service equals 45, such percentage increasing by 10% each year until 100% is reached).

The vesting rules use a fully retroactive service provision in calculating the vesting percentage and the amount of the accrued portion of the regular retirement benefit. A plan would be permitted to change vesting rules at any time if provision is made that vested benefits not be reduced or delayed for participants in the plan at the time of change. A plan would always be permitted to allow for vesting of benefits after a lesser period and in a greater amount than is required under any of the three vesting rules.

Class year profit-sharing plans.—Class year plans would be required to vest 100% of the employer's contribution no later than five years after the contribution was made.

Covered service.—In computing the period of covered service under a plan, an employee's entire service with the employer contributing to or maintaining the plan shall be considered. However, service prior to age 25, service during which the employee declined to contribute to a plan requiring employee contributions, service with a predecessor of the employer contributing to or maintaining the plan (except where the plan has been continued in effect by the successor employer), service broken by periods of suspension of employment (provided the rules governing such breaks in service are not unreasonable or arbitrary), and service where a participant has previously attained a 100% nonforfeitable right may be disregarded.

Contributory plans.—No plan may provide for forfeiture (1) of any employee contributions unless agreed to in writing, or (2) of the accrued portion of the regular retirement benefit to the extent that such portion is nonforfeitable and is attributable to employer contributions.

Section 204. Distribution of nonforfeitable benefits to terminating participants

Vested benefits to participants terminating before 65 would have to be distributed, at the option of the participant, at regular retirement age or age 65. Vested benefits to participants terminating after age 65 would have to commence immediately at the option of the participant. Survivor annuity and other options offered by a plan to normal retirees would have to be extended to all terminated vested participants.

[24] *Social Security offset plans.* Any pension plan with a Social Security offset feature would be required at the time of the first plan amendment, to provide that the amount of any offset not increase (1) for participants receiving benefits and (2) after the date of termination of a vested participant.

Section 205. Effective date

The effective date of this title would be two years after enactment. Collectively bargained plans would be extended up to 30 additional months to conform their bargaining agreements to this title.

TITLE III—FUNDING

Section 301. Coverage

Title III would cover all private pension benefit plans covered under title II except for profit-sharing and other individual account plans and unfunded voluntary fraternal type plans.

Section 302. Minimum funding standard

Every pension plan subject to title III (other than the above) must make annual minimum contributions equal to:

1. Normal cost plus no less than 30 but no more than 40-year amortization of unfunded accrued liabilities for all plan benefits; any accumulated actuarial gains and losses would be spread over the future service of active participants;

or, if larger,

2. A percentage of the unfunded portion of the present value of the nonforfeitable pension benefits. The unfunded portion would be recalculated each year so that an interest assumption of 5% would reduce the remaining unfunded portion by about 9.2% per annum or by about 57% in 20 years or 72% in 30 years.

Contributions made in excess of the minimum could be used to offset future minimum contributions, thereby permitting funding flexibility. Required minimum contributions in excess of tax deductible limits would be permitted to be carried over to succeeding years where tax deductions would be allowed.

Section 303. Enforcement of funding requirements; variances

Application would have to be made to the Secretary for a waiver of part or all of a minimum funding contribution. Benefits could not be increased until all such waived contributions had been paid off. After five waivers in a ten-year period, the Secretary could, after notice and hearing, order the termination of the plan or the merger of the plan with another plan of the employer. Benefits could not be increased by amendment during a period of waiver.

Section 305. Effective date

The effective date of this title would be two years after enactment. Collectively bargained plans would be extended up to 7 years to conform their bargaining agreements to this title.

TITLE IV—PLAN TERMINATION INSURANCE

Section 401.

This section establishes a Private Pension Plan Termination Insurance Program administered by the Secretary, which requires plans to

[25] insure unfunded vested liabilities incurred prior to enactment of the Act, as well as after enactment of the Act. The Secretary may provide insurance to cover unfunded vested liabilities of a plan not subject to the Act where he determines that such plan conforms to the vesting, funding and all other standards required by the Act.

Section 402. Conditions of insurance

This section requires the insurance program to insure participants against loss of vested benefits arising from plan termination.

The amount of vested benefit insurance is limited to 50 percent of highest average monthly wage of participants earned over a five year period, or $500 monthly, whichever is the lesser.

No insurance shall be paid if the plan is terminated less than three years from date of establishment or registration unless the Secretary determines that a registered plan was otherwise in substantial compliance with the Act and that the reserve position of the insurance program will not be adversely affected.

Insurance will not cover vested rights created by any plan amendment which took effect less than three years prior to plan termination.

No coverage is extended to participants who own 10 percent or more of employer voting stock.

Section 403. Assessments and premiums

This section requires plans to pay an initial uniform assessment to be prescribed by the Secretary to cover administrative costs of the program. The Secretary shall prescribe an annual premium rate based upon unfunded vested liabilities. For the first three years, the insurance premium shall not exceed 0.2 percent of unfunded vested liabilities incurred after enactment of the Act. With respect to those unfunded vested liabilities incurred prior to enactment the premium shall be 0.2 percent provided that the unfunded vested liabilities of the plan were funded at least 75% during the five-year period preceding enactment.

As to plans which on date of enactment were less than five years old, the premium shall be 0.2 percent, provided that the plan had been reducing its unfunded vested liabilities at a rate of no less than 5 percent annually. In the event plans do not meet the above funding standards, they can be charged a premium not to exceed 0.4 percent or less than 0.2 percent of pre-enactment unfunded vested liabilities.

Also, in the case of multiemployer plans (as defined in the Act), the premium rate for the initial three years shall not exceed 0.2 percent of unfunded vested liabilities, regardless of when such liabilities were incurred.

After the initial three-year period, the Secretary may prescribe an annual rate based upon experience, and unless Congress objects within 90 days, the new premium shall become effective.

The Secretary is required to consult with appropriate private and government agencies on matters relating to the assessment and premium rates before prescribing rates.

Section 404. Payment of insurance

This section requires that plans must notify the Secretary of intent to terminate, and failing to do so will make such persons personally liable for any losses incurred by the Pension Benefit Insurance Fund in connection with plan termination.

[26] The insurance to be paid shall be the difference between the plan's assets and unfunded vested benefits owed at the time of plan termination.

In addition, the Secretary is required to prescribe procedures under which funds of terminated plans shall be liquidated and paid out to cover vested benefits of participants. In implementing this authority, the Secretary may transfer terminated funds under his supervision or purchase annuities from qualified insurance carriers for participants or take such other action as may be appropriate. Persons who terminate a plan with intent to circumvent the Act or the WPPDA shall be personally liable for losses.

Section 405. Recovery

This section provides that, where employers in terminated plans are not insolvent, they or their successors-in-interest may be liable for reimbursement of a portion of insurance benefits paid. The liability of the employer is to pay 100% of the unfunded vested liabilities and in no event shall it exceed 50% of the employer's net worth.

The Secretary shall make arrangements with employers on equitable terms for the reimbursement of insurance paid.

The amount or amounts of any unpaid liability owned by an employer shall constitute a lien in favor of the government, but junior to any lien for unpaid taxes owed to the government.

Section 406. Pension Benefit Insurance Fund

This section establishes within the Labor Department a fund for the deposit of premiums, assessments, etc., made under the Act and for payment of such claims thereunder.

TITLE V. GENERAL PROVISIONS

Section 501. Variations; Appeals Board

The Secretary is authorized to grant variations from the requirements of titles II and III and Section 112. A Variation Appeal Board would be established to hear and determine appeals from decisions denying grants of variations.

Section 502. Studies

This section directs the Secretary to conduct research relating to the effects of the act, the role of private pensions, the operation of public and private pension plans, and methods to encourage the growth of the private pension system.

Section 503. Enforcement

This section would give the Secretary authority to conduct such investigations as may be necessary to determine whether any person has violated or is about to violate any provisions of title II or III or any rules or regulations which would result from enactment of titles II and III. Information about such investigations would be made available to any interested person and included in an annual report by the Secretary. Criminal penalties of five years imprisonment and $10,000 fine or up to a $200,000 fine in the case of a corporate felon would be assessed for willful violation of the Act. Civil actions by the Secretary, participants or beneficiaries to enforce the provisions of the Act are authorized in Federal Court.

[27] *Section 504. Annual report of the Secretary*

The Secretary would be required to submit an annual report to the Congress covering his administration of the Act.

Section 505. Rules and regulations

This section would authorize the Secretary to prescribe such rules and regulations as he finds necessary to carry out the provisions of the Act.

Section 506. Other agencies and departments

The Secretary would be authorized to enter into agreements that would avoid unnecessary expense and duplication and would permit cooperation among government agencies in performing his functions under title II, or III. He would also be authorized to reimburse other Federal agencies for facilities or services he utilized in doing so. The Attorney General would be authorized to receive such evidence as developed by the Secretary which may be found to warrant consideration for criminal prosecution.

Section 507. Administration

Chapters 5 and 7 of Title 5, United States Code (relating to administrative procedure) would be applicable to this Act.

No employee of the Department of Labor would be able to administer or enforce the Act with respect to any employee organization of which he is a member or employer organization in which he has an interest.

Section 508. This section would authorize to the Secretary such sums as may be necessary to carry out this Act

Section 509. If any provision of this Act were held invalid, the remainder of the Act would not be affected

Section 510. Interference with the rights protected under the Act would be unlawful.—The provisions of sections 404 and 405 would be applicable in the enforcement of this section

Section 511.

Any person who used coercion to interfere with the rights protected under the act would be subject to a $10,000 fine and/or imprisonment for up to one year.

Section 512. Registration

Within six months after the effective date of titles II and III, each pension and profit-sharing plan would have to file an application with the Secretary of Labor for qualification and registration. Plans established after that date would have six months in which to file such application. Plan amendments similarly would have to be reported to the Secretary. A certificate would be issued and continued in force so long as the eligibility, vesting and funding requirements of the Act are met.

Section 513. Enforcement of Registration

The Secretary of Labor may seek a court order to secure compliance whenever a determination is made that no application for registration has been filed, that the application should be denied or the registration cancelled, or that a plan has failed to make the required contributions or to pay such other assessments or fees as are required.

[28] *Section 514. Effect on other laws*

All State laws would be pre-empted except for those covering plans not subject to titles II and III.

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SUPPLEMENTAL VIEWS

First, we are satisfied that, after extended hearings and serious discussion, the committee bill generally is a good bill.

However, our deliberations have not led to full or complete agreement on the question of the necessity, economic desirability, cost or legal correctness of plan termination insurance. Initially, provision for this type of insurance was made in a separate bill (H.R. 462) because, without additional information, agreement on this provision (Title IV) was not possible.

Our primary consideration in writing pension reform legislation has been to help assure that workers now covered by pension plans get their expected benefits. At the same time, we have been careful not to inhibit benefit improvements for these covered workers and not to retard the expansion of the pension system in such a way as to deny retirement benefits to workers not now covered.

Accordingly, we reasoned that, by requiring stringent vesting and funding standards, the need for insurance could be realistically negated. Further, inasmuch as it was recognized by the Members of the Committee that legislation could not eliminate all plan terminations, we agreed that the possible losses due to any termination would be mitigated to considerable extent by including provisions in the bill:

(*a*) to prevent dilution of benefit security in business acquisition and merger situations;

(*b*) to provide for partial plan terminations with the approval of the Secretary of Labor;

(*c*) to provide fund distribution priorities on termination so there will be a more equitable distribution of all assets;

(*d*) to prevent "raiding" of assets by participants who leave the plan.

The Committee provision to impose a premium to insure the benefit already being funded on a sound actuarial basis creates an employer liability for the benefit if not funded, and thus radically changes the basic legal structure of all plans. It also increases the cost of funding by the amount of the premium rate, which at this time is not susceptible of determination, but is only estimated.

Because the determination of insufficient funding would in substantial part stem from market value losses of plan assets, the Committee bill is, in effect, insuring against fluctuations in the market. We know of no counterpart obligation in business compelling such insurance.

Additionally, we do not believe it possible to provide such a guartee without ultimate reliance on the Federal treasury.

Finally, Title IV raises a serious constitutional question as to whether by legislation we can change the contract of the employer from a promise to make certain contributions to a fund to a promise to pay the pension supported by a pledge of the employer's assets.

Title IV would require that an employer reimburse the insurance fund for 100% of any amounts paid out by the fund, up to an amount

[42] equal to 50% net worth of the employer. Accordingly, on passage of the Committee bill, an employer would be obligated to carry that liability in his balance sheet. This contingent liability would be such as to make the financial structure of any business appear unsound. Such liability would inevitably discourage additional employers from beginning new pension plans and existing plans from increasing benefits and thereby increasing the employer's liability.

In summary, other provisions of the Committee bill impose minimum eligibility and vesting, require adequate funding, and prevent other events which could dilute benefit security. We believe these additional standards should be effectuated and the need for insurance re-assessed. Pending such re-assessment, Title IV should be deleted.

ALBERT H. QUIE.
JOHN M. ASHBROOK.
JOHN N. ERLENBORN.
EDWIN D. ESHLEMAN.
ORVAL HANSEN.

[43]

ADDITIONAL VIEWS

As indicated by my vote to report H.R. 2 out of Committee, I favor legislation to provide reasonable pension protection for the 35 million people enrolled in private pension plans. However, I believe employees covered by State and local government retirement plans are entitled to similar protection, and I fail to understand the Committee's unwillingness to provide them that protection.

To the Committee's credit, it was agreed that public retirement plans should meet the bill's fiduciary standards and requirements for disclosure of information to participants. Minimum vesting and funding standards were rejected, however—the former in the assumption that most public plans provide adequate vesting, and the latter on the grounds that State and local governments and their taxing authority will be with us forever.

Public plans, for the most part, are known to be generous so far as vesting is concerned. Unfortunately, statistics are not available to support this assumption. Notwithstanding this lack of data, my point is that no public employee should be denied the minimum vesting rights the Committee bill asserts every private employee deserves.

The Committee bill provides for a study of these plans. Yet I am constained to point out that the original version of H.R. 2 would have covered these plans and that, in the course of our hearings on pension reform, we did invite interested parties to testify. Only a few accepted the invitation, but those representatives of public employee organizations, legislators, and actuaries who did submit testimony on this aspect endorsed the blanketing of public employees under Federal pension legislation. In spite of this support for inclusion, and with no apparent justification, the provision was dropped.

Presumably, the study recommended in the bill will reveal the funding status of various State and local plans. I submit that public plans are as notorious for their pay-as-you-go, or worse, funding schemes as they are for their comparative generosity in vesting.

Proof of concern by the participants themselves can be found in the courts. Public employees in Philadelphia, for example, have filed suit to compel adequate funding of a $36 million liability. In Detroit, a similar suit involves an $18.2 million liability; and, in my own State, the Illinois Education Association successfully conducted legal action to bring about sounder financing of a $1.7 billion unfunded past service liability together with current liabilities for new benefits.

The seeming perpetual life of the States and their political subdivisions gives us a false confidence, as these court cases attest. Acceptance of the premise that these governments will not go out of business as an argument against funding only postpones the inevitable.

At Thomas Bleakney, a respected actuary and author of *Retirement Systems for Public Employees*, points out, "The basic argument for funding with respect to public systems, in my opinion, is honesty in government—the cost of any governmental service should be known

[44] (and paid for) when the service is provided, and not ignored to be paid for at some future date."

Absent funding, which permits taxpayers to know the effect of new benefits on the government's budget, there is a decided tendency on the part of elected officials to increase benefits substantially and to leave the day of reckoning to their successors. Compounding the problem is the fact that these elected officials are frequently beneficiaries of these plans and so are in the position of negotiating from both sides of the bargaining table.

Not inconceivably, when the already burdened taxpayer is awakened to the true scope of this obligation, objection by court challenges could leave the security of the expected benefits in doubt, if not non-existent.

Court challenges, and the possible loss of benefits, could emanate as well from the premise that an unfunded public retirement plan amounts to deficit financing. Unlike the Federal Government, States are generally prohibited from operating with a deficit and from borrowing to balance the budget. By deferring until another day pension promises made today, a debt is undeniably created.

In some cases, the sudden imposition of a minimal funding requirement on public plans such as that recommended in H.R. 2 for the private sector could create a considerable burden for taxpayers. I do not suggest that identical rules apply to the public sector; but a separate, graded funding formula would mitigate this possibility.

In short, the Committee missed the opportunity in H.R. 2 to foster honesty in government and to give public employees the comprehensive protections and guarantees we deem vital to private employees. To do so is a mistake at the expense of taxpayers and State and local employees.

JOHN N. ERLENBORN,
Member of Congress.

INDIVIDUAL VIEWS

H.R 2 addresses itself to the fundamental concern of pension reform and insofar as the provisions extend, I am in general support of the action taken by the full Committee in reporting out this legislation.

However, I believe there are a number of areas which must be more carefully thought out in the days ahead if this Congress is to truly guarantee the rights of the American worker to a retirement free from financial worry.

In the area of reinsurance, the provisions in H.R. 2 would insure pension benefits in the event of program failure. If we are to truly have a "Retirement Bill of Rights" then we must recognize the inherent interdependence of the reinsurance program, the vesting and other provisions of any proposed legislation. To delete reinsurance would be to create a faulty and untested mechanism of guaranteeing pension benefits.

Earlier this session, I introduced H.R. 9999, the Omibus Pension Security Act. While several provisions of H.R. 9999, including reinsurance, are included in H.R. 2, there are significant factors that must be considered by the House if we are to truly have effective pension reform legislation.

First, it is fundamental to provide the American worker not only with the capability, but the right to appeal through the Secretary into the Courts any time he feels his rights have been violated. Although H.R. 2 and H.R. 4200 recently passed by the Senate does provide for administrative review, the Secretary should be empowered to "go to bat" for a plan participant. Accordingly, Congress and the Ways and Means Committee should consider Section 512 of H.R. 9999 which clearly defines the providing of legal assistance to plan participants.

Second, it is essential that to avoid administrative confusion that we centralize the responsibility for carrying out any pension reform legislation enacted in one agency. H.R. 9999 establishes a Pension Security Administration which would oversee the operation of every aspect of pension reform including vesting, funding, reporting and reinsurance. Whether or not responsibility is eventually lodged in the Department of Labor or the Department of the Treasury, administrative responsibility should be reserved for *one* agency, so that the working American will have to deal with one agency, not two, or three, or four.

Third, even given the above reform areas substantial procedural problems will remain to be worked out in the years ahead. Even with the passage of H.R. 2 and companion legislation from the House Ways and Means Committee no clear mechanism currently exists through which sufficient data and information can be channeled to the Congress to enable us to insure an effective and functional program. H.R. 9999 establishes a Bureau of Pension Statistics designed to keep care-

[46] ful tabs on the problems we encounter down the road after passage of a pension reform law. This is a full-time job and must be done separate of any operating agency. Accordingly, Congress should move to include such a Bureau in any legislation considered.

Fourth, the issue of "portability" should be considered. While it should be recognized that any attempt to make vested funds portable from one plan to another is impracticable and administratively unfeasible, it is possible, and indeed, imperative, that we provide for a system through which an individual may accrue vested funds from several plans throughout his work life-time. It is therefore imperative that Congress carefully consider a means to expedite portability in this matter.

In sum, these are some of the areas which should be addressed in addition to the provisions of H.R. 2. Hopefully, Congress will move to enact legislation including these concepts before the end of the session.

MARVIN L. ESCH,
Member of Congress.

House Report No. 93-779

2nd Session

[Bracketed numerals indicate official report page numbers.]

PRIVATE PENSION TAX REFORM

FEBRUARY 5, 1974.

Mr. Ullman, from the Committee on Ways and Means, submitted the following

REPORT

together with

SUPPLEMENTAL VIEWS

[To accompany H.R. 12481]

The Committee on Ways and Means, to whom was referred the bill (H.R. 12481), to amend the Internal Revenue Code of 1954 to provide pension reform, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. INTRODUCTION AND SUMMARY

H.R. 12481, as reported by the Committee on Ways and Means, deals with the tax aspects of making pension, profit sharing, and stock bonus plans fairer and more effective in providing retirement income for employees who have spent their careers in useful and socially productive work.

Your committee, in reporting this bill, anticipates that it will, in the House action, become a part of a broader bill dealing with retirement plans generally. It is expected that this bill will be combined with a version of H.R. 2, reported by the Committee on Education and Labor. This bill and the bill reported by the Committee on Education and Labor, are expected to jointly deal with participation, vesting, and funding with respect to pension plans. In these areas, this bill has been worked out in close coordination with the version of the bill expected from the Committee on Education and Labor to be sure that the general standards provided in these three areas are the same. Because of the expected coordination between your committee's bill and that of the Education and Labor Committee, no action is taken in this bill to deal with the general subjects of fiduciary standards, plan termination insurance, and reporting and disclosure, which are dealt with in H.R. 2.

This bill deals only with qualified plans and provides for enforcement with respect to retirement plans through the Internal Revenue

[2] Service, while the bill from the Committee on Education and Labor is expected to deal with both qualified and nonqualified plans and provide for enforcement through the Department of Labor. Because of the coordination and effort involved, it is not expected that this dual jurisdiction in these three areas will present problems. Not only have the standards in the two bills been coordinated, but also provisions have been made for joint regulations in areas where problems might otherwise arise.

In the areas of participation, vesting, and funding it is important for the Committee on Ways and Means to have a part in setting the standards involved since for plans qualifying under these standards there are significant tax advantages. At the same time, guidelines established for retirement plans also are of significance to a committee charged with the jurisdiction of labor laws. Although provision is made for dual enforcement in these two areas by the Internal Revenue Service and the Department of Labor, it is anticipated that these agencies will coordinate their efforts so as not to duplicate enforcement efforts.

This bill encourages provisions for the retirement needs of many millions of individuals. At the same time, the committee recognizes that private retirement plans are voluntary on the part of employers, and, therefore, it has weighed carefully the additional costs to the employers and minimized these costs to the extent consistent with minimum standards for retirement benefits.

In broad outline, the bill is designed—

(1) to increase the number of individuals participating in retirement plans;

(2) to make sure that those who do participate in such plans do not lose their benefits as a result of unduly restrictive forfeiture provisions or failure of the plan to accumulate and retain sufficient funds to meet its obligations; and

(3) to make the tax laws relating to such plans fairer by providing greater equality of treatment under such plans for the different taxpaying groups involved.

This bill also goes a long way toward equalizing the tax treatment of those in different lines of work. In the case of the self-employed, it makes a threefold increase in the deductible amount which can be set aside for retirement. At the same time, it provides limits on the contributions or benefits for individuals covered by qualified plans. The bill also provides deductions for a modest retirement savings set-aside for those who are not covered by any existing plans.

The bill continues to rely primarily on the tax laws to secure needed improvements in pension and related plans. In general, it retains the tax incentives granted under present law for the purpose of encouraging the establishment of plans which contain socially desirable provisions. However, it also improves the effectiveness of these tax incentives by extending or increasing them in certain cases where this is warranted and by pruning them where they have given rise to problems.

Present tax treatment of qualified plans

Present law encourages employers to establish retirement plans for their employees by granting favorable tax treatment where plans qual-

[3] ify by meeting nondiscrimination and other rules set forth in the Internal Revenue Code. Such qualified plans must cover a specified percentage of employees or cover employees under a classification found by the Internal Revenue Service not to discriminate in favor of employees who are officers, shareholders, supervisory employees, or highly compensated employees. Similarly, the contributions to such plans or the benefits paid out by them cannot discriminate in favor of such employees.

The favorable tax treatment granted qualified plans is substantial. Employers, within certain limits, are permitted to deduct contributions made to these plans for covered employees whether or not their interests are vested; earnings on the plan's assets are exempt from tax; and covered employees defer payment of tax on employer contributions made on their behalf until they actually receive the benefits, generally after retirement when their incomes and hence applicable tax rates tend to be lower.

The private pension system has shown substantial development under the present tax rules. Estimates of the coverage of private pension plans range from 23 million to 30 million employees for 1972 and 42 million employees are expected to be covered by 1980 without any change in law. Similarly, in 1970 about $14 billion was contributed to pension plans by employees and employers and 4.7 million beneficiaries received $7.4 billion in pension payments. Moreover, pension plan assets amounted to $150 billion (book value) in 1972 and are expected to reach $225 billion by 1980.

Problem areas

While the achievements of private retirement plans are substantial, a number of serious problems have become apparent. Those dealt with by this bill can be briefly outlined as follows:

Inadequate coverage.—Despite the rapid growth in pension coverage, about one-half of all employees in private nonagricultural employment are still not covered. Moreover, many plans have overly restrictive age and service requirements for participation, resulting in the exclusion of many employees.

Inadequate vesting.—Present law generally does not require an employee plan to give a covered employee vested rights to benefits—that is, the right to receive benefits if he leaves or loses his job before retirement age. Many private pension plans do provide vested rights to benefits before retirement, but as a general rule, employees do not acquire vested rights until they have served a fairly long time with the firm and/or are relatively mature. As a result, even employees with substantial periods of service may not acquire rights to pension benefits upon separation from employment.

Inadequate funding.—A significant number of pension plans are not adequately funded—that is, they are not accumulating sufficient assets to pay benefits in the future to covered employees. Under the present minimum funding requirements, contributions to qualified plans must be at least large enough to pay the normal costs (the pension liabilities created in the current year) plus the interest on unfunded accrued liabilities attributable to the past service of the covered employees. However, this minimum funding requirement is

[4] not adequate because it does not require the unfunded accrued liabilities for past service to be amortized.

Discrimination against individuals not covered by pension plans.—Individuals who are outside of qualified pension plans have no opportunity to set aside income for their own retirement under the favorable tax treatment accorded to individuals covered by such plans. These individuals must save for their retirement from income after tax and must pay tax currently on the income earned by their retirement savings.

Unjustifiable differences in tax treatment of corporate owner-employees and self-employed individuals under qualified plans.—At present, in practice there is almost no practical limit on the amount of pension contributions that corporations can make to qualified plans on behalf of corporate employees. This has resulted in abuse situations in which extremely large pension benefits have been financed for corporate employees in part at the expense of the general taxpaying public, as a result of the favorable tax treatment that is accorded.

The fact that pension contributions on behalf of corporate employees are in practice not subject to control has also given rise to claims of discrimination on the part of self-employed persons. Pension contributions made by self-employed persons on their own behalf are limited to 10 percent of earned income up to $2,500 a year under present law. These limits also have had the undesirable effect of inducing many individuals, including professional people, who would normally carry on their activities as sole proprietors or partners, to convert their activities to the corporate form almost entirely to secure the greater tax advantages associated with corporate plans.

Provisions of the bill

The bill deals with these problems in many different ways. The principal provisions of the bill are summarized below.

1. *Minimum Participation Standards.*—Generally, an employee cannot be excluded from a plan on account of age or service if the employee is at least 25 years old and has had at least one year of service. The one-year of service requirement may be extended to 3 years if immediate vesting is provided.

2. *Minimum Vesting Standards.*—Three alternative minimum vesting standards are provided. The first of these provides for at least 25 percent vesting at the end of the fifth year of covered service. Thereafter the vesting percentage is increased by 5 percent a year until a level of 50 percent is reached at the end of the tenth year. Following this, vesting increases at the rate of 10 percent a year until 100 percent vesting is reached at the end of the 15th year.

The second vesting standard under the bill is 100 percent vesting at the end of ten years of covered service.

The third vesting standard is the so-called rule of 45. Under this standard, there must be 50 percent vesting when the sum of the age of the individual and the number of years of covered service equal 45 (provided there is at least 5 years of service). An additional 10 per-

[5] cent per year is then required to be vested in each of the next 5 years of service.

These vesting rules are phased in over a five-year period beginning, in the case of existing plans, in 1976.

3. *Minimum Funding Standards.*—Normal costs are to be funded currently. Costs attributable to already-existing liabilities are to be amortized over a 40-year period. Liabilities under plan amendments and new plans generally are to be amortized over a 30-year period, except that in the case of multiemployer plans the amortization period is to be 40 years (in this latter case the Secretary of Labor can extend this for a further period of 10 years). Experience gains and losses are to be amortized over 15 years generally, but in the case of multiemployer plans over a period of 20 years (in this last case the period can be extended an additional ten years by the Secretary of Labor). These experience gains and losses generally will only be required to be recomputed every three years. The above funding standards are based upon accrued liabilities.

If funding requirements are higher under a second general standard which is based on accrued "vested" liabilities, this standard is to apply in lieu of the rules set forth above. Under this standard, accrued vested liabilities are determined, as also are the value of the plan's assets. Where the former exceeds the latter, the contribution for that year must be sufficient to cover the level annual payment required to amortize the difference in 20 years. A determination for a new 20-year amortization period is made in each of the succeeding years.

Where any of the requirements set forth above present hardship under a plan (and certain standards are met), the Secretary of the Treasury can permit variances spreading the current liability in this case over a 15-year period.

4. *Special Variance for Multiemployer Plans.*—In the case of multiemployer plans where the Secretary of Labor finds that the vesting and funding provisions seriously endanger the continuation of a plan, he can authorize exceptions to the vesting and funding standards described above.

5. *Government Plans.*—The participation, vesting, and funding standards set forth above do not apply in the case of governmental plans. In the case of these plans, the same standards continue to apply as under present law. Studies are to be made by the Ways and Means Committee and the Education and Labor Committee as to the need for change in these areas in the future.

6. *Joint and Survivor Annuities.*—Qualified plans in the future that provide annuities are to provide for them as joint and survivor annuities unless the employee elects out of such treatment.

7. *Effective Dates for Participation, Vesting, and Funding.*—Generally the participation, vesting, and funding provisions in the case of existing plans are to be effective as of January 1, 1976. In the case of new plans adopted after January 1, 1974, however, the participation, vesting, and funding provisions are to be effective as of the date

[6] of enactment. In the case of collective bargaining plans, the January 1, 1976, date is to be extended to the expiration date of the current collective bargaining agreement (but not beyond January 1, 1981).

8. *Federal Procurement Contracts.*—In the case of employees working under contracts relating to federal procurement, construction, or research, the Secretary of Labor is directed to make a study as to procedures to encourage special provisions for engineers and others similarly situated who tend to change from one job to another, in order to provide them with more immediate vesting than is true in the case of employees generally. The study in this case is to be completed in a two-year period and regulations carrying out the study are to be put into effect at the end of the next year unless either House of the Congress within 90 days after the receipt of such proposed regulations votes against these regulations.

9. *Duties of Secretary of Health, Education, and Welfare.*—Whenever employees with vested rights leave their employment (prior to retirement), a statement as to their vested rights is to be given them by their employer. A copy of this statement is also to be transmitted through the Treasury Department to the Secretary of HEW. The Secretary of HEW will then inform the employee when he applies for social security benefits as to any statements of this type which an employer has given HEW. The department is not to be responsible for the accuracy of any such statements.

10. *Plan Termination Insurance and the Rules Relating to Fiduciaries.*—Although a program of plan termination insurance to protect the rights of covered employees is desirable, this bill makes no provision for such a program. Also, no change is made in this bill to tighten the rules relating to fiduciaries of qualified retirement plans which would also be desirable. This is because H.R. 2, which has been reported by the House Committee on Education and Labor, provides for a program of plan termination insurance and also provides for additional rules regarding fiduciary requirements which are designed to correct any existing abuses.

11. *Tax Court Procedure.*—Provision is made in the bill for the appeal from the determination of the Internal Revenue Service as to the initial qualification of pension plans or the effects of amendments proposed to pension plans. This is to be dealt with by a declaratory judgment procedure in the U.S. Tax Court.

12. *Establishment of Office of Assistant Commissioner.*—Provision is made for the establishment in the Internal Revenue Service of an office of Assistant Commissioner of Pensions and Exempt Organizations. This office is to provide a centralized group for unifying the tax treatment of pension plans throughout the country. Authorization is made for funds in the case of this office.

13. *Contributions on Behalf of Self-Employed Individuals.*—The limitations on deductions for self-employed individuals are to be increased from 10 percent of their self-employment income, not to exceed $2,500 up to 15 percent of their self-employment income, not to

[7] exceed $7,500. A minimum of $750 may be deducted in these cases without regard to the percentage limitation.

14. *Individual Retirement Accounts.*—Individuals not covered by qualified or government pension plans are to be permitted to take a deduction of up to 20 percent of their earned income not to exceed $1,500. This amount may be set aside in a special custodial account with a bank, savings and loan, credit union, life insurance company or regulated investment company without tax consequences on the earnings on the balance in this account until such time as the individual draws down the amount. This amount cannot be drawn down without penalty before age 59½ (except in the case of death or disability) and the individual must begin drawing the amount down by age 70½ if penalty is to be avoided. An individual may establish the account directly himself or, alternatively, an employer or labor union may maintain accounts of this type for employees or members.

15. *Limitations on Benefits and Contributions.*—In the case of defined contribution plans (profit-sharing and money purchase pension plans), there may not be set aside with respect to an individual in a qualified plan in any year more than 25 percent of his compensation or $25,000, whichever is the lesser.

In the case of defined benefit plans, the pension which may be paid with respect to any individual may not exceed 100 percent of his compensation in his high three years of employment or $75,000, whichever is the lesser. (Both the $25,000 amount and the $75,000 amount referred to above are subject to cost-of-living allowances.) A "grandfather clause" provides that if an individual is eligible for more than a $75,000 pension based upon his current compensation by taking into account his additional period of employment up to the time of his expected retirement, this amount may be paid despite the $75,000 limitation.

If an employee is under both a defined benefit plan and a defined contribution plan, then an overall limit is applied to coordinate the two limits discussed above. In this case, the sum of (1) the percentage utilization of the maximum limit under the defined benefit plan and (2) the percentage utilization of the maximum limit under the defined contribution plan cannot exceed 140 percent. Amounts in excess of these limits may be provided under the plan, but may not be paid out of a qualified trust.

16. *Lump Sum Distributions.*—Lump sum distributions from qualified plans are to be treated as ordinary income subject to special 10-year averaging. This treatment is to apply to the post-1973 portion of such a distribution, with regular capital gain treatment available to the remaining portion (pre-1974) of the distribution. The distribution is to be apportioned between the income averaging part and the capital gains part on the basis of the employee's years of active participation in the plan after 1973 and his years before 1974.

17. *Salary Reduction Plans and Cash-or-Deferred-Profit-Sharing-Plans.*—Determination of the inclusion of income to an employee in

[8] the case of a salary reduction plan or a cash-or-deferred-profit-sharing plan is to be made on the basis of the way it would have been made before the Internal Revenue Service began the preparation of proposed regulations to change its administrative practices in this area. Those proposed regulations are to be withdrawn and no new regulations on this matter may be finally issued until after March 15, 1975.

18. *Revenue Effects.*—The tax provisions affecting retirement plans, which are in this bill, when fully effective, will result in an estimated net revenue loss of $460 million a year. An estimated revenue loss of $530 million a year is attributable to the provisions allowing individuals not covered by qualified plans to establish their own individual retirement plans and to the higher deduction limits for contributions by self employed people to H.R. 10 pension plans. This is offset by an estimated $70 million revenue gain attributable to the new tax treatment of lump sum distributions from qualified plans, and the provisions limiting contributions or benefits to qualified plans on behalf on any individual.

II. REASONS FOR THE BILL

One of the most important matters of public policy facing the nation today is how to assure that individuals who have spent their careers in useful and socially productive work will have adequate incomes to meet their needs when they retire. This legislation is concerned with improving the fairness and effectiveness of qualified retirement plans in their vital role of providing retirement income. In broad outline, the objective is to increase the number of individuals participating in employer-financed plans; to make sure to the greatest extent possible that those who do participate in such plans actually receive benefits and do not lose their benefits as a result of unduly restrictive forfeiture provisions or failure of the pension plan to accumulate and retain sufficient funds to meet its obligations; and to make the tax laws relating to qualified retirement plans fairer by providing greater equality of treatment under such plans for the different taxpayer groups concerned.

Essentially, your committee's bill represents a significant improvement in the tax treatment now applicable with respect to qualified retirement plans. Your committee regards the present legislation as part of an evolutionary process which keeps this basic framework but which builds on it new provisions which experience indicates are necessary for the proper functioning of these plans.

A fundamental aspect of present law, which the committee bill continues, is reliance on voluntary action by employers (and employees under contributory plans) for the establishment of qualified retirement plans. The committee bill also continues the approach in present law of encouraging the establishment of retirement plans which contain socially desirable provisions through the granting of tax induce-

[9] ments. In other words, under the new legislation as under the present law, no one is compelled to establish a retirement plan. However, if a retirement plan is to qualify for the favorable tax treatment, it will be required to comply with specified new requirements which are designed to improve the retirement system. Since the favorable tax treatment is quite substantial, presently involving a revenue loss of over $4 billion a year, it is anticipated that plans will have a strong inducement to comply with the new qualification rules and thereby become more effective in fulfilling their objective of providing retirement income.

The tax advantages associated with qualification under the Internal Revenue Code are substantial. Employers, within certain limits, are permitted to deduct contributions made to such plans on behalf of covered employees, whether or not the interests of covered employees are vested; earnings on the plan's assets are exempt from tax; and covered employees defer payment of tax on employer contributions made on their behalf until they actually receive the benefits, generally after retirement when their incomes and hence applicable tax rates tend to be lower.

THE ENCOURAGEMENT OF NONDISCRIMINATORY PLANS UNDER PRESENT LAW

As already indicated, our tax laws now provide substanital tax incentives for the establishment of nondiscriminatory retirement plans. In order to qualify as nondiscriminatory, a retirement plan must cover a specified percentage of employees [1] or cover employees under a classification found by the Internal Revenue Service not to discriminate in favor of employees who are officers, shareholders, supervisory employees, or highly compensated employees. Similarly, either the contributions to the plan or the benefits paid out by the plan must not discriminate in favor of officers, etc.

In adopting this legislation, your committee is aware of the achievements of the private pension system under the 1942 legislation. The private retirement system has grown rapidly over the past three decades. While the precise coverage of retirement plans is not known, estimates of the number of employees now covered by such plans range from 23 million to 30 million.[2] This compares with coverage of 4 million in 1940 and 9.8 million in 1950. (See Table 1.) By 1980, these retirement plans are expected to cover 42 million employees.[3]

[1] To qualify on this basis, the plan must cover 70 percent or more of all the employees, or 80 percent or more of all employees who are eligible to benefit under the plan if 70 percent or more of all the employees are so eligible, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding 5 years, employees whose customary employment is for not more than 20 hours in any 1 week, and employees whose customary employment is for not more than 5 months in any calendar year (sec. 401(a)(3)(A)).

[2] Department of Health, Education and Welfare, Department of Labor and Treasury Department, Coverage and Vesting of Full-Time Employees under Private Retirement Plans; Findings from the April 1972 Survey, BLS Report No. 423, Sept. 1973.

[3] Public Policy and Private Pension Programs. A Report to the President on Private Employees Retirement Plans by the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, January 1965, p. vi.

TABLE 1.—PRIVATE PENSION AND DEFERRED PROFIT-SHARING PLANS: [1] ESTIMATED COVERAGE, CONTRIBUTIONS, BENEFICIARIES, BENEFIT PAYMENTS, AND RESERVES, 1950, 1955, 1960-70

Year	Coverage [2] end of year (in thousands)			Employer contributions (in millions)			Employee contributions (in millions)			Number of beneficiaries, end of year (in thousands)			Amount of benefit payments (in millions)			Reserves, end of year (in billions)		
	Total	Insured	Non-insured	Total	Insured	Non-insured	Total	Insured	Non-insured	Total	Insured	Non-insured	Total [3]	Insured	Non-insured [3]	Total	Insured	Non-insured
1950	9,800	2,600	7,200	$1,750	$720	$1,030	$330	$200	$130	450	150	300	$370	$80	$290	$12.1	$5.6	$6.5
1955	15,400	3,800	11,600	3,280	1,100	2,180	560	280	280	980	290	690	850	180	670	27.5	11.3	16.1
1960	21,200	4,900	16,300	4,710	1,190	3,520	780	300	480	1,780	540	1,240	1,720	390	1,330	52.0	18.8	33.1
1961	22,200	5,100	17,100	4,830	1,180	3,650	780	290	490	1,910	570	1,340	1,970	450	1,520	57.8	20.2	37.5
1962	23,100	5,200	17,900	5,200	1,240	3,960	830	310	520	2,100	630	1,470	2,330	510	1,820	63.5	21.6	41.9
1963	23,800	5,400	18,400	5,560	1,390	4,170	860	300	560	2,280	690	1,590	2,590	570	2,020	69.9	23.3	46.6
1964	24,600	6,000	18,600	6,370	1,520	4,850	910	310	600	2,490	740	1,750	2,990	640	2,350	77.7	25.2	52.4
1965	25,300	6,200	19,100	7,370	1,770	5,600	990	320	670	2,750	790	1,960	3,520	720	2,800	86.5	27.3	59.2
1966	26,300	6,900	19,400	8,210	1,850	6,360	1,040	330	710	3,110	870	2,240	4,190	810	3,380	95.5	29.3	66.2
1967	27,500	7,700	19,800	9,050	2,010	7,040	1,130	340	790	3,410	930	2,480	4,790	910	3,880	106.2	31.9	74.2
1968	28,000	7,900	20,100	9,940	2,240	7,700	1,230	340	890	3,770	1,010	2,760	5,530	1,030	4,500	117.8	34.8	83.1
1969	29,000	8,700	20,300	11,520	3,030	8,490	1,360	350	1,010	4,180	1,070	3,110	6,450	1,160	5,290	127.8	37.2	90.6
1970	[4] 29,700	9,300	20,400	12,580	2,860	9,720	1,420	350	1,070	4,720	1,220	3,500	7,360	1,330	6,030	137.1	40.1	97.0

[1] Includes pay-as-you-go, multi-employer, and union-administered plans those of nonprofit organizations, and railroad plans supplementing the Federal railroad retirement program. Excludes pension plans for Federal, State, and local government employees as well as pension plans for the self-employed. Insured plans are underwritten by insurance companies; noninsured plans are, in general, funded through trustees.

[2] Excludes annuitants; employees under both insured and noninsured plans are included only once—under the insured plans.

[3] Includes refunds to employees and their survivors and lump-sums paid under deferred profit-sharing plans.

[4] Coverage for 1972 is estimated at 23,000,000 in coverage and vesting of full-time employees under private retirement plans: Findings from the April 1972 survey by the Departments of Health, Education, and Welfare and Labor. See BLS Rept. No. 42-3, September 1973. To the extent that this, 23,000,000 coverage figure is correct, the estimates of coverage shown in the above table are too high. Nonetheless, the coverage figures in the table may still be useful in giving an approximation of the relative increase in coverage over the past 2 decades or so.

Source: Compiled by the Office of the Actuary, Social Security Administration, from data furnished primarily by the Institute of Life Insurance and the Securities and Exchange Commission.

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[11] The growth which has occurred is also evidenced in other ways. Between 1950 and 1970, total annual contributions made to retirement plans by employees and employers rose from about $2.1 billion to about $14 billion. In 1950, 450,000 beneficiaries received $370 million from retirement plans; in 1970, 4.7 million beneficiaries received $7.4 billion in pension payments. Moreover, retirement plan assets soared from $12.1 billion in 1940 to $150 billion in 1972 (book value) and are expected to reach $225 billion by 1980.[4]

PROBLEM AREAS

Despite the substantial achievements of retirement plans, it has become apparent that a number of problems have arisen which prevent many of these plans from achieving their full potential as a source for retirement income. These problem areas are outlined below.

Inadequate coverage.—Despite the rapid growth in retirement plan coverage in recent years to its 1970 level of from 23 to 30 million employees, somewhere in the vicinity of one-half of all employees in private, nonagricultural employment are still not covered by retirement plans. Retirement plans are still relatively rare among small business firms and in agriculture. Moreover, even where employees work for a firm with a retirement plan, the age and service requirements for participation in the plan may be overly restrictive, excluding many employees.

Discrimination against the self-employed and employees not covered by retirement plans.—Another problem area is that present law discriminates against employees not covered by retirement plans and against the self-employed. This is primarily because the personal retirement savings of individuals not covered by pension plans must be made out of after-tax income, while those covered by retirement plans are permitted to defer tax on their employer's retirement contributions. In addition, the earnings on the retirement savings of noncovered persons are subject to tax as earned, while the tax on earnings of pension funds is deferred until paid out as a retirement benefit.

Self-employed people also frequently maintain that they are discriminated against as compared with corporate executives and owner-managers of corporations in regard to the tax treatment of retirement savings. At present, there is no comprehensive limit on the amounts the employer can contribute on behalf of corporate executives and owner-managers of corporations; similarly, there is no statutory limit on the amount of pension benefits that the latter can receive—so long as those contributions or benefits do not discriminate in favor of employees who are shareholders, officers, supervisors, or highly paid and do not constitute unreasonable compensation. As a result of legislation enacted in 1962 and amended in subsequent years, self-employed people can establish retirement plans for themselves and their employees but their deductible contributions to such plans on their own behalf are limited to 10 percent of earned income up to $2,500 a year.

Inadequate vesting.—Present law generally does not require a retirement plan to give a covered employee vested rights to benefits—

[4] Table 1 and Securities and Exchange Commission, Private Noninsured Pension Funds, 1972, and A Report to the President on Private Employee Retirement Plans, *op. cit.*

[12] that is, the right to receive benefits even if he leaves or loses his job before retirement age.[5] Over two-thirds of the private retirement plans provide vested rights to retirement benefits before retirement. However, as a general rule, employees do not acquire vested rights until they have accumulated a fairly long period of service with the firm and/or are relatively mature.

At present, only one of every three employees participating in employer-financed plans has a 50 percent or greater vested right to his accrued retirement benefits. Moreover, 58 percent of covered employees between the ages of fifty and sixty and 54 percent of covered employees 60 years of age and over do not have a qualified vested right to even 50 percent of their accrued retirement benefits.[6] As a result, even employees with substantial periods of service may lose retirement benefits on separation from employment. Extreme cases have been noted in which employees have lost retirement rights at advanced ages as a result of being discharged shortly before they would be eligible to retire. In addition, failure to vest more rapidly is charged with interfering with the mobility of labor, to the detriment of the economy.

Inadequate funding.—Another problem area is that a significant portion of present pension plans are not adequately funded—that is they are not accumulating sufficient assets to pay benefits in the future to covered employees. As a result, there is concern that many employees now covered by pension plans may not actually receive pensions when they retire because the funds will not be available to pay for those pensions.

In general, pension plans that are qualified under the Internal Revenue Code must meet certain minimum funding requirements by irrevocably setting aside funds in a trust or through the purchase of insurance contracts. Contributions to such plans must generally be at least large enough to pay the normal pension costs plus the interest on unfunded accrued liabilities which generally are attributable to the past service of the covered employees. However, this minimum funding requirement is not adequate because it is designed only to prevent the unfunded liabilities from growing larger and does not require any payment to reduce the amount of the outstanding unfunded liabilities, which may be substantial.

The available evidence suggests that many pension plans are adequately funded—but that a significant proportion of the plans have not been adequately funded. This is indicated, for example, by a survey made by the Senate Labor Subcommittee of 469 trustee-administered pension plans covering 7.1 million employees. In 1970, about one-third of the plans in the study covering one-third of the participants reported a ratio of assets to total accrued liabilities of 50 percent or less; while 7 percent of the plans covering 8 percent of the participants reported a ratio of assets to accrued liabilities of 25 percent or less. (See Table 2.)

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[5] However, as noted below, vesting is required for employees under so-called H.R. 10 plans for owner-employees and may also be required in other cases to prevent the plan from having a discriminatory effect in operation, or upon plan termination or complete discontinuance of contributions.

[6] U.S. Treasury Department—Fact Sheet, Pension Reform Program, as reprinted in Material Relating to Administration Proposal Entitled the "Retirement Benefits Tax Act", Committee on Ways and Means, 93d Cong., 1st sess., p. 37, Table B.

[13] TABLE 2.—FUNDING OF PRIVATE PENSION PLANS: ASSETS AT MARKET VALUE, AS PERCENT OF PRESENT VALUE [1] OF TOTAL ACCRUED RETIREMENT BENEFITS, BY PLAN AND BY PARTICIPANT: AS OF 1970

	By plan		By participant	
	Number [2]	Percent	Number	Percent
Assets as percent of accrued benefits:				
25 percent or less	33	7	541,801	8
26 through 50	118	25	1,798,945	25
51 through 75	104	22	2,134,601	30
76 through 100	117	25	1,211,298	17
101 through 125	55	12	949,975	13
126 through 150	20	4	134,252	2
151 through 175	8	2	52,498	1
Over 175	14	3	275,835	4
Total	469	100	7,100,205	100

[1] Present value of accrued benefits is actuarially determined.
[2] Sample consists of 469 trustee-administered plans. Comparable data were not available for insured plans.

Note: The sum of individual items may not equal totals because of rounding.

Source: Senate Committee on Labor and Public Welfare Report on S. 3598, The Retirement Income Security for Employees Act of 1972, 92d Cong., 2d sess., p. 97.

In general, the older plans are better funded than the newer ones. Over one-half of the plans covered by the study which were 6 years old or less had an assets-liabilities ratio of 50 percent or less, while 35 percent of the plans in existence for 17 years to 21 years had such an assets-liabilities ratio.[7]

Loss of pension benefits due to plan terminations.—Concern has also been expressed over the possible loss of pension benefits as a result of termination of pension plans. The Studebaker case, which has been widely publicized, illustrates how pension benefits can be lost as a result of termination of a plan. When Studebaker closed its South Bend, Indiana, plant in 1964, the employees were separated and the pension plan was terminated. The plan provided fairly generous vested rights and the funding apparently would have been adequate had the firm remained in business and the plan continued in operation. However, at termination, the plan had not yet accumulated sufficient assets to meet all its obligations. As a result, full pension benefits were paid only to employees already retired and to employees age 60 or over with 10 years or more of service. Little or no benefits were paid to large numbers of other employees, many of whom had vested rights.

A joint study of the Treasury Department and the Department of Labor indicates that there were 1,227 plan terminations in 1972.[8] These terminations resulted in the loss of $49 million of benefits (present value) by 19,400 pension participants in 546 of the terminated plans. The average loss of benefits for participants amounted to $2,500. Participants losing benefits represented about eight one-hundredths of one percent of workers covered by pension plans. The data, of course, cover terminations occurring over a one-year period and may not be the typical experience.

Misuse of pension funds and disclosure of pension operations.—There also has been concern about the administration of pension plans. It has been charged that all too frequently pension funds have not been

[7] Senate Committee on Labor and Public Welfare report on S. 3598, The Retirement Income Security for Employees Act of 1972, 92d Cong., 2d sess., p. 98.
[8] Department of the Treasury and the Department of Labor Study of Pension Plan Terminations, 1972—Final Report, August 1973.

[14] used in the best interest of covered employees. There have been cases of extreme misuse of pension funds.

The Welfare and Pension Plans Disclosure Act, which is administered by the Labor Department, was adopted in 1958 to protect the interests of welfare and pension plan participants and beneficiaries by requiring disclosure of information regarding such plans. This Act requires the plan administrators to file with the Secretary of Labor and to send to participants upon written request a description and annual report of the plain. The Act was amended in 1962 to make theft, embezzlement, bribery, and kickbacks Federal crimes where these occur in connection with welfare and pension plans. The 1962 amendment also conferred limited investigatory and regulatory powers upon the Secretary of Labor. However, abuses in the administration of pension plans and in the handling of pension funds have continued.

The Internal Revenue Code (sec. 503(b)) seeks to prevent abuses in the use of funds held under qualified retirement plans by prohibiting qualified trusteed plans from engaging in certain specified prohibited transactions such as lending funds without adequate security and a reasonable rate of interest to the creator of the plan, his family, or corporations controlled by him. Other prohibited transactions include payment of excessive salaries, purchase of property for more than an adequate consideration, sale of property for less than an adequate consideration, or any other transactions which result in a substantial diversion of funds to such individuals. Special additional rules apply to payment of excessive salaries, purchase of property for more than an trusts benefitting owner-employees.

OBJECTIVES OF THE MAIN PROVISIONS OF THE BILL

Although there have been significant legislative changes since the present basic framework of the tax laws relating to pensions was first adopted—principally in allowing self-employed people to establish retirement plans for themselves and their employees and in requiring the disclosure of information regarding welfare and pension plans—it has been more than 30 years since these basic pension provisions were first adopted. It is time for new legislation to conform the pension provisions to the present day situation and to provide remedial action for the various problems that have arisen in the retirement plan area during the past three decades.

As indicated above, the present provisions of the Internal Revenue Code provide tax inducements for the adoption of nondiscriminatory plans and to a limited extent other objectives. These nondiscrimination provisions are retained, but the new legislation also requires retirement plans to conform to additional requirements in order to qualify for the favorable tax treatment under the Internal Revenue Code. In taking this action, the committee has been mindful of the need to construct the new requirements so that they will provide meaningful improvement in the various problem areas noted under the present law. At the same time, the committee is aware that under our voluntary pension system, the cost of financing pension plans is an important factor in determining whether any particular retirement plan will be adopted and in determining the benefit levels if a plan is adopted, and that

[15] unduly large increases in costs could impede the growth and improvement of the private retirement system. For this reason, in the case of those requirements which add to the cost of financing retirement plans, the committee has sought to adopt provisions which strike a balance between providing meaningful reform and keeping costs within reasonable limits.

Generally, it would appear that the wider or more comprehensive the coverage, vesting, and funding, the more desirable it is from the standpoint of national policy. However, since these plans are voluntary on the part of the employer and both the institution of new pension plans and increases in benefits depend upon employer willingness to establish or expand a plan, it is necessary to take into account additional costs from the standpoint of the employer. If employers respond to more comprehensive coverage, vesting and funding rules by decreasing benefits under existing plans or slowing the rate of formation of new plans, little if anything would be gained from the standpoint of securing broader use of employee pensions and related plans. At the same time, there are advantages in setting minimum standards in these areas both to serve as a guideline for employers in establishing or improving plans and also to prevent the promise of more in the form of pensions or related benefits than eventually is available.

Coverage.—One of the major objectives of the new legislation is to extend coverage under retirement plans more widely. For this reason, the committee bill sets minimum standards on the age and service requirements which can be used to exclude employees from participation in plans. Under the new rules, a qualified plan cannot require an employee to serve longer than one year or attain an age greater than 25 (whichever occurs later) as a condition of eligibility to participate in the plan. Thus, an employee who reaches age 25 and has at least a year of service would be eligible to participate (unless he is excluded for some reason other than age or service). However, a plan that provides vested rights immediately on participation will be permitted to set the participation requirements at no more than 3 years of service and age 25.

The Committee believes that these rules are reasonable. They provide a balance between the need to grant employees the right to participate in pension plans at a relatively early age so that they can begin to acquire pension rights and the need to avoid the administrative drawbacks that would be involved in granting coverage to immature and transient employees whose benefits would in any event be small. The participation rules also prevent potential avoidance of the vesting rules in the committee bill.

The bill also adopts a number of provisions which are carefully designed to make the minimum age and service requirements for participation work effectively. The Secretary of the Treasury or his delegate is given the authority to determine under regulations what constitutes a year of service for purposes of fulfilling the participation requirement in order to make the service requirement sufficiently flexible to meet the many varying situations which arise in different industries operating under different conditions of employment. At the same time, guidance is provided to those framing the regulations so as to

[16] minimize the possibilities of abuse. The bill, for example, provides that a qualified plan may not establish a service requirement for participation which has the practical effect of treating as a year of service an average period for all employees of more than 12 months or which excludes any employee who has more than 17 months of continuous service. In addition, the bill provides that a seasonal employee whose customary employment is for at least 5 months in a 12-month period is generally to be given credit for a year of service if he works his customary season months in a 12-month period.

The Secretary of the Treasury or his delegate is also given authority to prescribe by regulations different rules for determining a "year of service" for those industries whose normal work schedules are substantially different from those that are generally applicable. (For example, the regulations could, where consistent with the practice of an industry, permit 100 hours of employment to be treated as one month, or 1,000 hours of employment to be treated as one year.)

The bill also provides guidance to the Secretary or his delegate in issuing regulations in regard to the computation of the years of service of an employee who has a break in service. This is of significance since an employee will generally receive greater vested rights if all his periods of service with the employer are combined and treated as one period of service than if each period of service interrupted by a break is treated separately. This matter involves difficult issues. On the one hand, it appears desirable not to require service prior to the break to be merged with service after the break where the break in service is of substantial duration and the period of prior service is relatively short. This is because in such cases, the plan frequently will not have records regarding the employee's prior service and the administrative difficulties resulting from any requirement to merge service prior to the break with service after the break might make employers reluctant to rehire employees and yet at the same time would not provide substantial benefits for the latter. On the other hand, where the break in service is of relatively moderate duration, treating each period of service as a separate period could give rise to abuses by giving employers an inducement to discharge covered employees and then rehire them after a short time in order to reduce the cost of financing plan benefits. An additional consideration is that where an employee has acquired an attachment to the firm by serving a substantial number of years, and particularly where he has accumulated substantial vested rights to benefits, it seems reasonable that all his service including service prior to the break should be taken into consideration in determining his participation under the plan.

Your committee has resolved these issues by providing that where an employer rehires an employee who has had a break of service of at least one year after serving with the employer for less than 4 consecutive years, the plan will not be considered to be following an unreasonable procedure merely because it does not take into consideration his prior service. However, where a rehired employee had completed at least 4 consecutive years of service before the break, his prior years of service must be taken into consideration for purposes of computing his years of service unless the break is for 6 years or more. However, if a rehired employee acquired a nonforfeitable right to at least 50 per-

[17] cent of his accrued benefits derived from employer contributions prior to the service break, all his prior service must be taken into consideration in computing his years of service, regardless of the duration of the break.

Under plans which provide defined or specified benefits, it is more expensive for an employer to finance an equivalent retirement benefit for an older employee than for a young employee. To avoid making it more difficult for older workers to find employment, the bill permits plans which provide defined benefits to exclude from participation employees who begin employment within 5 years of the normal retirement age. This, for example, permits a defined benefit plan which provides for a normal retirement age of 65 to exclude an employee who begins work at the age of 60. Such exclusions are not permitted under money purchase pension plans or profit sharing plans. Under these plans, an employee is not promised any specified benefits, but instead is entitled only to the amount that is in his account (employer contributions, forfeitures, and employee contributions, adjustments for earnings, losses, and expenses) with the result that it is no more expensive for the employer to cover older employees than younger employees under such plans.

For purposes of satisfying the coverage rules of the Internal Revenue Code, a plan is permitted to exclude from participation employees covered by a collective bargaining agreement where the agreement does not provide that such employees are to be included in the plan and there is evidence that retirement benefits were the subject of good faith bargaining. This provision has two objectives: first, it recognizes that employees who are represented in collective bargaining agreements may prefer other forms of compensation, such as cash compensation, to coverage in a plan; and second, it makes it possible for employees who are not covered by a collective bargaining agreement to receive the advantages of coverage in a qualified plan where some employees of the same firm have elected through collective bargaining agreement not to be covered by the plan.[9] At present, it frequently is not feasible for the former employees to receive the advantages of a qualified plan because the very fact that the employees covered by the collective bargaining agreement rejected coverage results in disqualifying the plan on the ground that it does not satisfy the coverage requirements for nondiscrimination.

Finally, all government plans (including the federal civil service pension plan) and plans of churches (unless they elect to be subject to the new rules) are exempted from the new participation standards as well as from the minimum vesting and minimum funding standards described below. However, both government plans and church plans must continue to meet the requirements for qualification under present law in order to make their employees eligible for the tax benefits associated with qualified plans. The committee exempted government plans from the new higher requirements because adequate information is not now available to permit a full understanding of the impact these new requirements would have on government plans. For this reason the

[9] In the case of a plan covering airline pilots under a collective bargaining agreement, the bill permits the exclusion of the employees who are not covered by the collective bargaining agreement for purposes of the coverage requirements for nondiscrimination.

[18] bill specifically provides that the Committee on Ways and Means and the Committee on Education and Labor are to study the participation, vesting, and funding practices of government plans, government plan fiduciary standards, factors affecting the mobility of government employees and those employed under Federal procurement contracts, and the need for Federal standards in each of these matters. Each committee is to submit to the House of Representatives not later than December 31, 1976, the results of the studies, together with its recommendations.

To give existing plans time to adjust to the new age and service participation requirements, the effective date of these requirements is deferred to January 1, 1976, for plans in existence on January 1, 1974. For plans adopted on or after January 1, 1974, the new minimum age and service requirements will be effective in the first plan year beginning after the date of enactment. However, for existing plans which were the subject of collective bargaining agreements, the minimum funding standard will not apply until the last of the present collective bargaining agreements terminates or January 1, 1981, whichever is sooner.

Vesting.—Coverage under a pension plan does not aid an individual if he later forfeits his right to his pension benefits upon voluntary or involuntary termination of employment. This is an important consideration in view of the fact that ours is a fairly mobile economy where employees tend to change jobs frequently, especially in their younger years. Moreover, the cyclical and technological nature of certain industries results in frequent layoffs over a work career for employees in those industries, as in aerospace and defense. The committee bill deals with this problem by requiring qualified pension plans to grant covered employees reasonable minimum vested rights to their accrued benefits.

The committee bill helps to assure that covered employees will actually benefit from pension plans by requiring qualified plans, as a condition of qualification under the Internal Revenue Code to meet reasonable minimum vesting standards. Qualified plans are required to grant covered employees nonforfeitable rights with respect to their own contributions. In addition, such plans are required to provide covered employees minimum vested rights with regard to employer contributions after they have fulfilled certain specified requirements. In adopting these minimum vesting requirements, your committee was guided by two broad considerations. The first relates to the need to balance the protection offered by the minimum vesting provision against the additional cost involved in financing the plan. Employees, of course, would be accorded the maximum protection if they were granted immediate and full vested rights to plan benefits. However, it is generally recognized that a requirement for immediate and full vesting would not be feasible because it would involve such substantial additional costs that it would impede the adoption of new plans and the liberalization of existing ones.

The second broad consideration guiding the committee in regard to minimum vesting is the need to provide adequate flexibility to the hundreds of thousands of retirement plans, to enable these plans to provide adequate vesting protection to their covered employees in the light of the individual circumstances and conditions confronting

[19] them. In other words, the committee does not believe that it would be desirable to force all retirement plans into one rigid mold so far as vesting is concerned.

In view of these considerations, the committee bill provides three alternative vesting options:

Under one option, a qualified plan would be required to provide an employee with vested rights to at least 25 percent of his accrued benefits from employer contributions after 5 years of covered service, plus an additional 5 percent for each of the next 5 years and 10 percent for each of the next following 5 years. This means that under this option, at least 50 percent of the employer-provided benefits must be vested after 10 years of covered service and 100 percent vested after 15 years of covered service. This option is designed to enable plans to provide the required vesting on a gradual basis according to years of service, generally without reference to the age of the employee. This option is neutral with respect to age, since all employees who fulfill the required service requirements are entitled to the specified vesting without regard to their age.

A second option permits firms which wish to provide faster vesting for their more mature employees than for their younger ones to do so by taking into consideration the age of the employee as well as his service for purposes of computing his vested rights. Under this option, the plan is required to provide a covered employee who has at least 5 years of covered service a vested right in at least 50 percent of the accrued benefits financed by the employer's contributions when the sum of his age and years of service equals 45; the minimum required vesting percentage would thereafter be increased by 10 percentage points a year in each of the following 5 years. This would, for example, provide an employee who began work for the employer at the age of 25, a vested right in 50 percent of his accrued benefits financed by employer contributions after 10 years of covered service when he reaches the age of 35. After completing an additional 5 years of service and attaining age 40 he would then be vested in 100 percent of his accrued benefits. On the other hand, an employee who starts to work for the employer at the age of 40 under this option would at the age of 45, upon completion of 5 years of service, receive a 50 percent vested right in his accrued benefits.

The third option provided under the committee bill permits qualified plans to fulfill the minimum vesting requirements by providing employees a 100 percent nonforfeitable right to accrued benefits derived from employer contributions when they have achieved at least 10 years of service. The committee provided this option because it grants covered employees complete vesting protection after the completion of a reasonably short period of service.

Because the objective is to encourage more adequate provision for retirement, plans are permitted to defer the payment of benefits to individuals with vested rights until they reach normal retirement age and are separated from the firm.[10] As a general rule, the plan will

[10] However, to avoid requiring a plan to carry relatively small amounts of benefits on its books for a long period of time, the bill permits a plan to elect to pay off the employee's vested rights in the form of a lump-sum payment when the employee is separated if the amount of the distribution is less than $1,750. In addition, at the election of the employee, a plan which so provides may make lump-sum payments of any amount to employees at the time they are separated from service in lieu of retirement benefits.

[20] specify what is normal retirement age for this purpose. However, in order to prevent undue delay in the payment of benefits, payment must begin not later than 60 days after the close of the last plan year in which the participant (1) attains age 65, (2) reaches the 10th anniversary of the start of his participation, or (3) terminates his employment. The "10th anniversary" provision was adopted to encourage the employment of individuals who are hired at mature ages for a long enough period to enable them to earn significant benefits under the plan.

The committee further decided to apply the minimum vesting requirements to benefits accrued prior to the effective date of the provision as well as to benefits accrued after this date on the ground that employees merit equal protection with regard to plan benefits regardless of when these benefits accrued. This is achieved by generally taking into account the employee's entire service with the employer in determining both his nonforfeitable vesting percentages and the amount of accrued benefits to which these vesting percentages are applied.

To keep the operation of the minimum vesting requirement reasonable and to avoid imposing undue burdens on plans, certain periods of service are permitted to be excluded in determining the employee's nonforfeitable rights. The service which may be excluded is:

(1) service before age 25,

(2) service during a period for which the employee declined to contribute to a plan requiring employee contributions,

(3) service during any period for which the employer did not maintain the plan,

(4) seasonal service which does not include a sufficiently long period of time in each 12-month period to be counted as service for purposes of the plan,

(5) certain service broken by periods of suspension of employment, and

(6) service before January 1, 1969, unless the employee has had at least 5 years of service after December 31, 1968. (This latter exclusion was adopted to prevent the possibility that plans would otherwise be required to incur extremely large costs for benefits to previously retired employees who would otherwise have the incentive to come back to a firm for relatively short periods of time, primarily in order to obtain plan benefits for their prior service).

How much protection is actually afforded to employees under the minimum vesting provision depends not only on the minimum vesting percentages set forth in the bill but also in the case of defined benefits on the accrued benefits to which these minimum vesting percentages are applied. For this reason, your committee has devoted particular attention to the development of fair and equitable procedures for the computation of accrued benefits.

Under the first option, the accrued benefit is determined by providing that the plan may not require employees to accrue benefits in any year of service at a rate which is more than 133⅓ percent of the rate of accrual in any other year.[11] The primary purpose of this

[11] In testing the annual rate of accrual for any plan year against the annual rate of accrual for any prior plan year, the plan may provide that accruals for any prior period before the 11th year of service are not to be taken into account.

[21] provision is to prevent attempts to defeat the objectives of the minimum vesting provisions by providing undue "backloading", i.e., by providing inordinately low rates of accrual in the employee's early years of service when he is most likely to leave the firm and by concentrating the accrual of benefits in the employee's later years of service when he is most likely to remain with the firm until retirement. Of course, a plan under which employees accrue benefits at a uniform rate would satisfy the requirements of this option.

Under a second option, a defined benefit plan may provide for an annual rate of accrual which is not less than 3 percent of the maximum benefit to which the participant would be entitled if he became a participant at the earliest possible entry age under the plan and served continuously until the earlier of age 65 or the retirement age specified under the plan. This treatment provides equal amounts of accrued benefits to employees who are separated prior to retirement age after having worked the same number of years, regardless of their respective ages at the time the service was performed.

Under present law, highly mobile employees such as engineers, frequently do not derive benefits from pension plans even when such plans have liberal vesting provisions because they tend to change jobs before they acquire vested rights in any particular plan. The bill approved by your committee will help such employees to secure actual benefits from pension plans. It provides that where an employer sets up different pension plans for different groups of employees the rate of vesting granted under the different plans need not be the same so long as the combined effect of all the plans is nondiscriminatory. This permits an employer to cover his highly mobile employees in a separate plan which provides faster vesting but lower benefits at normal retirement age than the other plans that he establishes for his other employees.

In addition, the committee bill instructs the Secretary of Labor to conduct a full and complete study of the steps necessary to ensure that professional, scientific and technical personnel and others working in associated occupations employed under federal procurement, construction or research contracts or grants will, to the extent feasible, be protected against the forfeitures of pension or retirement rights as consequence of job transfers or loss of employment resulting from terminations or modifications of Federal contract grants or procurement policies. The Secretary of Labor is further instructed to report the results of his study to the Congress within two years after the date of enactment of the Act. Also, if he determines it to be feasible, the Secretary is to develop regulations within one year after the date on which he submits his report to the Congress, which will provide for the better protection of the vesting rights of the employees concerned. These regulations are to take effect unless either house of the Congress adopts a resolution disapproving the regulations within 90 days after they are submitted to the Congress.

Under certain circumstances, a plan's vesting rules may cause the prohibited discrimination. Questions have arisen as to whether a plan which satisfies the vesting requirements provided by your committee automatically satisfies the vesting requirements of the nondiscrimination rules. To remove any possible ambiguity on this subject, the committee bill specifically provides that a plan which satisfies the minimum vesting requirements provided by this legislation is to be treated as satisfying any requirements regarding the vesting schedule and

[22] the rate at which benefits accrue, resulting from the application of the Internal Revenue Code requirements regarding nondiscrimination, unless (a) there has been a pattern of abuse under the plan (such as a firing of employees before their accrued benefits vest), or (b) there have been, or there is reason to believe there will be an accrual of benefits or forfeitures tending to discribinate in favor of employees who are officers, shareholders, or highly compensated.

Table 3 shows that the addtional costs of financing plans involved when the minimum vesting requirement adopted by your committee becomes fully effective is expected to be moderate. These cost estimates are necessarily based on assumptions as to turnover rates, age distribution, etc. However, the range of costs is believed to be broadly indicative of the expected experience of employers generally.

TABLE 3.—ESTIMATED RANGE OF INCREASE IN PENSION PLAN COSTS UNDER THE REQUIREMENTS FOR MINIMUM VESTING ADOPTED BY THE COMMITTEE

	Present vesting—			
	None	Moderate [1]	Liberal [2]	All plans
Percentage of pension plan members covered under such plans	23	56	21	100
Range of present plan cost as a percent of payroll	1.8–11.2	2.2–12.5	2.2–12.7	1.8–12.7
Range of increase in cost under committee vesting requirement:				
As a percent of payroll	.2–1.5	.1–.2	0	0–1.5
As a percent of present plan cost	5–58	1–8	0	0–58

[1] Plan provides some vesting, but less liberal than full vesting after 10 years of service.
[2] Plan provides full vesting after 10 years service or less, with no age requirement.

Source: "Estimates prepared for the Joint Commtitee on Internal Revenue Taxation," by Donald S. Grubbs, Jr.

The additional costs will, of course, be zero or smallest for those plans which now have liberal vesting provisions and greatest for those plans which now provide no vesting prior to retirement. This reflects the fact that the minimum vesting provisions will generally bring the costs of the latter plans up to the level of those plans which now have liberal vesting provisions. Overall, for all plans, the cost increases resulting from the new minimum vesting requirements will range from 0 to 1.5 percent of payroll.

In the case of plans adopted after January 1, 1974—which will have been adopted with knowledge of the new requirement—the effective date is the first plan year beginning after the date of enactment. However, for plans in existence on January 1, 1974, to provide time to adjust to the new minimum vesting requirements, the effective date of the minimum vesting standards is plan years beginning after December 31, 1975. For plans, which are maintained pursuant to collective bargaining agreements, however, the minimum vesting requirements take effect for plan years beginning after the expiration of the latest agreement or December 31, 1980, whichever is earlier.

In addition, for all plans in existence on December 31, 1973, the vesting provisions are to become effective gradually over a 5-year transition period. Under this rule, 50 percent of the vested rights generally called for under the legislation are to become effective in the first year in which the vesting requirement applies. Thereafter the required vesting is to increase 10 percentage points each year until

[23] reaching 100 percent of the vested rights generally required under the legislation after the fifth year.

Finally, the Secretary of Labor is authorized to provide variances from the generally applicable minimum vesting requirements for multi-employer plans whenever he finds that the application of these requirements would (1) increase the cost of the parties to the plan to such an extent that there would be (a) a substantial risk to the voluntary continuation of the plan, or (b) a substantial curtailment of pension levels or the levels of employees' compensation, or (2) impose unreasonable administrative burdens regarding the operation of the plan, and (3) where the application of these requirements would be adverse to the interest of plan participants generally. Under such variances, the Secretary of Labor would prescribe alternative methods by which the multi-employer plan concerned could satisfy the minimum vesting requirements for the period of time this is necessary. These variances from the vesting requirements are not, however, to be prescribed unless all plan participants and other interested persons have received adequate notice from the plan administrator of any hearing to be held to consider the variance.

Minimum funding standards.—Your committee believes that it is essential for plans to be adequately funded in accordance with a contributions schedule which will produce sufficient funds to meet the obligations of the plan when they fall due. Such an adequate contributions schedule for funding plans not only protects the rights of employees under the plan but also provides an orderly and systematic way for employers to pay their plan costs.

You committee believes that the minimum funding requirements under present law are inadequate because they do not require any provision to be made to amortize unfunded past service liabilities. Instead they merely require the contributions to the plan to be sufficient to pay normal costs (the costs attributable to the current operation of the plan) and to prevent an increase in unfunded liabilities. To remedy this, your committee has provided new minimum funding standards for qualified plans. In the most typical case, the standard requires contributions to the plan to be sufficient not only to pay normal costs but also to amortize all unfunded past service liabilities in level payments over specified periods of time. A second standard requires contributions to be based on the accrued unfunded vested liabilities of the plan if this results in higher annual payments than the general funding standard. It is anticipated that this second standard will be used for only a small minority of the plans which have relatively large unfunded vested liabilities.

The new funding standards do not apply to the following types of qualified plans:

(1) Profit-sharing and stock bonus plans. (There is no need for a requirement that contributions be sufficient to fund a specified level of benefits in the case of these plans since they do not specify that participants are to receive any designated amount of benefits, but instead require the paying out of whatever benefits the funds in the plan will purchase on the date the benefits are to begin.)

(2) Plans funded exclusively through the purchase of individual insurance contracts which provide for level annual premium pay-

[24] ments. (These plans are excluded from the funding requirements because they have behind them the funding of the insurance companies involved.)

(3) Government plans. (However, government plans are still required to meet the present funding standards which require contributions to be sufficient to pay normal pension costs plus the interest on past service liabilities. Also, as noted previously, your committee has provided for a study of government plans to determine the need for supplying funding standards.)

(4) Church plans unless these plans elect to be covered by such requirements, and

(5) Plans which after the date of enactment of the legislation do not provide for employer contributions.

In the most typical case where the first general funding standard is employed, employers maintaining single-employer plans not in existence on the effective date of the legislation must pay normal costs currently and amortize their past service liabilities in level payments over no more than 30 years. A similar amortization period of no more than 30 years is required for past service liabilities arising as a result of single-employer plan amendments after the effective date. However, in recognition of the fact that large numbers of plans assumed heavy past service liabilities prior to any requirement to amortize such liabilities, plans in existence on the effective date of the legislation are allowed a longer period—up to 40 years—to amortize past service liabilities existing at the beginning of the first plan year to which the requirement applies. In addition, multi-employer plans are allowed to amortize all past service liabilities, including those created after the effective date of the legislation, over a period of up to 40 years. This recognizes that multi-employer plans generally have an added element of financial strength in that their contributions come from a number of employers who as a group are less likely than comparable single employers to experience business difficulties.

This funding standard, which will apply to the overwhelming majority of plans, is comprehensive since it requires amortization of all accrued past service liabilities (i.e., both vested and nonvested unfunded past service liabilities).

The level payment method of funding adopted by your committee is analogous to the payment of a home mortgage in that each specified payment includes a payment for both interest and principal. It has the advantage of spreading the payments out evenly over the payment period which generally makes it easier for the employer to plan for meeting the payments. Another factor in your committee's decision is that the level payment method, while providing for adequate amortization of past service costs, initially adds only relatively moderate amounts to an employer's existing funding costs. This is because interest on unfunded accrued past service costs, which accounts for the bulk of the payments under the level payment method in the early years, is already required to be contributed to a defined benefit plan under present law.

Provision is also made for the equitable funding of experience deficiencies which arise when the actual plan costs turn out to be greater than were previously estimated on the basis of the actuarial assump-

[25] tions—for example, when the value of the plan assets is less than was expected. In establishing a minimum funding standard for such experience deficiencies, the committee sought to avoid two problems. If it allowed the experience deficiencies to be funded over a very long period of time, an incentive would be provided for the use of actuarial assumptions which understate the costs since any resulting deficiencies could then be made up over a long period of time without penalty. On the other hand, if the experience deficiencies were required to be amortized over too short a period, employers would encounter hardship in meeting the annual payments. This is especially pertinent in view of the fact that most actuarial or experience deficiencies are inadvertent.

Your committee's bill seeks to avoid both these problems by allowing experience deficiencies to be funded in level amounts over a period of up to 15 years for single employer plans and up to 20 years for multiemployer plans. Symmetrical treatment is provided for experience gains which are attributable to a favorable variation between actual experience and the actuarial assumptions entering into the determination of the employer's cost and contributions.

The determination of experience gains and losses for this purpose will generally be made every three years except where the Secretary or his delegate (pursuant to regulations) finds it necessary to require the determination to be made more frequently.

Relief measures are provided to mitigate the impact of the funding requirements in cases where it would otherwise result in hardship. The bill gives the Internal Revenue Service the authority to waive the minimum funding requirement in cases where the application of this requirement would involve substantial business hardship to the employer and would be adverse to the interests of plan participants in the aggregate.

However, the waived contribution must be made up in level payments over a maximum of 15 years. To avoid the indefinite postponement of the fulfillment of the funding standards, the committee bill further provides that not more than five such waivers may be made in any 15-year period.

The committee also recognizes that multi-employer plans which are negotiated as a result of collective bargaining agreements may involve different considerations in regard to funding than individual employer plans. While it is the objective of the committee's bill to require adequate funding for multi-employer plans as well as for individual employer plans, the committee is aware that a number of multiemployer plans are not as well funded as they might be at the present time and that the application of the new funding standards to such plans without an adequate transition period might cause hardship and be detrimental to the interests of the employees covered by such plans. For this reason, if 10 percent or more of the number of employers contributing to a multi-employer plan demonstrate to the satisfaction of the Secretary of Labor that they would experience substantial business hardships if they were required to amortize past service liabilities and experience deficiencies over the periods of time specified by the bill (40 years and 20 years, respectively), and if this requirement would be adverse to the interests of plan participants in the aggregate, then upon

[26] certification by the Secretary of Labor to the Secretary of the Treasury, these plans are to be allowed an additional 10 years to amortize such costs.

In addition, the Secretary of Labor is authorized to provide variances from the minimum funding requirements for multi-employer plans where he finds that the application of these requirements would increase costs to the extent that there would be a substantial risk to the voluntary continuation of the plan, impose unreasonable administrative burdens in regard to the operation of the plan and be adverse to the interests of plan participants in the aggregate.[12]

Your committee believes that the generally applicable funding standard, which requires past service liabilities to be amortized in level payments over a specified number of years, will generally provide an equitable and adequate approach to funding the vast majority of plans. However, in some cases where plans have very substantial vested liabilities and relatively small asset values, it appears desirable to require the unfunded vested liabilities to be amortized more rapidly than under the generally applicable funding standard. For this reason, your committee has provided a second funding standard, based on accrued unfunded vested liabilities. This standard is to apply in lieu of the generally applicable funding standard if it results in a higher annual contribution. Under this standard, the accrued vested liabilities of the plan and the value of its assets are determined. Where the former exceeds the latter, the contribution for that year must be sufficient to cover the first year's payment under a level annual payment schedule required to amortize the difference in 20 years. A new determination with respect to the applicability of this second funding standard is to be made in each of the succeeding years. It is contemplated that this funding standard will be required for only a small minority of qualified plans.

In general, for purposes of funding, the value of the plan's assets is to be determined on the basis of any reasonable actuarial method of valuation which takes fair market value into account under regulations prescribed by the Secretary of the Treasury or his delegate. However, to permit fixed obligations, which frequently are held until maturity, to be given stable values for funding purposes, the plan administrator is given the option of determining the value of a bond or other evidence of indebtedness (which is not in default as to principal or interest) on an amortized basis.

Your committee is aware that the actuarial assumptions made by actuaries in estimating future pension costs are crucial to the application of minimum funding standards for pension plans. This is because in estimating such pension costs, actuaries must necessarily make actuarial assumptions about a number of future events, such as the rate of return on investments (interest), employee future earnings, and employee mortality and turnover. In addition, actuaries must also choose from a number of funding methods to calculate future plan liabilities. As a result, the amount required to fund any given pension plan can vary significantly according to the mix of these actuarial assumptions and methods.

[12] The conditions under which such variances from the funding requirements may be granted are identical to those applying to variances from the minimum vesting requirements described above.

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[27] Conceivably an attempt might be made to secure uniform application of the minimum funding standards by authorizing the Secretary of the Treasury or some other authority to establish the specific actuarial assumptions and methods that could be used by pension plans. This would involve, for example, setting a specific rate of interest that could be used by certain pension plans or by specifying certain turnover rates for specified types of firms. However, the committee does not believe that this would be an appropriate procedure, since the proper actuarial assumptions may differ substantially between industries, among firms, geographically, and over time. Further, in estimating plan costs each actuarial assumption may be reasonable over a significant range and it would appear that the proper test would be whether all actuarial assumptions used together are reasonable. These considerations strongly indicate that any attempt to specify actuarial assumptions and funding methods for pension plans would in effect place these plans in a straitjacket so far as estimating costs is concerned, and would be likely to result in cost estimates that are not reasonable.

However, your committee's bill requires the actuarial assumptions of each plan to be certified by an actuary every three years (or more frequently if required by the Internal Revenue Service). These certifications will be reported to the Service. Moreover, in order to insure that such certification will be made by competent actuaries, the bill provides that the Secretary of the Treasury is to establish qualifications for actuaries and is to certify for practice before the Internal Revenue Service the persons who meet these standards. The Secretary of the Treasury is also to review the actuarial assumptions used by particular plans and an advisory board of actuaries is to be established to assist him in setting up general standards as to reasonableness of assumptions.

The bill also provides new and more effective penalties where employers fail to meet the funding standards. In the past, an attempt has been made to enforce the relatively weak funding standards existing under present law by providing for immediate vesting of the employees' rights, to the extent funded, under plans which do not meet these standards. This procedure, however, has proved to be defective since it does not directly penalize those responsible for the underfunding. For this reason, the bill places the obligation for funding and the penalty for underfunding on the person on whom it belongs—namely, the employer.

This is achieved by imposing an excise tax where the employer fails to meet the funding standards, which starts out at a relatively modest level and increases sharply where there is continued failure to make the indicated contributions. More specifically, if an employer fails to contribute sufficient amounts to meet the new funding requirements, he will be subject to a nondeductible excise tax of 5 percent per year on the amount of the underfunding for any year. If the employer fails to make up the underfunding by 90 days after original notification by the Internal Revenue Service (but with the Service in a position to grant extensions of time), then the employer is subject to a second level excise tax amounting to 100 percent of the underfunding. This determination by the Service is appealable to the Tax Court and no

[28] assessment may be made until after the end of the litigation. Since the employer remains liable for the contributions necessary to meet the funding standards even after the payment of the excise taxes, it is anticipated that few, if any, employers will willfully violate these standards.

For plans adopted after January 1, 1974, which will have been adopted with knowledge of the new requirement, the effective date of the new funding requirements is the first plan year beginning after the date of enactment. For plans in existence on January 1, 1974, which are not maintained pursuant to collective bargaining agreements, the effective date of the minimum funding standards is deferred to plan years beginning after December 31, 1975. And for plans which are maintained pursuant to collective bargaining agreements, the minimum funding requirements take effect for plan years beginning after the expiration of the latest agreement (if this is after December 31, 1975) or after December 31, 1980, whichever is earlier.

Other provisions to protect covered employees and their beneficiaries.—In addition to the minimum participation, vesting and funding standards provided in the bill, your committee has adopted a number of specific provisions to protect the rights of employees and beneficiaries under qualified plans.

Qualified plans must pay benefits in the form of a joint and survivor annuity, giving the surviving spouse an annuity equal to at least 50 percent of the annuity paid during the joint lives, unless the participant elects in writing before the annuity starting date not to take a joint and survivor annuity.

Qualified plans must provide that retirement benefits may not be assigned or alienated, except for voluntary and revocable assignments of not more than 10 percent of the benefits in payment of premiums for life insurance and medical and hospital insurance and certain other items.

Provision is made to prevent mergers or consolidation of plans from reducing the rights of participants. This is achieved by specifying that immediately after the merger each participant would be entitled to receive a benefit equal to or greater than the benefit he would have been entitled to receive immediately before the merger had the plan been terminated.

Protection is given to retired individuals and individuals who are separated from the service of the employer against reductions in private plan benefits when social security benefit levels increase. In general, under present integration procedures, social security benefits attributable to employer contributions are treated as though they were part of the private plan. As a result when the level of social security benefits increases, some integrated plans have reduced the amount of the retirement benefits that they provide for covered employees.

Present law under administrative practice provides that qualified plans may not use increases in social security benefit levels to reduce the benefits that they pay where the employees concerned are retired and are already receiving integrated plan benefits. The bill codifies this treatment for retired persons. It also extends the prohibition against reducing plan benefits where social security benefit levels are increased to cases where the individuals concerned are separated from

[29] service prior to retirement and have deferred nonforfeitable rights to plan benefits. This provision is effective for increases in social security benefits which take place after the date of enactment or on the date of the first receipt of plan benefits or the date of separation from service (whichever is applicable) if that date is later.

These changes do not affect the ability of plans to use the integration procedures to reduce the benefits that they pay to individuals who are currently covered when social security benefits are liberalized. Your committee, however, believes that such practices raise important issues. On the one hand, the objective of the Congress in increasing social security benefits might be considered to be frustrated to the extent that individuals with low and moderate incomes have their private retirement benefits reduced as a result of the integration procedures. On the other hand, your committee is very much aware that many present plans are fully or partly integrated and that elimination of the integration procedures could substantially increase the cost of financing private plans. Employees, as a whole, might be injured rather than aided if such cost increases resulted in slowing down the rate of growth of private retirement plans.

In view of the serious issues involved in the integration of private plans with the social security system, your committee believes that it is desirable to postpone action on this issue pending further study of this problem. More specifically, your committee plans to consider this overall problem again at the earliest opportunity, possibly in connection with future tax reform or social security legislation. However, your committee believes that no further integration of social security and pension benefits should be allowed under any further regulations issued by the Secretary or his delegate at least until June 30, 1975.

Portability.—In view of the fact that ours is a highly mobile economy, characterized by high employee turnover rates, various proposals have been made to establish a system for the portability of vested rights to benefits from one plan to another when an employee changes jobs.

While the complete portability of vested rights to benefits from one pension fund to another is hard to achieve because of the numerous basic differences in private pension plans, your committee's bill contains a number of provisions which will achieve much of the advantage of portability. Under present law, when an employee changes jobs, it is already possible for funds representing his vested rights to benefits under his old employer's plan to be transferred to the retirement plan of his new employer without payment of tax on an optional basis—that is, if the employee and the administrators of the plans involved agree to the transfer. Your committee's bill adds another way in which individuals can transfer their retirement funds on a tax-free basis to a tax-exempt retirement account. It allows them to establish a new type of account called a "rollover account." Under the new arrangement, individuals will have the right to roll over into individual retirement accounts, without payment of current tax, complete distributions of funds financed by employers under qualified plans, H.R. 10 plans, as well as funds from individual retirement accounts, provided that the transfer into the new account is made within 60 days of the withdrawals of the funds from the old plans.

[30] Provision also is made to supply adequate information to plan participants regarding their vested rights to retirement benefits so that they will not neglect to claim these benefits when they become eligible to receive them. In this connection, plan administrators are required to furnish each separated employee who has vested rights an individual statement showing the nature, amount and form of the deferred vested benefit to which he is entitled.

Also, in order to insure that employees will be fully alerted to their retirement benefits, the Social Security Administration will keep records regarding the vested rights of separated employees under single employer plans. Annual information pertaining to such vested rights will be forwarded by plan administrators to the Social Security Administration through the Internal Revenue Service. The Social Security Administration will then furnish this information regarding vested rights to individuals both on request and at the same time that official information is supplied to the employee or his beneficiary regarding social security benefits.

Because the furnishing of such information involves considerably more difficulties for multi-employer plans than for single-employer plans, the bill does not require multi-employer plans to supply individual statements regarding vested rights to separated employees; nor does it require multi-employer plans to file information showing the vested rights of separated employees. However, the Secretary of the Treasury after consultation with the Secretary of Health, Education and Welfare, may prescribe regulations requiring multi-employer plans to submit such information, to the extent it is found feasible.

Plan termination insurance.—Although your committee regards the development of an adequate program of plan termination insurance as essential to protect the rights of covered employees, the bill makes no provision for such plan termination insurance. This is because provision for plan termination insurance is made in H.R. 2, reported by the Committee on Education and Labor.

Fiduciary requirements.—Your committee's bill makes no change in the rules relating to fiduciaries of qualified retirement plans. As with plan termination insurance, this is not because your committee regards this matter as unimportant but rather because H.R. 2, reported by the House Committee on Education and Labor, contains provisions providing for additional rules regarding fiduciary requirements.

Enforcement.—Your committee's bill relies heavily on the tax laws in order to secure compliance with the new requirements that it imposes on pension plans. Plans, for example, are required to comply with the new coverage, vesting, and funding standards in order to qualify for favored tax treatment under the Internal Revenue Code. In addition, excise taxes are imposed for failure to meet the funding standards. As a result, these substantive pension provisions would be administered by the Internal Revenue Service.

Your committee believes that primary reliance on the tax laws represents the best means for enforcing the new improved standards imposed by the bill. Historically, the substantive requirements regarding nondiscrimination, which are designed to insure that pension plans will benefit the rank and file of employees, have been enforced through the tax laws and administered by the Internal Revenue Service. As

[31] a result, the Internal Revenue Service is already required to examine the coverage of the retirement plans and their contributions and benefits as well as funding and vesting practices in order to determine that the plans operate so as to conform to these nondiscrimination requirements. Also, the Internal Revenue Service has administered the fiduciary standards embodied in the prohibited transactions provisions since 1954.

Your committee believes that the Internal Revenue Service has generally done an efficient job in administering the pension provisions of the Internal Revenue Code. The very extensive experience that the Service has acquired in its many years of dealing with these related pension matters will undoubtedly be of great assistance to it in administering the new requirements imposed by the committee bill.

However, because the bill increases the administrative job of the Service in this respect, your committee believes that it is desirable to add to its administrative capability for handling pension matters. For this reason, the committee bill provides for the establishment by the Internal Revenue Service of a separate office headed by an Assistant Commissioner of Internal Revenue to deal primarily with pension plans and other organizations exempt under section 501(a) of the Internal Revenue Code, including religious, charitable, and educational organizations. In order to fund this new office, the bill authorizes appropriations at the rate of $70 million per year for such administrative activities. It is intended that the Internal Revenue Service obtain from all appropriate pension administration sources annual statistical data to indicate the operations of the private retirement system for the purpose of evaluations and public information.

In addition to providing additional opportunities for redress in case of disagreement with the decisions of the Internal Revenue Service on pension matters, both employees and employers will be allowed to appeal determination letters issued by the Internal Revenue Service to the Tax Court after exhausting their remedies under the Internal Revenue Service administrative procedures.

Equalizing tax treatment; in general.—Another objective of the committee bill is to provide more rational and equitable tax treatment under retirement plans.

The committee believes that there is need on equity grounds to grant individuals who are not covered by any kind of qualified pension plan some of the tax advantages associated with such plans by providing them with a limited tax deduction for their retirement savings.

In addition, there is no justification for the present widely disparate treatment which places no specific limitation on the amount of deductible retirement plan contributions for corporate employees and at the same time limits the deductible contributions to pension plans on behalf of the self-employed to a maximum of 10 percent of earned income or $2,500 a year.

This unjustifiable difference in treatment has resulted in unduly large tax advantages for certain corporate employees; it also discriminates against the self-employed and has had the undesirable result of encouraging large numbers of self-employed people to incorporate merely to secure the larger tax advantages available with respect to corporate retirement plans. This includes large numbers of profes-

[32] sional people who are now permitted by all 50 States and the District of Columbia to incorporate.

In view of these considerations, the committee has provided the following three changes which should be regarded as one package in the sense that the adoption of all three changes are needed at the same time in order to improve the tax laws in regard to pension plans.

Equalizing tax treatment; individual retirement plans.—Your committee's bill allows individuals who are not receiving the advantages of current coverage under qualified retirement plans to take deductions for annual contributions to a new type of individual retirement plan, up to 20 percent of earned income or $1,500, whichever is less.

These retirement plans will be available to all employees who are not active participants in a qualified retirement plan, in a governmental pension plan or in an annuity plan established by a tax-exempt or public educational institution under section 403(b) of the Internal Revenue Code.[13] Self-employed individuals who are not covered by qualified retirement plans (H.R. 10 plans) are also eligible to establish individual retirement plans for themselves.

The employer of any individual who establishes a personal retirement plan will be allowed to make tax deductible contributions to that individual retirement account on behalf of the employee which will not be currently taxable to the employee so long as the sum of the employee's own deductible contribution and the employer's contribution do not exceed the allowable 20 percent of compensation—$1,500 annual limit. Unions may also establish individual retirement accounts for their members.

In order to encourage the widespread use of such individual retirement plans, your committee has provided that the contributions to such plans can be invested in a wide range of investments, including special government retirement bonds which would be issued for this purpose, annuity contracts sold by insurance companies, mutual funds, corporate securities, banks and credit unions.

The earnings on the amounts put aside in the individual retirement accounts are to remain free of tax until they are distributed. Distributions from the individual retirement savings plans are to be taxable when received by the employee, generally upon retirement or upon death or disability. However, since the individuals' incomes will generally be relatively low when they receive such distributions, the latter will ordinarily be taxed at relatively low rates. Individuals will also enjoy tax savings from being able to defer payment of tax on the earnings of the retirement funds during the time they are retained in the tax-free plans.

Since the objective of the new provision is to encourage adequate provision for retirement needs, withdrawal of the retirement savings prior to age 59½ will result in a penalty tax equal to 10 percent of the amount of the premature distribution. However, early withdrawals are permitted without penalty where the taxpayer becomes disabled. In addition, to prevent the individual retirement savings plans from being used to postpone tax indefinitely, the retirement savings must either be distributed by the time the individual reaches age 70½ or distributed

[13] Such section 403(b) annuities confer most of the tax advantages associated with qualified pension plans.

[33] over the lives or life expectancy of the individual and his spouse beginning no later than age 70½.

Your committee anticipates that by encouraging employers to make modest contributions initially for the retirement needs of their employees, such individual retirement plans will lead eventually to the establishment of a significant number of new qualified retirement plans by employers. An employer who believes he cannot afford the entire cost of a retirement plan can start by contributing small amounts for employee individual retirement accounts, can increase his contributions over the years (providing it does not exceed the 20 percent-$1,500 annual limits per participant), and then can subsequently convert to an employer-financed qualified plan. The provisions allowing individuals to deduct contributions within the specified limits to individual retirement plans generally take effect for taxable years beginning after December 31, 1973.

Equalizing tax treatment; increasing deductions for H.R. 10 plans.—Your committee's bill grants self-employed people tax treatment with respect to retirement plans (H.R. 10 plans) which is more nearly comparable to that now accorded to corporate employees under qualified retirement plans. This is achieved by increasing the maximum deductible contributions a self-employed individual is allowed to make on his own behalf to a qualified plan from the present level of 10 percent of earned income up to $2,500 a year to 15 percent of earned income up to $7,500 a year. For H.R. 10 plans which are of the defined benefit type, provision is made for applying comparable limitations on the benefits that may be paid to self-employed individuals under regulations to be prescribed by the Secretary of the Treasury or his delegate.

In keeping with the major objective of securing more uniform tax treatment of self-employed people and corporate individuals under qualified retirement plans, contributions or benefits for self-employed people under qualified plans are also made subject to the same overall limitations that are placed on contributions or benefits for regular employees under qualified plans.

Your committee has also made provision to allow self-employed individuals, whose earned income fluctuates sharply, declining to low levels in some years, to continue to set aside a specified minimum amount regularly for retirement under an H.R. 10 plan. This is achieved by permitting a self-employed individual to deduct contributions to such plans amounting to $750 or 100 percent of their earned income, whichever is less, even though these amounts are in excess of the regular deduction limits.

The new more liberal limitations on contributions or benefits for self-employed people under qualified plans are also to apply to shareholder employees of subchapter S corporations (small business corporations) who are generally subject to the same limitations as self-employed people under qualified plans. This means, for example, that contributions of up to the lesser of 15 percent of earned income or $7,500 a year may be made under qualified defined contribution plans on behalf of such shareholder employees without giving rise to current tax for them.

In addition, provision is made to insure that self-employed individuals who wish to utilize the full maximum tax allowance for their

[34] own contributions will also provide significant pension contributions for their regular employees who are covered by the pension plan. This is achieved by allowing self-employed people to count no more than $100,000 of their earned income in computing pension contributions or benefits for themselves. This prevents a self-employed individual with an extremely large income from achieving the $7,500 maximum annual deduction for his own pension contribution through the use of a low contribution rate which would be detrimental to his employees since the pension contributions on their behalf are computed using the same contribution rate. For example, a self-employed individual who counts his first $100,000 of earned income for this purpose, must contribute to the plan at least 7.5 percent of the wages of his covered employees in order to be permitted a deductible contribution of $7,500 on his own behalf.

Finally, your committee adopted provisions to improve the effectiveness of H.R. 10 plans in achieving their retirement objectives and preventing abuses in the operation of such plans. Present law disqualifies the plan if willful contributions in excess of the allowable limits are made on behalf of owner-employees since such excess contributions unduly build up their tax-free accumulations in the plan. Experience has shown that this is not an adequate remedy since disqualification of the plan for excess contributions on behalf of owner-employees penalizes the regular employees who are not in any way responsible for the excess contributions. For this reason, instead of disqualifying the plan, where excess contributions are made on behalf of the self-employed individuals, the bill adopts a new more effective penalty, namely, a tax on the employer, amounting to 6 percent a year on the amount of the excess contribution. In addition, to discourage premature withdrawal of the H.R. 10 funds by owner-employees prior to retirement age, withdrawals before such individuals attain the age of 59½ (except in case of disability) are subject to an additional tax amounting to 10 percent of such premature contributions.

The new more liberal limits in regard to contributions on behalf of self-employed people under H.R. 10 plans are effective for taxable years beginning after December 31, 1973. However, the new limits on benefits under defined H.R. 10 benefit plans (which are designed to secure comparability with the limitations applying to H.R. 10 plans of the defined contribution type) the 6-percent tax on excess contributions for self-employed individuals and the 10-percent tax on premature withdrawals by owner-employees are effective for taxable years beginning after December 31, 1975.

Overall limitations on contributions and benefits for employees under plans.—In view of the vital role that the favorable tax treatment accorded under the Internal Revenue Code plays in stimulating the growth and development of nondiscriminatory retirement plans, your committee believes that it is essential to continue this treatment. In fact, as noted above, the bill adopted by your committee extends the favorable tax treatment more generally by increasing the allowable deductible contributions of self-employed people under H.R. 10 plans and by providing for the establishment of limited retirement savings plans for individuals who are not covered by qualified retirement plans

However, after careful consideration, your committee has concluded

[35] that it is not in the public interest to make the substantial favored tax treatment associated with qualified retirement plans available without any specific limitation as to the size of the contributions or the amount of benefits that can be provided under such plans. The fact that present law does not provide such specific limitations has made it possible for extremely large contributions and benefits to be made under qualified plans for some highly paid individuals. While there is, of course, no objection to large retirement benefits in themselves, your committee believes it is not appropriate to finance extremely large benefits in part at public expense through the use of the special tax treatment. Moreover, the fact that there are no specific limits on the size of the contributions or benefits that may be made under qualified plans on behalf of highly paid employees discriminates against the self-employed whose contributions or benefits under H.R. 10 plans are limited by law. For this reason, your committee has provided specific limitations on the amount of contributions and benefits that can be provided for any one individual under a qualified plan. These limitations, which apply to both employees and self-employed people under qualified plans, have been designed to avoid abuse of the favored tax treatment to finance extremely large pensions. However, the limitations are generous enough to permit substantial retirement benefits which are adequate judged from any reasonable standard.

Under defined contribution plans (money-purchase pension plans and profit-sharing plans), the sum of the employer's contributions for the employee, a specified portion of the employee's own contributions, and any forfeitures allocated to the employee cannot exceed 25 percent of the employee's compensation or $25,000, whichever is less. These limits would also apply to contributions made to qualified plans of exempt organizations under section 403(b).

Your committee decided to take employee contributions to qualified plans into account for purposes of this contribution limit because the employee gets a tax advantage from the fact that the earnings on his contributions remain free of tax so long as they are kept in the plan, thus permitting a tax-free buildup of funds. However, unlike employer contributions under qualified plans, employee contributions are made out of taxed income. For this reason, for purposes of counting employee contributions for purposes of the 25 percent and $25,000 annual limits on contributions on behalf of any employee under a defined contribution plan, there is to be excluded the greater of (a) employee contributions amounting to 6 percent of compensation or (b) one-half of the employee's contributions.

For plans which provide defined benefits, your committee has phrased the limit in terms of the amount of annual benefits that may be paid to a participant. More specifically, the annual benefit paid under such plans cannot exceed 100 percent of the participant's average compensation for his highest 3 years of earnings (regardless of the age at which the benefits start) or $75,000 beginning at age 55 or later, whichever is less. Where the annual benefit starts before age 55, the $75,000 annual limit on benefits is adjusted downward actuarially. However, to avoid any possible adverse effect on individuals with relatively modest retirement benefits, this benefit limitation is not to apply to retirement benefits which do not exceed $10,000 for the plan

[36] year or for any prior plan year. This exception from the benefit limitation is available only where the employer has not at any time maintained a defined contribution plan in which the participant was covered.

While any specific dollar limit on the amount of benefits under qualified plans is necessarily a matter of judgment, your committee believes that the annual limitation of $75,000 at age 55 or later achieves a reasonable balance in view of the considerations involved. Benefits starting at any age are allowed to amount to as much as 100 percent of average pay during the high 3 years of earnings after study disclosed that any lower percentage limit would adversely affect individuals with relatively modest earnings who are covered under generous plans. Your committee believes that it would be unwise to discourage liberal benefits for such individuals.

As noted above, the $75,000 annual limit is applied to a benefit financed by the employer which is payable in the form of a straight life annuity beginning at age 55. Correspondingly, higher benefits may be paid to the extent that they are financed by employee contributions. No actuarial adjustment is required to be made in the maximum annual limit on benefits under defined benefit plans where ancillary benefits which are not related to retirement are provided. For example, no downward actuarial adjustment in the limit is to be required for disability benefits before normal retirement age. In addition, no downward adjustment is to be made for a normal joint and survivor feature.

Moreover, to prevent abuse, the full maximum benefit may be paid only to individuals who have 10 years or more of service. Where an individual has served for less than 10 years, the maximum permissible benefit is reduced proportionately.

The contribution and benefit limits are applied in a way which prevents any individual from securing higher limits for himself merely because he is covered by several retirement plans financed by the same employer. For purposes of applying these limits, all defined contribution plans established by an employer are combined and treated as one defined contribution plan, and all defined benefit plans established by an employer are combined and treated as one defined benefit plan.

Also, if an individual is covered by both a defined contribution plan and a defined benefit plan established by his employer, then an overall limit is applied to coordinate the two limits discussed above. In this case, the sum of (1) the percentage utilization of the maximum limit under the defined benefit plan and (2) the percentage utilization of the maximum limit under the defined contribution plan cannot exceed 140 percent. For example, if, under the defined benefit plan, the employee is to receive a pension of $75,000 a year (using up 100 percent of the defined benefits limit), then the maximum additions to his defined contributions plan may not exceed 40 percent of what would otherwise be his defined contributions limit. Put another way, this overall limit, if both types of plans are used equally, may be satisfied by using up 70 percent of the limits applicable to each type of plan.

Because of the vital importance of maintaining the real value of retirement benefits, the bill instructs the Secretary or his delegate,

[37] through regulations, to make annual adjustments in the allowable limits to take account of increases in the cost of living. This includes adjustments in the $75,000 annual limit to benefits paid by defined benefit plans, the $25,000 limit to contributions under defined contribution plans and, in the case of a participant who was separated from service with the firm, the amount of his average earnings in his highest compensated 3 consecutive years of service.

Your committee has provided adequate time for adjustment to the new limits on benefits and contributions under retirement plans. In general, these limits apply to contributions made or benefits accrued in years beginning after December 31, 1975. However, to ease the transition to the new rules, an active participant in a defined benefit plan on October 2, 1973, will be permitted to receive an annual benefit, based on his annual rate of compensation on that date and the plan provisions in effect on that date, which exceeds $75,000 a year, provided the benefit does not exceed 100 percent of his annual compensation on October 2, 1973. Where this "grandfather" treatment is utilized, the cost-of-living adjustments in the limits, described above, are not available.

Finally, because the objective of the limits on contributions and benefits is to keep the tax advantages associated with qualified plans within reasonable bounds and not to restrict the amount of retirement benefits that may be paid to individuals under other arrangements, the bill specifically indicates that nothing in the provisions relating to such limits (or in the provisions of the bill which relate to minimum funding standards) is to be construed to require the disqualification of any plan solely because additional benefits are provided to the employee under nonqualified portions of the plans.

Lump-sum distributions under qualified plans.—Prior to the Tax Reform Act of 1969, lump-sum distributions made by qualified pension plans were generally taxed as long-term capital gains. Such capital gains treatment, however, had the disadvantage of allowing employees to receive substantial amounts of deferred compensation in the form of lump-sum pension distributions at more favorable tax rates than other compensation received currently. The 1969 Tax Reform Act sought to ameliorate this problem by providing that any part of such lump-sum distributions which represented employer contributions accrued in plan years beginning after 1969 was to be taxed as ordinary income rather than as capital gains. In addition, the 1969 Act provided a special 7-year averaging procedure for the portion of the lump-sum distribution taxed as ordinary income.

However, while the 1969 provisions were intended to provide more equitable treatment for such lump-sum pension distributions, they have not achieved their purpose. The Treasury has had great difficulty in providing regulations to carry out this provision. Problems have arisen both in determining the amount of the ordinary income element of a distribution and in determining the precise amount of tax imposed on account of the "ordinary income" element. Moreover, in practice the new proposed regulations have proved to be very complex and it is frequently maintained that individuals receiving lump-sum distributions have been unable to compute their taxes and that accountants and tax lawyers have been refusing to attempt the computations.

[38] Your committee believes that this situation cannot be permitted to continue. For this reason, it has provided a new method of taxing such lump-sum pension distributions which is relatively simple and yet at the same time equitable. Under the new provision, that portion of the distribution representing pre-1974 value receives capital gains treatment. The balance of the lump-sum distribution is to be taxed as ordinary income under a separate tax schedule (the tax schedule applicable to single people) generally without reductions, exclusions, or consideration of the taxpayer's other income. However, to insure that the tax paid by lower income individuals on their lump-sum distributions will generally not be more than under present law, a special minimum distribution allowance is provided under the separate tax rate schedule. In addition, averaging relief is provided for the portion of the lump-sum distribution which is taxed as ordinary income under the separate tax rate schedule by providing 10-year averaging for such income. This in effect provides a tax payable at the time of the distribution, but no greater in amount than the taxpayer could expect to pay were the income to be spread over his remaining life expectancy.

The new treatment of lump-sum distributions from qualified retirement plans is to apply to distributions made after December 31, 1973, in taxable years beginning after that date.

Salary reduction plans.—Under present law, employee contributions to qualified retirement plans are generally made out of taxed income without any tax allowance. However, in certain cases, employees have entered into arrangements with employers to accept salary reductions in return for contributions on their behalf to qualified retirement plans. If employer contributions to such plans are not taxed currently to the covered employees, this results in tax advantages for the covered employees as compared with making their own contributions to the retirement plan. Until the latter part of 1972, the Internal Revenue Service under administrative rulings recognized such salary reduction plans, providing that the amount of the reduction was not in excess of 6 percent of compensation and the plan met certain antidiscrimination requirements.

However, on December 6, 1972, the Internal Revenue Service issued proposed regulations (37 Fed. Reg. No. 235, p. 25938) providing that amounts contributed by an employer to a retirement plan in return for a reduction in the employee's basic or regular compensation or in lieu of an increase in such compensation are to be considered to have been contributed by the employee and consequently be taxable income to the employee.[14]

The proposed regulations dealing with salary reduction plans raise major issues of tax policy. The basic question is the extent to which employees should be allowed to convert what would otherwise be a nondeductible employee contribution to a retirement plan to tax-deferred employer contributions on their behalf. This, in turn, involves issues regarding the equitable treatment under the tax laws of employee contributions and employer contributions to qualified retirement plans.

[14] This ruling did not affect annuities provided employees of tax-exempt charitable, educational and religious organizations and employees of public educational institutions under section 403(b) of the Internal Revenue Code.

[39] In view of these basic issues, your committee has concluded that it would be desirable for the Internal Revenue Service to defer action on its regulations until the Congress has had further opportunity to consider this matter. For this reason, the bill directs the Secretary of the Treasury to withdraw the proposed salary reduction regulations issued on December 6, 1972. Moreover, no other salary reduction regulations may be issued in proposed form before January 1, 1975, or in final form before March 16, 1976. The bill further specifies that until new salary reduction regulations have been issued in final form, the law with regard to salary reduction plans is to be administered along the lines of the administration before January 1, 1972. Any salary reduction regulations which become final after March 15, 1975, for purposes of individual income tax, are not to take effect before January 1, 1975.

Labor unions providing pension benefits.—Your committee considered a provision recognizing the right of tax-exempt labor unions to provide pension benefits to its members from funds derived from members' contributions and the earnings on the contributions, without affecting their tax-exempt status. However, the committee concluded that labor unions are permitted to provide benefits in this manner under present law and as a result it decided such a provision is unnecessary. The Internal Revenue Service has recognized this result in a published ruling which provides "that payment by a labor organization of death, sick, accident or similar benefits to its individual members with funds contributed by its members, if made under a plan which has as its object the betterment of the conditions of the members does not preclude exemption of the organization under section 501(c)(5) of the code." [15]

III. REVENUE EFFECT

There are several kinds of revenue effects which can be expected to arise from the H.R. 12481. These are summarized in table 4.

First, three provisions designed to equalize the tax treatment of pensions have an impact on tax deductions. These are the provisions raising the maximum deductible amount that the self-employed can set aside annually for their retirement; making provision for employee retirement savings deductions for those not now covered under qualified retirement plans, government plans, or section 403(b) plans; and a provision which limits the maximum retirement benefit and the maximum deductible contribution on behalf of employees.

Tax revenues are also affected by the modification of the tax treatment of lump-sum distributions.

Finally, a third category of revenue effect from the bill arises not because of any change in tax deductions as such, but rather because increased amounts may be set aside by employees for vesting and funding. The bill imposes additional requirements in the areas of vesting and funding which must be met if the present favorable treatment for pensions is to continue to be available. These new requirements may result in employers making larger contributions to retirement plans, resulting in larger income tax deductions.

[15] Revenue Ruling 62–17, 1962–1, Cum. Bull. 87.

[40] TABLE 4.—*Estimated annual revenue effect of H.R. 12481 at 1973 levels of income and employment*

	Millions
I. Provisions designed to equalize tax treatment under pension plans:	
Increase in maximum annual deductible contribution by the self-employed under H.R. 10 plans to the greater of $750 (but not in excess of earned income) or 15 percent of earned income up to $7,500[1]	—$175
Allowing an individual not covered by a qualified retirement plan, government plan, or section 403(b) plan to deduct annually up to the lesser of $1,500 or 20 percent of compensation for contributions by him or on his behalf to a tax exempt retirement account, annuity, or bond plan established by him or to certain trusts established by employers or associations of employees (long-run effect)[2]	—355
Limiting the maximum annual benefit under defined benefit plans to the lesser of $75,000 (where benefits begin at age 55 or later) or 100 percent of average compensation for the three consecutive calendar years aggregating the highest compensation and limiting annual contributions under defined contribution plans to the lesser of $25,000 or 25 percent of compensation, with a cost-of-living adjustment to the dollar ceilings in the case of active participants and to the resultant amount under the 100 percent rule in the case of participants separated from service[3]	+10
Total, provisions designed to equalize tax treatment under pension plans	—520
II. Revised tax treatment of lump-sum distributions from retirement plans (long-run effect)[4]	+60
III. Revenue effect of minimum vesting provision.[5]	
Case 1: Assuming that the additional employer contributions to pension plans resulting from the minimum vesting requirement constitute a substitute for cash wages	—130
Case 2: Assuming that the additional employer contributions to pension plans resulting from the minimum vesting requirement constitute an addition to cash wages	—265
Case 3: Assuming that benefit levels of pension plans are adjusted downward to absorb the additional employer contributions to pension plans resulting from the minimum vesting requirement	0

NOTE.—There will be some revenue loss from funding but data are not available to determine the extent of this loss.

[1] Maximum deductible amounts effective for taxable years beginning after Dec. 31, 1973; other provisions effective for taxable years beginning after Dec. 31 ,1975.

[2] Maximum deductible amounts effective for taxable years beginning after Dec. 31, 1973; other provisions effective on Jan. 1, 1974.

[3] Apart from the exception for certain active participants in corporate defined benefit plans on Oct. 2, 1973, effective for contributions made or benefits accrued in years beginning after Dec. 31, 1975.

[4] Effective for distributions or payments made in taxable years beginning after Dec. 31, 1973.

[5] Effective for plan years beginning after the date of enactment for plans adopted after Jan. 1, 1974. Effective for plan years beginning after Dec. 31, 1975, for plans in existence on Jan. 1, 1974, except: (1) for plans under collective bargaining agreements, effective for plan years beginning after the agreement termination date (but not before Dec. 31, 1975) of the last agreement relating to the plan or Dec. 31, 1980, whichever is earlier; (2) for labor organization plans, effective for plan years beginning after the date of the second convention of the organization (but not earlier than Dec. 31, 1975) held after the date of enactment or Dec. 31, 1980, whichever is earlier; and (3) where the plan administrator elects, effective for plan years beginning after the date of enactment but before the latest date available to each of the above categories of existing plans, respectively.

Provisions designed to equalize tax treatment of retirement plans.—It is estimated that the provision increasing the maximum annual deductible pension contribution by self-employed persons on their own behalf to the greater of $750 (but not in excess of earned income) or 15 percent of earned income (up to $7,500) will result in an annual revenue loss of $175 million.

[41] The provision allowing an individual not covered by a qualified retirement plan, government plan, or section 403(b) plan to deduct annually the lesser of $1,500 or 20 percent of compensation for contributions by him or on his behalf to a tax exempt retirement account, annuity, or bond plan established by him (or to certain trusts established by employers or associations of employers) is estimated to involve a revenue loss amounting to $225 million for 1974 and rising to $355 million for 1977 (at 1973 income levels).

On the other hand, a revenue increase of $10 million a year at 1973 income levels is estimated to result from limiting the maximum annual benefit under defined benefit plans to the lesser of $75,000 (where benefits begin at age 55 or later) or 100 percent of average compensation for the three consecutive calendar years aggregating the highest compensation and limiting annual contributions under defined contribution plans to the lesser of $25,000 or 25 percent of compensation, with a cost-of-living adjustment to the dollar ceilings in the case of active participants and to the resultant amount under the 100 percent rule in the case of participants separated from service.

Altogether, when fully effective, these three provisions involve an estimated annual net revenue loss of $520 million.

Tax treatment of lump-sum distributions.—The revised tax treatment of lump-sum distributions from retirement plans (which provides for taxing that part of lump-sum distributions which is attributable to 1974 and later years as ordinary income subject to 10-year averaging) is expected to result in the long run in annual revenue gains amounting to $60 million a year based on 1973 levels of income.

Revenue effect of minimum vesting and funding provisions.—The new minimum vesting standards, which generally become effective for plan years beginning after 1975, will also involve an indirect loss of revenue, ranging from zero to an estimated $265 million a year (at 1973 income levels).

The minimum vesting requirement involves little or no revenue loss to the extent that the benefit levels of plans are adjusted to absorb the increased employer costs resulting from the requirement. This is because, in that event, the requirement would have no effect on the deductions taken for contributions to plans or on the taxable income of covered employees. If the additional amounts required to be contributed to pension plans as a result of the vesting standards are a substitute for cash wages, rather than a net addition to cash wages, the annual revenue loss is estimated at $130 million. This could occur, for example, if the additional employer payments into the pension plan are taken into consideration in setting future wage increases. In this event, the revenue loss results from the fact that the covered employees are permitted to postpone payment of tax on the employer contributions involved, instead of being required to pay tax currently, as would be the case had they received an equivalent amount of wages. Some part of this postponed $130 million of taxes presumably will be recovered in the future in tax payments on the benefits paid out by the plan.

The upper range of the estimate, $265 million, represents the revenue loss if it is assumed that the additional employer payments into the pension plans required by the new vesting standards constitute an

[42] addition to the cash wages that will be paid in any event. In this case employers will have larger total wage bills (for the sum of cash wages and wage supplements) and hence will take larger tax deductions, giving rise to a $265 million revenue loss.

It appears that realistically there is likely to be a combination of the three effects suggested above.

No revenue estimate is given for the increased funding requirements under the bill. Data are not available which would make a reliable estimate of this type possible. However, it is believed that the minimum funding requirements will have a relatively modest revenue effect.

IV. GENERAL EXPLANATION

A. Participation and Coverage

(Secs. 1011, 1015, 1017, 1021, and 1023 of the bill and Secs. 401, 410, and 414 of the Code).

PLAN PARTICIPATION—AGE AND SERVICE REQUIREMENTS

Present law

The Internal Revenue Code does not generally require a qualified employer pension, profit-sharing, stock bonus, annuity, or bond purchase plan to adopt any specific age or service conditions for participation in the plan.[1]

Existing administrative practice allows plans to exclude employees who (1) have not yet attained a designated age or (2) have not yet been employed for a designated number of years, so long as the effect is not discriminatory in favor of employees who are officers, shareholders, supervisors, or highly compensated employees. Also, under administrative practice, a plan may exclude employees who are within a certain number of years of normal retirement age (for example, 5 years or less) when they would otherwise become eligible, if the effect is not discriminatory.

On the other hand, in the case of a plan benefiting owner-employees,[2] the plan must provide that no employee with 3 or more years of service may be excluded (sec. 401(d)(3)).

However, all plans may exclude part-time employees whose customary employment does not exceed 20 hours a week, and seasonal employees whose customary employment does not exceed five months in any calendar year.

General reasons for change

The committee believes that, in general, it is desirable to have as many employees as possible covered by private pension plans and to begin such coverage as early as possible, since an employee's ultimate pension benefits usually depend to a considerable extent on the num-

[1] As described below (2. Plans Where a Collective Bargaining Unit is Involved: Other Anti-discrimination Provisions), a qualified plan must meet certain coverage standards. Several of the alternative standards require certain percentages of employees, or of eligible employees, to be covered by the plan, but in such cases the employer is permitted to exclude employees who fail to meet the plan's service requirements, not exceeding five years of service.

[2] An owner-employee is a sole proprietor or a partner with a greater than 10-percent interest in capital or profits (sec. 401(c)(3)).

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[43] ber of his years of participation in the plan. This is particularly important for employees who, because of the nature of their employment, shift from employer to employer over their working careers. In addition, early participation tends to spread the cost of providing employees with adequate pensions more evenly over the various firms for which the employee has worked over his entire working career, instead of concentrating the cost on his last few employers.

Of course, the general desirability of early participation must be balanced against the cost involved for the employer. Also from an administrative standpoint, it is not desirable to require coverage of transient employees, since benefits earned by short-term employees, in any case, are quite small. On the other hand, the committee believes that overly restrictive age and service eligibility requirements can arbitrarily frustrate the effective functioning of the private pension system. In view of these considerations, the committee has concluded that it is appropriate to specifically limit age and service eligibility requirements which an employer may incorporate in a qualified pension plan.

Explanation of provisions

In general.—In view of the considerations outlined above, the committee bill provides that a plan which is qualified under the Code is not to require, as a condition of participation, more than one year of service, or an age greater than 25 (whichever occurs later).[3] The committee believes that this rule will significantly increase coverage under private pension plans, without imposing an undue cost on employers. From an administrative point of view, however, the rule will allow the exclusion of employees who, because of youth or inexperience with the job in question, have not made a career decision in favor of a particular employer or a particular industry. Also, to encourage plans which provide 100 percent immediate vesting, the committee bill provides that such plans may require 3 years of service (and on age of 25) as a condition of participation. The committee believes that these rules take full account of the reasonable administrative and cost needs of plans to exclude employees in high turnover or high cost of benefit categories, and there is no authority in the tax law, apart from the specific provisions of the bill (including the maximum age provision discussed below), to allow qualified plans to exclude employees on account of age or service.

Year of service defined.—For purposes of the vesting and participation rules, the committee bill provides flexibility by indicating that the Secretary is to define a "year of service" by regulations in a manner which provides for its determination on a reasonable and consistent basis. For example, the regulations could specify that a plan could provide that each employee who had met the age and service requirements was to begin his participation on the anniversary date of his own employment, or that all eligible employees would be admitted on the anniversary date of the plan, or that each employee would be covered under the plan on the first quarterly anniversary date of the plan following the anniversary date of his employment.

[3] This rule applies whether or not the plan is a trusteed plan. That is, a plan funded through purchase of annuities from an insurance company is subject to these rules, as is a plan with investments managed by a trustee.

[44] However, to ensure that no abuse situation arises, the bill provides certain guidelines as to what constitutes a "reasonable" definition of a year of service. For example, under the bill, the plan's definition of a year of service would have to be such that no employee with more than 17 months of continuous [4] service could be excluded from the plan on account of service; moreover, the average employee (assuming hypothetically that employees were hired at the same rate each day throughout the year) could not have a wait of more than 12 months for participation. Of course this definition does not apply for purposes of benefit accrual, and a plan may use any reasonable definition of "year of service" for this purpose that is consistently applied, so long as the plan meets the antidiscrimination requirements of the law.

There are some industries whose normal work schedules are substantially different than those of more typical businesses. To deal with this problem, the committee bill provides that the regulations defining "year of service" are to take this factor into account. For example, the regulations might provide that in appropriate cases 100 hours of employment constitute a month, or 1,000 hours of employment constitute a year.

Participation of temporary and seasonal employees.—In the case of the seasonal employee, whose customary employment is at least 5 months, his normal season will be treated as a year. For example, if there is a 5-month fishing season in a certain area, and a fisherman is employed throughout the season by a company having a qualified pension plan, then, on the anniversary date of his employment, the fisherman is to be treated under the plan as though he had at least twelve months of continuous service for purposes of determining his right to participate in the plan.

Break in service.—The bill also provides a series of rules as to the effect of an employee terminating his service with an employer but then subsequently returning. These determinations are used in deciding whether the vesting schedule is to start over after the participant's break in service or to continue as of its status when the break in service first occurred. The rules governing the treatment of breaks in service set forth below in general are designed to place the employee, when he returns to service, at the same point in the vesting schedule that he was before the break in service, insofar as this is practicable without creating serious administrative problems. The bill provides for four interrelating rules.

First, where a break in service has occurred, a plan can provide that where an employee subsequently returns to service, the earlier service is not added to the more recent service until the employee has been back at least a year. This rule makes it unnecessary to search out the extent of prior service in the case of employees who return but stay for only a short period of time.

A second rule provides that where an employee has been in service at any time in the past for a sufficiently long period of time to obtain a vested right to 50 percent or more of the accrued benefits from employer contributions, upon return to employment his prior service,

[4] The term "continuous" is also to be defined in regulations to take account of the problem of seasonal employees, as well as factors such as sick leave, holidays and vacation periods, etc.

[45] before the break in service, is to be taken into account in applying the participation and vesting rules to his current situation. (The prior service would satisfy the plan's service requirements for participation.) The first rule set forth above, however, provides an exception to this rule.

Third, in the case of an employee who has completed 4 consecutive years of service before the break in service occurs, except as provided in the first rule above and the fourth rule below, service before the break is to be taken into account upon the employee's return to employment.

Fourth, in the case of an employee who has a break in service for a period of six years or more, service performed by the employee before the break in service need not be taken into account under the plan except in the case of employees coming under the second rule set forth above—that is, only where an employee has a vested right to 50 percent or more of employer contributions. Thus, where longer breaks in service occur, it will not be necessary to take into account prior service except in those cases where the employee had previously built up vested rights to the level of 50 percent or more.

Joint regulations on a year of service.—The regulations as to the meaning of a year of service, including those relating to breaks in service, are to be effective for plan years beginning after December 31, 1975, only if approved by the Secretary of Labor. Where the bill's provisions apply before that date (as in the case of new plans and plans which elect earlier dates), then regulations may be prescribed without the necessity of approval by the Secretary of Labor. However, those regulations are not to apply beyond the December 31, 1975, plan year cutoff date.

Other rules.—The committee intends that Treasury regulations specify the extent to which service with a predecessor of the employer is to be counted for purposes of the eligibility requirements. In the case of a multiemployer plan, service with any employer who was a member of the plan is to be counted towards an individual's participation requirement (sec. 1015 of the bill).

For purposes of these rules (and elsewhere in the bill), a "multiemployer plan" is a plan maintained pursuant to a collective bargaining agreement, to which more than one employer is required to contribute, and to which no one employer makes as much as 50 percent of the contributions. (After a plan has once qualified as a multiemployer plan, however, up to 75 percent of the contributions may be made by a single employer without affecting the multiemployer status of the plan.) In addition, the Secretary of his delegate is authorized to prescribe regulations establishing certain other requirements in the case of a multiemployer plan, dealing, for example, with the extent to which the plan should be liable to make benefit payments to participants, regardless of whether the participant's employer continues to make contributions under the plan.

Maximum age requirement.—In order not to discourage the hiring of older employees, the bill would permit a defined benefit pension plan to exclude employees who are within 5 years of normal retirement age at the time they would otherwise become eligible to participate if the exclusion does not result in a situation which is in-

[46] consistent with the coverage requirements of the tax law. Also, the plan may provide that the employee is not eligible to begin drawing retirement benefits until 10 years after he began to participate in the plan of participation (sec. 1021 of the bill). If a maximum age provision were to be prohibited, in the case of a defined benefit plan the cost considerations of providing a defined benefit to an older employee might discourage the hiring of the elderly. In the case of a defined contribution plan (such as profit-sharing plan or a money purchase pension plan), however, these cost considerations do not generally apply, and the committee therefore did not see why a maximum age limitation of this type should be permitted.

H.R. 10 plans.—The provisions of present law with respect to coverage under an owner-employee (H.R. 10) plan are not changed by the committee's bill. Present law already requires relatively early participation (after 3 years of service) and 100-percent immediate vesting in the case of owner-employee plans. The committee concluded that the retention of these provisions of present law was needed to protect the rights of employees in such cases. H.R. 10 plans will use the same rules as to a year of service, seasonal or part-time service, and breaks in service as will apply under the committee bill to corporate plans.

Government and church plans.—These provisions (as well as the corresponding provisions of the bill relating to vesting and funding) do not apply in the case of government plans, including the Federal civil service plan, and plans sponsored by State and local governments (including the District of Columbia), and any plan to which the Railroad Retirement Act applies. These plans may continue to remain qualified by continuing to meet the current law requirements (as in effect on the day before enactment). Also, new government plans may be qualified if they meet the requirements of present law. However, the Committee on Ways and Means and the Committee on Education and Labor are to study the extent to which it would be desirable to bring government plans under Federal participation, vesting, funding, and fiduciary standards, as well as matters affecting mobility of government employees and those employed under Federal procurement, construction, or research contracts or grants. The committees are to report to the House of Representatives no later than December 31, 1976.

Likewise, church plans (and plans of associations or convention of churches) will be exempt from the requirements of the bill unless the church files an election, in a form and manner to be prescribed in regulations, electing to come under the participation, vesting, and funding provisions of the bill (and the other rules which relate to these provisions), rather than to comply with the requirements of present law. Once an election is filed, however, it will be irrevocable. Generally, a "church plan" includes any plan maintained by a church or association or convention of churches, other than a plan primarily for benefit of employees in an unrelated trade or business of the church, or a multiemployer plan which includes employers which are not churches. However, for purposes of this definition of "church plan", if the plan was in existence on January 1, 1974, and at that time covered employees of another organization exempt from tax (under sec. 501) which was an agency of the church, then employees of the agency are to be considered as employees of the church.

[47] PLANS WHERE A COLLECTIVE BARGAINING UNIT IS INVOLVED; OTHER ANTIDISCRIMINATION PROVISIONS

Present law

Under present law (sec. 401(a)(3)), a qualified retirement plan must cover either (1) a specified percentage of all employees (generally, 70 percent of all employees, or 80 percent of those eligible to benefit under the plan if at least 70 percent of all employees are eligible) [5] or (2) such employees as qualify under a classification which is found by the Internal Revenue Service not to discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated employees. (A plan is not *per se* discriminatory for purposes of these rules merely because it is limited to salaried or clerical employees.)

Also, under present law, either the contributions or the benefits provided under a qualified plan must not discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated employees.

General reasons for change

Where employees covered under a collective bargaining unit prefer current compensation or some other form of benefits to coverage under a pension plan, employers sometimes are unable to establish a plan for other employees because the percentage requirement cannot be satisfied if the bargaining unit employees are not covered. It is then necessary for the plan to qualify as one which has coverage requirements that do not discriminate. The Service's approach (see Rev. Rul. 70–200, 1970–1 CB 101), which has generally been upheld by the courts, has been to look at the compensation of the group which is covered under the plan, and to allow the plan to qualify if the compensation of most of the participants is substantially the same as that of the excluded employees, the plan covers employees in all compensation ranges, and employees in the middle and lower ranges are covered in more than nominal numbers. Where most of the lower-paid nonsupervisory personnel are members of a collective bargaining unit which elects not to be covered by a pension plan, the remainder of the employees may include relatively large percentages of supervisors or highly compensated employees. As a result, under present law it may be impossible—because of the antidiscrimination requirements—to establish a qualified plan for the remaining employees.

Your committee believes that this situation can result in a hardship, where nonunion employees of an employer are forced to forego the benefits of a pension plan merely because those employees who are covered under a collective bargaining agreement choose nonpension benefits, or nonpension benefits plus pension benefits at a lower level than those provided nonunion employees. At the same time, the committee is concerned that any change in the law should not result in a situation where an employer might be able to exclude these employees from the pension plan without compensation for this in the form of other types

[5] In applying these numerical tests under present law, there are excluded employees who have been employed not more than a minimum period prescribed by the plan (up to 5 years), part-time employees (customary employment for not more than 20 hours in any one week), and seasonal employees (those whose customary employment is for not more than 5 months in any calendar year).

[48] of benefits. To deal with this situation, the committee bill provides that collective bargaining employees may be excluded for purposes of applying the coverage test, where the agreement does not provide that the union employees are to be included in the plan and there is evidence that retirement benefits have been the subject of good faith bargaining between the union employees and the employer.

Explanation of provisions

Collective bargaining unit.—The committee bill eases the application of the provisions of existing law by providing that employees covered under a collective bargaining agreement can be excluded for purposes of the coverage requirement if the employees are excluded from the plan and there is evidence that the retirement benefits have been the subject of good faith bargaining between the union employees and the employer.

If pension plan coverage had been discussed with the representatives of the union employees and no pension coverage was provided, either because the union employees were covered under a union plan (which might or might not offer comparable benefits to those provided under the employer plan), or because the employee representatives opted for higher salaries, or other benefits, in lieu of pension plan coverage, or for some other valid reason, then it would be permissible to exclude those union employees from the calculations. In effect, the collective bargaining agreement employees could then be excluded from the plan. Since this provision is intended to relax the coverage requirements of present law, in circumstances where the union employees elect not to participate in the plan, it follows, of course, that any plan which meets the coverage rules of present law, even though it excludes certain union employees, would not be adversely affected as to its tax-qualified status by this provision.

The committee anticipates that in any case where collective bargaining unit employees were excluded from a plan under this provision, the Internal Revenue Service will receive information as to the justification for the exclusion before ruling that the plan is qualified. There is no requirement that the collective bargaining agreement specifically state that the employees have elected to be out of the plan or to take a lower level of benefits. However, there must be evidence that the retirement benefits have been the subject of good faith bargaining between the union employees and the employer.[6]

The committee bill also provides that a plan is not to be considered discriminatory because it covers air pilots represented in accordance with the Railway Labor Act while not covering other employees working for the same employer if it covers a sufficient number or a nondiscriminatory cross-section of such pilots.

Nonresident alien employees.—The bill provides for the exclusion, for purposes of applying the coverage requirements and the antidiscrimination requirements, of those employees who are nonresident

[6] Once this issue had been negotiated, the union and the employer would not be required under this provision to renegotiate the issue at each bargaining session. However, the committee has been informed that it would constitute an unfair labor practice, within the meaning of the Federal labor laws, for an employer to refuse to negotiate in good faith with a labor union concerning retirement benefits. An example of good faith bargaining would include agreements or memoranda of understanding between railway companies and their employee representatives designed to effect changes in the Railroad Retirement Act of 1937 or Chapter 22 of the Internal Revenue Code, or both.

[49] aliens with no United States income from the employment in question. It was believed that the United States tax laws should not impede appropriate pension plan benefits for United States citizens or persons with United States earned income, merely because comparable benefits were not afforded to nonresident aliens with no United States income from the employment in question. Also, the mere processing of such cases would take an inordinate amount of time because of the complexity of applying rules to integrate the appropriate foreign equivalent of Social Security with the benefits or contributions provided by the employers under such plans.

Affiliated employers.—The committee bill also provides that in applying the coverage test, as well as the antidiscrimination rules, the vesting requirements, and the limitations on and benefits, employees of all corporations who are members of a "controlled group of corporations" (within the meaning of sec. 1563(a)) are to be treated as if they were employees of the same corporation. Thus, if two or more corporations were members of a parent-subsidiary, brother-sister, or combined controlled group, all of the employees of all of these corporations would have to be taken into account in applying these tests. A comparable rule is provided in the case of partnerships and proprietorships which are under common control (as determined under regulations), and all employees of such organizations are to be treated for purposes of these rules as though they were employed by a single person. The committee, by this provision, intends to make it clear that the coverage and antidiscrimination provisions cannot be avoided by operating through separate corporations instead of separate branches of one corporation. For example, if managerial functions were performed through one corporation employing highly compensated personnel, which has a generous pension plan, and assembly-line functions were performed through one or more other corporations employing lower-paid employees, which have less generous plans or no plans at all, this would generally constitute an impermissible discrimination. By this provision the committee is clarifying this matter for the future. It intends that prior law on this point be determined as if this provision had not been enacted.

At the same time, however, the committee provision is not intended to mean that all pension plans of a controlled group of corporations or partnerships must be exactly alike, or that a controlled group could not have pension plans for some corporations but not others. Thus, where the corporation in question contains a fair cross-section of high- and low-paid employees (compared to the employees of the controlled group as a whole), and where the plan coverage is nondiscriminatory with respect to the employees of the corporation in question, it is anticipated that the Internal Revenue Service would find that the plan met the antidiscrimination tests, even though other corporations in the controlled group had a less favorable retirement plan, or no plan at all. On the other hand, if, looking at the controlled group as a whole, it were found that a disproportionate number of highly compensated employees were covered under the plan of the corporation in question, or that the average compensation of covered employees was substantially higher in that plan than the average compensation of noncovered employees, it would be anticipated that the plan would not be

[50] found to be qualified, because the corporation does not contain a fair cross section of the controlled group employees.

Supervisory employees.—Under the committee bill, the category of "supervisors" is to be dropped from the list of personnel which a plan may not discriminatorily favor. The committee has been informed by the Treasury Department that all persons who are supervisors within the intent of present law also are officers, shareholders, or highly compensated employees, and that as a result this deletion will result in no substantive change in the antidiscrimination provisions of present law.

Coverage of temporary and seasonal employees.—In applying the coverage rules, the bill makes several changes from present law. In applying the 70 percent and 80 percent coverage tests, employees who fail to meet the minimum age and service requirements prescribed by the plan may be excluded (assuming these employees are actually excluded from the plan). These requirements may not be more than the top limit of one-year-service and 25-year-age requirements (or 3-year-service, immediate-full-vesting, and 25-year-age alternative) described above with respect to participation. Of course, the plan may provide lesser age and service requirements.

Present law permits exclusion, in applying the coverage calculations, of employees whose customary employment is for not more than 5 months in any calendar year; the bill retains the 5-month period but permits computations to be made on the basis of any 12-month period (not merely the calendar year) depending upon the period specified in the plan itself. Part time employees (as defined in regulations) may also be excluded from the plan.

Work product contributions.—In some industries, contributions may be made under a plan based on the work product of an individual who is not a participant (for example, contributions based on tonnage of minerals mined or processed). Obviously, such an individual may be excluded under the plan, notwithstanding the fact that contributions are made based on his work, if the individual fails to meet the minimum age or service requirements, or other lawful conditions that the plan imposes for participation. On the other hand, a person could be a participant in a plan even though neither he nor his employer make contributions on his behalf.

Effective dates

These provisions apply generally to plan years beginning after the date of enactment of the bill. However, to allow time for amendment for plans in existence on January 1, 1974, the provisions are to take effect in these cases for plan years beginning after December 31, 1975, unless the plan administrator makes an irrevocable election to have the provisions apply sooner (under regulations prescribed by the Secretary or his delegate), in which case the provisions will take effect at the beginning of the first plan year which occurs after the election.

Where the plan is subject to the provisions of a collective bargaining agreement in effect on January 1, 1974, the effective date is further postponed until the expiration of the collective bargaining agreement (or the expiration of the last relevant agreement in the case of a multiemployer plan or a single plan subject to more than one collective bargaining agreement), but without regard to any extension made after the date of enactment. For this purpose, a collective bargaining agree-

[51] ment will not be considered as terminated if it can be (or is) reopened with respect to relatively narrow issues only. For example, a collective bargaining agreement would not be considered as being terminated for this purpose if it can be reopened with respect to the benefit payable to a surviving spouse, if it can be reopened because of a change in payments with respect to voluntary coverage under Part B of the Medicare benefits under the Social Security Act, or if it can be reopened to increase benefits with respect to a quite limited group of employees.

A question has arisen as to how the effective date rules are to be applied to a plan which includes employees subject to one or more collective bargaining agreements and also employees not under any such agreement. The intent is that the presence of an insignificant number of union members as participants in a plan is not to be sufficient to delay the effective dates for an additional 5 years. On the other hand, the presence of a small number of nonunion participants should not force the untimely renegotiation of labor-management contracts. As a result, your committee intends that a plan is to be regarded as maintained pursuant to a collective bargaining agreement if (1) either the contribution levels or the benefit levels under the plan are to be determined under the agreement and (2) at least 25 percent of the participants are members of the unit of employees covered by the agreement. In addition, where an employer has one plan for collective bargaining unit employees and another plan for other employees, but those plans are essentially the same with regard to benefits and contributions, then the two will be considered as one for purposes of applying the rule described above as to when a plan with both union and nonunion participants is to be entitled to delayed effective date provisions.

In the case of a plan maintained by a tax-exempt (under sec. 501 (c)(5)) labor organization for its own employees, the effective date is postponed to the first plan year following the date on which the second convention of the organization is held after the date of enactment. But, in any event, all plans (including those subject to existing collective bargaining agreements) are to be subject to these provisions in plan years beginning after December 31, 1980.

An existing plan which would be entitled to a delayed effective date for the new participation, vesting, funding, etc. provisions is to be permitted to elect to have all those provisions apply sooner. Any such election must be made under Treasury regulations, must not be piecemeal (i.e., it is not permitted to be made for, say, vesting, without also applying to participation, funding, etc.), and is irrevocable.

Revenue effect

The revenue effect of these provisions is expected to be minimal.

B. Vesting

(Secs. 1012, 1014, 1015, 1017, 1021, 1023, and 1024 of the bill and secs. 401, 411, 414, and 6690 of the Code.)

Present law

Plans which qualify under the Internal Revenue Code are now required to provide vested (i.e., nonforfeitable) rights to participating

[52] employees when they attain the normal or stated retirement age. Employees must also be granted vested rights if the plan terminates or the employer discontinues his contributions.

However, qualified corporate plans are generally not required to provide vested rights to participating employees before normal retirement age unless this is considered to be necessary—in view of the likely pattern of employee turnover—to prevent discrimination against the rank and file employees in favor of officers, shareholders, supervisors, or highly paid employees. In other words, preretirement vesting is required only where its absence would cause discrimination in favor of officers, etc., who could be expected to remain with the firm long enough to retire and qualify for benefits, while the rank and file employees would continually be separated from the firm and lose their benefits.

Under an owner-employee plan,[1] the rights of all employees must vest in full as soon as they become participants (sec. 401(d)(2)(A)).

General reasons for change

Unless an employee's rights to his accrued pension benefits are nonforfeitable, he has no assurance that he will ultimately receive a pension. Thus, pension rights which have slowly been stockpiled over many years may suddenly be lost if the employee leaves or loses his job prior to retirement. Quite apart from the resulting hardship, your committee believes that such losses of pension rights are inequitable, since the pension contributions previously made on behalf of the employee may have been made in lieu of additional compensation or some other benefits which he would have received.

Today, slightly over two-thirds of the private pension plans provide some vested rights to pension benefits before retirement. However, as a general rule, employees do not acquire vested rights until they have been employed for a fairly long period with a firm or are relatively mature. Since there is no general applicable legal requirement for preretirement vesting, some plans do not offer this type of vesting at all, and among those plans which do, there is no uniformity in the vesting rules as provided. At present, only one out of every three employees participating in employer-financed plans has a 50-percent or greater vested right to his accrued pension benefits. Even for older employees, a substantial portion do not have vested rights. For example, 58 percent of covered employees between the ages of 50 and 60, and 54 percent of covered employees 60 years of age and over, still do not have vested rights to even 50 percent of their accrued pension benefits.[2] As a result, even employees with substantial periods of service may lose pension benefits on separation from employment. Extreme cases have been noted in which employees have lost pension rights at advanced ages as a result of being discharged shortly before they would be eligible to retire. In addition, your committee believes that more rapid vesting is desirable because it will improve the mobility of labor, and in this manner promote a more healthy economy.

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[1] An owner-employee is a sole proprietor or a partner with a greater than 10-percent interest in capital or profits (sec. 401(c)(3)).

[2] U.S. Treasury Department—Fact Sheet, Pension Reform Program, as reprinted in Material Relating to Administration Proposal Entitled the "Retirement Benefit Tax Act," Committee on Ways and Means, 93d Cong., 1st sess., p. 37, Table B.

[53] For reasons indicated above, your committee concluded that it is necessary and desirable to provide a minimum standard of vesting for all qualified pension plans. Clearly, however, it would be counterproductive to increase employer costs by more rapid vesting to such an extent as to significantly curtail the creation of new retirement plans (or to significantly curtail the increase of benefits in existing plans). The committee bill deals with this problem by requiring that all qualified plans must meet one of three minimum standards for vesting.

Explanation of provisions

General rule.—The committee bill provides that a qualified plan would have to meet one of three vesting standards with regard to benefits derived from employer contributions:

1. a graded vesting standard, under which the employee must be at least 25 percent vested in his accrued benefit after 5 years of covered service, with a gradual increase in this percentage in subsequent years, so that the employee must be 100 percent vested after 15 years of service;
2. full vesting after 10 years of covered service; or
3. a "rule of 45", under which an employee with 5 or more years of covered service must be at least 50 percent vested in his accrued benefit when the sum of his age and years of covered service total 45, with 10 percent additional vesting for each year thereafter.

Whichever of these alternatives is adopted, each employee would have to be fully and immediately vested in his accrued benefit derived from his own contributions.[3]

It should be made clear that the standards provided in the committee bill are only minimum standards. The bill's provisions are not intended to prohibit plans with more rapid vesting than that required under the standards in the bill.

Your committee believes that the new vesting rules should provide flexibility, so as to allow plans to choose from several reasonable standards a vesting schedule best suited to the needs of the particular business, and so as not to disrupt existing plans which already have provided reasonable vesting under one of several formulas. In addition, a transition rule and delayed effective dates are provided, so that plans may be amended in an orderly manner to come into compliance with the new minimum standards. Compliance with any of these standards, together with continued vitality of the antidiscrimination standards of the Internal Revenue Code, should afford substantial protection to employees against possible loss of their pension rights.

Graded vesting.—One of the alternatives under the committee bill provides that a qualified plan (whether trusteed or insured) would be required to give each participant vested rights to at least 25 percent of his accrued benefit from employer contributions after 5 years of service, plus 5 percentage points a year for each of the next 5 years and 10 percentage points a year thereafter. This would mean that there must be 100 percent vesting after 15 years of covered service.

[3] Thus, in general, the rules described hereafter relate only to benefits derived from employer contributions.

[54] This approach has the advantage of providing some vesting at a relatively early point in the employee's career. Thus, if the employee changes jobs after 5 years of service, he would be protected in his rights to at least some part of his accrued benefit. This rule (and, to a lesser extent, the 10-year 100-percent vesting rule and the rule of 45 vesting rule) proceeds on the assumption that some part of the obligation to provide reasonable retirement benefits should be shifted from the employee's last employer and should be shared by those who employed him earlier in his working career.

Also, because vesting occurs gradually, this alternative tends to bring down the cost of the vesting requirement to manageable levels by minimizing the cost of establishing a new plan or improving benefits under an existing plan. By avoiding the "notch" effect of an employee becoming entitled to too much of his vested rights in any one year, it avoids giving the employer an incentive to dismiss an employee rather than to absorb the sharp increase in pension plan costs that would result from a sudden increase in the vesting percentage after a number of years of service.

Ten-year 100-percent vesting.—Another alternative under the committee bill provides that a qualified plan could meet the vesting requirements by giving each participant vested rights to 100 percent of his accrued benefit derived from employer contributions after 10 years of service.

This approach avoids the recordkeeping and other administrative costs involved in accounting for partially vested rights. In the case of the employee who serves for 10 years, this alternative provides greater vesting protection than the graded vesting rule (discussed above) or, in general, the rule of 45 (discussed below).

The "rule of 45".—The third alternative under the bill, known as the rule of 45, would require that a plan provide each employee with vested rights to at least 50 percent of his accrued benefit when the sum of his age and years of covered service equals 45 (subject to a minimum service requirement of 5 years), with at least 10 percent additional vesting for each year of service thereafter.

The age-weighted approach has the advantage that it provides more protection to the older worker, who is closer to retirement, and who may not get another chance to earn a pension if he leaves his employment prior to retirement.[4] For this reason, your committee believes that the rule of 45 should be available as an alternative for those plans which would prefer to take an age-weighted approach.

Transition rule.—Your committee has concluded it is important that all qualified plans ultimately meet one of the three minimum standards in the bill. However, to impose the full force of these standards on existing plans without some transition period would, in some cases, subject these plans to substantial additional costs to pay for the required vesting, possibly causing a reduction of benefits in some plans, or even plan termination. To ease the cost factor in the case of plans already in existence which have not previously been subject to vesting requirements such as those set forth in the committee bill, the bill

[4] Under the present tax law, all rights must be fully vested when the employee attains the normal or stated retirement age, but an older employee who terminates his service prior to reaching retirement age generally does not have to be vested under present law (except to prevent discrimination).

[55] provides a transitional rule under which plans actually in effect on December 31, 1973,[5] would have a reduced vesting requirement for the first 5 years to which the new rules apply.

During the first year to which the bill's vesting standards apply, the plan would have to provide at least 50 percent of the regular requirement under the applicable vesting schedule—this 50-percent level would have to then be increased by 10 percentage points a year, so that the new rules would fully apply in the sixth year after the effective date. For example, under the graded vesting approach, during the first year in which the rules were applicable, an employee with 5 years of covered service would be at least 12.5 percent vested in his total accrued benefit (50 percent of the 25-percent requirement which is generally to apply after 5 years of service); this would increase to 18 percent the next year as the next step in the transition period was reached and also as the employee moved along the graded vesting schedule (60 percent of 30 percent), 24.5 percent the next year (70 percent of 35 percent), 32 percent the next year (80 percent of 40 percent), 40.5 percent the next year (90 percent of 45 percent), 50 percent the next year (100 percent of 50 percent), and by an additional 10 percentage points each year thereafter under the fully effective graded vesting schedule alternative of the bill. By use of this gradual approach, your committee believes that it will be possible to implement the new rules with a minimum of disruption to existing plans.

Preparticipation service.—Once an employee becomes eligible to participate in a pension plan, generally all his years of service with an employer, including preparticipation service, are to be taken into account for purposes of determining his place on the vesting schedule.

However, the plan may ignore service during a period for which the employee decided not to make contributions to a plan requiring employee contributions. Also, service need not be taken into account for periods for which the plan employer did not maintain the plan (e.g., periods before the plan was established or after the employer discontinued contributions but the plan was kept in existence for the purpose of paying already-earned benefits when due).

The committee bill also provides that for purposes of the vesting schedule, service before age 25 may be ignored whether or not the employee was a participant in the plan. This will have the effect of not discouraging plans from providing immediate participation and accrual of benefits for all employees. For example, in a plan providing for immediate participation, at age 30 an employee who had started on the job at 18 would have to be at least 25-percent vested in 12 years of accrued benefits under these rules (instead of only 5 years of accrued benefits, which would be the case if the plan did not permit participation until the employee was 25).

Service for an employer is to be taken into account for purposes of placement on the vesting schedule, even though the service was in a different division of the corporation, or with a different corporation member of the affiliated group. However, the bill does not require that such service be taken into account for purposes of accruing bene-

[5] A plan which went into effect after this date would not be eligible to use the transitional rule, even if the plan agreement included a retroactive clause which provided that the plan was in effect "as of" December 31, 1973.

[56] fits while the employee works for a division which does not have a plan. This may be illustrated by the following example.

Assume that an employee begins work at age 25 for division A of a corporation, which does not have a pension plan, and, at age 40 he transfers to division B, which does have a plan. Under all of the vesting standards, the employee would immediately become fully vested in the benefits which accrue under the plan, because of his 15 years of prior service with the employer.[6]

Benefits accrued in the past.—Generally, the vesting requirements of the bill are to apply to all accrued benefits, including those which accrued before the effective date of the provision. Years of service prior to the effective date also are to be counted for purposes of determining the extent to which the employee is entitled to vesting. For example, in the case of a plan electing the graded vesting alternative, if an employee joined a company at age 30 (at which time a plan was in effect), became a participant in the plan at age 35, and was age 40 on the effective date of the vesting provisions, he would have to become at least 50-percent vested at that time based on 10 years of service (although this percentage would be reduced under the transition rule for plans in effect on December 1, 1973). However, he might not have more than 5 years of accrued benefits since the minimum benefit accrual is based on participation.[7]

This would occur because of his 5 years of participation under the plan plus his 5 years of preparticipation service. Without this pre-effective date rule, it was apparent to your committee that employees who are now older employees would receive the advantages of required vesting only for the accrued benefits they would be able to build up gradually in the future and would receive no protection for benefits accrued prior to the effective date of these provisions, which would usually be the bulk of the benefits earned during their lifetimes.

Your committee considered various methods of providing that pre-effective date service be taken into account in the case of older employees only, but concluded that most such methods provided some type of undesirable "notch" effect and in most cases would result in little cost saving to the employer relative to the rule adopted in the bill.

However, it does not appear to be desirable to provide for retroactive vesting for employees who have already terminated their service with the employer, since this would create a substantial unexpected cost for the plan (thereby possibly jeopardizing the size of benefits for employees still covered under the plan) and might involve serious recordkeeping problems. Thus, the committee bill specifically provides that the plan is not required to take into account service performed prior to January 1, 1969, until the employee has served at least 5 years with his employer after December 31, 1968.

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[6] Conversely, an employee who worked for 5 years in division B, and then shifted to division A, would continue to increase his percentage of vesting in the benefits which he had accrued under the division B plan, even though division A did not have a plan. Of course he would accrue no benefits in the division B plan on account of his division A service (unless the plan provides otherwise).

[7] The employee need have only 5 years of accrued benefits, because the vesting provisions are to apply to pre-effective date service only to the extent of the employee's accrued benefits. The new participation standards are not to apply before the effective date of those standards: if these facts were to occur in the future, the employee would be at least 50-percent vested in at least 9 years of accrued benefits.

[57] *Multiemployer plans.*—In the case of a multiemployer plan governed by a collective bargaining agreement, the vesting requirements of the committee bill generally are to be applied as if all employers who are parties to the plan constituted a single employer. For example, years of service with employers A and B under the plan will be counted together in determining vesting, even though the employee now works for employer C (sec. 1014 of the bill).

Service that is seasonal, intermittent, etc.—For purposes of the minimum vesting rules, the question of whether an employee has performed a "year of service" will be determined in accordance with the same regulations which define this term in connection with the participation requirements, described above. Of course, a seasonal or part-time employee who performs a year of service for purposes of determining his place on the vesting schedule, may nonetheless accrue benefits at a slower rate than his full-time, year-round counterpart. However, the relationship between the rate of accrual for a full-time employee, and a part-time or seasonal employee would have to be reasonable and applied on a consistent basis under the plan in order to meet the antidiscrimination requirements. Service with a predecessor of the employer would also be counted, for purposes of the vesting rules, to the extent provided in regulations. Your committee anticipates that the regulations in this area will prevent a situation where an employee might lose his rights to vesting as a result of a business reorganization.

The basic rules have been set forth in terms of "years of service". However, the committee recognizes that there are a substantial number of industries in which the common concepts of years, months, weeks, or hours of service do not apply. For example, it may be appropriate in some industries to provide that a participant must work at least 1,000 hours in order to have completed a "year of service" for purposes of the participation rules and for purposes of determining where he is to be placed on the vesting schedule. Under the bill, the regulations are to take into account such variations of customary working periods.

It must be noted that it is not necessary that the "year of service" concept used for participation or vesting purposes be the same as the "year of service" concept used for purposes of accrual of benefits. For example (as indicated above), in a particular industry it may be appropriate to advance a person one year on the vesting schedule if he has completed 1,000 hours of work during the plan year. However, that same plan may provide that a full year's worth of benefits will accrue only if the employee completes 1,600 hours of service during the plan year. In such a case, completion of 1,200 hours would provide an accrual of .75 of a year's benefits, 1,000 hours would provide accrual of .625 of a year's benefits, 800 hours would provide accrual of .5 of a year's benefits.

Permitted forfeitures of vested rights.—A qualified retirement plan under the committee bill may provide that an employee's vested rights in accrued benefits derived from employer contributions (but not from his own contributions) may be forfeited in the event of the employee's death (although this exception is not to apply if the employee had retired and a "joint and survivor" annuity was to be provided).

[58] Also, a plan is permitted to suspend payment of benefits while the participant is working for the employer (for example, where an early retiree returns to work to increase his subsequent pension benefits). In the case of a multiemployer plan, the benefits may be suspended if the employee has resumed employment in the same industry even though not with the same employer. These rules are not to prevent suspension of part of an early retirement supplement (such as a so-called social security supplement) on account of reemployment, even with another employer or in another industry.

In addition, the bill provides for circumstances under which a retroactive plan amendment, if approved for this purpose by the Secretary of Labor, may be permitted to divest accrued benefits that had already become nonforfeitable. In order to be approved by the Secretary of Labor, such a retroactive amendment which divests what were otherwise nonforfeitable benefits, must have been initiated by the Secretary of Labor or proposed by the plan administrator and the Secretary of Labor must be satisfied that the administrator has given adequate notice to all plan participants and other interested persons. The Secretary of Labor must then give those interested persons an opportunity to be heard and must notify the Secretary of the Treasury of any such hearing. Further, the Secretary of Labor may approve such a divesting retroactive amendment only if he finds that (1) the amendment affects the plan only to such an extent as is necessary or appropriate to carry out the purposes of this pension bill and to provide adequate protection to the participants and beneficiaries, (2) but for the amendment, there would be a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or the levels of employee compensation, and (3) failure to make the amendment would be adverse to the interests of plan participants in the aggregate. Your committee concluded that, when such conditions occurred and those procedural safeguards were followed, it was appropriate to permit these divestitures.

It is permissible for the employee's vested accrued benefits to be "cashed out" under specified circumstances. On termination of a plan, if the value of the nonforfeitable benefit is less than $1,750, then the benefit may be cashed out by a lump-sum distribution whether or not the employee agrees to receive the distribution (but only if the plan permits such a distribution without regard to the employee's preferences). If the employee agrees to the cashing out of his nonforfeitable benefit then, whether or not the amount is less than $1,750, the benefit may be cashed out if the distribution was made on termination of the employee's participation in the plan or under such other circumstances as may be provided by Treasury regulations. Such a nontermination cashing out of accrued benefit might be permitted, for example, on the occasion of a revision of the formula for computation of accrued benefits under the plan. It must be noted that the rule described above permits the cashing out of vested accrued benefits but the service to which those benefits relate nevertheless must continue to be taken into account, in accordance with the rules described above (service that is seasonal, intermittent, etc.) for purposes of determining whether the employee has met the service requirement for participation and for purposes of determining the employee's place on the vesting schedule

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[59] with regard to benefits that accrue in the future. Also in cases where the employee's accrued benefit is not cashed out when the employee leaves the employer's service, if the employee is later reemployed, his percentage of vesting in the benefit which accrued before the service break may be increased on account of service which occurs after the break.

With the limited exceptions noted above, no rights, once they are required to be vested, may be lost by the employee under any circumstances (although, as under present law, the plan may pay the employee the actuarial value of his vested rights upon separation from service). For example, a vested benefit is not to be forfeited because the employee later went to work for a competitor, or in some other way was considered "disloyal" to the employer.[8] Also, rights to benefits are not to be forfeited merely because the employer (or plan administrator) cannot find the employee.

Accrued benefits.—Under the committee bill, the vested employee is protected in his rights to all, or a certain percentage, of his "accrued benefit." It is necessary to provide a statutory definition of an "accrued benefit" because, unless this is a defined amount, vesting of an "accrued benefit" in whatever form is specified by the plan has little, if any, meaning. In the case of any retirement plan other than a defined benefit pension plan, under the bill the employee's "accrued benefit" is the balance in his plan account.[9] This would include, for example, a money purchase pension plan, a profit-sharing plan and a stock-bonus plan.

In the case of a defined benefit plan the bill provides that the accrued benefit is to be determined under the plan, subject to certain requirements. The term "accrued benefit" refers to pension or retirement benefits and is not intended to apply to certain ancillary benefits, such as medical insurance or life insurance, which are sometimes provided for employees in conjunction with a pension plan, and are sometimes provided separately. To require the vesting of these ancillary benefits would seriously complicate the administration and increase the cost of plans whose primary function is to provide retirement income. Also, where the employee moves from one employer to another, the ancillary benefits (which are usually on a contingency basis) would often be provided by the new employer, whereas the new employer normally would not provide pension benefits based on service with the old employer. Also, the accrued benefit to which the vesting rules apply is not to include such items as the value of the right to receive benefits commencing at an age before normal retirement age, so-called social security supplements which are commonly paid in the case of early retirement but then cease when the retiree attains the age at which he becomes entitled to receive current social security benefits, and any value in a plan's joint and survivor annuity provisions to the extent that exceeds the value of what the participant would be entitled to receive under a single life annuity.

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[8] Some plans also provide that an employer may have lien rights against employee interest in a pension plan. These clauses would also be prohibited under the committee bill, except where the plan requires that the employee be given prior notice of any impending lien and there is a judicial hearing on the probable validity of the employer's claim.

[9] Separate accounting for each employee is required under the committee bill in the case of contributions to a defined contribution plan and for voluntary employee contributions to a defined benefit plan.

[60] Generally, an individual's "accrued benefit" under a defined benefit plan is to be expressed in the form of an annual benefit commencing at normal retirement age. Normal retirement age is the age specified in the plan, which may not be later than age 65 (or, if later, the 10th anniversary of the time the participant commenced participation in the plan).

To encourage older employees to remain on the job, many plans provide for a faster rate of benefit accrual in the employee's later years; thus, an employee might accrue a benefit equal to 1.5 percent of compensation for each year of service until age 55, and 2 percent per year thereafter. This technique is known as "back loading".

The committee believes that it is desirable to allow plans to continue to offer a reasonable amount of back loading as an incentive to its older employees. At the same time, it is obviously necessary to put some limits on this device; otherwise a plan which wishes to evade the vesting requirements could provide for de minimis accruals until an employee's last years of employment, at which point very large accruals would be provided. The committee bill takes account of both these factors by providing that the plan may not provide back loaded accruals which are more than one and one-third times the rate of accruals for prior years.

This 133⅓ percent standard may be used only by such plans as continue to accrue benefits during participation indefinitely. Consequently, "front loading" must be kept within the same 133⅓ percent limits, except that a plan is permitted to provide a greater degree of front loading during the employee's first 10 years of service.

For purposes of making the loading calculation, it will be assumed that compensation, social security benefits, cost of living adjustments, investment performance (where relevant), and all other relevant factors used to compute plan benefits will remain constant.

In the case of plans which provide for early retirement, for example, "30 and out" plans, or plans which allow retirement at age 55 after 20 years of service, the employee who meets the conditions for early retirement may receive a much greater benefit in terms of value than the employee who fails to meet the early retirement conditions. For example, if there were a plan which had a normal retirement age of 65, and an early retirement age of 55, with 30 years of service, and an annual benefit accrual of one percent of compensation, subject to a 30 percent of compensation ceiling, an employee who began work at 25, and retired at 55, would receive a benefit of 30 percent of compensation each year thereafter; but, if the employee left his job at age 54, he would receive a benefit of 29 percent a year which was not payable until age 65.

The committee believes it is desirable not to discourage early retirement plans. To place employees who leave before retirement under such plans on exactly the same footing with early retirees would, in some cases, impose such an additional cost burden on the plan that it might be necessary to eliminate the early retirement feature. At the same time, it is unfair to employees who must leave their jobs before retirement to put too large a premium on being able to hold on for the last few years.

Thus, the committee bill provides an alternative accrued benefit standard that may be met in lieu of the 133⅓ percent rule discussed

[61] above. Under this standard, each participant must accrue, for each year of participation (as indicated above, the year of participation used in accruing benefits need not be computed in the same manner as is used for determining "year of service" for purposes of participation and for determining one's status on the vesting schedule), not less than 3 percent of the benefit to which he would be entitled if he participated in the plan for 33 and one-third years and served until age 65 (or any earlier normal retirement age under the plan). Under this approach, too, benefits which cease by age 65 (or the earlier normal retirement) in general need not be taken into account. As in the case of the 133⅓ percent standard, the level of social security benefits and other relevant factors are to be treated as remaining constant. Where compensation is relevant in determining the maximum benefit, the maximum benefit is to be computed as though the employee continued to earn compensation at the same rate that is relevant under the plan. In other words, if the plan provides benefits based on high 3-year average compensation, then that average compensation based on the facts as they exist at the time the accrual is to be made, is to be assumed to continue until age 65 (or earlier normal retirement age). However, in no event is compensation to be taken into account for a period of more than 10 consecutive years.

In order to make clear that rate of accrual rules are not to be manipulated in order to achieve discrimination in favor of employees who are officers, shareholders, or highly compensated, the bill specifies (in the rules for coordination of the vesting standards with the antidiscrimination standards, below) that the Internal Revenue Service is to take account of rates of accruals as well as vesting schedules in determining whether there is prohibited discrimination.

Changes in vesting schedule.—Under the bill, if a plan is amended in a manner which changes its vesting schedule, each person who is a participant in the plan on the date the amendment is adopted (or is a participant in the plan on the amendment's effective date) is to continue to vest his accrued benefits at no less than the rate at which those benefits had been scheduled to be vested under the preamendment vesting schedule. This is to apply both to accrued benefits from preamendment service and to subsequent accrued benefits, and is to apply whether or not the participant had any vested benefits at the time of the amendment. The application of this rule may be illustrated by the following example: Suppose that A is a participant in a plan which follows the minimum requirements of the graded vesting schedule and that A has completed 4 years of service on the amendment date. The amendment provides that the plan is to vest under the minimum requirements of the 10-year 100-percent vesting schedule. Under this rule, at the end of A's next (fifth) year of service, he is to be 25 percent vested in his accrued benefits, as he would have been had the amended vesting schedule not been adopted. This vesting percentage is to be increased by 5 percentage points for each of the next 5 years, as under the minimum requirements of the graded vesting schedule. However, at the end of the tenth year of service, A's vesting percentage becomes 100 percent, because that is the higher rate provided under the new vesting schedule. The same vesting percentages would apply in each of the years if the amendment had been to change the vesting sched-

[62] ule in the opposite manner (i.e., from 10-year 100-percent vesting to graded vesting).

Allocations between employer and employee contributions.—In plans where there are both employer and employee contributions, it will be necessary to allocate the accrued benefit between the portion derived from the employer contributions, and the portion derived from the employee contributions. This allocation may have to be made because the employee is always fully vested with respect to amounts attributable to his own contributions but not necessarily with respect to those of the employer. Also, information of this type would be needed if an employee, upon leaving employment, desires to withdraw his own contributions.

In the case of any plan other than a defined benefit pension plan, the accrued benefit derived from the employee's contributions under the bill is the amount in his own separate account. If employee and employer contributions were not accounted for separately, the employee-contributed portion of the total accrued benefit would be treated as the fraction of the total which is the ratio of employee contributions to total contributions (after taking account of withdrawals).

In the case of a defined benefit pension plan which provides an annual benefit in the form of a single life annuity commencing at normal retirement age (without ancillary benefits), the accrued benefit derived from mandatory employee contributions (which could never be in excess of his total accrued benefit under the plan) would be treated as the total amount of the employee's "accumulated contributions" multiplied by a conversion factor.[10] In general, the conversion factor, which initially is to be fixed at 10 percent for a normal retirement age of 65, is to be used to convert the amount of the accumulated contributions to a single life annuity commencing at normal retirement age. For other normal retirement ages, the conversion factor is to be determined by regulations.

In determining the employee's accumulated contributions, under the bill, interest on the employee's mandatory contributions is to be compounded annually, initially at a rate of 5 percent (beginning with the first plan year subject to the vesting requirements imposed under the committee bill) to the date when the employee would reach normal retirement age. In addition, any interest accumulated on the employee's contributions (either compounded or simple) in accordance with the terms of the plan, prior to the date when the vesting provisions of the bill first apply to that plan, are to be treated as part of the employee's accumulated contributions. For purposes of this rule, an employee's mandatory contributions include any contributions made to the plan by the employee as a condition of employment, or of participation in the plan, or of obtaining benefits under the plan which are attributable to employer contributions.

The bill authorizes the Secretary or his delegate to adjust the conversion factor, and the assumed rate of interest on employee contributions, on a prospective basis, from time to time, as may be appropriate, but requires him to give at least one year's notice of any such action.

[10] Voluntary employee contributions are to be treated the same as a separate account.

[63] The adjustment in the interest rate would be made by comparing the long-term money rates and investment yields for a 10-year period ending at least 12 months prior to the year in which the adjustment would first apply, with the corresponding rates and yield for the 10-year period from 1964 through 1973.[11]

The committee anticipates that the Treasury, in determining money rates and investment yields, will use a composite of a number of indicators. For example, one possible approach might be to give equal values to the dividend yields of the Dow-Jones Industrial Average and the Standard and Poor's 500-Stock Average, and to the interest rates of Barron's or Moody's highest-rated bonds and United States Treasury long-term obligations. This composite, for the 1964–1973 base period, would be set at 5, and the interest rate in the future would be determined by the Treasury Department's comparison of this composite for the base period, with the same composite for the then most recent 10-year period. It is contemplated that this interest rate will be adjusted less often than annually, and that due regard will be given by the Treasury Department to the impact of any such adjustment on existing plans.

Discrimination.—Under present law, rapid vesting requirements are sometimes imposed on a plan in order to prevent discrimination. Your committee anticipates that the higher vesting standards provided in the bill will reduce the need to require faster vesting in order to achieve this purpose. On the other hand, there undoubtedly still will be cases where it will be necessary to require that the plan provide vesting over and above that required under the bill to prevent discrimination under a plan in favor of officers, shareholders, and highly compensated employees. Under the committee bill, the Internal Revenue Service is to require more rapid vesting (such as by requiring a greater portion of the accrued benefit to become vested or by requiring the benefit to accrue faster in order to minimize the possible discriminatory effects of "back loading") if it appears that there had been, or is likely to be, forfeitures under the plan which have the effect of discriminating in favor of the officers, etc. For example, in a profit-sharing plan, such forfeitures could directly benefit the proscribed class of individuals. But in a defined benefit plan there could also be discrimination by reducing the cost to the employer of providing a disproportionate amount of benefits for executives. In other words, if most highly paid employees remain (or are likely to remain) on the job, while other employees tend to leave, the Internal Revenue Service could find a pattern of discrimination (whether or not it was the result of a deliberate policy of dismissing employees in order to prevent vesting) and could require more rapid vesting (for example, by adjusting the vesting schedule, the accrual rate, or both).

Also, present law is designed to ensure that in the event of early plan termination, the benefits under the plan are not paid to employees who are officers, shareholders, or highly compensated employees in a discriminatory manner. The committee bill contains a provision to

[11] To forestall the need for plan amendments, the committee anticipates that a plan could satisfy the requirements of these provisions if it provided that interest on mandatory employee contributions would be computed at a rate of 5-percent, or at such other rate as may be required from time to time under the Internal Revenue Code of 1954, and the regulations issued thereunder.

[64] make it clear that the vesting requirements under the bill are not intended to operate to overturn these rules. Thus, for example, in the event of an early plan termination, a highly compensated employee might receive less than his otherwise vested benefit under the bill, if this were necessary to prevent discrimination.

Plan termination.—Under present law, all accrued benefits in a qualified pension plan must become fully vested (to the extent then funded) in the event of a termination, or the complete discontinuance of contributions under a pension plan. This rule will no longer be necessary with respect to discontinued contributions, because the committee bill (sec. 1013) now provides for an excise tax on underfunding. Employers whose plans are subject to the funding requirements of the committee bill cannot terminate their plans merely by discontinuing contributions, since the employers continue to remain liable for the required contribution.[12] However, the committee bill makes clear that this rule of full immediate vesting is still to apply in the case of a termination, or a partial termination. (Examples of a partial termination might include, under certain circumstances, a large reduction in the work force, or a sizable reduction in benefits under the plan.) Moreover, even after the plan has terminated, the employer is still under an obligation to pay the required funding of the plan through the date of termination and these make-up amounts (if any) are to be taken into account in determining the accrued liabilities which may become vested upon termination.[13]

Class year plans.—A class year plan is a profit-sharing or stock bonus plan which provides for the separate vesting of employee rights to contributions (or rights derived from contributions) to a plan on a year-by-year basis and the withdrawal of these amounts on a class-by-class basis as they mature. The minimum vesting requirements of the bill applicable to a class year plan are satisfied under the bill if the plan provides for 100-percent vesting of the benefits derived from employer contributions within 5 years after the end of the plan year for which the contributions were made. A separate rule is needed for class year plans since they are structured differently than most other types of plans. The 5-year full vesting rule provided in this case by the committee bill assures an employee who terminates his employment under a class year plan that he will not forfeit his rights to more than 4 years of employer contributions.

Recordkeeping requirements.—To carry out the intent of the vesting provisions (primarily those involving intermittent employment), the employer would be required to keep records of the years of service of his employees and the percentage of vesting which the employees had earned, together with any additional information required by the Secretary or his delegate in order to determine the employee's benefits. In the case of a multiemployer plan, the employer would furnish the required information to the plan administrator (who would be required to maintain the records), in accordance with regulations.

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[12] Plans which are not subject to the funding requirements (e.g., profit-sharing plans, church plans, and government plans) can be required to provide vesing of employee benefits (to the extent funded) if contribuions are completely discontinued.

[13] In the case of a multiemployer plan the Secretary or his delegate may provide by regulations for the situation where all the employers of the terminated plan did not contribute at the same rate or on the same basis.

[65] Failure to maintain or furnish the required records would result in a civil penalty of $10 for each employee with respect to whom the failure occurs, unless it is shown that the failure is due to reasonable cause. The committee expects that the necessary records will be retained by employers for at least 10 years following a break in service. After that, the employee could still establish his right to vesting based on prior service, but the burden of producing the evidence would shift to the employee.

In addition, the Social Security Administration is to be informed, in a time and manner to be prescribed under regulations, when an employee terminates his service prior to retirement with vested benefits.[14] This information, in turn, will be supplied to plan participants and beneficiaries upon request, and when the individual applies for social security benefits. This provision should minimize the danger that vested rights may be lost because a participant is unaware that he is entitled to receive a pension. (Regulations will provide for the situations where adequate records are not available for periods before the effective date of bill.)

Under the bill, the "plan administrator" would generally be the person so designated under the plan or, if there were no designation, the employer or organization who maintained the plan.

Variations.—In the case of a multiemployer plan, the bill (in sec. 1015) permits the Secretary of Labor to prescribe an alternate method (often referred to as a "variance") of satisfying the vesting schedules and accrued benefit requirements with respect to benefits attributable to employer contributions, if it is established to his satisfaction that rigid application of the requirements of the bill would increase the costs of the plan to such an extent that there was a substantial risk that the plan would be terminated, or there would be a substantial reduction in the benefits under the plan, or in the compensation of the employees. Such a variance could also be granted to prevent an undue administrative burden in connection with the plan.

The rules for such variances (which may be considered by the Secretary of Labor either on his own motion or on petition by the plan administrator, and only with appropriate notice and hearing safeguards) are described in detail below (in the funding portion of this general explanation).

Joint and survivor annuities.—Under present law, there is no requirement that a qualified employee plan must provide for survivor annuities. This can result in a hardship where an individual primarily dependent on his pension as a source of retirement income is unable to make adequate provision for his spouse's retirement years should he predecease her. To correct this situation, the committee's bill requires that if a plan provides for a lifetime annuity then, where the participant is married on the annuity starting date, the plan must provide for a joint and survivor annuity (or an arrangement, such as

[14] In the case of a multiemployer plan, the information would generally be furnished only when the employee left the plan; there would be no need to notify the Social Security Administration merely because the participant changed employers. Also, because of the large "turnover" rate in multiemployer plans, your committee contemplates that the regulations will provide that in the case of a multiemployer plan, no reporting is required for a reasonable period of, say, 2 years after the employee has last performed service under the plan.

[66] supplementary benefits for the participant's spouse which has essentially the same effect) where the survivor annuity is at least half of the annuity payable to the participant during the joint lives of the participant and his spouse.

The plan may provide that the participant has a reasonable period (as prescribed in regulations) before the annuity starting date during which he may elect in writing—after having received a written explanation of the terms and conditions of the joint and survivor annuity and the effect of such an election—not to take the joint and survivor annuity. The bill does not require the plan to "subsidize" the joint and survivor annuity. Consequently, such a joint and survivor annuity could be less (in terms of dollars per annuity payment) than the single life annuity. Also, the bill does not forbid plans from making reasonable actuarial adjustments to take appropriate account of the possibility that otherwise total costs would be increased because of adverse selection.

The joint and survivor annuity requirements are to apply only to plans to which the new vesting requirements of this bill are applicable. In other words, the joint and survivor rules would not apply to government plans, they would not apply to church plans unless an election had been made to come under the new rules, and the effective date in the case of existing plans would be delayed to the same extent that the effective date is delayed generally with regard to the new vesting provisions. Of course, the plans not subject to these provisions (or to which the new provisions would not apply for some years into the future) may offer joint and survivor options if they wish to do so. The mandatory provisions of the bill will not apply unless that participant's annuity starting date is on or after the effective date with regard to that plan and would not apply unless that participant was an active participant in the plan on or after that effective date.

Plan mergers.—The committee bill contains a provision (sec. 1021) to ensure that the rights of participants are fully protected in the event of plan mergers. Under this provision, which applies to any plan merger occurring after October 22, 1973, each participant must be entitled to receive a benefit immediately after the merger (determined as if the plan then terminated) which has not less than the value of the benefit he would have been entitled to receive immediately before the merger (determined as if the plan then terminated. Moreover, the funding of his accrued benefit must be at least as adequate after the merger as it was before the merger. Without such a provision, the committee was concerned that the rights of plan participants might be diluted in some instances, as the result of plan mergers. As a further safeguard, the bill requires that in the case of any plan merger which occurs after enactment, the plan administrator must give 30 days notice to the Internal Revenue Service, including an actuarial statement indicating that the requirements of the bill have been met.

Alienation.—To further ensure that the employee's accured benefits are actually available for retirement purposes, the committee bill also contains a provision requiring the plan to provide that benefits may not be assigned or alienated. (Of course, this provision is not intended to prevent the transfer of benefit rights from one qualified plan to another.)

[67] Nevertheless, a plan will be permitted to provide for voluntary and revocable assignments (not to exceed 10 percent of any benefit payment) for the purpose of paying premiums on life insurance, on medical or hospital insurance, or for any noncommercial and nonprofit purposes specified under Treasury regulations. Your committee understands that many plans provide for payments of premiums for supplemental hospital benefits (under the Social Security Act) and this provision is intended to specifically permit such an alienation. Your committee dealt specifically with life, medical, and hospital insurance premiums because such premiums are in many cases already paid by plans out of pension benefits for the convenience of the plan retirees. Your committee determined to permit reasonable flexibility to extend this practice to other types of payments in the future, concluding that the safeguards (revocability, 10-percent limit, and Treasury regulations) would be sufficient to prevent abuses which might endanger the right of future retirees to be secure in their retirement incomes.

This provision is not intended to interfere with the current practice in many plans of using vested benefits as collateral for reasonable loans from the plans, where the "prohibited transactions" provisions of present law (sec. 503 of the Code) and other fiduciary requirements are not violated.

Benefits of terminated participants.—Protection is given to retired individuals and individuals who are separated from the service of the employer against reductions in private plan benefits when social security benefit levels increase. In general, under present integration procedures, social security benefits attributable to employer contributions are treated as though they were part of the private plan. As a result when the level of social security benefits increases, some integrated plans have reduced the amount of the retirement benefits that they provide for covered employees.

Present law under administrative practice provides that qualified plans may not use increases in social security benefit levels to reduce the benefits that they pay where the employees concerned are retired and already receiving integrated plan benefits. The bill codifies this treatment for retired persons. It also extends the prohibition against reducing plan benefits where social security benefit levels are increased to cases where the individuals concerned are separated from service prior to retirement and have deferred nonforfeitable rights to plan benefits. This provision is effective for increases in social security benefits which take place after the date of enactment or on the date of the first receipt of plan benefits or the date of separation from service (whichever is applicable) if that date is later.

These changes do not affect the ability of plans to use the integration procedures to reduce the benefits that they pay to individuals who are currently covered when social security benefits are liberalized. Your committee, however, believes that such practices raise important issues. On the one hand, the objective of the Congress in increasing social security benefits might be considered to be frustrated to the extent that individuals with low and moderate incomes have their private retirement benefits reduced as a result of the integration procedures. On the other hand, your committee is very much aware that many present plans are fully or partly integrated and that elimination

[68] of the integration procedures could substantially increase the cost of financing private plans. Employees, as a whole, might be injured rather than aided if such cost increases resulted in slowing down the growth or perhaps even eliminated private retirement plans.

In view of the serious issues involved in the integration of private plans with the social security system, your committee believes that it is desirable to postpone action on this issue pending further study of this problem. More specifically, your committee plans to consider this overall problem again at the earliest opportunity, possibly in connection with future tax reform or social security legislation. However, your committee believes that no further integration of social security and pension benefits should be allowed under any further regulations issued by the Secretary or his delegate at least until June 30, 1975.

Payment of benefits.—To ensure that a participant can reasonably expect to receive his benefits during his retirement years, the committee bill requires a qualified plan (to which the basic vesting provisions apply) to commence payment of benefits to the participant (unless he elects otherwise in writing and this election is permitted by the incidental death benefits rule) not later than the 60th day after the close of the plan year in which the latest of these events occurs: (1) the participant attains age 65; (2) the 10th anniversary of the time the participant commenced participation in the plan; or (3) the participant terminates his service with the employer. This requirement is set in terms of the end of a plan year, rather than the date on which the event occurs, in order not to disrupt unduly the administrative practice of plans that begin retirement benefits for all new retirees on the same date. The second of the above alternatives (the 10th anniversary of commencement of service) is designed to permit a defined benefit plan to have an adequate period of time in which to fund the benefit for a person who first enters the plan at a relatively late age. The third of the above alternatives (termination of service) has been added in recognition of the fact that these benefits are designed primarily to provide for the participant's retirement.

Effect of withdrawal of employee contributions.—At the present time, many employee plans require employees to make contributions in order to receive employer contributions (or benefits to be funded by the employer). Some such plans permit employees to withdraw their contributions (or the benefits derived from their contributions) but impose as a "penalty" for such withdrawal the forfeiture of some or all of the benefits derived from employer contributions. Where this occurs, the effect is to reduce the retirement protection afforded to the employee. Your committee is not at this point expressing a view as to whether employee contributions or the right to withdraw those contributions are desirable features of retirement plans. However, it does not appear appropriate to provide for forfeitures derived from employer contributions merely because of a withdrawal by the employee. Accordingly, the committee bill specifically requires all qualified plans to forbid forfeitures of nonforfeitable benefits derived from employer contributions solely because of withdrawals by employees of any parts of the benefits derived from the employees' contributions.

This limitation is to apply only to plans to which the new vesting provisions of the bill apply.

[69] *Comparability of plans having different vesting provisions under the antidiscrimination rules.*—There are certain classes of employees, such as engineers, whose rate of job mobility is so high, that many of them would not receive protection even under the vesting provisions provided under the bill. To be effectively covered under a pension plan, these employees would have to receive a very substantial amount of vesting during their first 5 years of employment. At the same time, if all employees were to be provided with vesting on this rapid a basis under the plan, the cost might be so high that the employer would terminate the plan, or drastically reduce the benefits under the plan. To meet this situation, the committee bill contains a provision which would allow the engineers and other employees with a similar problem, in effect, to trade off some of their benefits in exchange for earlier vesting.

Under present law a single plan may satisfy the antidiscrimination requirements (sec. 401(a)(4)), if either the contributions or the benefits do not discriminate in favor of certain enumerated employees. Generally, profit-sharing plans, stock bonus plans, and money purchase plans can satisfy this requirement if the contributions are nondiscriminatory even though the benefits may discriminate. Defined benefit plans can satisfy this requirement if benefits are nondiscriminatory even though the contributions are discriminatory. A target benefit plan, a type of money purchase plan, may satisfy the requirement if the anticipated benefits do not discriminate even though the contributions do. (For this purpose actual investment experience is not considered.) Also under existing law, two plans can be considered as one for purposes of satisfying the antidiscrimination requirements, either as to contributions or benefits.

Under the committee bill an employer might set up two retirement plans, one with very rapid vesting, the other with slower vesting, but with higher benefits. The bill provides that for the purposes of applying the antidiscrimination rules, the two plans could be considered as a unit (as under present law) and the plan with more rapid vesting would not be considered discriminatory merely because of this feature (even if highly compensated employees were covered under the plan), if contributions were comparable or (in the case of defined benefit plans) if benefits under this plan were scaled down appropriately in relation to benefits provided under the plan with less rapid vesting. (Of course, each plan would have to at least meet the minimum vesting schedule provided in the committee bill and would also have to be nondiscriminatory as to the employees covered by it.)

Thus, in the case of a defined contribution plan, the tax deductible contributions to both plans would be required to be the same in proportion to covered compensation. This would mean, in effect, that employees in the plan with less rapid vesting would receive increased benefits as the result of forfeitures,[15] whereas there would be relatively few forfeitures under the plan with earlier vesting.

In the case of a defined benefit plan, the same principle of comparability would apply, but here the level of benefits under the plan with

[15] If the employer reduced his tax deductible contributions under the plan because of forfeitures, the tax deductible contributions to the plan with early vesting would also have to be reduced; comparatively, the employees in the plan with less rapid vesting would always have to accumulate larger benefits in proportion to empensation.

[70] earlier vesting would have to be lower, in relation to the benefits provided under the other plan. Generally, these comparisons would be made on an actuarial basis, in accordance with regulations.

By this provision the committee is clarifying this matter for the future. It intends that prior law on this point be determined as if this provision had not been enacted.

Protection of pension rights under government contracts.—Many employees, such as engineers, who are employed in industries engaged to a substantial extent in the performance of Federal contracts, have an unusually high rate of mobility which results to a considerable extent from terminations or modifications of Federal contracts, grants, or procurement policies. As a result of this unusual mobility, these employees are particularly susceptible to the loss of their pension rights due to changes in their employment status before they can become vested.

To meet this situation, the bill directs the Secretary of Labor to undertake a study, in consultation with professional societies, business and labor organizations, and other Federal agencies, of steps to be taken to ensure that professional, scientific, technical, and other personnel employed under Federal contracts are protected against loss of their pensions resulting from job transfers or loss of employment. The Secretary of Labor is to report to Congress on this subject within 2 years after the date of enactment and shall, if feasible, develop recommendations for Federal procurement regulations to safeguard pension rights in this situation within one year after filing his report. These regulations are to become effective unless either House of Congress adopts a resolution of disapproval within 90 days after the proposed regulations are submitted to the Congress by the Secretary of Labor. Of course, individual government agencies would be free to take action to protect the rights of workers employed under agency contracts, even if no comprehensive regulations, applicable on a government-wide basis, could be developed.

Church and government plans, and union-sponsored plans.—Church and government plans (described above under participation and coverage) are exempt from the vesting provisions of the bill but must comply with the requirements of present law in this area (as in effect on the day before enactment) in order to be qualified. Church plans may elect to come under the provisions of the bill and, once made, such an election will be irrevocable.

The committee bill also exempts from the vesting requirements plans which do not, at any time after enactment, provide for employer contributions—in other words, union-sponsored plans. Since these plans are, in effect, controlled by the employees for whose benefit they are established, there is no need to impose the vesting requirements of the bill. However, if the plan provides for employer contributions, the mere fact that no such contributions are made (either because the plan is fully funded, or because the employer fails to comply with the funding requirements of the bill, or for some other reason), will not result in an exemption for the plan from the vesting requirement.

Effective dates

These provisions apply generally to plan years beginning after the date of enactment of the bill. Later effective dates (which may vary from 1976 to 1981, depending on the circumstances of the plan) are

[71] provided in the case of plans in existence on January 1, 1974, in order to afford such plans adequate opportunity to adopt any amendments needed in order to conform to the new requirements resulting from this bill. The effective date provisions are described more fully above, in the discussion of participation and coverage requirements.

Revenue effect

Estimates of the revenue effect of the minimum vesting provisions vary with the assumption made about the relationship between additional employer contributions to pension plans and cash wages. If it is assumed that the additional employer contributions will be a substitute for cash wages, the estimated revenue loss is $130 million. On the other hand, if it is assumed that the additional employer contributions will be an addition to cash wages, the estimated revenue loss $265 million. The estimates under both cases assume that benefits under pension plans are not decreased and that no benefit increases are foregone as a result of the bill. The estimates are based on 1973 levels of income and employment.

C. Funding

(Secs. 1013, 1033 of the bill and secs. 404, 412, 4971, 6059, 6692, 7517 of the Code)

Present law

Under present tax law, contributions to a qualified pension plan generally must be sufficient to pay the liabilities created currently (*i.e.*, the normal pension costs) plus the interest due on unfunded accrued pension liabilities (past service costs) (regs. § 1.401–6(c)(2)(ii)).[1] This tends to keep the amount of unfunded pension liabilities from growing larger, but does not require any contributions to be made to amortize the principal amount of the unfunded liabilities.

Pension plan liabilities [2] generally are estimates and are based on actuarial calculations. Consequently, all actuarial methods, factors, and assumptions used must, taken together, be reasonable and appropriate in the individual employer's situation (Regs. § 1.404(a)–3(b)). When applying for a determination letter from the Internal Revenue Service that a plan is qualified, the actuarial methods, factors, and assumptions used generally must be reported to the Service, along with other information to permit verification of the reasonableness of the actuarial methods used. Changes in actuarial assumptions and methods must be reported annually to the Service.

Actual experience may turn out to be different from anticipated experience, changing the estimated pension liabilities (and needed contributions) and resulting in experience loss or experience gain. Depending on the circumstances, the contributions needed to make up experience losses may be deducted currently or may be added to past service costs and deducted only on an amortized basis.[3] Similarly, de-

[1] This requirement applies only to pension and not to profit-sharing or stock bonus plans.

[2] In determining liabilities, an employer must take into account factors such as the basis on which benefits are computed, expected mortality, interest, employee turnover, and changes in compensation levels.

[3] Under the "10-percent" deduction limit (sec. 404(a)(1)(C) of the Code), if the experience loss occurs using the same assumptions as previously, the additional contributions, subject to certain restrictions, may be deducted currently. If the deficit results from a loss in asset values or revaluation of liabilities using more conservative assumptions the deficit may be added to past service cost. Rev. Bull. 57–550, 1957–2 C.B. 266.

[72] pending on the circumstances, experience gains may reduce the plan cost currently or reduce costs under one of the spreading methods used to determine the amounts deductible.[4]

The value of plan assets also affects the amount of contributions. Under administrative rulings, assets may be valued by using any valuation basis if it is consistently followed and results in costs that are reasonable.

If an employer does not make the minimum required contributions to a qualified plan, under administrative practice the deficiency may be added to unfunded past service costs. However, the plan also may be considered terminated, and immediate vesting of the employees' rights, to the extent funded, may be required.

General reasons for change

Significant tax benefits are allowed under the Internal Revenue Code for plans that provide for employee retirement. Implicit in these tax benefits is the requirement that tax qualified plans will in fact provide the retirement benefits promised. However, the available evidence has demonstrated that a significant portion of existing tax qualified pension plans have not been adequately funded and are not accumulating sufficient assets to pay benefits in the future to cover employees. As a result, many employees now covered by tax qualified pension plans may not actually receive the pensions they have been promised, because the needed funds will not be available. Your committee believes that the present minimum funding requirement for plans qualified under the Internal Revenue Code is not adequate to prevent this underfunding, since it does not require any payment to reduce the amount of the outstanding unfunded liabilities, which may be substantial. As a result, your committee's bill provides new minimum funding standards.

Under the bill, normal costs of covered plans are to be currently funded. Additionally, newly-established unfunded past service liabilities of covered plans generally are to be amortized over no more than 30 years, although existing past service liabilities generally are to be amortized over no more than 40 years. In addition, experience deficiencies generally are to be amortized over no more than 15 years. (Generally, longer periods are to be allowed for multiemployer plans.) Alternatively, if funding requirements are higher under a second general standard which is based on accrued vested liabilities, this standard is to apply in lieu of the rules set forth above. Under this standard, accrued vested liabilities are determined, as also are the value of the plan's assets. To the extent the vested liabilities exceed the value of assets, the first year's payment under a 20 year amortization schedule (principal and interest) of unfunded vested liabilities is to be paid in the current year. A new determination with respect to the applicability of this second general standard is to be made in each of the succeeding years, starting with a new 20 year period. Of course, pension liabilities may be amortized at a faster rate than under the minimum required standard, if desired.

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[4] See Rev. Rul. 59–153, 1959–1 C.B. 89, discussing a pension plan using the "entry age normal method," where adjustment for gains is generally made by deducting the amount of gains arising in any year from the next year's deductible limit under sec. 404(a)(1)(C). See also Rev. Rul. 65–310, 1965–2, C.B. 145, discussing a plan using the "frozen initial liability method," where adjustments for gains are spread automatically as a part of current and future normal costs.

[73] Your committee recognizes that the amount required to fund a pension plan is in large part determined by actuaries' estimates of future plan costs, which in turn are based on the actuarial methods and assumptions used for each plan. Consequently, the determination of the amount of contributions that must be made to a plan to adequately fund the plan benefits is significantly affected by the professional decisions of the plan's actuary. Since there is no existing government regulation or licensing requirement for actuaries as there is for, *e.g.*, lawyers and accountants, your committee believes that minimum standards of competence should be established for persons who make actuarial computations for qualified plans. Consequently, the bill requires the Secretary of the Treasury (in regulations that are also to be approved by the Secretary of Labor) to set standards of competence for persons who make actuarial reports to the Internal Revenue Service. The bill also provides that actuaries enrolled to practice before the Service are to certify plan costs and report the actuarial methods and assumptions used for each pension plan. Your committee also contemplates that the Secretary will establish an actuarial advisory board to provide assistance in setting standards for enrolling actuaries, setting guidelines for actuarial assumptions and in other pertinent matters.

Additionally, your committee believes that the current sanctions on an employer for failure to adequately fund his qualified plan are inappropriate, since they may not affect an employer's decision to underfund his plan. For example, an employer may not feel any reason to make the minimum required contributions to his plan if the only consequence of underfunding is to give his employees vested rights in the amounts that are already funded. To resolve this problem, the bill provides an excise tax on the failure to meet the minimum funding requirements.

Your committee also recognizes that, within limits, employers who are financially unable to meet the funding requirements should be allowed to postpone paying contributions to their plans. Therefore, the bill allows the Internal Revenue Service to grant variances from certain minimum funding requirements if the employer demonstrates that substantial business hardship would otherwise result and that applying the minimum standard would be adverse to the interests of plan participants in the aggregate. The amount for which the variance is granted is to be amortized over no more than 15 years. The bill also provides that the Secretary of Labor may allow variances that would provide longer amortization periods for funding multiemployer plans if substantial business hardship would otherwise result. Additionally, in certain cases, the Secretary of Labor is to be able to prescribe alternative funding methods for multiemployer plans.

Explanation of provisions

Minimum funding rules, in general.—Your committee's bill establishes new minimum funding requirements for qualified plans so these plans will accumulate sufficient assets within a reasonable time to pay benefits to covered employees when they retire. Of course, contributions generally may be greater than these minimum requirements if the employer so desires (however, see discussion below under *Maximum deductions for plan contributions*). The new funding rules generally are to apply to any plan that, after the effective date of the

[74] funding provisions for the plan in question, has qualified (or has been determined by the Internal Revenue Service to qualify) under section 401(a), 404(a)(2) (employees' annuities plans), or 405(a) (bond purchase plans) of the Code. However, the new requirements generally are not to apply to profit-sharing or stock bonus plans, governmental plans, certain church plans, plans with no employer contributions, and certain insured plans. Once a plan or trust has been tax qualified, the minimum funding requirements will apply, and they are to continue to apply to the plan or trust, even if it later loses its qualified status. If a plan loses its qualified status, the deduction rules for nonqualified plans are to apply even though the minimum funding standard continues to apply to the plan.

Generally, under the new funding requirements the minimum amount that an employer is to contribute annually to a defined benefit pension plan includes the normal costs of the plan (as under current law), plus amortization of past service liabilities, experience losses, etc. The minimum amortization payments required by the bill are calculated on a level payment basis—including interest and principal—over stated periods of time. Generally, initial past service liabilities and past service liabilities arising under plan amendments are to be amortized over no more than 30 years (40 years for the unfunded past service liabilities on the effective date of these new funding rules, in the case of existing plans), and experience losses are to be amortized over no more than 15 years. However, generally experience gains and losses need not be calculated more often than every three years. With respect to multiemployer plans, past service liabilities generally may be amortized over no more than 40 years, and experience losses over no more than 20 years. However, an alternative funding standard, based on contributing a portion of the unfunded nonforfeitable liabilities under the plan, is to be used if it brings a higher level of funding in any year than would the basic minimum funding standard. This alternative standard is to apply both to multiemployer and other plans.

If an employer would otherwise incur substantial business hardship, and if application of the minimum funding requirements would be adverse to plan participants in the aggregate, the Internal Revenue Service may waive the requirement of current payment of part or all of a year's contributions of normal costs, and amounts needed to amortize past service liabilities and experience losses; the amount waived (plus interest) is to be amortized not less rapidly than ratably (including interest) over 15 years, and no more than 5 waivers may be granted for any 15 consecutive years. (As described subsequently other variances may be allowed by the Secretary of Labor for multiemployer plans.)

For money purchase pension plans, the minimum amount that an employer is to annually contribute to the plan is the amount that must be contributed for the year under the plan formula. For purposes of this rule, a plan (for example, a so-called Taft-Hartley plan) which provides an agreed level of benefits and a specified level of contributions during the contract period is not to be considered a money purchase plan if the employer or his representative participated in the determination of the benefits. On the other hand, a "target benefit

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[75] plan" is to be treated as a money purchase plan for purposes of the minimum funding rules.

Under the new funding rules, generally each covered plan is to maintain a new account called a "funding standard account." This account is to aid both the taxpayer and Internal Revenue Service in administering the minimum funding rules. The account also is used to assure that a taxpayer who has funded more than the minimum amount required is properly credited for that excess and for the interest earned on the excess. Similarly, where a taxpayer has paid too little, the account is to assist in enforcing the minimum funding standard, and to assure that the taxpayer is charged with interest on the amount of underfunding.

Each year the funding standard account is to be charged with the liabilities which must be paid to meet the minimum funding standard. Also, each year the funding standard account is to be credited with contributions under the plan and with any other decrease in liabilities (such as amortized experience gains). If the plan meets the minimum funding requirements at the end of each year, the funding standard account will show a zero balance (or a positive balance, if the employer has contributed more than the minimum required). If the minimum contributions have not been made, the funding standard account will show a deficiency (called an "accumulated funding deficiency").

The funding rules established by the bill are in addition to the rules which provide the maximum deduction limits for contributions to a plan. However, generally a contribution that is required by the minimum funding rules is to be deductible currently. In addition, the rules governing the maximum deduction limitations are to be changed to make them more compatible with the minimum funding requirements.

Normal costs and initial past service liabilities.—Your committee's bill specifically continues the requirement of present law that the normal costs (arising from current liabilities) of a defined benefit pension plan must be currently funded. In addition, in order to give assurance that a plan will have sufficient assets to pay benefits, the bill establishes new minimum requirements for funding accrued past service liabilities. In general, the bill requires that an employer's contributions to a defined benefit pension plan for initial past service liabilities is to be sufficient to amortize these liabilities, on an accrued basis, over no more than 30 years from the date that the plan is established (40 years for multiemployer plans).

For a plan in existence on the date of enactment, unfunded past service liabilities existing as of the effective date of the new funding provisions applicable to the plan are to be treated as initial past service cost to come under the minimum funding rule and are to be amortized over no more than 40 years. This longer period will allow existing plans sufficient time to make the transition into the new funding rules. Since existing plans may have to be amended to meet the new vesting and participation requirements of the bill (and these amendments would affect plan costs), the 40-year amortization period is to be allowed for past service liabilities existing as of the plan year for which the bill becomes effective, including those liabilities arising from amendments made to meet the new vesting and participation require-

[76] ments, even if those amendments are made retroactively after the effective date respecting the plan. However, the 40-year amortization is allowed only with respect to liabilities arising from retroactive amendments that are made by the time the employer must file his tax return for his taxable year in or with which the first plan year to which the new minimum funding requirements apply ends. In the cast of multiemployer plans, such retroactive amendments may be made within two years after the close of the first plan year to which the new minimum funding requirements apply.

The minimum funding requirement for past service liabilities in effect is analogous to payment over 30 years of a loan secured by a home mortgage. It requires contributions to the plan to be made not less rapidly than if made on a level payment basis over 30 years, with each payment including both interest and principal. For example, if the past service liability is $1,000,000 at the time a plan is established, the minimum level payment that is to be made each year, for 30 years, to meet the funding requirement (calculated at an interest rate of 6 percent per annum over the 30-year period) is $68,537 per year (assuming contributions are made at the beginning of each year). In addition, the employer would be required to contribute annually to the plan an amount equal to the normal cost of the plan.

The interest rate to be used in calculating the minimum payments for amortization of initial past service liabilities is the same rate as that used in determining plan cost, at the time the plan is established, or at the time the new funding requirements apply to the plan, in the case of plans in existence on the date of enactment. (Similarly, the interest rate used to amortize past service liabilities arising from amendments, to amortize experience losses, and to amortize contribution waivers also is the rate used to determine plan costs at the time the liability in question first arose.) If the interest rate used to determine plan costs is changed as of a later date in order to conform with experience, the initial amortization schedule of level payments is not to be changed, but the consequent increase (or decrease) in plan costs is to be amortized as an experience loss or gain (treated in the manner described below).

Under your committee's bill, the basic minimum funding rules—both those which apply to all past service liabilities and those which apply to normal costs—require funding on the basis of accrued, (that is, both vested and nonvested) liabilities, not merely on the basis of vested liabilities. The use of accrued liabilities for this purpose appears appropriate because it generally provides the most orderly and comprehensive method for funding the plan's entire liabilities. In this way, gradual payments will be made to fund all of a plan's present liabilities, including the presently nonvested accrued liabilities which are expected to vest in the future. Moreover, funding on the basis of accrued liabilities tends to produce somewhat more rapid funding, and as a result generally provides more protection to plan participants.

Generally, the 30-year amortization requirements initially add only moderately to an employer's funding cost under present law. This is true because under present law interest on unfunded accrued past service liabilities (which accounts for the bulk of the level amortization payments required under the bill in the early years) must be con-

[77] tributed to a qualified pension plan. Therefore, your committee believes that 30-year amortization will not hamper an employer in starting a new plan, or in adding plan amendments, that includes past service liabilities. Similarly, the 40-year amortization will not unduly increase present costs of an employer with an existing plan.

Plan amendments.—The bill provides that past service liabilities created by plan amendments are to be treated generally in the same way as initial past service liabilities of new plans for purposes of the minimum funding rules. Under the minimum funding rules these liabilities are to be amortized separately over a 30-year period (40 years for multiemployer plans) from the date the amendment is adopted even if this precedes the date on which benefits increase. For example, if the unfunded accrued past service liability added by an amendment is $100,000, the employer generally is to amortize this increase in past service liability in 30 annual payments of $6,854 (assuming an interest rate of 6 percent and that contributions are made at the beginning of each plan year).

Plan amendments which decrease past service liabilities (by decreasing plan benefits) are treated consistently with plan amendments increasing benefits; that is, decreases in past service liabilities from plan amendments are to be amortized over 30 years (40 years for multiemployer plans). Consequently, the minimum amortized annual payments to fund past service liabilities that must be contributed by an employer who decreases plan benefits generally will not be less, in any one year, than amortized payments required for an employer who started out with a plan providing the same (lower) benefits. (Of course, a decrease in benefits will often also decrease the normal cost which must be funded annually.)

Under the bill plan amendments may be made on a retroactive basis, to a limited extent, without the approval of the Secretary of Labor. In this case, plan amendments may be made after the close of a plan year and yet apply to that year if they are made within the time for filing the employer's return (including extensions) for the employer's taxable year with or within which that plan year ends. (Since a single employer's plan year is not a workable standard for multiemployer plans, with respect to multiemployer plans, an amendment may be made within two years after the close of the plan year.) It is expected that this provision may be used to decrease plan liabilities where an error has been made in calculating the amount of benefits that can be provided and funded under the minimum standard. However, amendments made under this provision are not to decrease accrued benefits of any participant determined as of the end of the first plan year to which the amendment applies.

This provision also may be used with respect to increases in plan liabilities. As discussed above, to the extent that past service liabilities are added by plan amendments that are effective as of the effective date of the new funding requirements for existing plans, and are made within the time allowed for retroactive amendment, these past service liabilities may be amortized over a 40-year period.

Your committee also recognizes that in certain cases where plan participants would otherwise suffer substantial adverse consequences, it may be appropriate for plan benefits to be retroactively reduced beyond

[78] the limit described above. Therefore, the bill provides that, on application of the plan administrator (or on motion of the Secretary of Labor) and after proper notice to all interested parties and a public hearing where interested parties are provided adequate opportunity to be heard, the Secretary of Labor may approve a retroactive decrease in plan benefits (whether or not nonforfeitable). However, before such approval is granted, the Secretary of Labor must make findings of fact that if the amendment is not approved, there would be a substantial risk that the plan would not be continued, a substantial risk of a curtailment of benefits (more than the curtailment that would occur with approval of the amendment), or a substantial risk that current levels of employee compensation would be substantially curtailed. Furthermore, the Secretary of Labor must find that failure to approve the amendment would be adverse to the interests of plan participants in the aggregate. Any amendment approved by the Secretary of Labor is to be retroactive only for such limited time period, and is to decrease benefits only to such extent, as is necessary or appropriate to carry out the purposes of the bill and as is necessary or appropriate to provide adequate protection to plan participants and beneficiaries

Your committee's bill provides that a retroactive decrease in benefits approved by the Secretary of Labor is not to eliminate a funding deficiency for purposes of the nondeductible 5 percent excise tax (discussed below). However, a reduction in benefits may be used to correct a funding deficiency for purposes of the 100 percent excise tax on underfunding (discussed below).

Experience losses and gains.—During the course of a pension plan, actual plan experience may turn out to be poorer than anticipated. For example, the value of plan assets may turn out to be less than expected. Where this occurs, there generally will be an "experience loss" which must be funded if the plan is to be able to pay the benefits owed.[5] Since experience losses relate to previously established plan liability, they may indicate that the plan has become underfunded in relation to the required minimum for funding normal costs and past service liabilities. Consequently, your committee believes it is reasonable to require faster funding for these amounts than for newly established past service liabilities. The bill provides that under the minimum funding rules these losses are to be amortized (with level annual payments, including principal and interest) over not more than 15 years (20 years for multiemployer plans) from the date the loss is determined. Your committee believes that a 15-year amortization period generally will provide adequate funding of experience losses, while at the same time protecting employers from potentially severe financial burdens arising from experience losses created by uncontrollable events.

Your committee understands that the 15-year period, while protecting the financial security of plans, generally will not discourage pension plans such as "final average pay plans" which increase accrued benefits as pay increases, and thus are generally desirable from the

[5] However, the bill provides that experience gains and losses are to be determined under the funding method used to determine costs under the plan. It is understood that some funding methods, such as the "aggregate method", do not provide experience gains or losses, but differences between anticipated and actual experience are subsumed in the basic funding requirements of the method. If a plan were to use such a funding method, it is anticipated that the plan would not need to separately amortize experience gains or losses.

[79] employee's view. Additionally, it is believed that under the 15-year requirement employers will not be subject to unnecessary financial burdens where they have experience losses beyond their control.

A pension plan also may have experience gains during the course of its operation. These gains would occur because experience is more favorable than anticipated. For example, the value of plan assets may be greater than expected. The bill treats experience gains symmetrically with experience losses, so that gains are spread over 15 years (20 years for multiemployer plans) from the date they are determined.

The bill provides that changes in accrued plan liabilities resulting from changes in actuarial method or assumptions are to be treated as experience losses (or gains). Additionally, the bill provides that changes in plan cost that result from changes in the Social Security Act (or other retirement benefits created by State or Federal law) or in the definition of wages under section 3121 of the Code are treated as experience losses (or gains). It is expected that the actuarial assumptions for plans affected by social security, etc. now generally will allow for such changes since to a substantial extent these changes may be anticipated. In this circumstance, if changes in plan cost from changes in social security were not treated as experience gains to be amortized, employers with plans that did not properly allow for social security changes might be able to, upon increases in social security payments, substantially decrease current contributions and thereupon plan participants would receive correspondingly less protection.

Your committee recognizes that plan experience rarely conforms to anticipations on a year-by-year basis, but that experience often is close to expectations over a longer period. Therefore, to smooth fluctuations in funding required by amortization of experience gains and losses, the bill provides that experience gains and losses are to be determined at least every three years and generally need not be determined any more frequently. However, under the bill the Secretary of the Treasury may provide by regulations that experience gains and losses are to be determined more frequently than every three years, in particular cases. Your committee expects that this generally will be required only for plans that show an unusual need for frequent calculations, such as for plans with relatively high claims for payments with respect to assets available. (Under the bill, regulations requiring more frequent determination of gains and losses are to be effective with respect to plan years beginning after December 31, 1975, only if approved by the Secretary of Labor. This is to ensure that the rules of the Internal Revenue Service and the Department of Labor with respect to frequency of determination of gains and losses are similar. It is anticipated that similar regulations prescribed by the Secretary of Labor are not to be effective for those years until approved by the Secretary of the Treasury.)

Additional funding standard.—Your committee recognizes that certain plans with a high proportion of nonforfeitable benefits in relation to assets available may not be adequately funded under the basic minimum funding standard. Therefore, an additional minimum funding standard is provided in the bill which is to be used in any year in which it would require a greater amount of plan contributions than would the basic minimum funding standard.

[80] Under the additional funding standard, the plan is to determine unfunded nonforfeitable liabilities (total nonforfeitable liabilities less plan assets). Then the amount required to amortize these unfunded nonforfeitable liabilities over a period of 20 years (including principal and interest) is to be calculated. The amount to be contributed is the first year's payment under that amortization schedule. This calculation is to be repeated each year (on the basis of a new 20 year period) in which the additional funding standard would require a higher contribution than the basic standard. Since the amount of unfunded nonforfeitable liabilities generally will decrease with contributions, in succeeding years the payment under the additional funding standard generally will be less than the prior year's payment. Therefore, this is a declining balance method of funding.

Your committee anticipates that the amount of unfunded nonforfeitable liabilities generally will be reported on an annual basis to the Department of Labor, and, thus, the basic figures required for this calculation will be readily available to most plans. Additionally, your committee understands that this additional standard will apply infrequently but that it will bring about necessary additional funding in the few cases where it will apply.

Variance from funding requirements.—At times an employer's financial circumstances may prevent him from meeting the minimum funding requirements. Your committee does not believe that in such a situation an employer should be forced to abandon his plan. To deal with cases of this type the bill provides that upon a demonstration by the employer of substantial business hardship and a showing that application of the minimum funding requirements would be adverse to the interests of the plan participants in the aggregate, the Internal Revenue Service may waive all or part of the minimum funding requirements for a year, including normal costs, amortization of past service costs and amortization of experience losses. However, to limit the underfunding which may occur in cases of this type, the bill provides that the Service may not waive all or part of the funding requirements for more than five years (whether or not consecutive) in any fifteen-year period.

Also, the Service may not waive amortization of previously waived contributions.

The bill provides that in determining whether substantial business hardship exists for single employer plans, the Service is to take into account factors such as whether the employer is operating at an economic loss (which may not be the same as operating at a tax loss), whether there is substantial unemployment or underemployment in the employer's trade or business, and whether it is reasonable to expect that the plan will be continued only if the waiver is granted. The determination of substantial business hardship is not to be limited to an examination of these factors, however, nor must all these factors be met for there to be a finding of substantial business hardship.

In determining whether a waiver should be granted, your committee contemplates that substantial business hardship generally will only occur in situations where the employer did not foresee, and could not

[81] reasonably have been expected to foresee (at the time the plan or plan amendment which gave rise to the liability in question was established), the event which causes the business hardship. Your committee contemplates that the Service will grant a waiver of funding normal cost only in unusual situations and will make a separate determination for each instance of waiving normal costs. Additionally, your committee expects that each successive application for waiver will be viewed in light of previous waivers' effects on the financial security of the plan, and that only rarely will the Service waive normal cost for more than one or two plan years based on the same business hardship.

The bill provides that if a waiver of funding requirements is in effect, the plan may not be amended in a way that would increase plan liabilities (through increasing benefits, changing the accrual of benefits, or changing the rate at which benefits become nonforfeitable) as long as there are any unfunded waived contributions outstanding under the plan. It is contemplated that generally other plans of the employer may not be established or amended to establish or increase benefits during a period of waiver. However, your committee contemplates that regulations will provide that an employer may reduce waived liabilities at a rate faster than that provided by the minimum funding requirements. It is also expected that in considering whether a waiver should be granted, the Service will weigh as a factor against the waiver any recent plan amendment (e.g., within three years before the request for waiver) that increases plan liabilities.

It is also contemplated that the Service may apply reasonable conditions to a waiver, and, for example, as a condition of waiver the Service may require plan amendments that eliminate previous recent increases in liabilities. It is recognized that the approval of the Secretary of Labor may be required in some cases, however, to retroactively reduce plan benefits. If a plan were to be amended to increase plan liabilities (or if a condition of waiver otherwise were violated) the amount waived and not yet amortized would immediately become part of the current minimum funding requirement in the year the condition is breached (and consequently this amount would immediately be charged to the funding standard account).

The amount waived by the Service must be amortized in no more than 15 equal annual payments (including interest and principal), beginning the year after the year the waived contributions were due. If a shorter period were required, after several years of waiver an employer's total contributions could be so high that it would be quite difficult to meet this obligation, particularly if the employer were just returning to financial stability. The bill provides that the amortization of the amount waived may not itself be waived in subsequent years.

Your committee's bill also provides a special relief provision for multiemployer plans, allowing longer periods to amortize past service costs or experience losses. This extension of time may be allowed if 10 percent or more of the employers contributing to the plan demonstrate to the Secretary of Labor that they would experience substantial

[82] business hardship if required to meet the otherwise applicable amortization requirements. In this case also, however, a variance is not to be allowed unless application of the minimum funding standards would be adverse to the interests of plan participants in the aggregate. In this case the Internal Revenue Service is to extend the amortization period for the time recommended by the Secretary of Labor, up to a maximum extension of 10 years (and therefore a maximum amortization period of 50 years for past service costs and 30 years for experience losses). In determining whether substantial business hardship exists in the case of multiemployer plans, the Secretary of Labor is to take into account factors such as (but not limited to) whether there is substantial unemployment or underemployment within the industry, whether the sales and profits of the industry are depressed or declining, and whether it is reasonable to expect that the plan will continue only if the waiver is granted.

Your committee believes that a strong showing of hardship must be made for longer extensions to be made available and it is intended that only rarely are extensions of more than 5 years to be allowed. Furthermore, as is the case generally with waivers, if the plan is amended to increase liabilities (through an increase in benefits, a change in the accrual of benefits, or a change in the rate of vesting) during the period that the waived liabilities are unfunded, the waiver is immediately to terminate and the waived liabilities are to become a part of the current year's minimum funding requirements. In addition, reasonable conditions may be applied to extensions of amortization periods. For example, if an extension is allowed for amortizing liabilities a corresponding extension might be appropriate for amortizing corresponding experience gains, or amendments that decrease plan liabilities.

Your committee also recognizes that in some situations it would be inappropriate to require multiemployer plans to meet the basic funding requirements. To meet this problem, the bill provides that the Secretary of Labor may prescribe an alternate funding method for a multiemployer plan, determining the annual contributions and credits to the funding standard account. The Secretary of Labor may also prescribe, under the variance procedure, alternative methods for satisfying the requirements of the bill with respect to changing the multiemployer plan's funding method or plan year.

A variance may be prescribed by the Secretary of Labor only after the Secretary holds a public hearing on the plan in question and allows interested persons, including participants and beneficiaries of the plan an opportunity to present their views. In this regard, a variance cannot be granted unless the Secretary of Labor is satisfied (and makes a finding) that all plan participants and other interested persons have received adequate notice from the plan administrator prior to any public hearing on the variance. If a variance is to be granted, the Secretary of Labor, after a public hearing, is to make a finding that the basic funding requirements would increase plan costs to such an extent that there would be a substantial risk that the plan would be terminated, that benefits under the plan would be substantially decreased without the variance, that (if the plan were continued

[83] at its current level) employee compensation would be substantially decreased, or that unreasonable administrative burdens would be imposed on the plan under the basic funding requirements. Additionally, the Secretary of Labor is to make a finding that the basic funding requirements (or discontinuance of the plan) would be adverse to the interests of plan participants in the aggregate. A variance is to be allowed by the Secretary of Labor only for such a limited period as is necessary or appropriate to carry out the purposes of the bill, and to provide adequate protection to plan participants and beneficiaries. In addition, the alternative method prescribed by the variance must also conform to these standards so that the method is necessary or appropriate to carry out the purpose of the bill and the method would provide adequate protection to participants and beneficiaries under the plan.

It is intended that generally applications for variances are to be made before the last day for timely contribution of the amount in question, and are to be acted upon expeditiously by the Internal Revenue Service and the Secretary of Labor.

The funding standard account.—As previously indicated, the bill requires that each covered plan must maintain a funding standard account. The purpose of this account is to facilitate the determination of whether a plan has met the minimum funding standard. A plan will meet the minimum funding requirements only if, at the end of each plan year, the account does not, on a cumulative basis, have an excess of charges for all plan years over credits for all plan years. The account is to be charged each year with the normal costs for that year and with the minimum amortization requirements for past service costs, experience losses, and waived contributions for each year. On the other hand the account is to be credited with the contributions made for the year, with amortized portions of cost decreases, resulting from plan amendments and experience gains, and with any waived contributions.

To determine if the plan meets the minimum funding standard, the funding standard account is to be reviewed as of the end of each plan year. However, the bill provides that an employer may contribute to a plan after the end of his taxable year and up to the date of filing his tax return, and these contributions may relate back to his previous taxable year. Thus, for example, where the plan and taxable years are the same this will allow payments made within this time to relate back to the previous plan year for purposes of the minimum funding requirements and the funding standard account. This should provide an employer with sufficient time to reconcile the funding standard account and make the contributions needed to avoid underfunding.

If the account has a positive balance at the end of the plan year, the employer will have contributed more than the minimum funding standard requires. Since income will be earned on amounts in the plan, the bill provides that this positive balance is to be credited with interest,[6] which will reduce the need for future contributions to meet the

[6] The interest rate or rates to be used to charge or credit the account are to be consistent with the rate or rates used under the plan to determine costs and are to be charged or credited in accordance with regulations.

[84] minimum funding standard. On the other hand, if the funding standard account has a deficit balance, the employer will have contributed less than required under the minimum funding rules, and the deficiency is to be charged with interest. Interest is charged in this case because the deficiency will become larger over time by the amount of income the plan would have earned had the minimum requirements been complied with and therefore the employer will have to pay more to the plan than just the amount he failed to contribute in the plan year. (A plan in existence on the date of enactment will start with a zero balance in its funding standard account on the effective date for the new funding rules applicable to the plan. Similarly, a newly-established plan will start with a zero balance in its funding standard account.)

An example of the operation of the funding standard account for a single employer defined benefit pension plan is described below.

It is assumed that in 1978 the plan is established with a past service liability of $1 million and a normal cost of $70,000. The interest rate used to determine liabilities under the plan for 1978 and for all years in this example is 6 percent per year. It is also assumed that this plan chooses to determine experience gains and losses on an annual basis, rather than every three years, as is generally allowed under the bill. In the first plan year, the employer contributes $138,537. The plan's funding standard account for 1978 will be as follows:

Credits:	
Employer contributions	$138,537
Charges:	
Normal cost	70,000
Amortization—initial past service cost (30 years)	68,537
Total	138,537
Net balance	0

In the year 1979 the plan is amended (effective for 1979), increasing past service liabilities by $100,000. The plan's normal cost for benefits as amended is $75,500. There is a net experience gain of $5,000 over the prior year. In this year, the employer's contribution is $165,975. The plan's funding standard account for 1979 will be as follows:

Credits:	
Employer contributions	$165,975
Amortization—experience gain (15 years)	486
Total	166,461
Charges:	
Normal cost	75,500
Amortization—initial past service liability	68,537
Amortization—past service liability from amendment (30 years)	6,854
Total	150,891
Balance	15,570
Interest on balance	[1] 934
Net balance	16,504

[1] This assumes that all amounts other than interest are charged and credited at the beginning of the year.

[85] In 1980 the normal cost of the plan is $76,200. There is an experience loss for the preceding year of $10,000. The employer contributes $135, 572. The plan's funding standard account for 1980 will be as follows:

Credits:	
Employer contributions	$135, 572
Amortization—experience gain	486
Total	136, 058
Charges:	
Normal cost	76, 200
Amortization—initial past service liability	68, 537
Amortization—past service liability from amendment	6, 854
Amortization—experience loss (15 years)	971
Total	152, 562
Net	—16, 504
Balance from previous year	16, 504
Balance	0
Interest on balance	0
Net balance	0

In case the additional funding standard applies, the funding standard account is to be charged with the excess of the amount to be contributed under the additional funding standard over the amount to be charged as normal cost, amortization of past service costs and experience losses, less the amortized credits for plan amendments that decrease liabilities and for experience gains. (However, to ensure the account is properly maintained, these amounts also are to be charged and credited to the account in this case.)

The funding standard account—special rules—combining and offsetting amounts to be amortized.—Your committee recognizes that the amortization rules may require a plan to keep accounts for amortizing a number of different items. While the amortization charges and credits to be entered in the funding standard account for any one year will net out to a single figure, some may prefer not to maintain a number of different amortization accounts. Therefore, the bill provides that amounts required to be amortized may, at the taxpayer's discretion, be combined into a single amount to be amortized.

The bill provides, pursuant to regulations to be issued by the Secretary of Treasury, that amounts which are amortizable credits and charges may be offset against each other with the balance to be amortized over a period determined on the basis of the remaining amortization periods for all items entering into the credits or charges, whichever is greater. Also, pursuant to regulations, amortizable credits (or amortizable charges) may be combined into one credit or one charge to be amortized over a period determined on the basis of the remaining amortization periods for all items entering into the combined amount. It is expected that if a taxpayer elects to offset or combine amounts to be amortized, this election will apply to all amounts (both charges and credits) required to be amortized for the year of election.

An example of the netting and combining of amortizable amounts by a single employer plan is described below.

[86] It is assumed that the plan has no past service cost. It is also assumed that the plan chooses to determine experience gains and losses on an annual basis rather than every three years as is generally allowed under the bill. In year 1, the plan has an experience loss of $40,000. In year 2, the plan has an experience gain of $15,000. In year 3, the plan has an experience loss of $10,000. In all these years the plan uses a 5-percent per annum interest rate in computing its plan costs.

The $40,000 experience loss that occurs in year 1 must be amortized over 15 years, requiring annual payments of $3,670. The first payment to amortize this amount is made in year 2.

At the end of year 2 (after one payment of $3,670) the remaining unamortized balance of the $40,000 experience loss is $38,145.[7]

The $15,000 experience gain that occurs in year 2 also is to be amortized over 15 years. Alternatively, it may be combined with the remaining experience loss of $38,145, reducing the unamortized loss by ($38,145 minus $15,000) to $23,145. It is expected that under regulations to be issued by the Secretary of the Treasury, the balance of $23,145 may be amortized over 14 years (the remaining amortization period of the greater amount), in equal annual payments of $2,227. At the end of year 3 (after one payment of $2,227) the remaining unamortized balance of the netted experience loss and gain is $21,964 (requiring annual payments of $2,227 over 13 years).

The $10,000 experience loss that occurs in year 3 would be amortized over 15 years in equal payments of $918 per year if it were to be separately computed and amortized. On combining this loss with the previous net experience loss, the base for amortization is ($21,964 plus $10,000) or $31,964. It is anticipated that under regulations to be issued by the Secretary of the Treasury this amount may be amortized by 13 annual payments of $3,145 ($2,227 plus $918) and thereafter one payment of $1,780.

Special rules—the full funding limitation.—In some cases, the difference between the total liabilities of the plan (all accrued liabilities including normal cost) and the total value of the plan assets may be smaller than the minimum funding requirement for the year. For example, this could occur where the plan assets had increased substantially and unexpectedly in value. Where the excess of total plan liabilities over assets is less than the minimum funding requirement otherwise determined, your committee believes that an employer should not have to contribute more than the amount of this excess liability, for upon contribution of this amount the plan will become fully funded. As a result, in this case the bill provides that the amount to be charged to the funding standard account (and to be contributed), is to be limited to the difference between the total liabilities of the plan and the fair market value of the plan assets. Since the full funding limitation reduces the amount otherwise required to be contributed to a plan, it appears appropriate to use the lower of fair market value or the value of plan assets as normally determined. (As discussed below, the value of plan assets as normally determined may be greater than fair market value in certain cases and in such situations use of the normal valuation method could inappropriately limit contributions to a plan.)

[7] This is based on the assumption of a 5 percent interest charge on the unpaid balance during the year.

[87] When the full funding limit applies, the amortization schedule for charges and credits to the funding standard account are to be considered as fully amortized, and these schedules generally are to be eliminated from the calculations under the funding standard account. However, if the plan is amended in later years to increase plan liabilities, a new amortization schedule would be established with respect to this increase in liabilities. For years after the full funding level is reached, the funding standard account will continue to be charged with the normal cost of the plan. Consequently, unless asset values increase correspondingly with the increase in plan liabilities, eventually the full funding limitation will not be applicable and the employer will have to make contributions to the plan to meet the minimum funding requirements.

If the employer fails to make the required contributions in a year in which the full funding limitation is applicable, the excise tax (described below) on underfunding in that year is to be based only on the amount that should have been contributed, given the full funding limitation.

For the purpose of calculating the full funding limitation, the bill provides that plan liabilities (including normal cost) are to be determined under the funding method used by the plan to determine costs for the year, if the liabilities can be directly calculated under this funding method. However, if this cannot be done under the plan's funding method, in order to allow the full funding limitation to apply, the bill provides that the accrued liabilities are to be calculated under the entry age normal method, solely for the purpose of determining the application of the full funding limitation.

Whether the full funding limitation applies generally is to be determined at the end of the plan year, after all plan liabilities for that year have accrued. For purposes of the full funding limitation, the value of plan assets generally is to be determined as of the usual valuation date for the plan. Since, as discussed above, contributions generally can be made to a plan after the end of a plan year and yet relate back to the previous plan year, there should be no timing problem with respect to such year-end calculations.

Special rules—money purchase pension plans.—Generally, the funding standard account for money purchase pension plans is to be charged annually with the amount that must be contributed for the year under the plan formula, and is to be credited with the amount that is paid. As a result, employers who have these plans must annually make the payments required under the plan. If the employer does not make sufficient contributions to meet the minimum funding requirements, he is to be subject to the excise tax described below. However, the Internal Revenue Service may waive the contributions required, in the same manner as it may waive these contributions for defined benefit pension plans.

For purposes of the funding rules, a "target benefit plan" generally is to be treated as a money purchase pension plan. However, a plan (for example, a so-called Taft-Hartley plan) that provides an agreed level of benefits and a specified level of contributions is not to be considered a money purchase pension plan if the employer or his representative participated in the determination of the benefits.

[88] *Special rules—collectively bargained plans and plans of controlled groups.*—Plans maintained pursuant to a collective bargaining agreement between employee representatives and one or more employers often provide for a predetermined level of contributions over a period longer than 12 months. Your committee believes that for the funding requirements to be workable in these cases, employers generally must be allowed to base their contributions on the bargained and agreed upon basis. Consequently, for purposes of maintaining the funding standard account, a plan year of a plan maintained pursuant to a collective bargaining agreement generally is to be considered as extending for the term of the collective bargaining agreement. This provision is intended to adapt the minimum funding standard to those plans where contributions are fixed by contract in accordance with a fixed standard, such as a specific dollar amount per hour of covered employment or a specific dollar amount per ton of coal mined.

Under such a plan if the actuarial assumptions were reasonable and the actuarial calculations were correct as of the beginning of the term of the agreement, and the agreed contributions were made, there would be no deficiency in the funding standard account for the term of the collective bargaining agreement. Any experience loss could be made up by adjustment of the contribution rate or the level of benefits for the term of the next agreement. The special definition of plan year would not affect the required periods of amortization or the computation of the excise tax; also, with respect to collectively bargained plans it is intended that experience gains and losses generally are to be determined at the end of each contract period, or at the end of every 3 calendar years if more appropriate for the particular plan.

The bill also provides that, to meet the needs of other collectively bargained plans, the Secretary of the Treasury may issue regulations that provide other periods that may be treated as plan years. For example, it is understood that some multiemployer collectively bargained plans are based on a number of contracts, each expiring at different times. It is expected that in this case the regulations would provide that the plan could use a 12-month period (or perhaps longer period if needed) for the plan year. In this case, when experience losses are determined, the plan trustees could arrange for an increase in contributions for the next year, or could arrange for a decrease in future benefits to allow negotiations to occur later to increase contributions. Additionally, as discussed above, limited retroactive plan amendments would be allowed without the approval of the Secretary of Labor for up to 2 years after the end of the plan year, so benefits could be reduced to a limited extent if needed to avoid a funding deficiency.

The bill also provides that in the case of collectively bargained plans, the minimum funding standard is to be determined as if all participants in the plan were employed by a single employer. The bill provides the same treatment for deduction purposes. This merely restates existing law.

In the case of a plan adopted by more than one corporation which is a member of a controlled group of corporations (within the meaning of section 1563(a) of the Code without regard to section 1563 (a)(3)(C)) the bill provides that the minimum funding standard

[89] and the excise tax on underfunding and the new rules with respect to maximum deduction limits (described below) are to be determined as if all members of the controlled group which adopted the plan were a single employer. Allocations of the minimum funding requirements, excise tax liability and deduction limits between members of the controlled group are to be determined under regulations prescribed by the Secretary of the Treasury.

Exclusions from coverage—insured plans.—If a pension plan is funded exclusively with certain individual insurance contracts, the bill provides that the plan is not subject to the minimum funding requirements. Your committee believes that if qualified insurance contracts are used to fund a plan and payments are timely made, the plan will be properly funded.

The contracts that are to qualify for this treatment are level annual premium individual insurance contracts where the premium is paid from the first date of an individual's participation in the plan (and from the time an increase in benefits becomes effective) and is not paid beyond the individual's retirement age. Also, the benefits under the plan must be the same as the benefits provided by the individual contracts at normal retirement age. In addition, the benefits must be guaranteed by the insurance company to the extent that premiums are paid. For the contracts to qualify, the insurance company must be licensed to do business in the State where the plan is located. Furthermore, premiums for all plan years must have been timely paid or the policy reinstated. In addition, rights under the contracts must not have been subject to a security interest during the plan year, and no loans must have been made on the policy during the plan year.

If any of these requirements are not satisfied, then the normal rules with respect to the funding standard must be followed. If a plan is initially funded with qualified insurance contracts, but, *e.g.*, a contract payment is not made, then the plan will become subject to the minimum funding rules and an excise tax may be owed (as described below) if the plan funding falls below the minimum standard. (Generally, if the payments had been timely made until this time, the funding standard account for the year of nonpayment would start with a zero balance, the accrued plan liabilities and properly amortized amounts would be charged to the account for the year in question, and any excise tax owed would be based on the net charges to the funding standard account for that year.)

Exclusions from coverage—profit-sharing plans, etc.—Under present law profit-sharing and stock bonus plans do not require a definite predetermined formula for determining the portion of profits to be shared annually with the employees. Since the contributions to these plans may be varied substantially year-by-year under the plan, your committee believes that it is inappropriate for profit-sharing and stock bonus plans to be governed by the minimum funding standard.

On the other hand, employer contributions under money purchase pension plans must be definitely determinable and fixed without being geared to profits. It is appropriate for these plans to be governed by the minimum funding standard since the application of this standard (as under present law) will require the employer to make definitely determined contributions to the plan.

[90] Your committee intends that plans generally are to be considered money purchase pension plans which meet the "definitely determinable" standard where the employer's contributions are fixed by the plan, even if the employer's obligation to contribute for any individual employee may vary based on the amount contributed to the plan in any year by the employee. For example, it is expected that a matching plan which provides that an employer will annually contribute up to 6 percent of an employee's salary, but that this contribution will be no more than the employee's own (nondeductible) contribution, will meet the "definitely determinable" criteria. In this case, the employer's contributions are set by the plan, will not vary with profits, and cannot be varied by the employer's action (other than by a plan amendment). (Of course, the plan must meet the nondiscrimination and other requirements of the Code to be qualified.)

Your committee understands that some plans are based solely on contributions from participating employees, without contributions of employers. In this case, your committee believes it would be inappropriate to make the employer responsible for the contributions of his employees. Consequently, where the plan has not provided for any employer contributions at any time after the date of enactment of the bill, the plan is to be exempt from the minimum funding standards and the excise tax on underfunding. Similarly, it would be inappropriate for the employer to be responsible for voluntary employee contributions, and consequently, voluntary contributions (and benefits attributed thereto) are to be disregarded for purposes of the minimum funding standard and the excise tax on underfunding.

Exclusions from coverage—government plans and church plans.—It has been argued that government plans should be exempt from the funding standards since the taxing power can be viewed as a practical substitute for these standards. On the other hand, your committee is concerned with reports that in the case of a number of governmental units, such generous pension promises have been made and so little funds have been set aside currently, that the practical likelihood of imposing sufficient taxes to pay those benefits may be open to question. In view of this conflict, your committee does not believe present law should be changed at this time regarding government plans which are qualified under the Federal tax laws.

The bill, therefore, provides that any tax-qualified government plan that meets the requirements of existing law with respect to funding will be exempt from the new minimum funding requirements. (This generally means that these plans must currently contribute normal cost plus interest on unfunded past service cost.) This exemption will apply both to existing and newly-established government plans.

In view of the information received with respect to possible underfunding problems of the plans, the bill provides that your committee and the Committee on Education and Labor are to study whether plans maintained by Federal, State, or local governments are adequately funded (taking into account the new minimum funding standards of the bill). Your committee and the Committee on Education and Labor is to submit to the House of Representatives the results of this study together with recommendations on funding standards for government plans by December 31, 1976.

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[91] Under the bill, government plans are plans established and maintained for their employees by the United States Government, or by the government of any State or political subdivision of a State, or by any agency or instrumentality of such governments. Also, except for the study described above, a plan to which the Railroad Retirement Act of 1935 or 1937 applies is to be treated as a government plan.

The bill also generally exempts church plans from the new funding requirements if these plans meet the funding requirements of present law. However, a church plan may elect to have all the provisions of the Internal Revenue Code regarding participation, vesting, funding, and form of benefit apply. If such an election is made, then the minimum funding provisions will apply to the plan. (Under the bill, once it is made, the election is irrevocable.)

A church plan is defined under the bill as a plan established and maintained by a church (or convention or association of churches) that is tax-exempt under section 501 of the Code. However, a church plan does not include a plan established and maintained primarily for the benefit of persons employed in connection with an unrelated trade or business. Nor does a church plan include a multiemployer plan if one or more employers are not tax-exempt under section 501 of the Code as a church (or convention or association of churches). With respect to plans in existence on January 1, 1974, if the plan applied on that date to employees of any tax-exempt agency of a church (or convention or association of churches) which established and maintained the plan, then the employees of the agency are to be treated as employees of the church (or convention or association of churches).

Actuarial considerations—enrollment of actuaries to practice before the Internal Revenue Service.—Defined benefit pension plan costs generally are actuarial estimates of future costs of the plan. In estimating pension costs, actuaries must make assumptions ("actuarial assumptions") about a number of future events, such as the rate of return on investments ("interest"), employees' future earnings, and employee mortality and turnover. Actuaries also must choose from a number of methods to calculate future plan liabilities. The amounts required to fund any given pension plan can vary significantly according to the mix of these actuarial assumptions and methods. As a result, the assumptions and methods used by actuaries are basic to the application of minimum funding standards for defined benefit pension plans.

Your committee believes that actuaries who perform services for qualified pension plans and report to the Internal Revenue Service regarding these plans should meet a reasonable standard of competence and be held to a standard of reasonableness in choosing their methods and assumptions. The bill requires that the actuarial assumptions which are used are to be reasonable in the aggregate; this restates present law. However, there is no existing government regulation of the actuarial profession as there is, for example, for lawyers and accountants. Te resolve this problem, the bill provides that standards and qualifications are to be established for enrolling actuaries to practice before the Internal Revenue Service (with regard to actuarial matters only).

Under the bill, the standards and qualifications to be satisfied for enrollment as an actuary are to include education and training in

[92] actuarial mathematics and methodology, and an appropriate period of actuarial experience. The education and training requirement is to be evidenced by a degree in actuarial mathematics or its equivalent from an accredited college or university, successful completion of an examination in actuarial mathematics and methodology to be given by the Secretary of the Treasury, or successful completion of other actuarial examinations deemed at least equivalent to those given by the Secretary. Your committee anticipates that actuaries also will be enrolled to practice before the Department of Labor with respect to pension plans. In order to make the enrollment requirements uniform for practice before the Internal Revenue Service and the Department of Labor, regulations issued by the Secretary of the Treasury with respect to standards and qualifications for actuaries are to be effective after December 31, 1975, only if approved by the Secretary of Labor. (Similarly, your committee anticipates that regulations issued by the Secretary of Labor with respect to qualification of actuaries are to be effective after that date only if approved by the Secretary of the Treasury.)

In addition, at the Service's discretion, the examination may be waived (for a limited period) for persons who present independent evidence that demonstrates they have special competence in actuarial matters relating to pensions because of their experience at the time the enrollment system is instituted. Your committee contemplates that the procedure for enrollment of actuaries will appropriately recognize the need for independent, competent professional work, and consequently practice without enrollment will be allowed only in unusual cases.

Your committee intends that the Secretary also establish duties relating to practice before the Internal Revenue Service by actuaries who are enrolled to practice. These duties may be similar to those required for attorneys, certified public accountants, and others who practice before the Internal Revenue Service, appropriately modified to take account of the special requirements of actuarial practice. For example, it is contemplated that the regulations will require an enrolled actuary to notify the Secretary if he discovers that an actuarial statement he prepared was not filed with the Secretary.

In formulating enrollment regulations, it is the committee's intent that the Secretary recognize to the extent feasible the varying degrees of actuarial skill required in the examination of different types of plans. For example, it is understood that many smaller and simpler plans are administered on the basis of standard actuarial tables which are widely published and on the basis of standard earnings assumptions. In these cases your committee has been informed that contributions have been adjusted from time to time to reflect deviations between actual plan experience and the standard actuarial and interest assumptions used. To the extent feasible, it is anticipated that the Secretary will make it possible to use such standard tables, etc., in the examination of these smaller and simpler plans, and make it possible for this work to be done by persons with the needed education and experience in pension plan administration whether or not their training includes the highest level of actuarial skills. The limited number of persons with a high level of actuarial skills makes it desirable that the standards acceptable for those examining smaller and simpler

[93] plans not be as restrictive as in the case of those examining the larger plans.

It is contemplated that the Secretary of the Treasury would reserve the power to suspend from practice before the Service any person enrolled to practice as an actuary after due notice and opportunity for hearing. Discipline might be imposed upon an enrolled actuary shown to be incompetent, or who does not comply with the rules and regulations established by the Secretary. Your committee intends that proceedings brought against enrolled actuaries will be instituted in the same general manner as proceedings against others practicing before the Service and will follow the same general procedure as other disciplinary proceedings. Generally, disciplinary proceedings would involve a complaint served on the actuary, an opportunity for answer, and an evidentiary hearing before a hearing examiner who would render a decision (appealable to the Secretary of the Treasury). An actuary involved in such a proceeding would have a right to be represented by counsel. It is contemplated that the discipline imposed could include suspension from practice before the Service, and that under appropriate circumstances a petition for reinstatement could be granted.

Actuarial considerations—reports of actuaries.—The Internal Revenue Service must receive detailed information on the actuarial assumptions and methods used to be able to evaluate whether costs of a qualified defined benefit pension plan have been properly determined. To resolve this problem, the bill requires periodic actuarial reports to be filed with the Internal Revenue Service by plan administrators of defined benefit plans subject to the new minimum funding standard. Consequently, actuarial reports will not be required for plans funded through qualified insurance contracts, and profit-sharing and money purchase plans, among others. However, actuarial reports will be required of any defined benefit plan subject to the new minimum funding standard, whether or not it remains tax-qualified.

Actuarial reports are to be made for the first plan year (or the first plan year to which this section applies) and every third year thereafter. Under the bill the Secretary may require more frequent reporting if necessary. The Secretary might require more frequent reporting in particular cases (for example, where a plan is to determine experience gains or losses more frequently than every three years) or in all cases if necessary. If the plan administrator fails to timely file the required actuarial reports, he will be subject to a penalty of $1,000 for each such failure unless it was due to reasonable cause.

Under the bill, the plan administrator generally is the person designated as such by the plan instrument. If no administrator is so designated, the administrator will be the employer for a single employer plan, and will be the joint board of trustees, etc., for a plan maintained by several employers or several employers and an employee organization. In other cases, the plan administrator will be the person prescribed by regulations issued by the Secretary of the Treasury.

The periodic actuarial reports must be prepared and signed by actuaries enrolled to practice before the Internal Revenue Service. The reports must include a description of the plan, a description of the funding method and actuarial assumptions used to determine costs under the plan, a certification as to whether the plan is adequately

[94] maintaining a funding standard account, and any other information regarding the plan as the Secretary may require. For example, it is contemplated that the periodic reports will include detailed information on the basis for any change in actuarial assumptions.

The actuary who prepares the reports must certify that, to the best of his knowledge, the report is complete and accurate. He must also certify whether, in his opinion, the funding method is reasonable and the actuarial assumptions used to determine the plan costs are reasonable in the aggregate. It is contemplated that the actuary will be subject to discipline and may be suspended from practice before the Internal Revenue Service if he falsely certifies a report.

Actuarial considerations—actuarial assumptions, methods, valuation of assets.—Since actuarial calculations determine plan costs, the bill includes several basic rules regarding these calculations. Under the bill, plan liabilities must be determined on the basis of actuarial assumptions that, in the aggregate, are reasonable. Your committee recognizes that frequently there is a range of actuarial assumptions which may be appropriate for determining the costs of a defined benefit pension plan, and the choice of the appropriate assumptions is very much a matter of judgment. In this circumstance, an employer may attempt to substitute his judgment for that of his actuary, which may lead to situations where plan costs are not being independently determined by an actuary. Your committee believes that it is inappropriate for an employer to substitute his judgment in these matters for that of a qualified actuary, and it is contemplated that if such a circumstance were to arise an actuary would have to refuse giving his favorable opinion with regard to the plan.

Since the actuarial assumptions used must be reasonable in the aggregate, it is anticipated that, on audit, the Internal Revenue Service will (as presently) require a change of assumptions where they do not meet this standard. However, unless the assumptions used are substantially unreasonable, it is contemplated that generally the Service will not require a change of assumptions to be made effective for years prior to the year in which the audit is made.

Under the bill, plan liabilities are to be determined under the funding method used generally to determine costs under the plan. In addition, since a change in the actuarial method used can have a substantial effect on a plan's cost, the bill also provides that the Internal Revenue Service must approve, pursuant to regulations, a change in the plan's funding method before the new method may be used to calculate plan costs. Similarly, approval must be obtained for a change of the plan year before the new year may be used by a plan. It is expected that the regulations under this provision will establish rules similar (but appropriately modified) to the regulations governing approval of changes in accounting methods. Therefore, it is expected that generally before a change in actuarial method or plan year will be approved a taxpayer must establish a substantial business purpose for the change and that consideration will be given to all the facts and circumstances with respect to the change. It is contemplated that a change in funding method is to be allowed only if it does not significantly adversely affect the funding of the plan. Also, your committee contemplates that upon approving a change in actuarial method or

[95] plan year, conditions are to be established to prevent distortion of income or distortion of funding of the plan.

Your committee recognizes that there are a substantial number of accepted methods of valuing assets of pension plans and many of these methods are designed to take into account market value and also to level out short-run market swings. Your committee believes that such valuation methods are appropriate since sharp, short-run variations in asset values could significantly affect the required funding if fair market value were the only accepted method of valuing assets for funding purposes. This would be inappropriate since pension plans are funded to meet the needs of the long-run, frequently over an employee's whole working life. On the other hand, your committee also recognizes that pension plans must value assets in a way that takes into account market value. Otherwise, there may be no relation between a plan's funding program and the assets actually available to pay benefits.

Under the bill, generally plan assets are to be valued on the basis of any reasonable actuarial method of valuation that takes into account fair market value, pursuant to regulations to be issued by the Secretary of the Treasury. (Your committee anticipates that plan assets also will be valued for purposes of minimum funding requirements that are to be administered by the Department of Labor. In order to provide for a uniform valuation of assets, Treasury regulations with respect to valuation which apply to plan years beginning after December 31, 1975, are to be effective only if approved by the Secretary of Labor. Similarly, your committee anticipates that regulations applying to such plan years issued by the Department of Labor are to be effective only if approved by the Secretary of the Treasury.)

Your committee anticipates that fair market value generally would be an acceptable valuation method. On the other hand, it is contemplated that using cost or book value without taking account of changes in fair market value would not be an acceptable valuation method.[8] However, it is intended that acceptable valuation methods may include (but not be limited to) the use of a moving average (over, *e.g.*, five years), or increasing asset values each year by a stated percentage of the previous year's asset value under the assumption that an even long-range appreciation will occur (in some cases, this increase may be reduced by realized appreciation or other income received from the asset). Another alternative method may be to capitalize the current amount of income from each asset as a perpetuity, using the plan valuation rate of interest. For a valuation method to be reasonable, it is expected that the asset values obtained under the method of valuation used are to bear a reasonable relationship to fair market value, and that if fair market value and the value under the method used differ significantly over a period of several years that the value under the plan would be adjusted accordingly. However, where an unacceptable method is being used by an existing plan, it is contemplated that the Service will allow a transition so that the plan will have time to write up its asset values. Furthermore, it is expected that the method chosen must be used consistently by the plan.

[8] However, in a case where fair market value tended to fluctuate around cost, a reasonable actuarial method may determine that cost is the appropriate value.

[96] It is also expected that the regulations will provide reasonable methods for valuing life insurance or annuity contracts, which will recognize the special nature of such contracts for valuation of pension plans.

Your committee also recognizes that often a pension plan will acquire bonds or other debt instruments as a long-term investment to be held until maturity. In that event, it would seem inappropriate to require the plan to change its valuation of the bond in accordance with market fluctuations. Therefore, the bill provides that a plan may elect to value its bonds or evidence of indebtedness on an amortized basis. At the election of the plan, the amortization may run from initial cost at purchase to par value at earliest call date or to par value at maturity. This election is to be made at the time and in the manner prescribed by regulations. The election is to be revocable only with the consent of the Internal Revenue Service and is to apply to all bonds and evidences of indebtedness owned by the plan. Although the bill explicitly recognizes this as one reasonable method of valuation that a plan may use to value bonds or evidences of indebtedness, other valuation methods may be used for these assets. (Also, it may be reasonable to use the method explicitly recognized for bonds or indebtedness for valuing other assets.)

Actuarial considerations—actuarial advisory board.—Your committee believes that the Secretary of the Treasury could be significantly aided in resolving a number of problems regarding actuaries and actuarial assumptions, etc., if he had the advice of experienced actuaries drawn from different areas of practice. Accordingly, your committee intends that the Secretary establish an advisory board chosen from among experienced actuaries in government, teaching, business and insurance, and independent consulting practice.

Your committee intends that the board advise the Secretary in such matters as the enrollment system for actuaries, reasonable standards and criteria for determining actuarial assumptions to be used for plans, and determining what constitutes generally accepted principles of actuarial practice.

Enforcement.—The sanctions under present law on the failure to meet the minimum funding requirements appear to have little effect on an employer's decision to fund a plan at the required minimum levels. To resolve this problem, the bill imposes an excise tax on the employer if he fails to fund the plan at the minimum required amounts (only if a waiver has not been obtained).

The tax initially is to be 5 percent of the accumulated funding deficiency—the excess of charges over credits in the funding standard account—at the end of the plan year. If a plan year ends with an aggregate funding deficiency, the employer will owe a 5 percent excise tax on the deficiency and that tax may be due for the taxable year of the employer with or within which the plan year ends. Furthermore, a deficiency in a prior year will continue in later years (and will be increased with interest), until paid. The 5 percent tax will apply to each year (of the employer) in which there is a funding deficiency at the end of the plan year. For example, if there is a funding deficiency in 1978 that is not corrected until 1980, there will be a 5 percent tax on the 1978 deficiency and a 5 percent tax on the 1979 deficiency (which will be the same as the 1978 deficiency plus interest).[9] If the

[97] deficiency is corrected within the time allowed for contributions for the year 1980, there would be no 5 percent tax for 1980.

In any case in which the 5 percent tax is imposed and the accumulated funding deficiency is not corrected within the correction period allowed after notice by the Internal Revenue Service, a 100 percent tax equal to the accumulated funding deficiency (to the extent not corrected) is to be imposed on the employer. In accord with present law respecting the excise taxes with regard to private foundations, neither the 5 percent nor the 100 percent taxes are to be deductible.

As discussed above, the bill provides that an employer's contributions to a plan that are made by the time for filing its tax return can relate back to the year of that return. Consequently, generally an employer will have a period of time after the close of the plan year to contribute to the plan and avoid the excise tax on underfunding. In addition, the bill provides that for purposes of the minimum funding requirements, a plan can be amended to a limited extent without the approval of the Secretary of Labor after the close of the plan year, but by the time for filing the employer's return for the taxable year with or within which the plan year ends (in the case of multiemployer plans, the amendment may be within two years of the close of the plan year). This allows limited retroactive decreases in plan benefits so liabilities for the excise tax can be reduced when there has been a mistake in estimating the amount of benefits that an employer could properly fund.

As discussed above, under certain conditions a plan also may be retroactively amended with the approval of the Secretary of Labor for earlier years. Such a retroctive amendment is not, however, to eliminate a funding deficiency for purposes of the initial 5 percent tax, although it may constitute correction for purposes of the 100 percent tax.

The minimum period allowed for correcting any funding deficiency after notice from the Service is 90 days from the date of mailing a notice of deficiency with respect to the 5 percent tax. However, this period may be extended for the time that the Internal Revenue Service determines is reasonable and necessary to eliminate the accumulated funding deficiency (and is automatically extended for any period in which a deficiency cannot be assessed under section 6213(a) relating to petitions to the Tax Court). It is intended that the Secretary require significant reasons before granting an extension under this provision.

It is intended that reasonable conditions may be applied to any extension of time, such as (but not limited to) a requirement that regular payments be made toward funding the deficiency and such as not allowing a plan amendment that increases plan costs until the deficiency is paid off. Correction generally will be made by paying off the principal amount of the funding deficiency plus interest to the date of payment, at the rate used to determine plan costs for the years the deficiency remained unpaid.[10]

[9] Of course, if an employer fails to contribute a plan's normal cost in any year, that amount will not thereafter become a past service cost (or experience loss to be charged in amortized amounts. The funding standard accounts will show as a deficiency subject to tax each year until corrected the unpaid normal cost plus interest (as well as any unpaid past service cost, plus interest).

[10] It is contemplated that if a plan becomes subject to the full funding limitation after it has an accumulated funding deficiency that no correction will be required, but the nondeductible 5 percent first level excise tax will be owed for each year in which there is an accumulated funding deficiency.

[98] In the usual case, the excise taxes will be owed when a deficiency is showing in the plan's funding standard account. However, as under present law, where the actuarial assumptions used in determining the minimum funding requirements are unreasonable in the aggregate, the Service may on audit retroactively (for open years) require a change in these assumptions. Such a change may result in a change in the plan's funding standard account. If a funding deficiency occurs as a result of such change, an excise tax may be levied. It is expected that retroactive changes of actuarial assumptions would occur only where the initial assumptions used were substantially unreasonable.

The bill provides special rules for applying the excise tax to collectively bargained plans. Generally, the "plan year" for a collectively bargained plan will be considered to be the contract period. If, at the beginning of that contract period, the actuarial assumptions used in setting the plan contributions are reasonable in the aggregate, and the actuarial calculations are correct, then generally no excise tax will be owned by employers who timely pay their appropriate share of the plan contributions during the contract period. However, to the extent that plan contributions are not timely paid, the funding standard account may show a deficiency and an excise tax would be owed. (The excise tax would be owed on the basis of the employer's taxable year and not on the basis of the plan year which runs for the period of the contract.) When a plan has such an accumulated funding deficiency, generally the tax will be imposed only on the employers who do not timely contribute, since the underfunding is the result of their failure to contribute.

At the end of a contract period, even assuming that all contributions were timely made, a collectively bargained plan can have experience losses. In that event, the next contract must provide for the experience loss. This generally will be by higher contributions, though it could also be by amending the plan to decrease benefits. If appropriate adjustments in contributions or benefits do not occur, then the plan will have a funding deficiency and an excise tax will be owed. Liability for this tax is to be determined first on the basis of failure to meet the required employer contributions under the plan, and then on the basis of respective liabilities for contributions under the plan.

The bill also provides special rules for applying the excise tax to a controlled group of corporations. Under the bill, if corporations that are members of a controlled group (defined by section 1563(a) of the Code without regard to section 1563(e)(e)(C)) adopt a plan, the excise tax on underfunding is to be determined as if all the corporations were a single employer, and the tax is to be allocated to each corportion in accord with regulations prescribed by the Secretary of the Treasury. It is expected that generally the minimum funding requirements will be allocated proportionately to the relative amount of plan liabilities attributed to the employees of such corporation and any funding tax will be allocated in proportion to failures to make these required minimum contributions.

Maximum deductions for plan contributions.—If an employer wishes to deduct contributions to an employee benefit plan which are greater than the minimum contributions required, the amount deductible will be subject to the maximum deduction limits.

[99] Contributions to a pension plan presently are deductible under three alternative provisions, the "5 percent" method which allows deductions to be taken for contributions not in excess of 5 percent of the annual compensation of the covered employees (sec. 404(a)(1)(A) of the code), the "level cost" method (sec. 404(a)(1)(B) of the code), and the "normal cost" method (sec. 404(a)(1)(C) of the code).

Unlike the "level cost" method and the "normal cost" method, the 5-percent limitation on contributions is often unrelated to the funding needs of the pension plan, for it frequently is not determined by the level of benefits provided by the plan. Consequently, the 5-percent method has allowed employers to contribute and deduct more than is reasonably needed to fund a pension plan.

The bill repeals the 5-percent deduction limitation (present sec. 404(a)(1)(A) of the code). Thus, deductible contributions under a qualified pension plan generally are to be limited under either the "level cost" or the "normal cost" methods. However, in place of the 5 percent limitation, the bill adds a new sec. 404(a)(1)(A) (discussed below) relating to contributions needed to meet the minimum funding standard.

The "normal cost" method (sec. 404(a)(1)(C) of the Code) presently allows a maximum deduction of normal cost plus 10 percent of unfunded past service costs. The 10 percent figure includes interest as well as principal, and therefore this method is not the same as 10-year amortization.[11]

To put the minimum contribution requirements and maximum deduction limitations on a comparable basis, the bill amends the "normal cost" deduction limitation rules to allow a maximum deduction of normal cost plus amounts needed to amortize past service costs in ten equal annual payments (including principal and interest). Under this provision, initial past service costs could be amortized over ten years from the date established (past service cost established by plan amendment could be amortized over ten years from the amendment, and experience losses could be amortized over ten years from the date they are determined). The maximum deduction for any year would be the amount determined under ten-year amortization and no more than this amount could be deducted in any year even though less than this amount were contributed in a prior year.

Your committee recognizes that under the minimum funding rules an employer might have to contribute more than the maximum allowed for deduction under the "level cost" or "normal cost" limits. For example, this could occur if the employer corrected a substantial funding deficiency for a prior year. Consequently, the bill provides that in such cases if the minimum funding standard requires a contribution to a tax-qualified pension trust which is greater than the maximum amount otherwise deductible, the amount contributed to satisfy the minimum standard is to be deductible. However, this rule does not apply to contributions to plans that are subject to the minimum funding standard but are not tax-qualified. Additionally, contributions must meet the requirements of sec. 162 before being deductible under sec. 404.

[11] Since the 10 percent figure includes interest as well as principal, it is estimated that, depending upon the interest rate, an employer usually may deduct amounts needed to fund accrued past service costs over 12–14 years.

[100] In order to put the minimum funding requirements and maximum deduction limits on a compatible basis, the bill also provides that the funding method and actuarial assumptions used to determine the amount deductible are to be the same as the method and assumptions used to determine the minimum funding required. In addition, the maximum amount deductible generally cannot be more than full funding limitation of the minimum funding standard; otherwise, deductions would be allowed for contributions greater than needed to fund the plan.

Present law generally allows deductions for contributions to overlapping combinations of pension, profit-sharing, and stock bonus plans of up to 25 percent of compensation paid or accrued to all the employees who are beneficiaries under the plans. In some cases, where there has been a previous contribution greater than the deductible limits, the deduction can be up to 30 percent of aggregate compensation. In accordance with the decision to limit contributions to defined contribution plans to 25 percent of employee compensation, the bill provides that maximum deductions for contributions to overlapping plans are to be 25 percent of aggregate compensation, and the provision for an additional 5 percent for carryovers is to be eliminated.

Under present law, contributions by an accrual basis taxpayer made by the time for filing his tax returns may be treated as paid in the year for which the return is due. This allows taxpayers time after the close of their taxable year to determine the amount of their contributions to be made to a plan. The bill extends this rule to cash basis taxpayers.

With regard to collectively bargained plans, the bill (as present law) provides that the maximum deduction limits are to be determined as if all participants in the plan were employed by one employer. Further, the bill provides that the amount contributed by each employer under a collectively bargained plan will not exceed the maximum deduction limitation if the anticipated employer contributions for the plan year are no greater than the limitation. With respect to a plan adopted by several corporations that are members of a controlled group, the maximum deduction limitations are to be determined as if all employers were a single employer, and deductible amounts are to be allocated in accordance with regulations to be prescribed by the Secretary of the Treasury.

Effective dates

The new minimum funding requirements and the new rules with respect to deductions generally are to apply to plan years beginning after the date of enactment of the bill. However, with respect to plans in existence on January 1, 1974, the new funding standards and deduction rules are to apply to plan years beginning after December 31, 1975. If a plan existing on January 1, 1974, is maintained by a labor organization exempt under section 501(c)(5) of the Code exclusively for the benefit of the employees of the organization, the new funding rules are to apply to this plan for plan years beginning after December 31, 1980, or beginning after the last day of the second convention of the labor organization occurring after enactment of the bill, whichever is earlier.

If an existing plan is maintained under a collective bargaining agreement, then the new funding standard and deduction rules are to

[101] apply to plan years beginning after December 31, 1980, or the date on which the agreement terminates, whichever is earlier. The date of termination is to be determined without regard to any extension agreed to after the date of enactment of the bill.[12]

Plans in effect on January 1, 1974, may elect to have the Internal Revenue Code provisions relating to participation, vesting, funding, and form of benefit apply to plan years beginning before the otherwise applicable effective date and all plan years thereafter. The election is to be made by the plan administrator and is to be irrevocable.

The provisions of the bill defining governmental plan, church plan, multiemployer plan, and plan administrator are to be effective on the date of enactment.

The provision of the bill establishing enrollment procedures for actuaries is to become effective upon enactment. The provisions relating to filing actuarial reports are to become effective at the same time as the general provisions relating to the new minimum funding rules.

Revenue effect

It appears clear that the new funding provisions will give rise to additional income tax deductions by employers in the immediate years ahead. However, the statistical data available do not provide any method for determining the size of this revenue effect. It is believed, however, that it will not represent a large revenue loss. In the longer run, it appears unlikely that the greater immediate funding expected under this bill will have any appreciable effect on revenues. Although funding occurs earlier under the bill than under present law, the income tax deductions taken by employers under the bill would for the most part ultimately be taken under the present funding rules.

D. Administration and Enforcement

(Secs. 1041, 1051, and 1052 of the bill, and secs. 7476 and 7802 of the Code)

Your committee's bill relies heavily on the tax laws in order to secure compliance with the new requirements that it imposes on employee pension, profit-sharing and stock bonus plans. The bill, in providing new standards of coverage, vesting, and funding continues the administration of these provisions in the Internal Revenue Service.

Many aspects of compliance have been discussed in conjunction with the various substantative provisions described in the bill. This includes, for example, the new excise taxes imposed with respect to underfunding.

In a number of other ways, however, efforts have been made to improve the provisions of existing law. The provisions of this type discussed here are the new office set up in the Internal Revenue Service to administer the new standards in this bill as well as the authorization of funds to provide for this administration. In addition, the bill deals with the problem raised as to the absence under existing law of a judicial review for letters of determination as to the qualification status of plans. Procedures are also set out whereby employees can question the qualification of plans.

[12] For statement relative to the termination of a collective bargaining agreement, see the discussion under the effective date with respect to "A. Participation" above.

Present law

Under present law, the national office of the Internal Revenue Service is organized on a general activity basis rather than a tax or subject basis.[1] At the present time, there are six Assistant Commissioners of Internal Revenue in the national office whose activities are broken into the following categories: collection and taxpayer service, compliance (including auditing), inspection (internal security), planning and research, technical (rulings) and administration (housekeeping). Similarly, the field offices of the Service are organized on a similar line. Within each of these broad categories there are Service units whose jurisdictional breakdown is by subject matter under examination. For example, the Miscellaneous and Special Provisions Tax Division under the Office of Assistant Commissioner (Technical) contains an Actuarial Branch, a Pension Trust Branch and an Exempt Organization's Branch. However, various other aspects of national office employee benefit plan and tax exempt organization administration are under the Office of Assistant Commissioner, Accounts Collection and Taxpayer Service and the Office of Assistant Commissioner, Compliance.

General reasons for change

Concern has been expressed in the case of the administration of employee benefit plans (and also tax exempt organizations) as to whether the Internal Revenue Service with its primary concern with the collection of revenues is giving sufficient consideration to the purposes for which these organizations are exempt. Many believe that the present organization of the Service causes it to subordinate concern for the protection of the interests of plan participants (or the educational, charitable, etc., purposes for which the exemptions are provided).

On the other hand, the enormous growth in retirement plans during the last third of a century has proceeded largely under the tax regulations of the Internal Revenue Service. Moreover, clearly the greatest single protection for rank and file employees during this time has been the Internal Revenue Service's administration of the provision denying any special tax treatment for contributions or benefits discriminating in favor of employees who are officers, shareholders, supervisors, or highly compensated employees. The thrust of this provision is to require broader substantial participation in the plans than would be provided but for the Service's administration of the statute.

At the same time, it must be recognized that the natural tendency is for the Service to emphasize those areas that produce revenue rather than those areas primarily concerned with maintaining the integrity and carrying out the purposes of exemption provisions. Similar concern has been expressed in the past over the Service's administration of the provisions of the tax law relating to exempt organizations.

Your committee believes that in the employee benefit plan and tax exempt organization area it should be easier to emphasize the basic objectives involved if the activities relating to these plans and exempt

[1] Reorganization Plan No. 1 of 1952 which went into effect on March 15, 1952. For a description of the present organization of the Internal Revenue Service, see Statement of Organization and Functions (C.B. 1970–1, 442).

[103] organizations were more closely coordinated, if the activities in these areas relating to auditing, rulings, etc. whether in the field or in the national office are brought together and if the top direction for these activities also has specialized in them. For the reasons outlined, the bill establishes a separate office in the Internal Revenue Service, headed by an Assistant Commissioner for Employee Plans and Exempt Organizations to deal primarily with plans that are (or claim to be) qualified under section 401 of the code and organizations that are (or claim to be) exempt from income taxes under section 501(a) of the Code. This includes pension, profit-sharing and stock bonus trusts and plans, religious, educational, and charitable organizations and foundations as well as the various other exempt organizations described in section 501(c) of the code. Similar functional units are to be established in the various regional and/or district offices. The committee has decided to authorize funds of $70 million a year to fund this new unit in the Internal Revenue Service.

Explanation of provisions

Office of Assistant Commissioner, Employee Plans and Exempt Organizations.—The bill establishes within the Internal Revenue Service a new office of Assistant Commissioner to be known as the Office of Assistant Commissioner, Employee Plans and Exempt Organizations. This office is to have the supervision and direction of the basic activities of the Internal Revenue Service in connection with pension, etc. plans (governed by secs. 401 through 415 of the code) and tax exempt organizations (exempt from tax under sec. 501(a) of the code). The bill authorizes the prescribing of the activities this office is to be responsible for in connection with organizations exempt from tax (under sec. 501(a) of the code) and plans which receive the special tax benefits of the qualified deferred compensation provisions of the tax laws (secs. 401 through 415 of the code).

In connection with deferred compensation plans it is intended that this office will be made responsible for, among other things, the question as to the qualification of the plan and the related trust and the exemption from tax of the trust. It also is intended that question as to the deductibility of contributions to a plan, the taxability of a beneficiary of an employees' trust and the taxation of employee annuities be included in the jurisdiction of this office. In addition, it is planned that this office would have responsibility over the minimum standards relating to funding of the plan and the excise tax for underfunding, including the enrollment and reports of actuaries.

In connection with organizations exempt from tax (under sec. 501(a) of the code) it is intended that this office have the responsibilities as to an organization's exempt qualification, the taxes on unrelated business income of an organization exempt from tax, and the rules relating to the private foundation provisions of the Internal Revenue Code.

To carry out the provisions of this bill, it is intended that the principal activities referred to above will be transferred from the various Assistant Commissioners' offices to the new Office of the Assistant Commissioner (Employees Plans and Exempt Organizations). With these transfers it is intended that the Assistant Commissioner (Employee Plans and Exempt Organizations), under the direction and

[104] supervision of the Secretary, or his delegate, will have the authority to direct national and field office policy in connection with the basic activities of the Service relating to employee plans and exempt organizations.

Authorization of appropriations.—The responsibilities and functions allocated to this new office are to be funded by separate appropriations, authorization for which is made in this bill. Presently the costs of administering the provisions of the tax law relating to exempt organizations are about $20 million and the cost of administering the provisions relating to employee plans is about $22 million. This suggests a total of $42 million, but with the new activities provided in the case of pension plans and the expanded requirements under the 1969 Act with respect to exempt organizations, it is anticipated that significantly more revenue than this will be required to carry out these functions in the future. Accordingly, the bill authorizes $20 million for the remaining portion of the fiscal year ending June 30, 1974, and $70 million for succeeding fiscal years.

Effective date

These provisions are to be effective 90 days after the date of enactment of the bill.

Revenue effect

It is believed that this provision will not have any revenue effect.

2. TAX COURT DETERMINATIONS

Present law

Plans which meet the requirements of the Internal Revenue Code (that is, are exclusively for the benefit of employees, are nondiscriminatory in regard to coverage and benefits, do not engage in prohibited self-dealing transactions and meet certain other qualifications) receive special tax treatment designed to foster their growth. It is not necessary, in order to receive this special tax treatment, that a prior determination be obtained from the Internal Revenue Service as to the qualification of a plan. However, to assist employers in their development of plans or plan amendments, the Internal Revenue Service issues determination letters indicating whether or not proposed plans or amendments qualify for the special tax treatment. As a practical matter, since taxpayers generally want assurance in advance that their plans or amendments will qualify, in most cases they obtain prior determinations from the Internal Revenue Service when adopting a plan or modification. Such a determination relates to the qualification of the plan (sec. 401 of the code) and the tax-exempt status of the related trust (sec. 501 of the code).

Under the Internal Revenue Service's published procedures, this generally takes the form of a determination letter issued by a district director. The district director may request technical advice from the national office on issues arising from a request for a determination letter. Also, the applicant may request national office consideration of the matter if the district director does not act within 30 days from notice of intent to make such a request, or acts adversely.

Standards are set as to the type of situation in which the national office will entertain a request for consideration of a case. It will, for

[105] example, consider a case where the contemplated district office action is in conflict with a determination made in a similar case in the same, or another district. The procedure provides for a conference in the national office, if it is requested by the applicant.

General reasons for change

In most cases an employer is ultimately able to obtain national office consideration of a request for a determination by means of a request for technical advice by a district director or by appeal to the national office of a district director's determination or failure to make a determination. In some cases, the Service has refused to make a determination with respect to the status of a plan and related trust. In either case, however, the employer has exhausted his remedies after the action by the national office.

As a practical matter, there is no effective appeal from a Service determination (or refusal to make a determination) that a proposed pension plan fails to qualify for the special tax benefits. In these cases, although there may be a real controversy between the employer and the Service, present law permits the employer to go to court only after he has made contributions to the plan, deducted them, and had those deductions disallowed. The long time period and the related uncertainty, coupled with the threat of the ultimate loss of the tax deduction, almost always causes the employer to go along with the Service, even if he disagrees with the Service's position. In addition the determination letter procedure does not permit employees, or their unions, to question the qualification of plans.

Your committee believes that both employers and employees should have a right to court adjudication in the situations described above. The bill deals with the problem by providing that, in the event of an unfavorable determination (or failure to make a determination), the employer may ask the Tax Court for a declaratory judgment as to the status of a new plan, a plan amendment or a plan to be terminated. In addition, your committee has decided that interested employees should be allowed to participate in the consideration by the Service of an employer's request for a determination and any controversy connected with it. An employee who intervenes in the Service's determination procedure is to be entitled to receive a copy of the determination issued by the Service in connection with the proceeding. If the employee questions a Service determination with respect to the qualification of a particular plan, he may petition the Tax Court to issue a declaratory judgment as to the status of the plan.

Your committee believes that this procedure is desirable because it will permit all interested parties to the controversy (the Government, the plan administrator, the employer, and his employees) to have an opportunity to participate in the administrative determination of the matter and to have an opportunity to contest the Service determination of the matter.[2]

While the committee decision permits employers and their employees to petition the Tax Court for a declaratory judgment in connection

[2] The present Service procedure provides that appeals from a district director are to be considered by the national office in Washington, D.C., and as a result, if a party wishes to make an oral presentation, he must incur the cost of travel. The Service has instituted a regional appeals procedure in connection with the status of an organization exempt by reason of section 501(c)(3) and it is hoped that the Service will be able to institute a similar appeals procedure for employee benefit plan determinations.

[106] with a new plan, a plan amendment, or a plan termination, the committee also expects the Service to establish procedures whereby interested parties (including employees regardless of whether they are plan participants or plan beneficiaries) may question the continued qualification of a plan and a related trust and obtain a determination from the Service. In such a case, it is believed that the Service should afford the employer and other interested parties an opportunity to be heard before issuing a determination letter with respect to the plan and related trust. If the Service ultimately concludes that a plan is no longer qualified, then the Service is to proceed in the usual manner by notice of deficiency.

While this new declaratory judgment procedure is being made available to parties who desire to use it, there is no requirement that a party use this new procedure to determine the status of a plan. Further, there is no requirement, as a condition for qualification, that a request for a determination be made.

Explanation of provisions

In general.—The bill provides that the United States Tax Court is to have jurisdiction in the case of an actual controversy involving a determination by the Internal Revenue Service with respect to the initial qualification or continuing qualification of a retirement plan. This applies to pension, profit-sharing, and stock bonus plans (described in sec. 401(a)), annuity plans (described in sec. 403(a)), and bond purchase plans (described in sec. 405(a)).

In order to satisfy the Tax Court that an actual controversy exists, an employer will have to place the plan into effect prior to the time that he petitions the Tax Court for a declaratory judgment. However, a new plan is to be treated as in effect even if it includes a provision that the funds contributed to it by the employer and employee may be refunded in the event that the plan is found not to be a qualified plan. If the contributions are refunded, all deductions for contributions would be disallowed and all income derived by the trust would be includable in income by the person who receives the payment. In the case of a plan amendment or plan termination, the action by the employer or plan trustee also may be put into effect on a conditional basis. Since the special tax benefits provided by the tax law are provided as an incentive to employers to adopt plans which provide for broad coverage of employees and protection of participants and beneficiaries, these individuals are to be treated as interested parties (under regulations prescribed by the Secretary or his delegate), and thus may petition the Tax Court to declare that the plan as constituted does not satisfy the requirements of the tax law designed to protect the employees and their beneficiaries as intended by Congress. For example, a participant under a plan would be entitled to bring an action if he alleges that the vesting provisions under the plan do not satisfy the minimum vesting requirements of the tax law (sec. 411), and thus the plan is not entitled to the tax benefits provided for qualified plans unless the plan is amended to satisfy the minimum vesting requirements. Similarly, such an action might be brought with regard to the antidiscrimination, the participation and coverage, or other requirements of current law or as added by this bill.

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[107] The Tax Court is to have jurisdiction to make a declaration with respect to the initial or continuing qualification of such an employee retirement plan only with respect to a new plan, a plan amendment, or a plan termination. Any such declaration is to have theforce and effect of a final judgment or decree and is to be reviewable as such. The court is to base its determination upon the reasons provided by the Internal Revenue Service in its notice to the party making the request for a determination, or based upon any new matter which the Service may wish to introduce at the time of the trial. The Tax Court judgment, however, is to be based upon a redetermination of the Internal Revenue Service determination and not on a general examination of the provisions of the plan or related trust. The burden of proof rules are to be developed by the Tax Court under its rule-making powers.

The judgment of the Tax Court in a declaratory judgment proceeding is to be binding upon the parties to the case based upon the facts as presented to the court in the case for the year or years involved. This, of course, does not foreclose future action (within the limits of the legal doctrines of estoppel and stare decisis) if an examination of the operations of a plan indicates that the plan does not in operation meet the requirements for qualification.

Procedure.—It is anticipated that the normal rules of the Federal courts as they relate to declaratory judgments are to be applicable under the Tax Court declaratory judgment procedure. For this purpose, however, the filing of any pleading by a petitioner may be held to be premature, unless the petitioner establishes to the satisfaction of the Tax Court that he has complied with the requirements prescribed under regulations by the Secretary of the Treaury providing for notice to interested parties that a Tax Court declaratory judgment proceeding is being initiated. It is anticipated that the Treasury regulations will provide that a party requesting a determination letter with respect to the qualification or continuing qualification of an employee retirement plan must give notice to parties in interest at the time of the request for the determination in order to apply to the Tax Court for a declaratory judgment with respect to such a request for a determination.

Exhaustion of administrative remedies required.—For a petitioner to receive a declaratory judgment from the Tax Court under this provision, he must demonstrate to the court that he has exhausted all administrative remedies which are available to him within the Internal Revenue Service. Thus, in the case of an employer, or a plan administrators he must demonstrate that he has made a request to the Internal Revenue Service for a determination and that the Internal Revenue Service has either failed to act, or has acted adversely to him, and that he has appealed any adverse determination by a district office to the national office of the Internal Revenue Service, or has requested or obtained through the district director technical advice of the national office. To exhaust his administrative remedies a party must satisfy all procedural requirements of the Service. For example, the Service may decline to make a determination if an employer fails to supply the Service with the necessary information on which to make a determination. In addition, the Service should decline to make a

[108] determination if it is not satisfied that the employer has taken reasonable steps to notify all employees who might have an interest in the action on request for a determination.

A petitioner is not to be deemed to have exhausted his administrative remedies in cases where there is a failure by the Internal Revenue Service to make a determination before the expiration of 270 days after the request for such a determination to be made. Once this 270-day period has elapsed, a petitioner who has exhausted his remedies may bring an action even though there has been no notice of determination from the Internal Revenue Service.

No petition to the Tax Court may be filed after 90 days from the date on which the Secretary or his delegate sends notice to a person of his determination (including refusals to make determinations) as to the qualification of the plan. This notice is to be sent to the person requesting the determination and to any other person who has participated under the Internal Revenue Service regulations in the administrative determination of the qualifications of the plan.

While the Service presently does not provide any procedure for employee objection to proposed determinations concerning the qualification of a plan, it is anticipated that the Service will adopt procedures similar to those procedures provided for employers making the request for the determination. These procedures would permit employees who have an interest in the requirements necessary for the plan to qualify to participate in the administrative determination of whether a plan is entitled to qualified status. An employee must exhaust these remedies before petitioning the Tax Court for a declaratory judgment. If there has been a failure to provide an employee with adequate notice of a request for a determination, then he need only exhaust those administrative remedies that are available to him at the time he receives adequate notice.

Tax Court Commissioners.—In order to provide the Court with flexibility in carrying out this provision, the bill authorizes the Chief Judge of the Tax Court to assign the Commissioners of the Tax Court to hear and make determinations with respect to petitions for a declaratory judgment, subject to such conditions and review as the Court may provide.

Effective date

The amendments providing for petitioning of the Tax Court to issue declaratory judgments are to take effect on January 1, 1978.

Revenue effect

It is not believed that this provision will have any revenue effect.

E. Limitations on Contributions and Benefits

(Secs. 2001 and 2003 of the bill and secs. 72, 401, 404, 415, 1379, and 4972 of the Code)

Present law

Under present law generally, if an employer maintains a funded plan which does not meet the requirements for qualifications under the Internal Revenue Code, no deduction is allowed for contributions to the plan by the employer until the rights of the employees on

[109] whose behalf the contributions are made are no longer subject to a substantial risk of forfeiture (and then only if separate accounts are maintained for the employees) or are actually paid. At that time, a deduction generally is allowed the employer, but the employee then must take the contributions into his income. Also the earnings on these contributions are not tax exempt. In comparison with the nonqualified plan, under the qualified plan the employer may receive a deduction for contributions to the plan, the earnings on the contributions are tax exempt, and the employees generally do not have to take the contributions into income until benefits are actually distributed to them.

Under present law, different rules are provided for employer and employee contributions in the case of qualified plans for self-employed individuals (H.R. 10 plans), plans of "regular" corporations, and plans of electing small business corporations (subchapter S).[1] These are described below.

H.R. 10 plans.—The amount of annual deductible contributions to an H.R. 10 plan on behalf of a self-employed person cannot exceed the lesser of 10 percent of his earned income [2] or $2,500 (sec. 404(e)). In addition, nondeductible contributions may be made in certain cases, but these contributions on behalf of owner-employees may not exceed the lesser of 10 percent of earned income or $2,500. Allowable voluntary contributions of employees of owner-employees must be at least proportionate to allowable voluntary contributions for owner-employees (sec. 401(e)(1)(B)(ii)).

"Regular" corporate plans.—In the case of a "regular" corporate plan (except as discussed in footnote 1) there are no limitations on the benefits an employee can derive from a qualified plan. There are, however, limitations on the amount of the contribution that is deductible. Different limitations apply to profit-sharing and stock bonus plans and to pension plans. All those limitations are based on the aggregate covered payroll rather than being on an employee-by-employee basis.

In the case of profit-sharing or stock bonus plans, the amount of the contribution that is allowable as a deduction is not to exceed in the aggregate 15 percent of compensation to employees covered under the plan. Contributions in excess of the 15-percent limitation may be carried over to future years. In addition, within certain limits, to the extent that an employer does not make the full 15-percent contribution in one year he may increase the amount of his deductible contribution in a future year.

In the case of pension plans, the amount of the contribution that is deductible is not to exceed 5 percent of the compensation to employees covered under the plan, plus the amount of the contribution in excess of 5 percent of compensation to the extent necessary to fund normal pension costs and remaining past service costs of all employees under the plan as a level amount or as a level percent of compensation over the average remaining future service of plan participants. In the al-

[1] All the types of plans must, in addition to the rules described below, meet the general reasonable compensation tests (sec. 162). The statute does not specify limitations on the benefits which may be paid under a qualified pension plan. However, in Rev. Rul. 72–3, 1972–1 CB, 105 the Internal Revenue Service ruled that pension benefits from a qualified pension plan are intended as a substitute for compensation, and that in general a plan which provides benefits in excess of an employee's compensation is therefore not qualified.

[2] "Earned income" is generally defined as being equivalent to "net earnings from self-employment"—the kind of income that may be subject to self-employment taxes in lieu of FICA taxes (sec. 401(c)(2)).

[110] ternative, the taxpayer may compute the limit on his deductible contributions by limiting his deduction to his normal cost for the plan plus 10 percent of the past service cost of the plan (sec. 404(a)). In practice, these limitations have very little effect in limiting the size of contributions to regular corporate pension plans.

Where an employer contributes to two or more retirement plans which are governed by different limits on deductions (pension or employee's annuities on the one hand, and profit-sharing or stock bonus, on the other hand), the total amount annually deductible under the plans cannot be more than 25 percent of compensation otherwise earned by the plan beneficiaries. If any excess is contributed, it may be deducted in the following year; the maximum deduction in the following year (for carryover and current contributions together) is 30 percent of compensation. A carryover is available for additional excess contributions which are deductible in the succeeding taxable years in order of time.

Subchapter S plans.—The limitations on the deductibility of contributions to a subchapter S corporation plan are the same as those in "regular" corporate plans. However, a shareholder-employee (an employee who owns more than 5 percent of the outstanding stock of the corporation) must include in his gross income the amount by which the deductible contributions paid on his behalf exceed the lesser of 10 percent of his compensation or $2,500 (sec. 1379(b)).

Professional corporations.—Generally, lawyers, doctors, accountants and certain other professional groups in the past have been unable to carry on their professions through the form of corporations because of the personal nature of their responsibility or liability for the work performed for a client or patient. Consequently, their contributions to retirement plans were limited by the rules governing self-employed persons. In recent years, however, all States have adopted special incorporation laws which provide for what are generally known as "professional corporations." These have been used increasingly by groups of professional persons, primarily to obtain the more favorable tax treatment for pensions generally available to corporate employees. The Treasury Department, in the so-called Kintner regulations, held that professional corporations were not taxable as corporations. A number of court cases, however, have overturned the regulations and the Service has now acquiesced and generally recognizes these professional corporations as corporations for income tax purposes.

General reasons for change

Many self-employed people, especially professionals, feel that they are discriminated against as compared with corporate executives and proprietary employees of corporations in regard to the tax treatment of retirement savings. This is because, at present, there is no comprehensive limit on the amounts the corporate employer can provide under a qualified plan on behalf of its executives and proprietary employees. Self-employed persons, on the other hand, are subject to the contribution limits described above.

In addition, many of the self-employed argue that, as a result of these contribution limits, it is difficult for them to provide adequately for their retirement, particularly as many professionals have a limited number of years of peak earnings, in which it is comparatively

[111] easy to set something aside. It is also argued that the $2,500 limit is no longer appropriate, since in the approximately 10 years since H.R. 10 was first enacted, there has been a substantial inflation factor in the economy. Furthermore, it is contended that the present law in the retirement plan area creates an artificial incentive for the incorporation of businesses which more traditionally, and perhaps more appropriately, have been conducted in unincorporated form. For all of these reasons, the committee believes that a substantial increase in deductible contributions for self-employed individuals is justified at the present time. Under the bill, the present limits would generally be increased to 15 percent of earned income, up to a maximum deduction of $7,500 per annum.

At the same time that some individuals have been questioning the relatively low level of tax deductible contributions for H.R. 10 plans, others have questioned the wisdom of permitting virtually unlimited pension benefits in corporate plans to be funded out of tax-free dollars.

Your committee recognizes the importance of tax incentives in creating a strong private pension system. At the same time, however, your committee believes it is appropriate to provide some limitations to prevent the accumulation of corporate pensions out of tax-sheltered dollars which are swollen completely out of proportion to the reasonable needs of individuals for a dignified level of retirement income. Moreover, by imposing limitations on corporate plans, and liberalizing the limitations which are imposed under present law on H.R. 10 plans, the bill takes a long step forward to achieving tax equity in this area. Thus, the bill provides, in general, that a qualified trust may not provide a defined benefit in excess of $75,000 a year, or 100 percent of the employee's average high-3 years of compensation (whichever is less) and that contributions to a qualified money purchase pension plan, profit-sharing plan or stock-bonus plan may not exceed $25,000 a year, or 25 percent of the employee's annual compensation (whichever is less). These provisions do not limit the size of the pension which the employee may receive from a non qualified plan, which is financed out of taxed dollars. The only effect of the provisions is to limit the size of the pension which is subsidized by the tax laws.

Explanation of provisions

1. *H.R. 10 plans—in general.*—The bill increases the maximum deductible contribution on behalf of self-employed persons to the lesser of $7,500, or 15 percent of earned income. (A similar, although not identical, rule is applied in the case of defined benefit pension plans.) However, no more than the first $100,000 of earned income may be taken into account in applying the percentage limits. The $100,000 ceiling on the earned income rate base means that a self-employed person (or a shareholder employee in a subchapter S corporation) with more than $100,000 income will have to contribute at a rate of at least 7½ percent on behalf of his employees if he wishes to take the full $7,500 deduction on his own behalf (in order to comply with the antidiscrimination requirements).[3] A self-employed person

[3] The limitations on nondeductible contributions on behalf of owner-employees in a self-employed plan are not increased, however.

[112] earning more than $100,000 who wishes to contribute $5,000 for himself will have to contribute at least 5 percent on behalf of his employees.

For purposes of these rules a self-employed person is allowed only one $100,000 contribution base, no matter how many plans he may establish for a trade or business. For example, a self-employed person with $200,000 of earned income could not cover himself under two plans, each of which also covered half of his employees, and use up his $7,500 limit by contributing at a rate of 3.75 percent under both plans; in other words, contributions for all employees would have to be at a 7.5 percent rate, if the self-employed individual was to be allowed to make a $7,500 deductible contribution on his own behalf.

The committee bill also contains a provision to permit self-employed individuals to set aside up to $750 a year out of earned income as a deductible contribution, even though it exceeds the otherwise applicable percentage limitation (15 percent of earned income). This provision will enable certain organizations of the self-employed, such as the Jockeys' Guild, to set up retirement plans for their members without having to confront complex record-keeping and administrative problems, and will also allow any self-employed individual who wishes to do so to save for his retirement, even though his earned income in a particular year is relatively low.

Subchapter S corporations.—Since Subchapter S corporations are not subject to normal corporate tax, and the stockholders of the corporation are taxed generally like self-employed partners. Your committee believes it is appropriate to retain section 1379 in the Code. However, the bill raises the limitations on contributions for Subchapter S stockholders to the same substantially increased deductible amounts (15 percent of earned income, or $7,500) which are allowed under the bill for self-employed individuals.

Defined benefit plans for the self-employed.—Under present law, most self-employed plans are defined contribution plans because of the limitations on contributions imposed on self-employed persons under present law. Your committee believes that the option of having defined benefit plans should be available to the self-employed and shareholder-employees of Subchapter S corporations. Accordingly, the bill provides that the Secretary or his delegate is to prescribe regulations which will allow self-employed plans (or plans benefiting shareholder-employees of a Subchapter S corporation), in effect, to translate the 15 percent-$7,500 limitation on contributions, to which they would otherwise be subject, into limitations on benefits which they could receive under a defined benefit plan. The bill also provides certain "guideline regulations" which the Secretary must follow in carrying out the purposes of the bill.

A defined benefit plan which follows the guideline regulations is to be subject to the limits on deductions for corporate defined benefit plans rather than the 15 percent-$7,500 limitation.

Under the formula provided in the bill, the basic benefit for the employee (that is, a straight life annuity commencing at the later of age 65 or 5 years from the time the participant's current period of participation began, with no ancillary benefits and assuming no employee

[113] contributions) is not to exceed the amount of the employee's compensation [4] which is covered under the plan (up to a maximum of $50,000) times the percentage shown on the following table.

Age at participation	*Percentage*
30 or less	6.5
35	5.4
40	4.4
45	3.6
50	3.0
55	2.5
60 or over	2.0

The percentages in early years are higher to reflect the fact that contributions made during these time periods earn interest for a longer period prior to retirement than contributions made in later years. Thus, for purposes of applying the table, past service credits are not to be considered in determining at what age a self-employed individual's period of participation in the plan began. The Secretary or his delegate is to have authority to prescribe regulations in cases of plans which provide something other than the "basic benefit." Also, the regulations are to specify percentages for individuals who become participants at ages between those shown on the table. In addition, the Secretary or his delegate is given authority to prescribe new percentages, to be used in years beginning after December 31, 1977, based on changes in money rates and mortality tables occurring after 1973.

To illustrate how this formula would work, assume that a self-employed person enters a defined benefit plan at age 30, and participates in the plan for 5 years, with income covered under the plan of $20,000 per annum. At age 35, he leaves the plan, but at age 50, he again becomes a participant. For the first 5 years his covered income is $30,000 per year, then $40,000 for the next 5 years, and finally $50,000 for the last five years prior to his retirement

The calculation would work as follows:

Age	Compensation per year	Rate	Benefit earned per year	Total benefit
30–35	$20,000	6.5	$1,300	$6,500
50–55	30,000	3.0	900	4,500
55–60	40,000	3.0	1,200	6,000
0–65	50,000	3.0	1,500	7,500
Total				24,500

Thus, the maximum benefit which could be paid to the individual under the plan in the form of a single life annuity commencing at age 65 with no ancillary benefits would be $24,500 per year.

In order to receive the maximum benefit accrual rate under the formula in a later period, a self-employed individual might establish a plan for himself at an early age, but with a very low rate of accrual, or a very low compensation base on which the benefit accrual was measured. Thus, his employees during this period would only receive a low-

[4] In the case of a self-employed individual the term "compensation" means earned income; in the case of a shareholder-employee the term means the amounts received as compensation from the Subchapter S corporation.

[114] benefit accrual. Later, when some of these employees had departed, the self-employed individual might seek to raise the rate of accrual. To prevent this sort of abuse situation, the bill requires that the regulations must provide that any increase in the rate of accrual or the compensation base [5] under the plan, would be treated, only with respect to such increase, as beginning a new period of participation for the self-employed individual. For example, assume that a plan was established by an individual at age 30, which provided for a 6.5 percent rate of accrual, but that the compensation base under the plan was only $10,000. Then, at age 40, the individual wishes to increase the annual benefit accrual to the maximum permissible amount. This would be computed by taking 6.5 percent of the first $10,000 of compensation, and 4.4 percent (the maximum rate of accrual for a self-employed individual who enters a plan at age 40) of additional compensation up to the $50,000 ceiling, for a total accrual of $2,410 per year for an individual having at least $50,000 of compensation.

The committee bill also provides that for purposes of the antidiscrimination rules, the maximum amount of compensation which is to be taken into account is to be $100,000. (This is the same ceiling provided in connection with contributions to a money purchase plan.) For example, if a self-employed person established a defined benefit plan for himself at age 50 (where a 3 percent rate would apply) and earned $100,000 per year, benefits under the plan for his employees could be earned at the rate of 1.5 percent of covered compensation, and the plan would not be considered to be discriminatory. In other words, the maximum benefit which could accrue per year for the self-employed person would be 3 percent of $50,000, or $1,500, which is equivalent to 1.5 percent on a $100,000 base. Thus, the self-employed person would be permitted to make contributions which would purchase a 1.5 percent benefit for his employees. However, even if the self-employed person's earnings were $200,000, benefits earned for the employees under the plan could not drop below the 1.5 percent rate.

A plan which covers owner-employees may not take advantage of the regulations authorized in this provision, unless it provides benefits for all participants under the plan on a nonintegrated basis.

In order to assure reasonable comparability between defined benefit and defined contributions and combination of plans, the regulations are to provide for appropriate adjustments in the allowable amount of deductible contributions, or permissible rate of benefit accruals in cases where the same self-employed individual is a participant in two or more plans. For example, a $3,750 contribution to a money purchase pension plan (for an employee whose earnings is at least $50,000) has the effect of reducing the maximum allowable rate of accrual under a defined benefit plan by one-half. In addition, a change in the rate of accrual by reason of this rule is to be treated as a new period of participation for purposes of determining the maximum rate of accrual under the table provided for defined benefit plans.

For purposes of the above rules, all plans of a controlled group of partnerships (within the meaning of secs. 414(c) and 415(h) of the code) are to be aggregated for purposes of the limitations.

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[5] Of course, an increase in the amount of compensation earned by the self-employed individual would not trigger a new period of participation.

[115] *Excess contributions.*—Under present law, if excess contributions are made on behalf of an owner-employee, these must be repaid with the earnings thereon within 6 months after the mailing of notice by the Internal Revenue Service; otherwise the plan will become disqualified with respect to that individual. In the case of an excess contribution which is willfully made, the plan will become disqualified with respect to the owner-employee, and he is barred from participating in a qualified plan for the 5 succeeding years. In contrast a shareholder-employee who is subject to the same deduction limits need not repay the excess contributions but must take those amounts into income.

This rule can work a hardship in cases where a relatively minor violation of the excess contribution rules could result in a complete disqualification of the plan with respect to an owner-employee. Moreover, the present rules will not work well in the context of a defined benefit plan, because it is difficult, if not impossible, to trace particular contributions to benefit accruals under the plan for particular employees. For these reasons, the bill repeals the provisions of present law outlined above.

At the same time, it is clear that there must be some rule to discourage excess contributions in order to prevent the tax-free accumulation of earnings on contributions in excess of those permitted under the law. Since the major abuse of overfunding is that it permits the tax-free accumulation of the earnings on the excess contribution, your committee's bill imposes an excise tax of 6 percent on excess contributions to plans for the self-employed. The tax is to be paid by the employer who maintains the plan.

In the case of a defined contribution plan (for example, a money purchase pension plan), excess contributions include amounts contributed by the employer in excess of the 15 percent of earned income, or $7,500 deduction limits on contributions on behalf of self-employed persons. In the case of a defined benefit plan, the tax is imposed where the plan is fully funded at the close of the employer's taxable year, and is imposed upon the amount that has not been deductible for the taxable year or any prior taxable year (i.e., the amount of the carryovers). Also, in either type of plan, excess contributions include voluntary contributions by owner-employees in excess of the allowable amount of such contributions. As under present law, voluntary contributions on behalf of owner-employees may not exceed the lesser of 10 percent of earned income, or $2,500. Moreover, allowable voluntary contributions under the plan for employees other than owner-employees must be at least proportionate to allowable voluntary contributions for owner-employees. As under present law, excess contributions do not include amounts which are allocable under regulations to the purchase of life, health or accident insurance.

In the case of a plan funded through level premium insurance payments, the employer may contribute an amount based on an average of the allowable deductible contributions for an owner-employee for the three immediately preceding taxable years without triggering the tax on excess contributions, even though this amount is in excess of the deductible contribution which can be made for that employee for the taxable year in question. However, any such amounts will be treated as part of the owner-employee's distributable share of the partnership

[116] income for income tax purposes and as a voluntary contribution by the owner-employee for purposes of the excise tax on overfunding.

To encourage plans to repay the amount of any excess contributions (and in recognition of the cumulative advantages of excess contributions), the committee bill provides that the excise tax is to be cumulative. For example, assume that an employer made a contribution of $15,000 on behalf of an owner-employee in a year in which only a $5,000 contribution was allowable as a deduction. An excise tax of $600 would be imposed for that year.[6] If, in the following year no amounts were contributed to or repaid from the plan, but an additional deductible contribution of $5,000 were allowable for that year, an excise tax of $300 would be imposed ($10,000 minus the $5,000 deductible contribution allowable for year two, equals $5,000, times 6 percent, equals $300).

Regulations will provide for the situation where there are two or more plans benefiting the same self-employed individual, or where there are two or more partnerships or proprietorships under common control.

Premature distributions.—Under present law, in general, where amounts are distributed under a qualified plan to an owner-employee before he attains age 59½, section 72 provides that the tax imposed on such amounts shall be not less than 110 percent of the amount of the increase in his taxes due to the distribution. Where the premature distribution exceeds $2,500, then, for purposes of computing the penalty, it is averaged over the current year and the four preceding years.

The purpose of the provisions allowing a deduction for contributions to a qualified retirement plan is to allow money to be set aside on a tax-sheltered basis for retirement purposes. Where the retirement plan contributions are withdrawn prior to the retirement years, this purpose is frustrated. The committee therefore believes that there should be a substantial deterrent to prevent an owner-employee from treating his retirement plan as a tax-free savings account which he can withdraw prior to retirement.

The provisions of present law do not fully serve this purpose. The amount of the penalty varies depending on the taxpayer's marginal rate of tax on his other income during the year in which he receives the premature distribution. Also, present law affords an opportunity for the owner-employee to minimize the penalty by arranging to receive the premature distribution in a year in which his other income is low, or his deductions are high.

To remedy this situation, the bill repeals the penalty provisions of present law and imposes instead an income tax of 10 percent on the amount of the premature distributions. This is in addition to any other income taxes payable on this distribution, and would not be offset by any tax credits (other than the refundable credits for overwithholding, overpayment of tax, and the gasoline tax credit). Also, this tax would not be treated as reducing the individual's tax liability under the minimum tax provisions.

As under present law, the penalty tax would not apply in the case of a distribution due to death or disability.

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[6] In a plan which permits voluntary contributions by owner-employees, the plan might treat part of excess employer contributions as a voluntary contribution, as under present law, thus reducing the tax on overfunding. However, under these circumstances, owner-employees would have to take the amount of the voluntary contribution into income.

[117] *Withdrawing of voluntary contributions by owner-employees.*—Under present law, amounts received from a retirement plan before retirement are tax free to all participants other than owner-employees to the extent of all nondeductible contributions made to the plan by the participants. Thus, all participants other than owner-employees may, if the plan permits it, withdraw their voluntary contributions prior to retirement. The bill extends this same treatment to owner-employees.

Time for making contributions.—Under present law, contributions to a self-employed plan must be made by the end of the taxable year in order to be deductible for that year. Often this can create difficulties for the self-employed person, who may not have at hand all the information necessary for him to determine how much he is permitted to contribute on his own behalf. In order to meet this problem, the bill provides that tax deductible contributions of self-employed plans (and all other qualified plans) may be made at any time up to the point when the Federal income tax return (corporate or individual, as the case may be) for that year is due (including any extension). This rule should provide the additional time necessary for the individuals involved to make the required calculations and determine the amount of the maximum deductible contribution which is permitted for the taxable year in question.

2. *Overall limitation—in general.*—As part of the process of moving toward parity in the tax treatment of corporate plans and H.R. 10 plans, the committee bill contains provisions imposing overall limitations on the contributions and benefits which are allowable under qualified plans and retirement accounts and annuities which receive favorable tax treatment.[7] This overall limitation must be satisfied in order for the favorable tax benefits under the plan, annuity, or account to be retained. H.R. 10 plans and plans of Subchapter S corporations are also subject to these rules.

Plans to which limitation applies.—The overall limitation applies to a trust which is part of a pension, profit-sharing, or stock bonus plan (described in sec. 401(a)), an annuity contract (described in sec. 403(b)), an employee annuity (described in sec. 404(a)(2)), and an individual retirement account or annuity (described in sec. 408).

Defined benefit plans—limitation on benefits.—Under the committee bill, in general, the highest annual benefit which can be paid out of a defined benefit plan to a participant is equal to the lesser of (1) $75,000, or (2) 100 percent of the participant's average compensation from the employer during his highest 3 consecutive calendar years of aggregate earnings during the period he was an active participant in the plan[8] (or his average compensation during the period of his participation in the plan if this was less than 3 years) Compensation for this purpose includes the participant's earnings from his employment and includes bonuses and other taxable payments except for deferred compensations, stock options, and other distributions which receive special tax benefits.

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[7] Nothing in the committee bill would prevent the payment of any amount of compensation or pension benefits on a nontax-sheltered basis, subject only to the rules of section 162 that in order for the employer to receive a deduction, compensation paid to employees must be reasonable, and the rules of section 404(a)(5) dealing with contributions to nonqualified trusts.

[8] If the individual was an employee of several corporations in a controlled group, his earnings from all members of the group would be aggregated for purposes of these rules.

[118] The 100-percent limitation is simply a clarification of present law. The Internal Revenue Service has ruled that a pension is essentially a substitute for earning power during the retirement years (Rev. Rul. 72–3, 1972–1 C.B. 105). Your committee agrees with this interpretation and believes that no qualified pension plan should pay benefits which are higher than an employee's average earnings during his highest 3 years. The committee also believes that it is desirable to impose some dollar limitations on the size of a pension which may be paid out of tax-sheltered dollars and the $75,000 limitation which is imposed under the bill is generous enough to afford a reasonable standard of living.

To prevent the erosion of the value of an employee's pension due to inflation, the committee bill permits a qualified defined benefit plan, in accordance with regulations, to provide a cost-of-living adjustment for employees who have retired or terminated their service under the plan, over and above the 100 percent limitation or the $75,000 limitation. The adjustment to the $75,000 and the 100 percent ceilings will be provided annually by the Secretary or his delegate to reflect cost-of-living increases.

The procedures used in the regulations will be similar to those used in adjusting the old age and survivor's benefits under the social security law (but without regard to the timing or amount of any increase specifically authorized by action of the Congress).

Benefits paid in the event of early retirement would not have to be scaled down from the 100 percent of salary level on an actuarial basis. However, the $75,000 limitation must be scaled down in the event of early retirement prior to age 55, but not below $10,000. In general, the benefits payable under a defined benefit pension plan would not have to be reduced for pre-retirement ancillary benefits, such as medical, death, and disability. Only post-retirement ancillary benefits which are directly connected with the retirement benefit need be taken into account in computing the limitations. Thus, for example, the value of an annuity paying a sum certain, a post-retirement death benefit or a guaranteed payment for a period of years would be an ancillary benefit which needs to be taken into account.

Your committee believes that it is socially desirable to encourage joint and survivorship benefits. Accordingly, it has concluded that no adjustment should be made for the provision of such a benefit for the participant and his spouse to the extent that the benefit payable to the survivor is not greater than the benefit which would be payable if both the participant and his spouse were alive. To be a joint and survivors annuity, the benefit payable to the survivor must be for the full life of the survivor.

In the case of a contributory plan, upward adjustments in the benefit schedule would be permitted in accordance with regulations, to reflect the fact that part of the annuity had been purchased with the employee's own after-tax dollars.

The committee expects that all of these adjustments will be substantially equivalent to the adjustments now provided under present law for a plan which is integrated with social security.

As a further adjustment, the defined benefit otherwise allowable in accordance with the rules described above is to be reduced by

[119] multiplying the otherwise allowable benefit by a fraction, the numerator of which is the employee's years (or part thereof) of service with the employer and the denominator of which is 10. For example, if an individual who had 3 years of service had an average high-three years salary of $50,000 (and no other adjustments were required) his maximum benefit could not exceed 3/10ths of $50,000, or $15,000 per annum. This prevents a situation where an individual might receive an extremely high pension, even though he had only a few years of active service under a plan.

The purpose of providing an overall limitation is to prevent the accumulation of excessive pension benefits out of tax-free dollars. But the committee sees no useful purpose to cutting back on the benefits of the average working man who has a relatively limited amount of income. Accordingly, the bill specifically provides that notwithstanding the 100-percent limitation, or the required adjustments for certain ancillary benefits, a qualified defined benefit plan (or plans) of the employer may pay an annual retirement benefit of up to $10,000 per annum to any employee who has not been a participant in any defined contribution plan of the employer.

Defined contribution plans.—Under present law, there is no limitation on the amount which may be contributed to an employee's retirement account under a corporate defined contribution plan, although the employer may not, in any one year, deduct contributions in excess of 15 percent of the aggregate compensation paid to employees covered under a profit-sharing plan, or 25 percent of the aggregate compensation paid to employees under a combination profit-sharing and pension plan (except in the case of carryovers, where the present limit is 30 percent).

The committee bill retains these rules (with certain modifications, as discussed below). But the committee believes it is also appropriate to impose limitations on the annual additions which can be made to an individual employee's account under a defined contribution plan in order to achieve some measure of comparability with the limitations imposed under the bill on the benefits which may be paid under a defined benefit plan. For purposes of these rules, defined contribution plans include profit-sharing and stock bonus plans, as well as money purchase pension plans and target benefit plans.

Under the committee bill, the annual additions to an employee's account under a qualified plan or plans of the employer may not exceed the lesser of (1) $25,000, or (2) 25 percent of the individual's compensation from the employer during the year. The term "annual additions" means (1) the employer's contributions under the plan, (2) the lesser of one-half of all the employee's contributions or all the employee contributions in excess of 6-percent of compensation, and (3) any forfeitures which are added to the employee's account during the year.[9] For purposes of these rules, only a portion of the employee contributions is counted because the employee receives only one of the two tax advantages generally associated with contributions to a qualified plan—deferral of the taxes on the earn-

[9] The term "year" will be defined in regulations. Generally, in cases where there is only one plan, the "year" will be the plan year. In cases where there is more than one plan involved, the regulations will set forth the criteria for determining the relevant year.

[120] ings on the contributions—but does not receive a tax deduction for the amount of the contribution when it is made. The option of excluding the first 6 percent of employee contributions recognizes the fact that many plans provide for small amounts of employee contributions and it would greatly increase the complexity of the provision if small amounts of contributions for which there were relatively small tax advantages had to be taken into account. The $25,000 limitation will be adjusted annually for the cost of living in accordance with regulations in the same manner as the $75,000 limitation.

As previously indicated, under present law the contributions allowable as a deduction in a combination profit-sharing and pension plan may not exceed 25 percent of the aggregate compensation to employees covered under the plan. However, where excess contributions are made, these may be carried forward and deducted in succeeding years, and the deduction limitation for those years is increased from 25 to 30 percent. The committee bill modifies this result by continuing to allow the carryover, but providing that the ceiling on deductible contributions remains at 25 percent.

In addition, under present law, in the case of a profit-sharing plan alone, the limitation on deductible contributions is 15 percent of the aggregate compensation paid to employees covered under the plan. In cases where the employer fails to utilize his full 15 percent allowance. the unused portion may be carried forward and used in succeeding years, up to 30 percent of aggregate compensation limit for the taxable year. The bill provides that the carryover of unused contribution limits in this case may not result in a situation where the employer could deduct more than 25 percent of aggregate covered employee compensation for the year.

Combination plans.—Where a corporation has 2 or more plans, or 2 or more different types of plans, the limitations, of course, must operate as an overall ceiling on the maximum benefit the employee can obtain under all the plans. Otherwise, it would be possible to escape the limitations by the simple device of establishing as many plans as were needed to provide the benefits desired. Additionally, rules are needed where an employee is employed by two or more related corporations of the same employer, some of whom have separate retirement plans. In such a case the committee bill provides that all the plans are to be subject to the overall ceiling. The overall ceiling would be computed, in general, by aggregating similar plans (defined contribution or defined benefit) and reducing the limitation on one type by the benefits or contributions of the other.

For purposes of these rules, all of the defined benefit plans of an employer (whether or not terminated) are treated as one plan, and all of the defined contribution plans (whether or not terminated) are treated as one plan. If an employer maintains a defined benefit and a defined contribution plan each plan would be subject to the limit; in addition the two plans must be combined in computing the overall limitation.

To achieve this purpose, the bill establishes a formula (to be applied each year by each employee) under which a defined benefit plan fraction for the year is added to a defined contribution

[121] plan fraction. If the sum of these fractions exceeds 1.4, then one or more of the plans will be disqualified. Of course, the employer is free to adjust either the benefits accruing under the defined benefit plan or the annual additions to a defined contribution plan for particular employees to prevent this from happening. The committee anticipates that many plans will include "fail safe" provisions, which automatically freeze either the rate of benefit accrual, or the amount of annual additions, to a level necessary to prevent the overall limitation from being exceeded for any employee. A plan is to be permitted to contain such a provision without violating the requirement that a qualified plan must provide for fixed and determinable benefits.

The numerator of the defined benefit plan fraction is the "projected benefit" of the participant under the plan determined as of the close of the year and the denominator is the maximum benefit which would be permitted under the plan under the limitations established in the bill. For purposes of computing the projected benefit, it is assumed that the participant's compensation for all future years will equal his compensation during the year in question. It is assumed that all other relevant factors considered in computing the benefit, such as provisions of the plan, social security benefit levels, and cost-of-living will remain constant as of that year.

The numerator of the defined contribution plan fraction is the total amount of annual additions to the participant's account through the close of the year in question and the denominator of this fraction is the maximum amount of additions which could have been made for that participant, under the provisions of the committee's bill for the year in question and all prior years of service with that employer.[10]

For example, assume that an employee is employed at age 40 and immediately becomes a participant in a defined benefit plan which accrues a benefit annually equal to 2 percent of his high three years of compensation (adjusted for the cost-of-living). His annual rate of compensation is $150,000. At age 45, he becomes a participant in a defined contribution plan of his employer.

In the case of this employee, his projected benefit under the defined benefit plan, assuming he works until the normal retirement age of 65, would equal 50 percent of his average high three years of compensation or $75,000. Since $75,000 is the maximum amount of the annual benefit which is payable from a qualified plan under the provisions of the committee bill (assuming no increase in the cost-of-living) contributions could be made for the employee under the defined contribu-

[10] In order to prevent a situation where a plan in existence before the effective date of the provisions might start off under these provisions with a deficit, the committee bill provides that for purpose of the defined contribution plan fraction, additions to the account prior to January 1, 1976, will be treated as not being in excess of the additions which would have been allowable for those years under the provisions of the committee bill.

Since many defined contribution plans permit employees to make "catch-up" contributions to take into account the fact that an employee did not make the maximum contribution for a past year, the computations necessary to compute the defined contribution fraction as of January 1, 1976, may be made on a cumulative basis. In recognition of the fact that plans may have to be amended to satisfy these new limitations and that existing plans often permit 10-percent employee contributions on a cumulative basis, the bill provides that employee contributions are not to be taken into account if made prior to January 1, 1976, if not in excess of the maximum amount of contributions permissible under the plan as in effect on October 2, 1973, to the extent that the contributions are 10 percent (or less) of the employee's salary, computed on a cumulative basis. The maximum amount of contributions permissible under the plan as in effect on October 2, 1973, is intended to include the maximum amount of contributions permissible under amendments to a plan approved by the Internal Revenue Service before October 2, 1973, and actually put into effect before the end of the year 1973.

[122] tion plan, if the defined contribution fraction did not exceed four-tenths.

Assuming that the defined benefit plan were amended to provide that future accruals would equal 1 percent of compensation (or $1,500 per year in the case of this employee), his projected benefit under the defined benefit plan would then equal $45,000, 30 percent of his high three years of compensation (which equals 60 percent of his $75,000 limitation). This would mean that 80 percent of his overall limitation could be provided under the defined contribution plan.

For purposes of these rules, plans of all corporations, partnerships, or proprietorships which are under common control will be aggegated. Generally, the question of common control will be determined under sec. 1563(a) of the Code (and secs. 414(b) and (c) of the Code), except that a 50-percent control test will be applied for purposes of these rules, instead of the 80-percent test imposed under that section. Also to be aggregated are any sec. 403(b) annuity plans or individual retirement accounts (established under the provisions of this bill) in which the individual is a participant. For purposes of these rules, the participant will be treated as having 100 percent control of these plans. For example, a sole proprietor maintaining an H.R. 10 plan for himself who is also a participant in a section 403(b) plan would aggregate the two plans as he has control over both plans.

In the event of a merger between two employers of the same employee, the overall limitation is not less than the aggregate benefits he has already accrued under the plans of both employers if there was no common control before the merger. In other words, the employee will not be forced to give up benefits he has already earned prior to the merger.

If it is determined upon application of the bill formula that the limitations contained in the bill have been exceeded, then the determination as to which plan or plans must be disqualified will be made by the Internal Revenue Service in accordance with regulations. The regulations are to provide that no terminated plan may be disqualified until all other plans have been disqualified (since there might be no recovery of taxes in the case of plans which had terminated in a year for which the statute of limitations had already run). Also, to prevent undue hardship, the regulations are to provide that plans still in existence generally are to be disqualified on a basis which will affect the fewest number of employees.

Additional benefits.—The bill contains a provision which makes it clear that benefits or contributions in addition to those allowable in connection with qualified plans may be paid or accrued on behalf of an employee, so long as this is not done on a tax deferred basis. For example, an employer would be free to provide additional defined benefits under a so-called "pay as you go" plan, which means, in general, that the benefits are paid by the employer as they fall due, and the plan is not funded. Here, the employer would receive his deduction at the time when the employee was required to take the benefits into income.

Similarly, the employer would be free to make defined contributions into a taxable trust or bank account on behalf of the employee and these amounts could be set aside for pension purposes. However, the employer would not be entitled to a deduction (except as provided in

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[123] sec. 404(a)(5)) until the employee's rights to these amounts are no longer subject to a substantial risk of forfeiture at which time the employee would be required to take them into income.

Special rule where records are not available.—In the case of existing plans, it may be that the employer will not have adequate records to determine the amount of additions which have been made for his employees under a defined contribution plan. Likewise, the employer may have no way to determine the amount of additions which would have been allowable for his employees under the provisions of the committee bill, had those provisions been in effect for the years in question. Accordingly, the Secretary or his delegate is authorized to prescribe regulations establishing reasonable assumptions which may be used by the employer in determining the amount of additions and allowable additions for years prior to the effective date of these provisions.

Likewise, in the case of plans which may be established in the future, the employer will be aware that no contributions or additions have been made on behalf of his employee, but may not have adequate records to establish the amounts of allowable additions which could have been made. Thus, the Secretary or his delegate is authorized to establish reasonable assumptions which may be used by the employer

Effective dates and transition rules

In general, the amendments with respect to H.R. 10 plans, including the provisions increasing the amount of the deductible contributions which may be made on behalf of the self-employed, are to apply to taxable years beginning after December 31, 1973. However, the rules facilitating the use of defined benefit plans for the self-employed, as well as the rules modifying the treatment of excess contributions under H.R. 10 plans and the rules with respect to the taxation of premature distributions, are to apply to taxable years beginning after December 31, 1975.

The new rules with respect to corporate limitations will apply to contributions made or benefits accrued in years beginning after December 31, 1975.

However, the committee was concerned that the limitations imposed on the bill should not have the effect of cutting back the pension of anyone under the provisions of an existing plan. Accordingly, the bill contains a transition rule for any individual who is, on October 2, 1973, an active participant in a defined benefit plan. Under the terms of this provision, an employee may receive an annual benefit which does not exceed 100 percent of the individual's annual rate of compensation on October 2, 1973 (including bonuses whether or not they were taken into account in the base for benefits under the plan as in effect on that date). However, the benefit may not exceed the annual benefit which would have been payable to the participant on retirement if all the terms and conditions of the plan in effect on October 2, 1973, (without regard to any amendments to the plan actually adopted after that date even though such amendments may, for other purposes, be given retroactive effect) had remained in effect until the employee's retirement, and his compensation taken into account under the plan for any period after October 2, 1973, had not exceeded his annual compensation on that date.

[124] If the plan provides for a postretirement cost of living adjustment on October 2, 1973, such an adjustment may also be taken into consideration in determining the allowable benefits for a participant under the "grandfather" provision. Any future increases in the bill's basic benefit limitation under the bill's cost of living adjustment provision, however, are applicable only to the generally applicable limits and not to the limits under the transitional "grandfather" clause. As a result, in future years many individuals are likely to elect to use the regular benefit limits despite the fact that they are eligible to use the "grandfather" provision, because the adjusted regular limits may permit a higher allowable benefit limit.

Individuals who wish to use these transitional provisions must elect to do so in a time and manner to be prescribed under regulations. Generally, the election will be made by the plan administrator in the year in which the employee retires. Once made, the election will be irrevocable.

Revenue effect

By increasing the maximum amount that self-employed persons will be allowed to deduct as contributions to H.R. 10 plans to 15 percent of earned income up to $7,500 a year, a revenue loss is estimated that will amount to $175 million annually. A revenue gain of $10 million is estimated to be the result of the provision that applies certain limitations on the contributions and benefits under retirement plans. The net result of these two provisions that are designed to equalize tax treatment for pension plans is a revenue loss of $165 million. These estimates assume 1973 levels of income and employment.

F. Employee Savings for Retirement

1. INDIVIDUAL RETIREMENT ACCOUNTS (SEC. 2902 OF THE BILL AND SECS. 219, 402, 408, 409, 4973, 4974, AND 6693 OF THE CODE)

Present Law

Generally, an employee is not allowed a deduction for amounts contributed from his own funds to a retirement plan. While an employer's qualified plan may allow employees to contribute their own funds to the plan,[1] no deduction is allowed for these contributions (except to the extent that tax excludable contributions made in connection with salary reduction plans may be viewed as employee contributions). However, the income earned on employee contributions to an employer's qualified plan is not taxed until it is distributed.[2]

General reasons for change

While in the case of many millions of employees, provision is made for their retirement out of tax-free dollars by their participation in qualified retirement plans, many other employees do not have the opportunity to participate in qualified plans. Often, plans are not avail-

[1] Generally, if the plan allows it, employees may make voluntary contributions to a qualified retirement plan of up to 10 percent of compensation. I.R.S. Publication 778, p. 14 (Feb., 1972).

[2] At one time, Congress took the position that a contribution to an H.R. 10 plan on behalf of a self-employed person was made half by the employer and half by the self-employed person: no deduction was allowed for half of the contributions (presumably, that half "contributed by" the self-employed person). This limitation (sec. 404(a)(10)) was repealed for taxable years after December 31, 1967.

[125] able because an employer is not willing to incur the costs of contributing to a retirement plan since, in general, the employer contributes funds which are in addition to the compensation otherwise paid his employees. Employees who are not covered under a qualified plan are disadvantaged by the fact that earnings on their retirement savings are subject to tax, and grow more slowly than the tax-sheltered earnings on contributions to a qualified plan.

Your committee's bill deals with this problem by making available a special deduction for amounts set aside for retirement by employees who are not covered under a qualified plan (including an H.R. 10 plan), a government plan, or a tax exempt organization annuity plan (sec. 403(b)). Individuals in this status, in computing their income tax, will be permitted to deduct up to $1,500 a year or 20 percent of compensation, whichever is less, for contributions to an individual retirement account. The earnings on this amount will also be tax free. As in the case of H.R. 10 plans, the amounts set aside plus the earnings are to become taxable to the individual generally after he has reached retirement age, when he receives benefits from the account.

Explanation of provisions

In general.—Under your committee's bill, a retirement savings deduction is to be allowed individuals for contributions to an individual retirement account, an individual retirement annuity, or a qualified retirement bond. The maximum annual deduction is to be $1,500, or 20 percent of compensation, whichever is less. Amounts allowed as a retirement savings deduction are to be deductible from gross income (instead of from adjusted gross income) so that any taxpayer, even a taxpayer who does not itemize but uses the standard deduction, is to be allowed a retirement savings deduction. In this manner, this program will be available to the widest possible group of taxpayers. Individual retirement accounts may be established by individuals, by employers for the benefit of their employees, and by labor unions for the benefit of their members. This will widen the availability of the retirement savings deduction.

If nondeductible contributions are erroneously made to an individual retirement account during the year (*e.g.*, because contributions are larger than the amount deductible), the individual generally will be able to withdraw the excess contribution without penalty. If the excess contribution is not withdrawn, generally it is to be subject to a nondeductible 6 percent excise tax in each year in which it remains in the individual retirement account.

Except in the case of excess contributions, amounts generally are to be withdrawn from an individual retirement account only after reaching retirement age. To encourage an individual to retain these amounts for retirement, the bill generally imposes a penalty tax of 10 percent of the amount received on premature distributions occurring before age 59½ or disability. Upon reaching age 59½, however, a participant may withdraw his funds even if he continues to work. In addition, the bill generally requires that funds in a retirement account are to be withdrawn from the account starting no later than the year in which the participant reaches age 70½. If insufficient withdrawals occur from that time on, a nondeductible excise tax is to be imposed on the excess accumulation that should have been withdrawn.

[126] Generally, all amounts received from an individual retirement account will be taxed in full as ordinary income, since neither the contributions nor the earnings thereon will have been subject to tax previously. No capital gains or special lump-sum distribution rules are to apply to receipts from these accounts. However, the individual may use the general five-year averaging provisions (sec. 1301).

Your committee recognizes that individuals may wish to change the assets in which their contributions are invested. To facilitate this, the bill allows a limited tax-free "rollover" between individual retirement accounts. Also, a tax-free rollover is allowed from qualified plans to an individual retirement account.

Deduction for contributions to individual retirement account, etc.— Under the bill, an eligible individual is to be allowed a maximum retirement savings deduction of up to $1,500 per year or 20 percent of compensation includible in gross income, whichever is less, for contributions to an individual retirement account, individual retirement annuity or qualified retirement bond. Your committee intends that, for this purpose, compensation generally is to include only compensation for personal services, and is not to include earnings from property (such as interest and dividends). Additionally, since self-employed persons are to be allowed the retirement savings deduction (if they do not participate in an H.R. 10 plan), compensation includes earned income (as defined in sec. 401(c)(2)). If the individual's compensation is not includible in his gross income (*e.g.*, as income earned from sources outside the United States) it is not to be treated as compensation for purposes of the retirement savings deduction.

The retirement savings deduction is to be available to each eligible individual. Consequently, an individual's marital status and whether he or she files a joint tax return will not affect contributions for the retirement savings deduction. If both husband and wife are eligible, they can each make contributions to his or her own individual retirement account, etc., and each is to be eligible for a deduction of up to $1,500 (or $3,000 total on a joint return). In addition, the bill also provides that community property laws of a State or other jurisdiction are not to apply with respect to the retirement savings deduction. For example, if husband and wife live in a community property State and the husband earns $7,500, the husband may contribute up to $1,500 (20 percent of $7,500) to an individual retirement account, etc., even though half of the income is owned by the wife under State law. Also, if the husband earns $15,000 and his wife earns no income, only $1,500 may be contributed and deducted by the husband under the retirement savings deduction and no contribution may be made by his wife.

The retirement savings deduction is to be allowed as a deduction from gross income.

For an individual to be allowed a retirement savings deduction, contributions are to be made to an individual retirement account, etc., within the taxable year for which the deduction is claimed. Thus, if a taxpayer is on a calendar year, contributions are to be made no later than December 31 of the year for which he wishes to take a deduction.[3]

[3] If, at the end of the year, he is not sure of the total amount that he can deduct, the individual can make a slightly larger contribution than otherwise allowable, and will have until the time for filing his tax return for that year to withdraw the excess without penalty.

[127] Contributions must be made in cash (currency, checks, etc.), and contributions in property are not to be deductible.

Deduction not allowed for active participants in qualified, etc., plans.—Your committee intends that the deduction for retirement savings (and contributions to individual retirement accounts, etc.) generally is to be available only where an individual does not participate in any other tax-supported retirement plan. Therefore, the retirement savings deduction is to be allowed an individual only if he is not an active participant in a qualified plan (sec. 401(a)), a qualified annuity plan (sec. 403(a)), a qualified bond purchase plan (sec. 405), a government plan, or a section 403(b) annuity at any time during the taxable year for which the deduction is claimed.[4]

Generally, for purposes of the retirement savings deduction, an employee is to be considered an active participant in a plan if, for the year in question, benefits are accrued under the plan on his behalf (as in a defined benefit pension plan), the employer is obligated to contribute to the plan on the employee's behalf (as in a money purchase pension plan), and the employer would have been obligated to contribute to the plan on the employee's behalf if any contributions were made to the plan (as in a profit-sharing plan). An individual is to be considered an active participant in a plan if he is accruing benefits under the plan even if he only has forfeitable rights to those benefits. Otherwise, if an individual were able to, *e.g.*, accrue benefits under a qualified plan and also make contributions to an individual retirement account, when he later becomes vested in the accrued benefits he would receive tax-supported retirement benefits for the same year both from the qualified plan and the retirement savings deduction. However, to avoid substantial administrative problems, if an individual becomes a participant in a plan and under that plan is given past service credit for prior years of service with the employer, he will not be considered to have been an active participant in the plan in the years for which the past service credit is given.

An individual generally is not to be considered to be an active participant in a plan after he has separated from service with a vested interest in the plan. Also, an individual is not to be considered an active participant in a plan after his employer has completely terminated contributions under the plan, even though the trust continues to provide benefits for the individual.

For purposes of the retirement savings deduction, a government plan is a plan established by the Federal Government or a State (including the District of Columbia) or local government (or an agency or instrumentality of the same) for its employees. For example, the Federal Civil Service Retirement Plan is a government plan. However, Social Security and Railroad Retirement plans are not to be considered government plans. Even if a government plan is not tax qualified, an individual who is an active participant in the plan is not to be able to participate in an individual retirement account, etc.

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[4] An individual who is an active participant in a tax-exempt organization annuity plan (sec. 403(b)) is not to be entitled to a retirement savings deduction. An individual is to be considered an active participant in a section 403(b) annuity plan even if, during the period in question, his rights under the annuity contract are forfeitable. Consequently, if contributions are made on behalf of an individual under a section 403(b) annuity contract in anticipation that his rights will later be nonforfeitable, he cannot make contributions to an individual retirement account, etc., and he is not to be entitled to the retirement savings deduction for the taxable year in question.

[128] If an employee is given the option to elect not to be covered by a qualified, etc., plan and he so elects, generally he will not be treated as being an active participant in the plan for purposes of the retirement savings deduction. For example, if an employer offers a qualified plan that requires matching employee contributions, but the employee elects not to participate in the plan, he is not to be considered as an active participant in the plan. However, where an employee who opts out of a qualified plan can elect later to become an active participant in it and can receive benefits for all prior years (for which he opted out) upon payment of, *e.g.*, all mandatory contributions plus interest for the prior periods, the employee is to be treated as being an active participant in the plan for the prior years with respect to which he pays the required amount and accrues benefits. Otherwise, an individual could receive a retirement savings deduction for a number of years and also, at his own discretion, later become covered by a qualified plan for the same years.

Excess contributions to individual retirement account, etc.—Under the bill, generally only deductible amounts are to be contributed to individual retirement accounts or to buy an individual retirement annuity or a qualified retirement bond, and no nondeductible employee contributions are to be made.[5] However, your committee recognizes that the contributions made on behalf of an employee to an individual retirement account, etc., may be larger than the individual's allowable retirement savings deduction. For example, an individual who has contributed to a retirement account may change jobs in mid-year and become an active participant in a qualified plan of his new employer during that year. In this case, a retirement savings deduction is not to be allowed and the contributions made to an individual retirement account will be excess contributions.

In such a case, the individual may avoid penalties on the excess contribution if he receives a timely distribution from the individual retirement account (or annuity) of the excess contribution, plus the income earned on that excess amount to the date of distribution. In general, a distribution will be timely if it is received from the account or annuity no later than the time (including extensions) for filing the employee's tax return for the year in question.[6]

If timely distribution of excess contributions (and income thereon) is made from an individual retirement account or annuity, the excess contribution that is returned is not to be included in gross income, since the taxpayer has not taken a deduction for this amount. However, any net income attributable to, and distributed with, the excess contribution is to be included in the individual's income in the year received, since it will not have been previously taxed as income to him.

Your committee believes that generally it is necessary to provide a direct incentive to avoid excess contributions to individual retirement accounts and annuities and to stimulate timely withdrawals of excess contributions.

[5] However, as discussed below, nondeductible "rollover contributions" are to be available to individual retirement accounts in certain circumstances.

[6] The time for filing is intended to be the due date for filing the original return (plus extensions) and is not to include the time for filing amended returns. The time for distributions of excess purchases of qualified retirement bonds is slightly different, as described below.

[129] Therefore, under the bill a nondeductible excise tax is to be imposed on contributions to individual retirement accounts and annuities in excess of the amounts deductible as retirement savings, unless these amounts (with earnings) are timely distributed from the account. This tax is to prevent the unwarranted tax deferral that would exist from income on excess contributions, and is to be 6 percent of the amount of the excess contributions. The excise tax is to be paid by the individual who made the excess contributions.

If an excess amount is contributed to an individual retirement account (or annuity) in one year and the excess is not eliminated in later years, the excise tax is to be owed on the excess amount for the year of contribution and for each successive year until the excess is eliminated. (The amount of the excess is to be determined as of the end of the individual's taxable year.) However, an individual may eliminate an excess contribution in later years if he does not take his maximum allowable deduction for retirement savings in the later years. Under the bill, if an individual takes less than the maximum amount allowed as a retirement savings deduction in any year after the excess contribution is made, the difference between the maximum allowed deduction and the amount taken is to reduce a prior excess contribution.[7]

For example, in 1975, an individual earns $7,000 and contributes $1,500 to an individual retirement account. His maximum available deduction is $1,400 (20% of $7,000), so there has been an excess contribution of $100. If he received the $100 (plus income earned thereon) by the time he files his tax return for 1975, he would not be subject to the excise tax. However, if he does not receive payment by that time, he will owe an excise tax of $6 (6 percent of $100). In 1976, he earns $7,500 and contributes $1,500 to his individual retirement account. Since there is an excess contribution in his account (as a result of the 1975 excess contribution), the individual has until the time for filing his tax return for 1976 to receive a distribution of $100 (plus income earned on the contribution) from the retirement account. If the $100 is returned by this time, the individual will not receive a deduction for 1976 for the full $1,500 (but will only receive a deduction for $1,400), and is to take into income the earnings paid out from the account in the year received. If the individual does not receive the excess contribution (plus earnings) in this manner, he is to owe a 6 percent excise tax for 1976, since at the end of that year there still will be an excess in the account attributable to the 1975 contribution. In 1977, he earns $7,500 and contributes $1,400, although he could take a maximum retirement savings deduction of $1,500. In this case, the excess contribution is to be reduced by the difference between the maximum deduction available and the deduction taken, which is $100 ($1,500 less $1,400). Consequently, the excess attributable to the 1975 contribution is to be eliminated and no excise tax is to be owed for 1977.

If the individual is no longer eligible to participate in an individual retirement account or retirement annuity, so he cannot forego a contribution to the account (or cannot withdraw part of the previous year's contribution to reduce the excess contribution), to avoid the 6 percent excise tax he may withdraw the excess contribution (subject

[7] However, contributions less than the maximum in prior years are not to reduce the excess contribution; otherwise, the limits on contributions could be effectively circumvented.

[130] to the 10 percent additional tax if he receives the distribution before age 59½ or disability). The amount received in this case is to be included in full in the individual's gross income since, like all amounts in an individual retirement account, this amount will have no basis.

Your committee intends that the retirement savings deduction is to be used for retirement purposes and is not to be available for accumulating income on a tax-free basis after retirement. Therefore, under the bill, no contribution is to be made to an individual retirement account, etc., and no retirement savings deduction is to be allowed for a taxable year in which the individual becomes age 70½ (and for any later year). This conforms to the general requirement (discussed below) that distributions must be made from an individual retirement account, etc., no later than the year in which a participant attains age 70½. If a contribution is made for an employee who has attained age 70½, it is to be treated as an excess contribution subject to the 6 percent excise tax.[8]

Contributions to individual retirement accounts, etc.—miscellaneous.—Under the bill, an employer (including a self-employed person) may establish an individual retirement account for the benefit of some or all of his employees and make contributions to the account on their behalf either in the form of additional compensation or a salary reduction plan. However, this is to be available only for employees who are not covered by qualified, government, or exempt-organization plans. Any employees who are not covered under such plans (including those excluded from coverage due to length of service requirements or because of age) may be covered under an employer-sponsored individual retirement account or, alternatively, may establish their own individual retirement accounts.

Amounts contributed to an individual retirement account, etc., by an employer for an employee generally are to be included in the employee's gross income as compensation, whether or not these amounts are deductible. However, if an employee pays his employer amounts out of after-tax dollars to be contributed to an individual retirement account, etc., on his behalf by the employer, this amount is not to be included in the employee's income. Amounts that constitute employee compensation and are contributed to an individual retirement account, etc., by the employer are to be subject to tax under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). However, these contributions are not to be subject to withholding if it is reasonable for the employer to believe at the time of contribution that the employee will be entitled to a deduction for the payment. In this regard, generally it will be reasonable for an employer to make a lower withholding only when the amount contributed to the individual retirement account, etc., is based on periodic withholding from compensation otherwise paid the employee. Otherwise, the employer generally will not be able to reasonably estimate the amounts to be contributed to the account, etc., and will not be able to base his lower withholding on the estimate of such contributions.

Since the deduction for contributions to individual retirement accounts is to be available to the self-employed as well as employees, the

[8] The contribution also may become subject to the excise tax on excess accumulations, described below.

[131] bill will also benefit people such as jockeys, who in years of low earnings are limited in what they can contribute to an H.R. 10 plan by the 15 percentage-of-income limitation if they wish to contribute in excess of $750.

Individual retirement accounts—requirements.—Under the bill, an individual retirement account generally is to be a domestic trust created or organized by a written instrument for the exclusive benefit of an individual or his beneficiaries. The governing instrument is to provide that the trustee will not accept more than $1,500 per year on behalf of any individual, and is to provide that the individual's interest in the account is nonforfeitable, without exception.

The balance in an individual retirement account generally may be invested in any assets that are acceptable investments for a qualified plan. The account balance could, for example, be invested in insurance annuity contracts, in a savings account with a savings and loan institution or a credit union, or in stock of a mutual fund. However, account assets generally are not to be commingled with other property except in a common trust fund.

Under the bill, no assets of an individual retirement account are to be invested in life insurance contracts and the trust instrument must so provide. Thus, the account cannot purchase life insurance protection under any retirement income, endowment, or other contract which includes a life insurance element. The individual retirement account is to be used to provide retirement income and life insurance is an asset designed for a different purpose—to provide funds for survivors. In addition, the individual retirement account is to receive only amounts that are deductible under the retirement savings deduction. If life insurance protection were purchased with contributions to an individual retirement account, the amount paid for the insurance would not be deductible by the participant and an allocation would have to be made each year between the deductible and nondeductible amounts, substantially complicating the administration of an individual retirement account. Consequently, your committee believes that if life insurance protection is to be acquired, it should be done through the many other methods now available, and not through the individual retirement account.

The trust instrument also is to provide that the entire interest of a participant will be distributed by the end of the year in which he reaches 70½ or that distribution will begin by that time and (in accordance with regulations to be issued) will be distributed over the life of the participant (or lives of the participant and his spouse), or over a period of years not exceeding the life expectancy of the participant or the participant and his spouse. This is substantially the same requirement as now applies to distributions from H.R. 10 plans.

The bill also generally requires, with respect to distributions, that the trust instrument must provide that if a participant (or his surviving spouse) dies before receiving the entire interest in the account, the entire remaining interest will be distributed within five years of death or used to purchase an immediate annuity payable to the beneficiaries. This also is substantially the same requirement as now applies to distributions from H.R. 10 plans.

[132] Under the governing instrument, the trustee of an individual retirement account generally is to be a bank (described in sec. 401(d)(1)).[9] In addition, a person who is not a bank may be a trustee if he demonstrates to the satisfaction of the Secretary of the Treasury that the way in which he will administer the trust will be consistent with the requirements of the rules governing individual retirement accounts. It is contemplated that under this provision the Secretary of the Treasury generally will require evidence from applicants of their ability to act within accepted rules of fiduciary conduct with respect to the handling of other people's money; evidence of experience and competence with respect to accounting for the interests of a large number of participants, including calculating and allocating income earned and paying out distributions to participants and beneficiaries; and evidence of other activities normally associated with the handling of retirement funds. Additionally, your committee expects that the Secretary generally will give weight to evidence that an applicant is subject to Federal or State regulation with respect to its activities, where this regulation includes, e.g., suitable rules of fiduciary conduct. It is anticipated that the Secretary probably will not allow individuals to act as trustees for individual retirement accounts.

Although the bill generally requires that a trustee administer an individual retirement account trust, the bill also provides that a custodial account may be treated as a trust, and that a custodian may hold the account assets and administer the trust. Under the bill, a custodial account may be treated as a trust if the custodian is a bank (described in sec. 401(d)(1)) or other person, if he demonstrates to the satisfaction of the Secretary of the Treasury that the manner in which he will hold the assets will be consistent with the requirements governing individual retirement accounts. Again, it is contemplated that the Secretary will require substantial evidence (as described above) to determine if a person other than a bank may act as custodian.

The bill provides that the trustee of an individual retirement account (or issuer of a retirement annuity) is to report annually to the Secretary of the Treasury regarding contributions to the account or annuity and regarding other matters as prescribed by regulations. Your committee intends that the regulations will include a requirement that the trustee or issuer file annual information returns with the Internal Revenue Service (with copies to each individual for whose benefit a retirement account or a retirement annuity is maintained) on the amount of contributions to and distributions from the account or annuity. Under the bill, there is to be a penalty of $10 for each failure to report, unless due to reasonable cause.

Individual retirement annuities—requirements.—Under the bill, retirement savings also may be invested in annuity contracts, called individual retirement annuities. An individual retirement annuity is to be an individual annuity contract that is issued by an insurance company in the name of the person who pays for the annuity (or on whose behalf payments are made). The individual's rights in the contract are to be nonforfeitable, without exception. In order to assure

[9] The bill amends section 401(d)(1) to provide that Federally insured credit unions are to be considered "banks" for purposes of determining who can be a trustee of an individual retirement account, etc.

[133] that payments under the contract will be used for retirement, the terms of the contract are to specifically provide that it is not transferable. Similarly, it is intended that the terms of the contract will prohibit the owner of the contract from using it as security for a loan.

To conform to the limits on the retirement savings deduction, the contract also is to provide that the annual premium is not to be greater than $1,500.

Additionally, as with individual retirement accounts, it is intended that the annuity contract is not to include any life insurance element. Any refund of premiums is to be applied (before the close of the calendar year following the refund) toward payment of future premiums or toward the purchase of additional benefits, and the annuity contract is to so provide.[10]

To assure that retirement savings are used for retirement purposes, the annuity contract is to include provisions requiring distribution of the annuity beginning at the close of the year when the contract owner reaches age 70½. (This provision is similar to the analogous provision regarding individual retirement accounts and H.R. 10 plans.) Also, the contract is to include provisions with respect to distribution after the death of the contract owner (and his spouse) that are similar to the provisions to be included for individual retirement accounts.

Employer- and union-established individuals retirement accounts.—Under the bill, employers and labor unions are to be able to establish individual retirement accounts for their employees or members. In this case, the same rules that govern individual retirement accounts generally are to apply to an employer- or union-established individual retirement account. For example, the interest of the participants in the account are to be nonforfeitable without exception and the trust instrument is to so provide. Under the bill, additional requirements also are to be met by employer- and union-established individual retirement accounts.

An employer or union may establish a single individual retirement account trust for a number of employees or members. However, there is to be a separate accounting for each participant's interest in the individual retirement account, and the trust instrument is to provide for such an accounting. Although there is to be separate accounting for each of the participants, this does not mean that the contribution on behalf of each participant must be held separately from the other assets in the retirement account, but the assets of the account may be held and invested together for all participants.

Under the bill, the trust instrument of an employer- or union-established individual retirement account also is to provide that assets are to be held exclusively for the benefit of the participants or their beneficiaries. The exclusive benefit rule governing individual retirement accounts established by an employer or a union is the same rule that governs qualified plans and trusts (sec. 401), and all of the requirements that must be met under the existing exclusive benefit rules also are to be met by these individual retirement accounts. For

[10] This applies only with respect to refunds of premiums that were deductible and, therefore, properly paid. With respect to premiums in excess of the amount deductible under the retirement savings deduction, as discussed above it is intended that the excess premiums may be repaid to the individual within the time for filing his tax return for the year in question. If no deduction was taken, no income is to be recognized on receipt of this excess premium. However, earnings on the excess premium are to be distributed along with it, and the earnings are to be reported as income in the year received.

[134] example, under the present exclusive benefit rule, the trust instrument must make it impossible for corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of the participants or their beneficiaries; this same rule is to apply to individual retirement accounts. Additionally, the exclusive benefit rule is to apply to individual retirement account investments in the same way as it applies to qualified plan investments.

It is intended that where an employer has both a qualified plan and an employer-sponsored retirement account, the qualified plan must meet the nondiscrimination standards without regard to the individual retirement account.

Taxation of individual retirement accounts, prohibited transactions, etc.—Generally, the bill provides that an individual retirement account is to be exempt from Federal income taxation.[11] However, if the retirement account has unrelated business taxable income, it is to be subject to tax on this income under section 511 of the Internal Revenue Code. All of the rules relating to unrelated business income (including those in sec. 512 respecting unrelated business taxable income, sec. 513 respecting unrelated trade or business, and sec. 514 respecting unrelated debt-financed income) that apply for purposes of section 511 are to apply with respect to individual retirement accounts.

The bill also applies the existing prohibited transaction rules (sec. 503(b) and sec. 503(g)) to individual retirement accounts. Under the bill, if an individual engages in a prohibited transaction with his individual retirement account trust, his account is to become disqualified as of the first day of his taxable year in which the prohibited transaction occurs.[12]

With respect to an individual retirement account established by an employer or a union, if a participant in the account engages in a prohibited transaction with the individual retirement account trust, that individual's account in the trust is thereupon to be treated as a separate individual retirement account trust and this deemed separate trust is to become disqualified as of the first day of the individual's taxable year in which the prohibited transaction occurs.

For example, if an employer with 100 employees establishes an individual retirement account for all his employees and one employee violates the prohibited transaction rules by borrowing money from the retirement account trust, then the whole retirement account trust is not to be disqualified. However, that portion of the trust which constitutes the separate account of the employee who engaged in the prohibited transaction is to be disqualified. In this way, individuals will have a substantial incentive to avoid engaging in prohibited transactions, and if a prohibited transaction occurs, only the individual who engages in that transaction (or the individual who is related, *e.g.*, by marriage, to the person who engages in the transaction) will be penalized.

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[11] As with annuities geenrally, the owner of an individual retirement annuity is not to be currently taxed on the annual increased value of the annuity, but is taxed on receipt of annuity payments. Also, as with Series E bonds generally, the income earned on the qualified retirement bonds is generally not taxable until redemption (or "maturity," if earlier).

[12] The bill provides that an individual is to be treated as "creator" of the account for the purpose of applying the prohibited transaction rules. Under sections 503(b) and 503(g), certain transactions between a trust and its "creator" (and persons attributed to the creator) are prohibited.

[135] If an individual retirement account is disqualified, the participant is then to be taxed as if he had received a distribution (on the first day of his taxable year in which the prohibited transaction occurred) of the fair market value of all the assets in his account. Since his basis in his account is to be zero, the entire amount received will be ordinary income. In addition, if the deemed distribution occurs before the individual is age 59½ or disabled, the 10 percent additional tax (described below) on premature distributions is to apply. (Otherwise, a participant who wanted a premature distribution would have an incentive to engage in a prohibited transaction.) The individual is to be taxed currently on all income earned in his account after the disqualification occurs, since the account will cease being an individual retirement account.

With respect to individual retirement annuities (which are nontransferable and cannot be hypothecated), the bill prohibits the owner of the contract from borrowing money from the insurance company issuing the contract, under or by use of the contract. If any prohibited borrowing occurs (regardless of the amount involved) the contract is to lose its qualification as an individual retirement annuity as of the first day of the taxable year of the contract owner in which the borrowing occurs. In this case, the owner is to include in income for that year the fair market value (which may not be the same as the cash surrender value) of the contract as of the first day of that year. Since the owner's basis in the contract is to be zero, the entire amount deemed distributed is to be taxable to him as ordinary income. In addition, the 10 percent additional tax (described below) on premature distributions may apply to this deemed distribution. (If the annuity contract is sold, exchanged or hypothecated, in violation of its terms, it is intended that the same consequences will occur as with a prohibited borrowing from an insurance company.)

An employer who maintains an individual retirement account also is not to engage in prohibited transactions (as defined in sec. 503(b) and 503(g)) with the retirement account. Otherwise, the employer—who may have substantial control over the trust—would be able to engage in dealings with the trust to the detriment of the employees who participate in it. Therefore, the bill also treats the employer as the creator of an individual retirement account trust which he maintains for purposes of the prohibited transaction rules.

Your committee believes that it would be inappropriate for a prohibited transaction involving the employer, or persons attributable to the employer (and not involving any account participant),[13] to result in a penalty to any participant. Consequently, the bill provides that if an employer (or persons related to him) engages in a prohibited transaction with a retirement account maintained by him, the employer is to lose all deductions for compensation to the extent of the contributions to the retirement account in his taxable year in which the prohibited transaction occurs, and for all prior open years.

For example, if the employer contributed to the account (under a salary reduction type plan) $10,000 in each of 1975, 1976, and 1977 and if he engaged in a prohibited transaction in 1977, his deduction for the $10,000 contribution in 1975, the $10,000 contribution in 1976,

[13] Where the employer is also a participant (such as a self-employed person who participates in the account), the consequences attendant upon "employer" status are to occur.

[136] and the $10,000 contribution in 1977 would be disallowed (if all these years were open). No deduction for these amounts would be allowed under any provision of the Internal Revenue Code (including but not limited to sec. 162).[14]

Distributions from individual retirement accounts, etc.—Generally, the proceeds from an individual retirement account (individual retirement annuity and qualified retirement bond) are to be fully taxable to the individual when distributed. Since contributions to the account, etc., will be made with tax-free dollars and income of the account, etc., will not be taxed as earned, the individual's basis in the account, etc., is to be zero.

The amounts distributed from a retirement account, etc., are not to be eligible for capital gains treatment, and the special averaging rules applicable to lump-sum distributions (under sec. 72) also are not to be available. This should encourage the individual to take down the amounts ratably over the period of his retirement. However, the individual is to be permitted to use the general averaging rules (sec. 1301).

If an individual borrows money, using his interest in the account as security, the portion used as security is to be treated as a distribution from the account to the individual. This treatment is also consistent with your committee's intention to encourage retirement savings since in this case if the employee uses his account as security for a loan he has no funds left for retirement.

For purposes of the estate and gift taxes, the amounts in individual retirement accounts, individual retirement annuities, and qualified retirement bonds are not to be excluded from tax (secs. 2039(c) and 2517). This too is consistent with your committee's intention that the funds be used during the individual's retirement period.

If an annuity contract is distributed from an individual retirement account, it is not to be included in income when received if the annuity contract generally meets the rules governing individual retirement annuities. In this case, the participant essentially will have received an individual retirement annuity contract and all the individual retirement annuity rules (including those with relation to borrowing under or by use of the contract) are to apply to the distributed contract.

Your committee intends that savings accumulated through an individual retirement account, etc., are to be used for retirement purposes and should not be distributed before the participant reaches age 59½ or is disabled;[15] this follows present law governing H.R. 10 plans. Under the bill, if there is a premature distribution, the individual's income tax otherwise due is to be increased by 10 percent of the total amount of the premature distribution that is included in his gross income for the taxable year. For example, if an unmarried individual

[14] Where contributions are made to an employer-established individual retirement account both by the employer and individual participants, the employer is to lose deductions for compensation paid in open years to the extent of the total contributions to the account in those years. For example, in 1975, the employer makes $2,500 of contributions to the individual retirement account which he maintains and the employer engages in a prohibited transaction with the trust in that year. Also in 1975 individual participants contribute $2,500 to the individual retirement account. In 1975 the employer pays more than $5,000 of compensation to his employees. For 1975, the penalty on the employer for engaging in the prohibited transaction is a disallowance of $5,000 of deductions for compensation paid.

[15] Disability is to be determined under the same rules that apply to H.R. 10 plans (sec. 72(m)(2)).

[137] with taxable income (after all exemptions and deductions) of $20,000 receives a premature distribution of $3,000, his income tax for the year of receipt would be $6,690 ($5,230 on $20,000 of taxable income, plus $1,160 on the $3,000 premature distribution, plus a $300 penalty tax on the premature distribution).

The 10-percent additional tax is to apply to any premature "deemed distribution" that occurs on account of a prohibited transaction involving a retirement account or retirement annuity.

The 10-percent additional tax generally is not to be offset by any tax credits (other than the refundable credits for overwithholding, overpayment of tax, and the gasoline tax credit). Also, this tax is not to be treated as reducing the individual's tax liability under the minimum tax provisions (sec. 56).

The 10-percent penalty tax on premature distributions is not to apply in the event of death or disability. However, your committee expects that the Internal Revenue Service will require that the custodian must receive proof of disability if making distributions under the disability provision. Generally it is intended that the proof be the same as where the individual applies for disability payments under social security.

(The 10-percent penalty tax also is not to apply to a distribution of excess contributions made within the time for filing the individual's tax return for the year in which the excess contributions occur.)

Your committee also intends that the amounts contributed to an individual retirement account are to be used for retirement purposes, and are not to be retained in the account, beyond the maximum age for payout. If sufficient payments are not timely made from the retirement account (or retirement annuity), then an excise tax is to be imposed on the amount of the under-distribution.[16] The payments needed to avoid this excise tax are to be provided by regulations and are to follow the rules (described above) with respect to payment no later than the year in which the participant attains age 70½ (or payment on the death of a participant or his spouse). If the amount paid out is less than the minimum required, there is to be a nondeductible 50 percent excise tax on the difference between the minimum payout required for the year in question and the amount actually paid out. The tax is to be paid by the individual to whom the minimum payments should have been made. For example, if the minimum annual amount that is to be distributed from a retirement account is $100, and only $60 is distributed by the end of the taxable year (of the payee), then an excise tax of $20 (50 percent of $40) is to be paid by the payee.

Tax-free rollovers.—To permit flexibility with respect to the investment of an individual retirement account, the bill provides that money or property may be distributed from an individual retirement account to the person for whose benefit the account is maintained without payment of tax, provided this same money or property is reinvested by the individual within 60 days in another qualifying individual retirement account maintained for this benefit. Rollover transfers to an individual retirement account are, of course, subject to the same limits and rules as other individual retirement accounts (such as, the rules relating to premature distributions or prohibited transactions). The trans-

[16] As discussed below, slightly different rules apply to the qualified retirement bonds.

[138] fer may be desired because the individual desires to shift his investments, for example, from, or to, an annuity contract, a mutual fund, or a savings account.[17]

Before releasing the account, the committee anticipates that the trustee will be required by the Internal Revenue Service to receive a declaration of intention from the individual as to the proposed reinvestment (except in the case of an individual who was entitled to receive a distribution because of his retirement at age 59½, or because of disability). The custodian is also to be required to notify the Service that a distribution of assets from the account had been made and the reason for making the distribution.

Also, since annual contributions to an individual retirement account cannot be larger than $1,500 except for rollover contributions, it is expected that the trustee who receives a rollover contribution will require a declaration from the individual that the payment is a rollover contribution.

If property other than money is received as a distribution, to be eligible for the tax-free rollover, the same property received is to be contributed to the retirement account. For example, if an individual receives stock in a distribution from a qualified plan, the same stock that is received is to be contributed to the individual retirement account, to avoid taxation on the original distribution.

The bill also allows a tax-free rollover from a qualified plan to an individual retirement account. In this case, the plan participant would have to receive his entire interest in the plan and the distribution would have to occur on account of his separation from service and within one taxable year to qualify for a tax-free rollover.

In the case of a tax-free rollover from a qualified plan, the amount contributed to an individual retirement account is to be the same amount of money (or the same property) received from the qualified plan less the amount considered contributed to the qualified plan by the individual as an employee contribution. (The amount of contribution to an individual retirement account is to be reduced by the amount of employee contributions because all amounts in the retirement account are to have a zero basis, and it would be inappropriate to apply this zero basis rule to employee contributions.)

As with a rollover between individual retirement accounts, the same property (other than money) received from a qualified trust is to be contributed to the retirement account. However, in this case, the fair market value of the property contributed is to be no greater than the total value of the rollover contributions which can be made to the individual retirement account. For example, if an individual receives securities worth $5,000 and cash of $5,000 from a qualified plan, and $5,000 of this amount represents employee contributions, then all of the securities are to be contributed to the retirement account to qualify for the tax-free rollover.

If the rollover contributions to a retirement account are greater than the amount allowed, then the 6 percent excise tax is to apply to the excess contributions.

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[17] Amounts cannot be rolled over to an individual retirement account from a disqualified (through prohibited transactions, etc.) retirement account (or disqualified retirement annuity). Similarly, excess contributions to a retirement account, etc. cannot be rolled over.

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[139] To prevent too much shifting of investments under this provision, the bill provides that an individual can transfer amounts between individual retirement accounts only once every three years. However, he may rollover amounts received from a qualified plan to an individual retirement account within that three year period.

Qualified retirement bonds.—In addition to the various types of investment described above in which deductible employee retirement savings can be placed, the bill also provides that these amounts may be invested annually in a special retirement bond, to be issued by the Federal Government. The bonds are to be issued under the Second Liberty Bond Act and are to provide for the accumulation of interest until the time of redemption.

The bonds are to be issued in the name of the individual on whose behalf they are purchased for retirement (the "registered owner") and are not to be transferable, under any circumstances, except to his executor in the event of his death (or to a trustee for his benefit in the event he becomes incompetent to manage his own affairs). For example, the bonds could not be pledged for the payment of debts, and could not be assigned to a trustee in bankruptcy. Also, the bonds could not be awarded to the individual's spouse as a result of a divorce settlement. As with other investments made through the retirement savings deduction, the employee's right in these bonds are to be nonforfeitable, without exception.

In conformity with the general provisions for individual retirement accounts and retirement annuities, the bill provides that the bonds generally are only to be cashed after the individual has reached the age of 59½ years, or if he becomes disabled. If he dies, the bonds could be redeemed by his estate. There would be one further exception to cover the case of an individual who purchased the bonds, believing that he would be eligible for the deduction for that year, only to discover later that he was not eligible. For example, an individual might purchase the bond early in the year, and later become a participant under a qualified retirement plan sponsored by his employer. To meet this situation, the bill provides that the bond may be redeemed at any time within 12 months of its purchase without penalty (and without payment of interest).[18] This provision could also be used by individuals who purchased the bond, but discovered within a year that they needed the money for other purposes. In this case the Internal Revenue Service is to be notified that the bond has been redeemed and, therefore, would be on notice that no deduction would be allowed because of its purchase. Consistent with the general rules for individual retirement accounts and retirement annuities, the bill provides that the bonds are to cease to bear interest when the individual reaches age 70½. In addition, during that year the individual is also required to take any of these bonds he is still holding into income, even if he does not cash them in. It is anticipated that these rules will be set forth on the face or back of the bonds.

Also, for similar reasons, the bill provides that if the registered owner dies before age 70½ or before the bonds are cashed in, the bonds

[18] If the bond was not cashed within the 12 months grace period, the individual would still not receive the deduction, in those cases where he was not eligible for it. However, when he cashed in the bond at a retirement age, the proceeds of the bond would constitute income to him (since his basis in the bond would be zero under the bill).

[140] are to cease to bear interest five years after the death of the registered owner or when the registered owner would have attained age 70½, whichever is earlier.

When the bonds are redeemed, the full proceeds of the bonds, including any interest earned on them, is to be treated as ordinary income to the individual, whose basis in the bonds would be zero.[19] However, if the individual chose to do so, he could treat this income under the general averaging provisions of the tax law (sec. 1301).

As noted above, if the bond is redeemed within 12 months after the date of its issuance, the proceeds would not be included in gross income if no deduction is allowed on the purchase of the bond.

Effective date

The deduction for retirement savings is to be available for taxable years beginning after December 31, 1973. All other provisions with regard to the individual retirement account, etc. are to take effect on January 1, 1974.

Revenue effect

This provision allowing an individual not covered by a qualified retirement plan, government plan, or section 403(b) plan to deduct annually the lesser of $1,500 or 20 percent of compensation for contributions by him or on his behalf to a tax-exempt retirement account, annuity, or bond plan established by him (or to certain trusts established by employers or associations of employees) is estimated to involve a revenue loss amount to $225 million for 1974 and rising to $355 million for 1977 (at 1973 income levels).

2. SALARY REDUCTION PLANS AND OTHER MATTERS (SECS. 1015 AND 2005 OF THE BILL AND SEC. 414 OF THE CODE)

Present law

Generally, an employee is not allowed to deduct amounts which he contributes from his own funds to a retirement plan. While an employer's qualified plan may allow employees to contribute their own funds to the plan,[1] no deduction is allowed for these contributions. However, the income earned on employee contributions to an employer's qualified plan is not taxed until it is distributed.[2]

In the case of a salary reduction plan or a cash or deferred profit-sharing plan, however, the Internal Revenue Service has permitted employees to exclude from income amounts contributed by their employers to the plan, even where the source of these amounts is the employees' agreement to take salary or bonus reductions or forgo salary increases. In the case of a cash or deferred profit-sharing plan, the employee generally has the election to take a bonus currently in cash or deferred by payment into the plan. In the case of a salary

[19] The provisions of sec. 72 (relating to annuities) and sec. 1232 (relating to bonds) are not to apply to qualified retirement bonds.

[1] Generally, if the plan allows it, employees may make voluntary contributions to a qualified retirement plan of up to 10 percent of compensation. I.R.S. Publication 778, p. 14 (Feb. 1972).

[2] At one time, Congress took the position that a contribution to an H.R. 10 plan on behalf of a self-employed person was made half by the employer and half by the self-employed person; no deduction was allowed for half of the contribution (the half regarded as "contributed by" the self-employed person). This limitation (sec. 404(a)(10)) was repealed for taxable years after December 31, 1967.

[141] reduction plan, the employee generally agrees with his employer to reduce his salary or forgo a salary increase which is contributed into a pension plan for his benefit. In either case, if the plan met certain nondiscrimination requirements, the Internal Revenue Service in the past had taken the position that, under certain circumstances, the payment into the plan would be treated as an employer contribution, not taxable to the employee until benefits were received from the plan. The maximum amount that could be so treated generally was 6 percent of compensation.[3]

On December 6, 1972, the Service issued proposed regulations (37 Fed. Reg. 25938) which would change this result in the case of qualified pension plans by providing that amounts contributed to such a plan in return for a reduction in the employee's basic or regular compensation, or in lieu of an increase in such compensation, will be considered to have been contributed by the employee and consequently will be taxable income to the employee.

The proposed regulations would not affect the tax treatment of contributions to certain qualified profit-sharing plans, where the contributed amounts could be received as a bonus; however, it was indicated that there would be reconsideration of the rulings permitting exclusion of such profit sharing contributions. (Rev. Rul. 56–497, 1956–2 C.B. 284; Rev. Rul. 63–180, 1963–2 C.B. 189; Rev. Rul. 68–89, 1968–1 C.B. 402.) Public hearings have been held on these proposed regulations but regulations in final form have not yet been issued.

General reasons for charge

A number of difficult issues of policy have recently arisen in connection with salary reduction pension plans and cash or deferred profit-sharing plans. On the one hand, it is argued that these types of plans provide a vehicle which allows an employer who could not afford the cost of a conventional pension pension plan to provide pension benefits for at least those of his employees who agree to take the salary reduction. Also, it is argued, there is hope that once a salary reduction plan has been established, the employer may eventually shift to a plan where there are employer contributions with no offsetting reductions in pay for the employees.

On the other hand, many feel that it is difficult to distinguish, for purposes of tax policy, between a contribution made by the employer, at the employee's option in return for a reduction in his pay, and a contribution made by the employee after receiving his pay check from his employer, which is clearly nondeductible under present law. Also, because the salary reduction type plan covers only those employees who elect to be covered (at a cost in terms of their take-home pay), this often means that many employees will not be covered, whereas it is generally desirable that as many employees as possible be covered under the private pension system. Thus, it has been sug-

[3] In the case of employees of tax-exempt charitable, educational, religious, etc., organizations and employees of public educational institutions, a specific statutory provision provides for employer contributions of up to 20 percent of compensation, times years of service, reduced by amounts previously contributed by the employer for annuity contracts on a tax excluded basis to the employees (sec. 403(b)). The regulations under the statute allow the employer contributions to be made under these salary reduction plans. Antidiscrimination provisions that apply generally to qualified plans do not apply to those tax sheltered annuities. The committee bill does not affect the tax treatment of these contributions (although limits are applied to them).

[142] gested by some that salary-reduction plans should be subject to stricter coverage requirements than those imposed in the past by the Internal Revenue Service.

The committee believes that it is impossible to deal with these issues in a satisfactory way without the opportunity for extensive consideration. Moreover, it believes that salary-reduction and cash or deferred profit-sharing plans should not be discouraged until there has been an opportunity for legislative consideration as to what their status should be. Accordingly, the committee bill provides that the proposed regulations should be withdrawn for one year, to give the committee a further chance for study.

Explanation of provisions

Salary reduction plans.—Under the committee bill, the proposed Treasury regulations with respect to salary reduction plans are to be withdrawn. No proposed regulations are to be issued in this area before January 1, 1975. At that point, if Congress has not acted, Treasury may, at its discretion, issue a new set of proposed regulations, which may or may not be similar to the regulations which are to be withdrawn. However, if regulations are issued, they may not become final prior to March 16, 1975, and may not be retroactive for income tax purposes prior to January 1 of that year.

During 1974, the law is to be administered in accordance with the legal principles which were applied before January 1, 1972. In other words, salary reduction plans which already hold favorable ruling letters will continue to remain qualified during 1974, and contributions to those plans will be treated as tax-excludable to the employee on the same basis which would have been the case in 1971. Also new salary-reduction plans may apply for and receive favorable ruling letters if such letters would have been issued based on similar facts in 1971. However, the Internal Revenue Service may wish to provide that ruling letters issued to new plans in this area are limited to 1974.

Cash or deferred profit-sharing plans are to be treated in a similar manner. During 1974, the qualified status and the tax treatment of contributions to such plans is to be governed under principles set forth in Rev. Rul. 56–497, 1956–2 C.B. 284, Rev. Rul. 63–180, 1963–2 C.B. 189, and Rev. Rul. 68–89, 1968–1 C.B. 402. However, if Congress does not decide otherwise. Treasury and the Service may, if they so decide, change their pre-1972 position on the law in this area, by regulations, ruling or other actions, so long as such changes do not become final before March 16, 1975, and are not retroactive prior to January 1, 1975.

For purposes of the social security taxes and the Federal withholding taxes, the regulations are not to be retroactive.

So-called "cafeteria plans", in which the employee may have a choice between cash and certain fringe benefits, some of which may be taxable and some which may normally be nontaxable (e.g., health insurance, group term life insurance within the permissible limits) are to be in the same legal situation during 1974 as salary reduction plans. Your committee sees no difference between this type of plan and salary reduction plans, and concludes that they should receive similar treatment. Here too the committee bill requires a one-year preservation

[143] of the pre-1972 status quo, and the tax treatment of fringe benefits selected under this type of plan is to be governed by the principles which were being applied by the Internal Revenue Service prior to 1972 to salary reduction plans. In the absence of Congressional action, Treasury and the Internal Revenue Service will be free to take any action which is deemed appropriate for 1975, but the regulations may not be issued in final form prior to March 16, 1975.

The committee wishes to make clear that absolutely no inference is to be drawn from this action that Congress either agrees or disagrees with pre-1972 interpretation of the law by Treasury and the Internal Revenue Service concerning salary-reduction plans, cash or deferred profit-sharing plans or cafeteria style plans, or that it agrees or disagrees with the interpretation embodied in the proposed regulations concerning salary-reduction plans which are to be withdrawn under the bill. There is also to be absolutely no inference that if Congress does not act in this area within a year that it would or would not be appropriate to reissue these regulations, or that it would or would not be appropriate to extend the principles thereof to cover cash or deferred profit-sharing plans or cafteria style plans.

Designated contributions.—Under present law, contributions which are designated as employee contributions are generally treated as employee contributions for purposes of the Federal tax law. For example, this is the case with respect to employee contributions under the Federal Civil Service plan. Your committee's bill contains a provision to clarify this rule for the future. This provision provides that amounts that are contributed to a qualified plan are not to be treated as an employer contribution if they are designated as employee contributions.

However, some State and local government plans designate certain amounts as being employee contributions even though statutes authorize or require the relevant governmental units or agencies to "pick up" some or all of what would otherwise be the employee's contribution. In other words, the governmental unit pays all or part of th employee's contribution but does not withhold this amount from the employee's salary. In this situation the portion of the contribution which is "picked up" by the government is, in substance, an employer contribution for purposes of Federal tax law, notwithstanding the fact that for certain purposes of State law the contribution may be designated as an employee contribution. Accordingly, the bill provides in the case of a government pick-up plan, that the portion of the contribution which is paid by the government, with no withholding from the employee's salary, will be treated as an employer contribution under the tax law.

Effective date

The provisions dealing with salary reduction plans and treatment of contributions designated as employee contributions are to take effect upon enactment.

Revenue effect

There is no revenue effect from these provisions since they are consistent with present law, in the case of designated contributions, and simply postpone for one year any possible reinterpretation of present law in the case of salary reduction plans.

G. Lump Sum Distributions

(Sec. 2004 of the bill and secs. 72, 402, and 403 of the code)

Present law

Retirement benefits generally are taxed under the annuity rules (sec. 72) as ordinary income when the amounts are distributed, to the extent they do not represent a recovery of the amounts contributed by the employee. However, an exception to this general rule under the law in effect before the Tax Reform Act of 1969 provided that if an employee's total accrued benefits were distributed or paid in a lump-sum distribution from a qualified plan within one taxable year on account of death or other separation from service (or death after separation from service), the taxable portion of the payment was treated as a long-term capital gain, rather than as ordinary income.

The capital gains treatment accorded these lump-sum distributions allowed employees to receive substantial amounts of deferred compensation at more favorable tax rates than compensation received currently. The more significant benefits under this treatment apparently accrued to taxpayers with adjusted gross incomes in excess of $50,000, particularly in view of the fact that a number of lump-sum distributions of over $800,000 have been made.

To correct this problem, the Tax Reform Act of 1969 provided that part of a lump sum distribution received from a qualified employee's trust within one taxable year on account of death or other separation from service (or death after separation from service) is to be given ordinary income treatment, instead of the capital gains treatment it had been given under prior law. Insofar as the distributions are considered as being attributable to post-1969 years, the portions of the benefits which represented employer contributions were accorded ordinary income treatment while the portions which represented appreciation, interest, or dividends on the amounts accumulated continued to be given capital gains treatment. Of course, no tax was imposed with respect to the employee's own contribution. The use of capital gains treatment was continued for the entire taxable portion attributed to 1969 and earlier years.

The 1969 Act provided a special seven-year "forward" averaging treatment for the portion of the lump-sum distribution treated as ordinary income. A regular employee (or his beneficiary) is eligible for this seven-year averaging treatment if he has been a participant in the plan for five or more taxable years or if his beneficiary received the lump-sum distribution because of death.

In the case of retirement plans for the self-employed ("H.R. 10 plans", the Self-Employed Individuals Tax Retirement Act of 1962) the entire lump-sum distribution (excluding the employee contributions) are taxed as ordinary income, but with five-year forward averaging.[1] No change was made in this provision by the Tax Reform Act of 1969.

[1] The self-employed are eligible for this special averaging if the lump-sum distributions are received on account of death, disability or if received after age 59½. As with regular employees, the distributions must also be received within one taxable year, and only if the self-employed person had been a plan participant for five or more taxable years preceding the taxable year of the distribution. However, unlike regular employees, the self-employed are not entitled, under present law, to the special averaging simply because of a separation from service.

[145] Self-employed who elect to be taxed under this special averaging rule cannot for the same taxable year use the regular income averaging rules (sec. 1301 *et seq.*) as to this income or other ordinary or capital gain. However, the self-employed generally find this special averaging more advantageous than the regular five-year averaging rule generally available because the latter may be used only to the extent that the income averaged exceeds 120 percent of that taxpayer's average income in the four prior years. Unlike the self-employed, however, the regular employee may use his special seven-year averaging for the ordinary income portion of his lump-sum distribution while using the regular averaging provisions for the capital gain portion of the distribution as well as for any other income he may have.

Reasons for change

The Treasury has had great difficulty in formulating regulations to carry out the 1969 Act provisions for regular employees in determining the precise break-down between ordinary income and capital gain in a lump-sum distribution. It has also had great difficulty in formulating regulations to carry out the 1969 Act provisions for determining the amount of tax imposed on account of the "ordinary income" element of post-1969 lump-sum distributions. Recently, the Treasury withdrew its earlier proposed regulations on the second point and substituted new ones which, in general, would produce lower tax liabilities than those determined under the earlier set of proposed regulations. The new regulations also would produce lower tax liabilities than under current long-term capital gain rates in many cases, and this could mean that they would result in revenue losses, rather than revenue gains, in comparison to the law which would have applied in the absence of any special action with respect to this provision in the Tax Reform Act of 1969.

More important, the new proposed regulations appear to share with the old proposed regulations the problem of excessive complexity. It is frequently maintained that lump-sum distributees are unable to compute their taxes, and that accountants and tax lawyers have been refusing to attempt the computations.

To eliminate undue complexity but maintain the revenue at least as high as that which would result under the proposed regulations under the 1969 Act provision, the committee chose to introduce a new and simplified method of computing the tax due on lump-sum distributions. The substance of the 1969 change in the tax treatment would be preserved, however. Under the bill, all pre-1974 portions of lump-sum distribution would be taxed as capital gain, rather than as ordinary income. The effect of the January 1, 1974, cutoff date under this bill is to provide long-term capital gains treatment for that portion of future distributions that relates to years after 1969 and before 1974; under the 1969 Act, portions of the distributions allocable to those years would have been taxed as ordinary income.

Under the simplified computational rules, ordinary income portions of lump-sum distributions from qualified plans are to continue to benefit from special "forward" averaging. The portion of the distribution representing pre-1974 value is to receive capital gains treatment, as

[146] stated above. The portion of the distribution attributable to post-1973 value in excess of the employee contributions is to be subject to tax as though it were ordinary income of the taxpayer, but his only income, and with 10-year averaging.

This ordinary income treatment for the post-1973 value of the lump-sum distribution is computed completely separately from the taxpayer's other income. This separate computation is used because it was found that taxpayers were, in effect, being treated quite differently depending upon the presence or absence of other income in the year of distribution—something which they sometimes had in their power to control.

The 10-year averaging is provided in order to give roughly the equivalent of what the tax would be were the individual to live 10 years after retirement and receive his interest in the plan over that period. In this case, a tax is completed on $\frac{1}{10}$th of the distribution computed as if the taxpayer had no other income or deductions. After the tax is computed, the result is multiplied by 10, and this amount is then added to the employee's tax liability on his other income. His tax liability on this other income takes into account not only his tax on wages, salary, or investment income, etc., but also the capital gains tax on the portion of the lump-sum distribution attributable to pre-1974 value. The tax liability on this other income does not in any way, however, take into account the portion of the lump sum distribution treated as ordinary income.

In making the ordinary income computation on the post-1973 value, a special minimum distribution allowance is provided to insure that the tax on relatively small lump-sum distributions will generally be not more than it would be under present law. This allowance is phased out for lump-sum distributions over $20,000.

A major problem with the rule arrived at under the 1969 Act was the difficulty in determining the value of the distribution attributable to years before 1970 for which capital gains treatment was continued by that Act. To meet that problem, the committee bill provides that where a lump-sum distribution relates to active participation which began before 1974 and ended after that time, the distribution is to be apportioned between the pre-1974 participation (eligible for capital gains treatment) and post-1973 participation (treated as ordinary income under a separate 10-year averaging computation) on the basis of the amount of time in which the employee was an active participant in each period. This method will significantly simplify the computation previously required.

Table 1 presents a comparison showing the average effective tax rates applicable for taxpayers in various situations and with various amounts of lump-sum distributions, with the methods of computing post-1973 taxable value as capital gain, under present law (with the proposed regulations), and under the committee bill.

[147] TABLE 1.—COMPARISON OF INCOME TAX TREATMENT OF LUMP SUM DISTRIBUTIONS UNDER THE COMMITTEE BILL WITH CAPITAL GAINS TREATMENT AND WITH THE TREATMENT PROVIDED IN 1969 (AS SHOWN BY PROPOSED REGULATIONS)

Assumed adjusted gross income, other than lump-sum distribution [1]	Assumed lump-sum distribution [2]	Average effective income tax rates (percent)		
		Capital gains treatment (1973 law) [3]	1969 treatment as shown by proposed regulations [4]	Rates which apply under Ways and Means Committee bill when all but employee contributions are ordinary income
$5,000	$2,500	7.4	5.1	7.0
	5,000	7.7	5.3	7.0
	10,000	7.4	5.6	7.0
	50,000	8.5	10.6	16.3
	60,000	8.7	11.3	17.8
	100,000	10.6	13.2	20.9
$10,000	5,000	8.1	5.7	7.0
	10,000	9.2	5.9	7.0
	20,000	9.5	8.9	7.3
	50,000	10.4	12.0	16.3
	100,000	12.2	15.4	20.9
	200,000	15.8	19.5	26.2
$25,000	12,500	15.6	11.5	7.1
	25,000	15.7	13.9	9.7
	50,000	16.7	16.1	16.3
	125,000	18.8	20.0	22.2
	250,000	22.3	23.2	28.8
	500,000	25.6	27.2	40.4
$50,000	25,000	24.6	19.6	9.7
	50,000	24.8	21.0	16.3
	100,000	25.5	22.2	20.9
	250,000	27.0	25.2	28.8
	500,000	29.1	28.4	40.4
	1,000,000	31.2	32.5	53.1
$100,000	50,000	25.0	30.1	16.3
	100,000	28.2	31.4	20.9
	200,000	30.7	33.8	26.2
	500,000	32.0	37.0	40.4
	1,000,000	33.8	38.8	53.1
	2,000,000	35.1	43.9	61.5

[1] Income other than lump-sum distributions consists of income taxed at ordinary rates and which is not subject to either the maximum tax on earned income or the minimum tax on items of tax preference. To avoid problems of maximum tax on earned income, ordinary income in excess of $50,000 is considered as coming from sources other than earnings. Taxable income is computed from AGI by deducting the larger of the standard deduction or itemized deductions equivalent to 15 percent of AGI and from personal exemptions of $750 each. Taxpayer is considered to be married and filing a joint return. No additional itemized deductions are considered to accrue to the taxpayer due to the receipt of lump-sum distribution.

[2] Net of taxpayer's basis.

[3] 50 percent inclusion of capital gains in AGI. Taxpayer is eligible for either alternative tax of 25 percent on 1st $50,000 of capital gains or normal 5-year income averaging. Four prior year base period income is assumed to be the same as taxable income excluding distribution for the current year, except for $5,000 AGI class which is assumed to have a base of $1,462.50 and the $10,000 AGI class which is assumed to have a base of $5,850.

[4] 70 percent of distribution assumed to be capital gains; 30 percent ordinary income.

The committee concluded that in the interest of simplification it was desirable to provide the same averaging treatment for lump-sum distributions for both the self-employed and the regular employees. As a result, the distinction of present law that accords 5-year averaging to distributions to self-employed and 7-year averaging to distributions to regular employees is eliminated and the 10-year averaging treatment referred to above is made available in both cases.

[148] Under the committee bill, the portion of eligible distributions attributable to pre-1974 value is to be taxed as capital gain to the self-employed in the same manner as in the case of regular employees. Also in both cases, the bill will allocate distributions between capital gain and ordinary income on the basis of the portion of the time the employee was a participant prior to 1974 and after 1973.

Many of the requirements for lump-sum treatment are the same under present law for regular employees and the self-employed.[2] However, there also are differences in present law in granting eligibility for lump-sum treatment in the case of regular employees and the self-employed, and because of basic differences in their status it was necessary to retain some of them. One difference is that regular employees may claim the special averaging treatment if the distribution is on account of their separation from service, whereas the self-employed cannot. It was necessary to maintain this distinction because there is no comparable concept of "separation from service" for the self-employed.

On the other hand, the committee bill does remove a difference in treatment between the self-employed and regular employees by permitting the latter, as well as the self-employed, the right to claim the special averaging treatment in instances of distributions to those who have attained age 59½ whether or not there is a separation from service. However, both classes of persons are to be eligible for this special treatment only once after attaining age 59½.[3]

The committee bill also removes another difference in treatment between these two classes of persons by providing that the self-employed, as well as regular employees, may claim the normal five-year averaging (provided under sec. 1301 of the code) for their other taxable income, including any capital gain portions of their lump-sum distributions. (The regular five-year averaging rule is provided under present law for cases in which taxable income in any taxable year increases markedly from taxable income in prior years).

Explanation of provisions

Under the simplified computation of the tax on lump-sum distributions, the post-1973 portion of a distribution is to be taxed as ordinary income (but with 10-year "forward" averaging), thus maintaining the recognition in the Tax Reform Act of 1969 that the taxable portions of these distributions are basically deferred compensation, and generally should be taxed as is other compensation; that is, as ordinary income. Ten-year averaging is provided to recognize the fact that the distribution represents compensation which generally is received spread out over the taxpayer's life beginning with the time he retires. Ten-year averaging, insofar as the size of the tax is concerned,

[2] In the case of both regular employees and the self-employed, in order to qualify for the ten-year averaging, the entire distribution made to them must be made within one taxable year and they must have been participants in the plan for at least five years prior to the year in which the distribution was made. This latter rule does not apply to distributions made in the event of death.

[3] The special averaging will continue to be made available to distributions on account of the disability of a self-employed person (in general if the disability is an impairment which would result in death or can be expected to be of long-continuing and indefinite duration). Regular employees may claim the special averaging for distributions on account of disability only if the disabled employee has attained age 59½ or is separated from service, as, for example, on account of the disability.

[149] achieves this result. It is believed that it would be unfair to use the high tax rate that would be applicable if the distribution were treated as received wholly in one year. As a result of the averaging, the distribution would be taxed roughly as if it were received in 10 equal parts in 10 years. The decision to tax this income separately from all other income (to the extent it is not treated as pre-1974 income eligible for capital gains treatment) was made on the basis that most distributees will have little or no other taxable income in the years following their retirement.

The decision to use 10-year averaging is attributable to the fact that 10 years represents the approximate life expectancy of a person age 65 and therefore is approximately the period over which the income would be spread if not received in the form of a lump-sum distribution.

The portion of the distribution attributable to pre-1974 service is to be taxed as capital gain and taxed along with any other income the taxpayer may receive. For this income, the committee believed it was appropriate to preserve the pre-1969 treatment (at current capital gains rates) to the fullest extent possible. The portion which constitutes a return of employee contributions continues to be nontaxable as a return of basis.

Under the computation, the capital gain portion is included in the amount of the taxable distribution prior to the deduction of the minimum distribution allowance and the application of the 10-year averaging rule. After a total tax is determined under the 10-year averaging rule, the tax on the ordinary income element is the portion of that total tax determined according to that portion of the plan participant's total time in the plan that was spent after 1973. The capital gain is added to the taxpayer's other income and this total (minus regular deductions, exclusions, etc.) is taxed under usual rules. (See the examples at the end of this section.)

A further simplification from prior law in the computation is the determination of the amounts to be attributed to pre-1974 employment (capital gain taxation) and to post-1973 employment (10-year averaging with ordinary income taxation). That attribution is to be made on the basis of the amount of time in which the distributee was an active participant in each period. Thus, if a distributee was an active participant from January 1, 1971, through December 31, 1980, three-tenths of the taxable portion of his distribution would be taxed as capital gain while seven-tenths would be taxed as ordinary income and averaged over 10 years.

Although the breakdown between capital gain and ordinary income is normally to be made on the basis of the number of calendar years in which the participant was active in the plan before and after December 31, 1973, the Secretary is authorized to issue regulations describing circumstances under which participants may use plan years instead of calendar years. This is intended to further simplify the computation for those plan participants whose information concerning their participation is prepared and given them by plan administrators in terms of plan years, rather than calendar years.

In order to treat all distributees equally, all computations of the tax on the ten-year averaging ordinary income portion are to be made

[150] on the basis of the tax schedule for unmarried individuals.[4] In addition, community property laws are generally to be ignored for these purposes.[5]

In computing the tax on the ordinary income element, a special minimum distribution allowance is to be provided to give assurance that the tax on relatively small lump-sum distributions will not be appreciably more than under present law. In the computation, the amount of the taxable distribution (the total distribution less the participant's payments) is to be reduced by the minimum distribution allowance before the tax is computed. The allowance is half of the distribution up to $20,000. Above that level, it is phased out on a $1.00 for $5.00 basis, with the result that it is entirely eliminated for distributions of $70,000 or more.

To protect against tax avoidance possibilities the bill provides that distributions made during the current taxable year and the five previous taxable years of the recipient are to be included in the ten-year averaging computation for purposes of determining the tax rate on the last distribution. When the total tax is determined, however, the amount of this tax attributable to any earlier distributions (determined as illustrated in the examples following this discussion) is to be subtracted and the tax on the final distribution is the remainder. Generally all distributions made within the current and five prior taxable years to the same recipient are to be subject to this five-year lookback rule. Lump-sum distributions made prior to 1974 need not be aggregated under this rule.

Aggregation of distributions for this purpose is required of all lump-sum distributions in the current and five prior years with respect to the same recipient.[6] In the case of receipt of subsequent distributions by the plan participant in the six-year period, this would mean the aggregation by the participant of all those distributions would be required. In the case of a plan participant receiving a distribution from his or her own retirement plan and also receiving a distribution as a beneficiary, those distributions would also have to be included in the aggregation. Moreover, it is not intended that a recipient of one distribution could escape the inclusion of another distribution he is entitled to claim by directing that it be made instead to a beneficiary.

Aggregation is required only of lump-sum distributions. If a recipent is entitled to special averaging for a distribution, but does not elect the special averaging, he is not required to aggregate that distribution with a subsequent lump-sum distribution for which he does

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[4] Distributees, in computing the tax on their other income (including the capital gain element of the distribution), may use any appropriate tax schedule. They are not restricted to the schedule for unmarried individuals.

[5] Prior to the computation of the separate tax on the ordinary income portion of the distribution, under the committee bill an amount must be subtracted from the income of the retiree. In community property states, the amount subtracted will, of course, generally be only one-half of the ordinary income portion of the lump-sum distribution. The other half of this lump-sum distribution must be subtracted from the income of the spouse which may be reported on a separate tax return. After the computation of the separate tax with respect to the ordinary income portion, this tax is added to the tax of the retiree alone as otherwise computed, and not to that of the spouse where she is computing her tax on a separate return. The capital gain portion of the lump-sum distribution in a community property state is to continue as under present law to be included one-half in the income of the retiree and one-half in the income of the spouse.

[6] Requiring aggregation of all lump-sum distributions with respect to the same participant, rather than with respect to the same recipient, was rejected because of the difficulty recipients would have in determining the amount of previous lump-sum distributions to different recipients, as well as the tax paid by those earlier recipients.

[151] elect the special averaging since the former distribution is excluded from the definition of a lump-sum distribution.

The distribution of an annuity contract is to be taken into account in the taxation of lump-sum distributions although the contract itself is not to be treated as a taxable lump-sum distribution. If an annuity is distributed to a recipient in the same six-taxable-year period in which a lump-sum distribution that is not an annuity distribution is made to the same recipient, the value of the annuity (only for purposes of computing the tax on other lump-sum distributions) is to be added to the amount of cash or value of the other property distributed and a tax is to be calculated on the sum. From that amount is to be subtracted the tax calculated on the value of the annuity alone (reduced by the minimum distribution allowance applicable to the total). The remainder is the tax on the taxable portion of the aggregated lump-sum distribution.[7] The value of the annuity, for these purposes, is to be the present value of the payments anticipated under the annuity contract, computed with regard to the life expectancy of the recipient.

The effect of treating annuity distributions as lump-sum distributions is only to increase the tax rate payable on the taxable distribution.

Annuity distributions, standing alone, remain nontaxable, as under present law. Furthermore, their inclusion in the computation is not to increase the capital gains tax payable on account of pre-1974 value of the aggregated distributions.

Of course, trusteed annuities, the rights to which have not been distributed, are not to be included in the lookback rule computation.

The committee bill does not change the present tax treatment of distributions of employer securities. Therefore, appreciation of the value of employer securities between the time the securities were allocated to the participant's account and the time of the distribution would not be taxed upon the distribution, but would be taxed as capital gains upon an eventual sale of those securities by the recipient. These, unlike distributions of annuity contracts, would not be included in the aggregated distributions for purposes of the tax computation.

A recipient of a distribution could not use this special ten-year-averaging method unless he combines all amounts received in any taxable year that might be eligible for this special averaging system into a single lump-sum distribution. For example, if an employee has been working for separate employers at any time during his working career and receives in one taxable year distributions from two or more employers of the entire amounts (or, in the case of an annuity purchase, is credited with the entire amount) due him under the plans of those particular employers, that employee must treat all the distributions to him in that year as a single lump-sum distribution in order to claim the ten-year averaging.

For a distribution to be eligible for the special lump-sum distribution treatment an employer must distribute to an employee (or, in the case of an annuity, distribute to that employee's credit) all of the bal-

[7] If the distribution of an annuity is the final lump-sum distribution in any six-taxable-year period, a tax is determined based on the tax rate applicable to the total of the aggregated distributions, including the annuity distributions. The tax deemed payable on account of the annuity distributions is subtracted, as above described, a credit is given for the tax earlier paid on account of the cash distributions, and the remainder is the tax due for the final taxable year in the six-year period on account of the distributions. Of course, this does not increase the basis of annuity contract.

[152] ance due the employee from all the employer's pension plans, all the balance from that employer's profit-sharing plans, or all the balance from that employer's stock bonus plans. This prevents the tax avoidance which would otherwise occur as the result of successive distributions in subsequent years from different plans of the same employer.

Although the number of separate distributions is limited as described above, elections to use this special ten-year averaging may be made freely for all permitted lump-sum distributions until the employee has attained age 59½. And that time, only one election may be made with respect to that employee. This would permit a widow to make an election for the special averaging for a distribution on account of her deceased husband while making another election in a subsequent year for her own retirement distribution although both she and her husband had attained age 59½ at the time of the distributions. However, an employee who receives a lump-sum distribution on his own account after age 59½ and elects the special averaging treatment may not thereafter make the same election for another distribution on his own account in another taxable year. The effect of this is to prevent most retiring taxpayers from avoiding the aggregation required under the five-year rule by electing the special averaging for years that are six or more years apart.

Despite the limitation of one election with respect to individuals who have attained age 59½, if such an individual makes an election to use ten-year averaging for one distribution, and then later receives an annuity distribution within the six-year aggregation period, the annuity and the prior distribution (or distributions) must be aggregated.

It is contemplated that a taxpayer will make his election on the income tax return for the taxable year in which the distribution was made. The election, however, is not to be irrevocable, and can be changed so long as the income tax return could be amended or a refund claim could be filed. (Normally, a refund claim must be filed within three years after the return is filed.)

Individuals, estates and certain trusts may elect to use this special lump-sum distribution treatment.[8] Of course, the normal constructive receipt and anticipatory assignment of income rules would be applicable to distributions to trusts, as under present law. Thus, if a lump-sum distribution is made to a nontestamentary trust having a beneficiary other than the employee as the primary beneficiary, the distribution would generally be taxable to that employee.

As a result of this and the specific language of the bill, an individual could not avoid the aggregation rules by making distributions to multiple trusts for the benefit of the same beneficiary. Similarly, the aggregation rule could not be avoided by reciprocal trusts.

A trust would not be permitted to make the election, and thereby claim the special averaging treatment, if the use of the trust by the distributee has affected the includibility of the distribution in the gross estate of the employee for purposes of that employee's estate tax.

[8] However, an estate or a trust will be prohibited from making the election if an election has already been made—by another trust or by the individual himself—with respect to that same individual after he has attained age 59½.

[153] The plan participant would be treated as the recipient of a distribution, for purposes of the aggregation rules, if he causes a lump-sum distribution to be made to a trust for the benefit of his wife, but with the income or right to the income reserved to himself, or in any other situation in which the participant would be treated as the substantial owner of the trust under the present tax rules, even if the grantor of the trust is the employer or plan.

The tax paid on a lump-sum distribution under this special averaging treatment rule is neither to be a tax preference item (in the sense of section 56 of the Code), nor is it to be used as a part of the tax paid that reduces the minimum tax on tax preference items.

First example.—On December 31, 1975, A terminates his services and receives a lump sum distribution of $65,000 from a qualified plan. The distribution includes employer securities with a fair market value of $25,000 and a basis of $10,000. A has been participating in the plan since January 1, 1966. The plan is noncontributory. A is married; both A and his wife are 50. Their only other income is A's salary of $15,000 and his salary from a second job ($5,000). Their itemized deductions are $3,000. Their average base period income from the preceding four years (1971 through 1974) is $14,000.

The tax on the portion of the distribution which is not treated as a long-term capital gain is computed as follows:

Net distribution ($65,000 total distribution less $15,000 unrealized appreciation on employer securities)	$50,000
Less: Minimum distribution allowance: 50 percent of first $20,000	10,000
Reduced by: 20 percent of net distribution in excess of $20,000	6,000
	4,000
Distribution less allowance	46,000

The tax on $\frac{1}{10}$th of the distribution less allowance computed from the tax rate schedule for single taxpayers is $816.00.

Multiply this amount by 10: $8,160.00.

Then, multiply by the fraction,

$$\frac{\text{Years of participation in plan after 1973}}{\text{Total years of participation}} = \frac{2}{10}\ 0.2$$

which yields $1,632.00.

Thus, the tax on the ordinary income portion of the distribution is $1,632.00.

The amount of the distribution taxed as a long-term capital gain is the amount of the net distribution multiplied by the fraction,

$$\frac{\text{Years of participation before 1974}}{\text{Total years of participation}} = \frac{8}{10}\ 0.8$$

Net distribution	$50,000
Capital gains element	40,000

The capital gains element is taxed along with other income (exclusive of the ordinary income element) in the normal way. The tax on the taxable income of $35,500 ($15,000 salary from first job, plus $5,000 from second job, plus $40,000 capital gains element of lump sum distribution, less $20,000 capital gains exclusion, less $3,000 item-

[154] ized deductions, less two $750 personal exemptions) is calculated using the tax rate schedule for married taxpayers filing joint returns. In this case the alternative tax on capital gains is not available, but the regular-five-year income averaging provisions are.

Ordinary tax	$10, 130. 00
Tax—Using regular income averaging [1]	8, 828. 00

[1] As indicated above, average base period income is $14,000.

Selecting the tax computation method which yields the smallest amount of tax, A uses the regular five-year income averaging method and has a tax of $8,828.00.

Finally, A combines the tax on the capital gains portion of the distribution and his salary, with the tax on the ordinary income portion of the distribution:

Tax on salary and capital gains portion of distribution	$8, 828. 00
Tax on ordinary income portion of distribution	1, 632. 00
Total 1975 income tax	10, 460. 00

A's basis in the employer's securities is $10,000.

Second example.—On December 31, 1976, A receives a distribution from a qualified plan with respect to his second job. In this case the distribution is a nontransferable annuity contract, the value of which is $6,000; and a cash distribution of $4,000 financed solely by the employer. A had participated in the plan since January 1, 1967. Mr. and Mrs. A's only other income in 1976 is A's salary of $25,000 and interest of $3,000 on the $40,000 cash received in the prior lump sum distribution. They have itemized deductions of $2,100. Mr. and Mrs. A's 1976 tax is computed as follows:

First, compute the tax on the portion of the distribution which is not treated as a long-term capital gain and which is taxed separately.

Step 1:

1976 cash distribution	$4, 000
1976 annuity contract	6, 000
Prior year net distribution	50, 000
Total	60, 000
Less: Minimum distribution allowance: 50 percent of first $20,000	$10, 000
Reduced by: 20 percent of net distribution in excess of $20,000	8, 000
Total	2, 000
	58, 000

Ten times the tax on one-tenth of $58,000 (from the rate schedule for single taxpayers) is $10,680.

Step 2:

1976 annuity	$6, 000
Minimum distribution allowance from Step No. 1	2, 000
Total	4, 000

Ten times the tax on one-tenth of $4,000 (from the rate schedule for single taxpayers) is $560.00.

Step 3: $10,680.00—$560.00=$10,120.

Step 4:

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[155] Determine ordinary income and capital gains elements of A's distribution and his prior year distribution. The ordinary income element of A's latest distribution is determined by multiplying the cash distribution of $4,000 by:

$$\frac{\text{Years of participation in plan after 1973}}{\text{Total years of participation}} = \frac{3}{10} = 0.3$$

Thus, A's ordinary income element is $1,200. $10,000 of Mr. A's prior distribution of $50,000 was ordinary income.

Thus, the tax on the ordinary income element is the fraction of the tax from Step No. 3 which the ordinary income elements of the 1976 and prior year distributions bear to the entire distributions.

$$\left.\frac{\$1,200+\$10,000}{\$4,000+\$50,000}\right\} \times \$10,120 = \$2,098.96$$

Step 5:

The tax on the ordinary income element of A's 1975 distribution from their 1973 income tax income return was $1,632.00. Subtracting that from the tax calculated in Step No. 4 yields the tax on the ordinary income element of A's latest distribution:

$$\$2,098.96 - \$1,632.00 = \$466.96$$

Second, compute the tax on all other income, including the capital gains portion of the distribution.

Step 6:

In Step No. 4, the ordinary income element of the distribution was calculated as $1,200. Therefore, the long-term capital gains element is:

$$\$4,000.00 - \$1,200.00 = \$2,800.00$$

Step 7:

The capital gains element is taxed along with other income in the ordinary manner.

Capital gains element	$2,800
Less: 50 percent of net long-term capital gain	1,400
Total	1,400
Salary	25,000
Interest	3,000
Adjusted gross income	29,400
Less: Itemized deductions	2,100
Less: Personal exemptions (2×$750)	1,500
Taxable income	25,800

The tax on $25,800 is calculated using the tax rate schedule for married taxpayers filing joint returns. In this case, neither the alternative tax on capital gains nor the regular five-year income averaging provision is available.

Ordinary tax	$6,308.00

Third, A combines the tax on the capital gains portion of the distribution and his other income, with the tax on the ordinary income portion of the distribution.

[156] *Step 8:*

Tax on capital gains portion of distribution and on other income	$6,308.00
Tax on ordinary income portion of distribution	466.96
Total 1976 income tax	6,774.96

If in the examples above, A has attained age 59½, he may elect to treat only one of the distributions as a lump sum distribution qualifying for ten-year averaging. In computing the tax liability on the distribution which he elects to qualify for ten-year averaging, A will not aggregate any distribution (except in the case of a distribution of an annuity contract) made after attaining age 59½ which is not treated as a lump sum distribution for purposes of the ten-year averaging.

Effective date

These lump-sum distribution provisions are to apply to distributions made in taxable years beginning after December 31, 1973. The aggregation required under the five-year lookback rule is not to include distributions made prior to that effective date.

Revenue effect

The revised tax treatment of lump-sum distributions from retirement plans is expected to result in the long run in annual revenue gains amounting to $60 million a year based on 1973 levels of income.

H. Miscellaneous

1. Registration with Social Security

General reasons for change

The mobility of labor in the United States has been steadily increasing. From the standpoint of the economy, this is generally viewed as a desirable factor since it enables us to overcome labor shortages in limited areas or specific industries. It also tends to decrease frictional unemployment. However, those employees who move from job to job have had difficulty in earning vested retirement benefits, and even where these benefits are earned, they have faced difficulties in collecting the benefits upon retirement.

Your committee understands that, upon retirement, employees who frequently changed employment during their working years may have difficult problems in locating their former employers and the retirement plans in which they may have vested benefits. At times, this results from their former employers (or the plans) having changed name or address, or having merged with other organizations. At other times, the employees themselves may not have been able to maintain the records needed to enable them to contact their former employers. Alternatively, they may have forgotten that they had vested rights in plans with former employers.

To resolve this problem, the bill provides that the Social Security Administration is to maintain records of the retirement plans in which individuals have vested benefits, and is to provide this information to plan beneficiaries.[1]

[1] The bill also provides for a tax-free transfer of funds between a qualified plan and individual retirement accounts, which should meet any additional need for "portability".

[157] *Explanation of provisions*

Under the bill, the administrator of every funded plan of deferred compensation is to file an annual statement with the Secretary of the Treasury regarding individuals who have a right to a deferred vested benefit under the plan and who, during the year, separated from service covered by the plan. The Secretary of the Treasury is to provide this information to the Secretary of Health, Education, and Welfare; in this way it is contemplated that the plan administrator can file this statement together with other annual returns for the plan filed with the Secretary of the Treasury. (It is also contemplated that similar registration requirements will be established under the Labor Department. Consequently, to avoid the problem of duplicate reports, the bill provides that regulations issued by the Secretary of the Treasury respecting this provision will not be effective for plan years beginning after 1975. Your committee expects that the Secretary of the Treasury also will approve regulations issued by the Secretary of Labor.)

The annual statement is to include the name of the plan, the name and address of the plan administrator, and the name and taxpayer identifying number (generally the Social Security number) of every individual who has separated from service covered by the plan in the plan year for which the statement is filed and who is entitled to a deferred vested benefit under the plan. The statement also is to include information on the nature, amount and form of the individual's deferred vested benefit as of the time he left employment. In addition, the statement is to include other information required by the Secretary of the Treasury. However, the statement need not include information about persons who separated from service if they were paid retirement benefits, such as annuities, from the plan during the year of separation. In addition, each covered plan is to notify the Secretary of the Treasury of any change of name of the plan or change of name or address of the plan administrator, any plan termination, or any plan division or merger or consolidation with any other plan.

The plan administrator also is to furnish each individual included in the annual registration statement with the information in that statement regarding his plan rights. In addition, the plan administrator is to furnish satisfactory evidence to the Secretary of the Treasury, upon filing the annual registration statement, that he has furnished individual plan participants with a statement of their rights under the plan. It is expected that a declaration under penalty of perjury of delivery or mailing to each named individual will ordinarily be sufficient evidence.

With respect to multiemployer plans, it may be difficult for plan administrators to determine when a plan participant has separated from service. Consequently, the Secretary of the Treasury is to establish regulations providing for annual registration statements by multiemployer plans.

Upon the request of the plan participant (and in accordance with regulations), the Social Security Administration will furnish him any information which it has relating to his vested retirement plan benefits. In addition, when a person applies for Social Security retirement, disability, death, or hospital insurance benefits, on determining whether these benefits are due, the Social Security Administration will

[158] also inform the claimant of any information which it has relating to the vested retirement plan benefits of the participant. The Social Security Administration is not to attempt to verify the accuracy of the information it receives with respect to plan rights, nor to determine the present value or status of any plan rights, but is only to report the information that it receives and records.

Your committee understands that the value of plan rights will often change between the time that a report is made and the time a participant (or his beneficiaries) are informed of their rights by the Social Security Administration. However, your committee believes it is important for a plan to go on record as to these rights as of the time of separation from service. Additionally, it is expected that the Social Security Administration will make it quite clear, at the time it informs applicants of their rights, that the information given is what was received from the plan and that changes in rights may have occurred after the time the information was received from the plan.

In order that persons who have left employment with vested rights before the effective date of this provision may benefit from the provision, the bill provides that the Secretary of the Treasury also may, pursuant to regulations, receive reports from covered plans relating to the deferred vested retirement benefits of any plan participant who has terminated his employment with the employer in plan years before the effective date of the provision. These reports would be filed by plan administrators on a voluntary basis. Voluntary reports also may be filed by governmental plans and church plans.

If a plan administrator fails to file the annual registration statement, he is to be subject to a penalty of $1 per day for each participant with respect to whom there has been a failure to file; the maximum penalty is $5,000 per plan year. However, plan administrators will not be subject to the penalty upon failure to file due to reasonable cause. A penalty also is to be imposed on a plan administrator who does not file with respect to changes in plan status. The penalty is to be $1 per day, up to a maximum of $1,000; however, no penalty will be owed if failure to file was due to reasonable cause.

If a plan administrator willfully furnishes a false or fraudulent statement of vested rights to individual participants or willfully fails to furnish the required statement, he will be subject to a penalty of $50 per participant.

Effective date

The provisions of the bill which require an annual registration statement with respect to persons separating from service with vested benefits (and with respect to the certificate of rights furnished to each such person) are to with respect to plan years beginning after December 31, 1975.

2. REQUIREMENTS FOR QUALIFICATION OF TRUSTS BENEFITING OWNER-EMPLOYEES

Under present law (section 401(d) of the code), if a trust provides benefits for employees some or all of whom are owner-employees, the

[159] trust may qualify for tax benefits only if the trustee is a bank.[1] The committee believes that this provision is too restrictive, and that other entities could handle the task as well.

For that reason, the committee bill (section 1022) would permit a "person" other than a bank to be the trustee of such a trust without causing the trust's disqualification. The bank or other person performing as such a trustee must be able to satisfy the Internal Revenue Service that he will hold the trust assets in a manner consistent with the general eligibility requirements for tax qualification. Furthermore, the provision in present law allowing someone (including the employer) other than the trustee or custodian to have authority to control the investments of the plan account, whether by directing the investment policy or by exercising a veto power over investments, is retained under the committee bill.

This provision generally applies to plan years beginning after the date of enactment. However, in case of a plan in existence on the date of enactment, the provision applies to plan years beginning after December 31, 1975.

3. CUSTODIAL ACCOUNTS AND ANNUITIES

Present law permits custodial accounts to qualify for tax benefits as if they were trusts, provided that the custodian is a bank, and provided also that the custodial account meets the requirements that a trust would have to meet for qualification. Furthermore, the custodial account's assets must be invested solely in open-end mutual funds or solely in annuity, endowment, or life insurance contracts (and certain other conditions must be met) (sec. 401(f)(1)).

The committee believes that allowing entities other than banks to be custodians of custodial accounts that might be qualified would enhance competition and open the field to other types of enterprises that wish to engage in it and are suited for it. Accordingly, the committee bill permits a person other than a bank to be custodian of such a custodial account. In addition, in order to permit the participation of the insurance industry, the committee bill allows an annuity contract to be treated as a trust that is eligible for qualification, provided that the annuity contract meets the same requirements a custodial account must meet, just as it treats a custodial account as eligible for qualification. The bank or other person holding the assets of the custodial account or holding the annuity contract must satisfy the Internal Revenue Service that it will hold the assets in a manner consistent with the general eligibility requirements for tax qualification. (For example, any distributions prior to age 59½ to owner-employees would have to be reported to the Internal Revenue Service.)

Just as the bank is treated as the trustee of a qualified custodial account under present law, so also would another entity holding the assets of a qualified custodial account or holding a qualified annuity contract be treated as the trustee under the proposed amendment.

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[1] This subsection of present law, and the proposed amendment, would be inapplicable for trusts created before October 10, 1962, that did not qualify for tax benefits on October 9, 1962. Those trusts would not be entitled to use either a bank or another person as trustee of a trust benefiting owner-employees.

[160] This provision generally applies to plan years beginning after the date of enactment. However, in case of a plan in existence on the date of enactment, the provision applies to plan years beginning after December 31, 1975.

4. SECTION 403(B) ANNUITY PLANS

Under present law, contributions to a section 403(b) plan (a plan funded by employers for the benefit of teachers or employees of tax-exempt organizations) may be invested only in insurance contracts. The committee believes that it would be desirable to provide more flexibility in this area, and, accordingly, the committee bill provides that these contributions may also be placed in qualified custodial accounts if those funds are to be invested in mutual funds. The committee bill, however, would make these custodial accounts subject to certain requirements of the code, such as those pertaining to reporting, unrelated business income, and prohibited transactions.

This provision generally applies to plan years beginning after the date of enactment. However, in case of a plan in existence on the date of enactment, the provision applies to plan years beginning after De-December 31, 1975.

5. REPORTING AND PUBLICATION OF RETURNS

In order that many of the new rules governing qualified plans may be enforced, new reporting and publication requirements are needed.

The bill restates present law by requiring employers (or plan administrators) who establish or maintain deferred compensation plans to file annual information returns. Also, the bill provides that the Secretary of the Treasury may provide reporting requirements with respect to the retirement savings deduction and individual retirement accounts, etc.

The bill opens to public inspection the employer's application for a determination that a plan is qualified and that the trust under the plan is exempt (including papers submitted in support of these applications). Additionally, determination letters issued by the Internal Revenue Service dealing with qualification or exemption of plans and trusts are to be open to public inspection. Annual returns with respect to qualified plans are also to be open to public inspection. However, under the bill information contained in these papers and documents from which the compensation of any participant (or other person) may be ascertained is not to be open to public inspection. (However, all other information in these documents is to be available to the public, including information such as the numbers of individuals covered and not covered in a plan, listed by compensation range.) These rules are to enable plan participants and beneficiaries to obtain the full information needed to enforce their plan rights, pursuant to the new rules established in the bill, and are also to protect the confidentiality of information regarding the financial status of specific individuals.

The bill establishes a penalty for failure to file annual returns; the penalty will be $10 for each day that a return is late, up to a maximum penalty of $5,000 for any one failure to file. However,

[161] this penalty will not be owed if failure to file is shown to be due to reasonable cause. For this purpose, your committee's intent is that a failure to provide material items of information called for on a return be treated as a failure to file a return.

The provisions of the bill making applications, determination letters and other documents open to public inspection are to go into effect for applications filed or documents issued after December 3, 1975. The provisions of the bill requiring annual returns to be filed are to become effective for plan years beginning after the date of enactment. The provisions regarding reporting with respect to individual retirement accounts are to become effective on January 1, 1974.

6. CERTAIN PUERTO RICAN PENSION PLANS

Present law

Under present law a pension trust, to be a qualified trust under section 401 of the code, must be created or organized in the United States. Thus, a Puerto Rican pension trust which qualifies for tax exemption under the laws of Puerto Rico (13 L.P.R.A. § 3165) is not exempt from U.S. tax on its income from U.S. sources.

General reasons for change

Puerto Rican pension trusts which satisfy the requirements of the Puerto Rican tax law are unable to diversify their portfolio by investing in U.S. securities without paying U.S. income tax on the income derived from such investments since they are not able to qualify for exemption under the U.S. tax law. On the other hand, since the requirements for qualification under U.S. and Puerto Rican law are roughly comparable, a Puerto Rican pension plan is able today to establish a trust in the United States which satisfies both the U.S. and the Puerto Rican tax provisions. Since the Puerto Rican Government has established requirements in its tax law for when a trust forming part of a pension plan for participants who are residents of the Commonwealth of Puerto Rico is entitled to be treated as a qualified trust, your committee believes it is appropriate to eliminate the distinction under U.S. law as to the place of organization or creation of a trust entitled to be qualified under U.S. law, if that trust is created or organized in Puerto Rico and if the trust has satisfied the requirements for qualification under the Puerto Rican tax laws.

Explanation of provision

Your committee's bill provides that for purposes of exemption from U.S. tax under section 501(a) of the code, a trust which is part of a pension, profit-sharing, or stock bonus plan all of the participants of which are residents of the Commonwealth of Puerto Rico is to be treated as an organization described in section 401(a) of the code, if the trust forming part of the plan is exempt from income taxes (13 L.P.R.A. § 3165) under the laws of the Commonwealth of Puerto Rico.

Effective date

The provision is to be effective for taxable years beginning after December 31, 1973.

[162] 7. DEDUCTION FOR CERTAIN EMPLOYER CONTRIBUTIONS FOR SEVERANCE PAYMENTS REQUIRED BY FOREIGN LAW

Present law

Under present law contributions to a nonqualified trust are deductible (sec. 404(a)(5)) in the year in which an amount attributable to the contribution is included in the gross income of the participant, but in the case of a plan in which there is more than one participant only if separate accounts are maintained under the plan for each participant. Generally, amounts attributable to the contribution under such a plan would be includable in a participant's income in the taxable year that the participant's rights become nonforfeitable

General reasons for change

The laws of a number of foreign countries require an employer who is engaged in a trade or business in that country to make payments to its employees at the time the employee separates from the service of the employer. This type of requirement of foreign law generally results in a plan which is in the form of a defined benefit plan and for which separate accounts are not maintained for the participants. The requirement of separate accounts for the participants as a condition of deductibility is generally necessary for employees who are subject to U.S. taxes in order that separate accounting is maintained for the amount that is required to be included in the employee's gross income.

In the case of employees who are nonresident alien employees of the employer employed in a trade or business in a foreign country, their gross income from their employment is from sources outside the United States and is not subject to U.S. tax. Accordingly, your committee has decided that the requirement of separate accounts is an unnecessary requirement in the case of nonresident alien employees who are employed in a trade or business receiving benefits required by

Explanation of provision

Your committee's bill provides that for taxable years beginning after December 31, 1973, an employer in determining for purposes of section 404(a)(5) the taxable year in which any contribution is includable in the gross income of nonresident alien employees of such employer, paragraph (5) of section 404(a) is to be applied as not requiring that separate acounts be maintained for the nonresident alien employees if three conditions are satisfied. First, the employer is engaged in trade or business in a foreign country. Second, with respect to that trade or business, the employer is required by the laws of that foreign country to make payments, based on periods of service, to its employees or their beneficiaries after the employee's death, retirement, or other separation from service. Third, the employer establishes a trust (whether organized within or outside the United States) for the purpose of funding the payments required by the foreign law. A nonresident alien individual is treated for this purpose as including an amount in gross income, even if the income is from sources outside the United States and is not subject to U.S. tax.

Effective date

This provision is to be effective for taxable years beginning after December 31, 1973.

Under present law, the Civil Service Retirement System and most employee retirement plans of State and local governments are qualified under the Code. It appears, however, that many governmental plans, including the Federal plan, may be unable to meet the new participation, vesting, and funding standards that would be contained in the committee bill. The committee bill, therefore, would require the committee to study the extent to which governmental plans in fact do not meet the new standards and to make recommendations as to the extent to which those plans, or some of them, should be required to conform to the new standards.

Although governmental agencies do not pay taxes, and hence would not lose any tax deductions for current employer contributions if their plans should fail to qualify, one consequence of governmental plans' ceasing to qualify would be that the employees covered by those plans would have to take into income benefits funded by employer contributions (including any increments in those benefits) as those benefits vested (become nonforfeitable), rather than later, upon distribution of the benefits. In addition, it appears uncertain whether the trust funds of nonqualifying governmental plans would be taxable on the interest and appreciation earned by the funds.

A certain consequence of a failure of a governmental plan to qualify would be that lump-sum distributions would not be eligible for the special averaging treatment permitted under certain circumstances if such distributions are made from qualified plans. In addition, the exclusion from the gross estate of the value of an annuity receivable by certain beneficiaries to the extent attributable to employer contributions would be lost if the plan were not qualified, and so also would be lost the employee's right to elect to make an annuity a joint and survivor annuity (thus making payments become payable to a beneficiary at or after the employee's death) without thereby incurring gift tax liability.

In general, the committee would seek to determine whether requiring governmental plans to adhere to the new standards (to the extent they do not already do so) would entail unacceptable cost implications to governmental entities. With regard to funding, it has been argued that governmental plans should be exempt from funding standards since the taxing power can be viewed as a practical substitute for these standards. On the other hand, there have also been reports that in the case of a number of governmental units, such generous pension promises have been made, and so little funds have been set aside currently, that the practical likelihood of imposing sufficient taxes to pay those benefits may be open to question.

The committee, in determining whether any governmental plan is adequately funded, would consider the taxing power of the particular governmental unit involved, as well as the new funding standards.

This provision (requiring the described study by the Ways and Means Committee) would take effect upon the date of enactment of the committee bill. The provision calls for the committee's recommendations stemming from the study to be submitted to the House not later than December 31, 1976.

9. RETROACTIVE REMEDIAL CHANGES TO QUALIFIED PLANS

Employers may now retroactively cure defects in employee benefit plans (which do not meet the requirements for tax qualification) by making remedial amendments by the 15th day of the third month after the end of the taxable year of the employer in which a plan is newly established. Retroactive remedial changes however may not be made with respect to plan amendments.

The time allowed for remedial changes may be too short for a plan to be cured to qualify as of the year in which it is established. This occurs because many plans are established at the end of the year and thus only 2½ months are available to cure a plan. Additionally, plan amendments (which may be as significant as newly established plans) may not be retroactively cured. As a result of these limitations, plans may not be qualified, to the detriment of employers and employees.

The bill provides that retroactive remedial amendments may be adopted to cure a plan regardless of whether failure occurs on establishing a new plan or because of an amendment to an existing plan. The bill also extends the time to adopt a retroactive remedial amendment to the time (including extensions) for filing the employer's return for the taxable year for which the plan or amendment was adopted or put into effect, or to a later time designated by the Service. It is expected that the regulations will provide for extension for reasonable cause, such as the filing of a bona fide request for a determination by the Service that a plan or plan amendment is qualified.

This provision is to become effective on the date of enactment.

10. RULES FOR CERTAIN NEGOTIATED PLANS

Present law

Under present law, special rules are provided for contributions paid by an employer to a plan providing welfare and pension benefits if the plan was established before 1954 as a result of an agreement between a union and the Government during a period of Government operation of the major part of the productive facilities of the industry in which the employer is engaged (sec. 404(c)). Under this provision, contributions are not deductible under the deferred compensation provisions of the code but are deductible solely under section 162 as trade or business expenses. Present law also provides that this provision is to have no effect with respect to contributions to a trust on or after any date on which the trust is exempt from tax under section 501(a).

General reasons for change

This provision was enacted in recognition of the special circumstances surrounding the establishment of the United Mine Workers Welfare and Pension Plan Trust, i.e., the fact that the plan was negotiated during a period that the U.S. Government was a party to the agreement establishing the plan and was in control of a substantial number of the coal mines in the country.

It has been called to the committee's attention that changes in the coal mining industry and in the administration of the welfare and

[165] pension trust have made it desirable to establish two separate trusts—one for the payment of welfare benefits and the second for the payment of retirement benefits. Your committee believes that this is a desirable objective and that the pension trust should be allowed to satisfy the requirements for qualification of pension plans in order to obtain the favorable tax benefits associated therewith. Of course, the plan would also have to meet the standards relating to coverage, vesting and funding provided in this bill.

Your committee is aware that a number of recent court cases have required the coverage and payment of pension benefits to individuals whose participation in a qualified pension plan would cause the pension plan to be disqualified. Accordingly, your committee believes that rules should be provided so that the pension plan may qualify without forcing the plan administrator to relitigate issues which have been resolved by the courts.

Explanation of provision

In order to facilitate the restructuring of the welfare and pension plan into two separate plans, your committee's bill provides special rules in the case of any individual who, before July 1, 1974, was a participant in the United Mine Workers Plan. First, an individual who was self-employed (within the meaning of sec. 401(c)(1)) such as a coal hauler is to be treated with respect to his service under the plan as not a self-employed individual but as an employee of a participating employer under the plan. This provision will enable the plan to meet the requirement of being a plan of an employer for the exclusive benefit of his employees with respect to certain self-employed individuals who have traditionally been covered under the plan. Second, in order to be certain that the self-employed individuals covered under the plan do not establish separate H.R. 10 plans on their own behalf, the bill provides that earnings derived from service covered by the plan are not to be treated as being earned income (within the meaning of sec. 401(c)(2)). Third, an individual who was a participant before July 1, 1974, is to be treated as an employee of a participating employer under the plan for service covered under the plan before July 1, 1975. This provision is designed to enable non-participating employers whose employees were covered under the plan to agree to become participating employers and thus maintain coverage for their employees. Of course, individuals who retire prior to July 1, 1975, are to be treated as if they were employed by a participating employer even though the employer does not agree to become a participating employer or if the employer is no longer in existence.

The bill further provides that section 277 (relating to deductions incurred by certain membership organizations in transactions with members) is not to apply to any trust described in section 404(c). This provision is added to enable the welfare trust to pay benefits to members and deduct the payments from any investment income it may have. Since questions have been raised as to the scope of section 277, your committee concluded that it could not wait until resolution of this issue because it is felt that there is great urgency for the Mine Workers to make the desired changes in their Welfare and Pension Plan. Your committee's decision is not to be construed as any indication as to the

[166] scope of section 277 and its applicability to other non-exempt trusts which may be paying similar types of benefits to its members. Similarly, it is not to be construed to furnish any indication regarding the applicability of section 277 to the United Mine Workers plan prior to the effective date of the new provision. Instead, this decision should be viewed as a further attempt to effectuate the policy which led the Congress to enact section 404(c).

Since the desire of the United Mine Workers is to establish the pension plan as a qualified plan under section 401(a), the bill provides that section 404(c) is not to apply to the pension plan once it becomes a qualified plan except for the purpose of determining which individuals are to be treated as employees of a participating employer under the plan.

Effective date

The amendments made by this section of the bill are to apply to taxable years ending on or after June 30, 1972.

V. EFFECT ON REVENUES OF THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

In compliance with clause 7 of rule XIII of the Rules of the House of Representatives, the following statement is made relative to the effect on revenues of this bill. Apart from the revenue effect of the minimum vesting and funding provisions, the bill is expected to decrease revenues by about $460 million a year after the provisions become fully effective (approximately 3 years in the future) but at 1973 levels of income. The new minimum vesting standards could involve a revenue loss of possibly as much as $265 million a year after 1975 but probably the revenue loss will be only about half this amount. Data are not available which would make a reliable estimate as to the revenue impact of the new minimum funding requirements. It is believed, however, that the revenue effect in this case will be relatively modest. The Treasury Department agrees with this statement.

In compliance with clause 27(b) of rule XI of the Rules of the House of Representatives, the following statement is made relative to the vote by the committee on the motion to report the bill. The bill was ordered reported by a voice vote.

VI. SUPPLEMENTAL VIEWS OF HON. JAMES C. CORMAN AND HON. SAM GIBBONS

We share the hope and expectation of the other Ways and Means Committee members that H.R. 12481 will provide real protection for the pension rights of working Americans. Further, we hope this bill will place some limits on the amount of money which can be set aside for retirement, with special tax treatment, by high-income persons.

However, we would be remiss if we did not point out that this legislation is by no means the final answer to the vast array of issues relating to the pension system. In fact, there is a great and pressing need

[167] for further action in such areas as these: (1) placing additional limits on the use of pension and profit-sharing plans as tax shelters, and (2) reassessing the relation of the social security system to the private pension system and the costs and benefits of the Government roles in each one.

COSTS AND BENEFITS

Each year the Federal Government loses about $4 billion in tax revenues because of the special tax treatment which is allowed for pension, profit sharing, and related plans designed to provide Americans with retirement benefits.

These tax benefits are intended basically to induce corporations, including professional organizations, and other businesses to set up retirement plans for their employees.

However, Mr. Frederic Hickman, Assistant Secretary of the Treasury for Tax Policy, admits that pension and profit-sharing plans have in fact become "the quintessential tax shelter." He calculates that the upper 8 percent of workers (including executives) receive 50 percent of the tax benefits involved, while the bottom 50 percent of wage earners receive only 6 percent of the benefits.

Mr. Hickman also indicates that the tax shelter features of these retirement plans are particularly valuable to higher income persons, who would normally pay high rates of income tax.

Following is a chart (chart 1) that indicates how important tax benefits are in the formation of a pension.

CHART 1

Tax Subsidy Element in Pensions
(ALL IN CONSTANT DOLLARS)

IF THE EMPLOYER CONTRIBUTES 15% OF SALARY

	EXECUTIVE		EMPLOYEE	
	WITH TAX BENEFITS	WITHOUT TAX BENEFITS	WITH TAX BENEFITS	WITHOUT TAX BENEFITS
STARTING TAXABLE SALARY	$ 30,000	$ 34,500	$ 10,000	$ 11,500
ENDING TAXABLE SALARY	100,000	115,000	18,000	20,700
AFTER-TAX PENSION	25,990	12,312	8,005	5,765
"TAX SUBSIDY"	53%		28%	

Assumptions: Participation age 35 to age 65; 6% interest; 2½% inflation; joint returns; executive has outside income equal to deductions.

Prepared by the Treasury Department.

[168] Obviously, the $4 billion a year which is lost in pension-related tax breaks must be made up by increased tax burdens on other taxpayers. It should also be noted that the coverage of pension plans extends to only something like 42 percent of the private, nonfarm work force, so that many workers receive no benefit at all from these tax losses to the Government.

It's clear that one of the greatest reasons for excessive executive salaries is the tax avoidance which can be managed by earmarking large portions of these salaries for pension or profit-sharing plans. With some executive salaries hovering at the $100,000 to $300,000 level, it's easy to see why these executives put up such a strong resistance to any limitation on tax deductible contributions to their pension funds.

This is an area ripe for immedate remedy.

There is absolutely no justification for as generous a limit on these tax deductible contributions as is contained in H.R. 12481. No candidate for public office could possibly defend the U.S. Government for subsidizing a $75,000 a year pension for corporate executives, and we certainly should not be enacting laws that we cannot defend in public.

Unfortunately, a motion to reduce this limitation to the still-generous sum of $60,000 a year lost in committee on a rollcall vote of 14 nays to 9 yeas.

Another effect of our special tax treatment of retirement plans is to create a huge reserve of investment assets which operate outside of our tax system. The book value of these assets was $154 billion in 1972. By 1980, their value is expected to increase to $225 billion. The implications of this fact for our economy, especially for our stock market and our capital markets, should not be taken lightly.

It is essential that we monitor the effects of H.R. 12481, including the results of our tax incentives to pension plans, very closely. Careful analysis of the costs and benefits of this legislation is needed if we are to be able to judge the prudence of our efforts in this area. Also, we should be especially sensitive to any Federal measures which may prove unduly hard on small businesses or may further aggravate the trend toward bigness and concentration in our economy.

In addition, if we are to continue to use our tax system to subsidize private pension benefits, we'll need a lot more progress in distributing the tax benefits involved more equitably among all workers.

It is claimed that the new individual retirement account provided for in this bill will advance us toward this goal. This new creation should be watched very carefully to see whether it will in fact benefit low- and middle-income workers without pension plan protection—or whether it will become another tax shelter for those with high incomes who are well able to provide for their retirement without any additional help from the Federal Government.

[169] We look forward to further consideration of the tax issues relating to pension reform when the committee takes up tax issues in the near future.

THE ROLE OF SOCIAL SECURITY

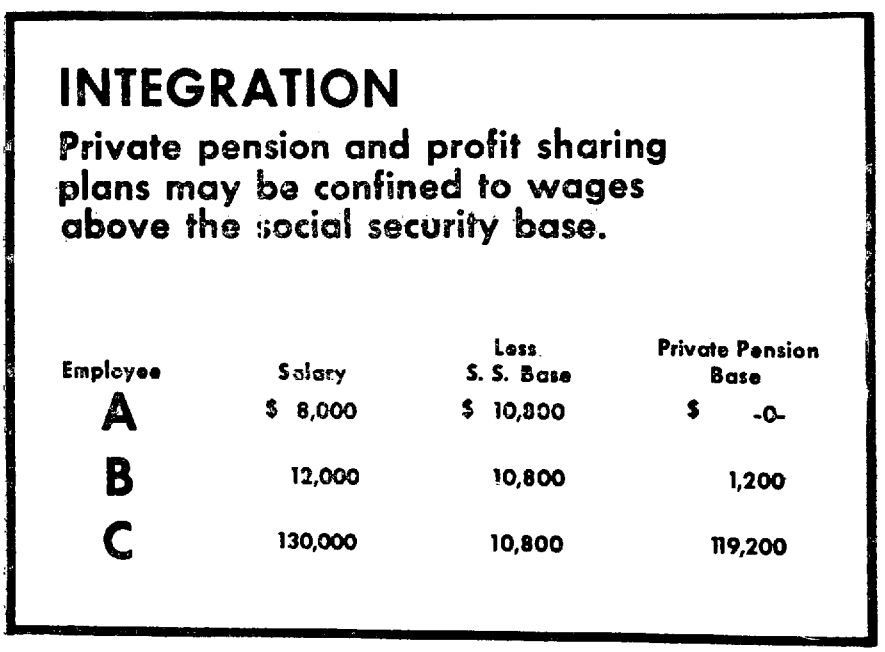
It became clear during the committee's consideration of H.R. 12481 that sufficient thought had not been given to the respective roles that will be played in the future by the social security and the private pension systems in providing retirement income security for working Americans. This is a general problem in that further decisions are going to have to be made on how Federal tax dollars, or tax benefits, can best be used for this purpose, if they are to be so used.

The committee did not take action on the thorny issue of "integration," but instead postponed further consideration of the problems of fairness which are involved until social security issues are taken up later in the year. It cannot be stressed too strongly that remedial action is needed in this area.

Integration is a particularly disturbing equity problem. Often involved are the attempts of those in charge of pension plans to exclude from the coverage of these plans those who earn less than the social security wage base—which is now $13,200 a year.

Chart 2 illustrates how integration can be used to eliminate or drastically reduce the private pension base for lower paid employees.

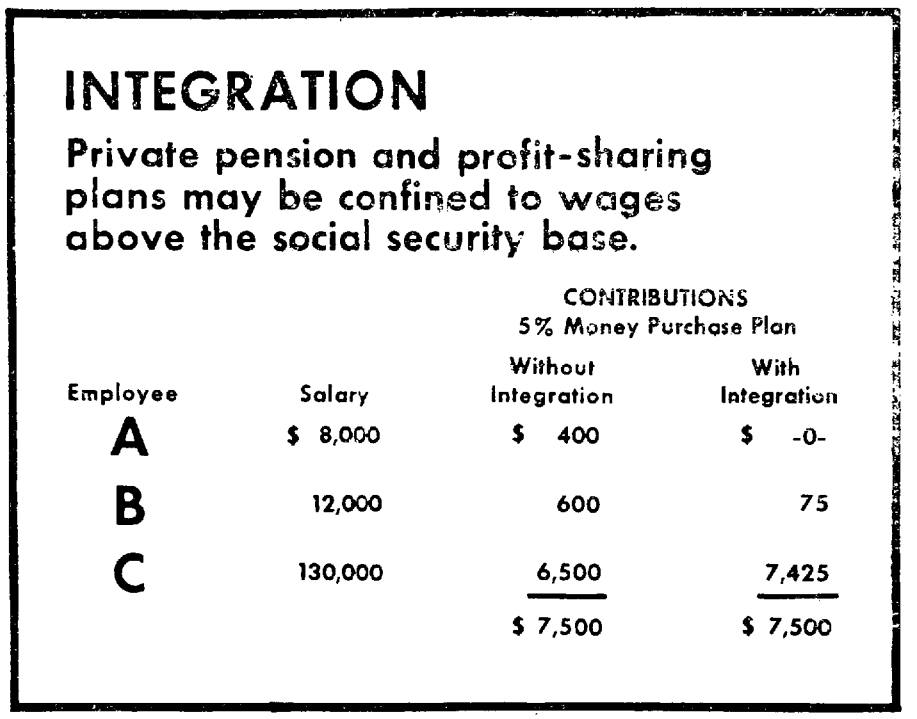
CHART 2



Prepared by the Treasury Department. (*1973 social security wage base was used.*)

[170] Chart 3 shows how integration affects the amount of employer contributions to a pension plan.

CHART 3



Prepared by the Treasury Department (December 1973).

Admittedly, the social security system provides basic retirement benefits for American workers. However, well over half of the work force makes less than $13,200 a year. If the purpose of our special tax benefits for pension plans is to induce businesses to operate pension plans for the benefit of their employees, is it appropriate to provide these full generous tax benefits to those who exclude their lowest paid employees from the protection of their pension plans—while reaping the tax benefits involved for themselves?

Should taxpayers be called upon to finance increased social security benefits to keep up with inflation and also be made to bear the tax loss which results from our special tax treatment for such "integrated" pension plans?

Studies by the Joint Economic Committee have shown that it is sometimes the person who pays the least in social security taxes who gets the most favorable treatment under present social security formulas. In view of this double inequity, it is time that Congress stopped letting the Internal Revenue Service regulate "integration" and made a thorough investigation of the problem. We look forward to early action by the Ways and Means Committee on this.

JAMES C. CORMAN.
SAM M. GIBBONS.

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Conference Report No. 93-1280

2nd Session

[Bracketed numerals indicate official report page numbers.]

EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

AUGUST 12, 1974.

Mr. PERKINS, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 2]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2) to provide for pension reform, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SHORT TITLE AND TABLE OF CONTENTS

SECTION 1. This Act may be cited as the "Employee Retirement Income Security Act of 1974".

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* * * * *

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JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 2) to provide for pension reform, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate struck out all of the House bill after the enacting clause and inserted a substitute amendment. The conference has agreed to a substitute for both the Senate amendment and the House bill. The statement following the table of contents explains the principal differences between the substitute agreed to in conference and the House and Senate bills.

[255] I. Reporting and Disclosure (Secs. 101–111 of the Bill)

The House bill requires annual reporting of detailed financial and actuarial data and comprehensive plan descriptions to the Secretary of Labor, and disclosure of more limited data to the participants. The financial and actuarial data filed with the Secretary of Labor are required to be in the form of a conventional audited financial statement prepared by a qualified accountant and a certified actuarial statement prepared by an enrolled actuary.

The Senate bill requires submission of comparable financial and actuarial data and plan descriptions to both the Secretary of Labor and participants. Like the House bill, actuarial data is required to be certified by an enrolled actuary. Unlike the House bill, all reports were required to be submitted on forms promulgated by the Secretary. The conference substitute is described below. In general, the substitute combines the rules of both the House and Senate bill.

The conference substitute adopts the reporting format contained in both the House and Senate bills. Each plan (unless exempted) is to be required to report annually to the Secretary of Labor certain financial and actuarial data. In addition to these reports, each plan will be required to have prepared an audited financial statement and defined benefit plans must have a certified actuarial report. Special reports are also required at the time of plan terminations.

The Secretary of Labor is given the authority to prescribe forms for reports to him (other than the audited financial statement and certified actuarial report) paralleling similar authority already available to the Secretary of Treasury. The two Secretaries are to unify, to the extent feasible, the reports made to them and it is expected that all of the material subject to the form authority of either Secretary, comprising the annual reports to be made by a plan, can and should be reported on a single form.

Plans subject to the provisions and exemptions

Under the conference substitute, the new reporting and disclosure requirements are to be administered by the Secretary of Labor and are to be applied to all pension and welfare plans established or maintained by an employer or employee organization engaged in, or affecting, interstate commerce. Governmental plans, certain church plans, workmen's compensation and unemployment compensation plans, plans maintained outside the United States for the benefit of persons substantially all of whom are nonresident aliens, and so-called excess benefit plans, which provide benefits in addition to those for which

[256] deductions may be taken under the tax laws, are exempted from the requirements. The Secretary of Labor also is authorized to waive and modify certain of these requirements for employee benefit plans.

All plans of the types subject to the reporting and disclosure provisions are to be required to file an annual report with the Secretary of Labor regardless of the number of participants involved. However, simplified reports may be authorized for plans with fewer than 100 participants.

Contents of annual report

The annual report generally is to include audited financial statements for both welfare plans and pension plans. With respect to welfare plans the statement is to include a statement of assets and liabilities, a statement of changes in fund balance, and a statement of changes in financial position. With respect to employee pension plans the statement is to include a statement of assets and liabilities and a statement of changes in net assets available for plan benefits, including details as to revenues and expenses and other changes aggregated by general source and application.

In the notes to the annual financial statement, the accountant is to disclose any significant changes in the plan, material lease commitments and contingent liabilities, any agreements and transactions with persons known to be parties-in-interest, information as to whether a tax ruling or determination letter has been obtained, and any other relevant matters necessary to fairly present the financial status of the plan. In addition, in the case of employee pension plans the notes should also deal with funding policy (including policy with respect to prior service costs and changes in such policies during the year). An accountant may rely on the correctness of any actuarial matter certified by any enrolled actuary if the accountant indicates his reliance on such certification.

In addition to the audited financial statement, the annual report is to include for all employee benefit plans a statement on separate schedules showing among other things, a statement of plan assets and liabilities aggregated by categories, a statement of receipts and disbursements, a schedule of all assets held for investment purposes aggregated and identified by issuer, borrower, or lessee and a schedule of each transaction involving a person known to be a party-in-interest. Also, a schedule of all loans and leases in default at the end of the year or which are classified during the year as uncollectible is to be included in the annual report.

There is also to be supplied with the annual report a schedule listing each transaction which exceeds 3 percent of the value of the fund. If some or all of the assets of a plan are held in a common or collective trust maintained by a bank or similar institution the annual report is to include the most recent annual statement of assets and liabilities of the common or collective trust. (The Secretary of Labor will have authority to prescribe for the filing of a master copy of the annual

[257] statement of this common or collective trust in order to avoid duplicative filings of this statement by plans participating in this common or collective trust.)

With respect to persons employed by the plan the annual report is to include the name and address of each fiduciary, the name of each person who receives more than minimal compensation from the plan for services rendered, along with the amount of compensation (or who performs duties which are not ministerial), the nature of the services, and the relationship to the employer or any other party in interest to the plan. Also, the reasons for any changes in trustees, accountant, actuary, investment manager, or administrator are to be provided in the annual report.

As indicated in the discussion of the funding provisions, under the conference agreement, the annual report is to include an actuarial statement for all pension plans which are subject to the funding requirements of title I. If plan benefits are purchased from, and guaranteed by, an insurance company, the annual report is to include the premiums paid, benefits paid, charges for administrative expenses, commissions and other information. The insurance carrier is to certify to the plan administrator the information needed to comply with the annual reporting requirements within 120 days after the close of the plan year, or within such other period as is prescribed by the Secretary of Labor.

The annual report for a plan is to be filed within 210 days after the close of the plan year or within such period of time as the Secretary of Labor may require in order to reduce the necessity for duplicate filing with the Internal Revenue Service. The Secretary of Labor may reject the filing of an annual report if he finds that it is incomplete or there is a material qualification in the accountant's or actuary's opinion. If a revised report is not submitted within 45 days after rejection, the Secretary may retain an accountant to perform an audit, or retain an actuary, whichever is appropriate, or bring a civil action for legal or equitable relief. The plan is to bear the costs of any expenses of an audit or actuarial report.

Accountant and actuary reports

Every plan is to retain on behalf of its participants an independent qualified public accountant who annually is to prepare an audited financial statement of the plan's operations. The accountant is to give an opinion as to whether the financial statements of the plan conform with generally accepted accounting principles and the statement is to be based upon an examination in accordance with generally accepted auditing standards. An accountant's opinion is not to be required for statements prepared by banks or similar institutions or an insurance carrier if the statements of the bank or insurance carrier are certified by the bank and are made part of an annual report. For purposes of this provision a qualified public accountant includes certified public accountants, licensed public accountants and any person certified by

[258] the Secretary as a qualified public accountant in accordance with regulations published by him for a person who practices in a State where there is no certification or licensing procedure for accountants. Further, to the extent a plan is not required to make an annual report to the Secretary of Labor an annual audit is not required (and an independent, qualified public accountant need not be retained). Also the Secretary of Labor may waive the requirement of an audited financial statement in cases where simplified annual reports are permitted to be filed.

Every plan subject to the funding requirements of title I must retain an enrolled actuary who is to prepare an actuarial statement on an annual basis. This statement is to show the present value of all plan liabilities for nonforfeitable pension benefits allocated by the termination priority categories. The actuary is to supply a statement to be filed with the annual report as to his opinion as to whether the actuarial statements of the plan are reasonably related to the experience of the plan and to the reasonable expectations of the plan. The actuary is to use assumptions and techniques as are necessary to form an opinion as to whether the contents of the matters upon which he reports are in the aggregate reasonably related to the experience of the plan and to reasonable expectations, and represent his best estimate of anticipated experience under the plan. The actuarial statement is not required for plans which need not file annual reports, and may be waived by the Secretary of Labor for plans for which simplified annual reports are allowed.

Reports on termination

In addition to the annual reports which must be filed with the Secretary of Labor, special terminal reports are required to be filed for pension plans that are winding up their affairs. These terminal reports may also be required by the Secretary of Labor for welfare plans. Also in the year a plan is terminated the Secretary may require the supplementary information to be filed with the annual report.

Disclosure to participants

Each administrator of an employee benefit plan is to furnish to each participant and to each beneficiary a summary plan description written in a manner calculated to be understood by the average plan participant or beneficiary. The summary is to include important plan provisions, names and addresses of persons responsible for plan investment or management, a description of benefits, the circumstances that may result in disqualification or ineligibility and the procedures to be followed in presenting claims for benefits under the plan.

Summary plan descriptions are to be furnished to participants within the later of 120 days after the plan is established or 90 days after an individual becomes a participant. Updated plan descriptions are also to be provided to participants every five years thereafter where there have been plan amendments in the interim; in any case, a

[259] new description is to be is to be provided every ten years. Also, participants are to receive descriptions of material changes in a plan within 210 days after the end of any plan year in which a material change occurs. Also, the annual report and plan documents are to be available for examination by participants or beneficiaries at the principal office of the plan administrator and such other places as is necessary to provide reasonable access to these reports and documents. Thus, if the participants covered under the plan are employed in more than one geographic area, each geographic area is to have available for examination the required documents. Each participant is also to be furnished a copy within 210 days after the close of the plan year of the schedule of plan assets and liabilities and receipts and disbursements as submitted with the annual report, including any other material which is necessary to thoroughly summarize the latest annual report. Upon a written request, a plan administrator is to furnish a participant or beneficiary a complete copy of the comprehensive plan description, the latest annual report and other instruments under which the plan is established and operated. The plan administrator may charge a reasonable amount for fulfilling such a request.

Upon the request of a plan participant or beneficiary, a plan administrator is to furnish on the basis of the latest available information the total benefits accrued and the nonforfeitable pension benefit rights, if any, which have accrued. No more than one request may be made by any participant or beneficiary for this information during any one 12-month period.

A copy of the statement of the deferred vested benefits in the plan for individuals who have terminated employment during a plan year which is furnished to the Social Security Administration also is to be furnished to the individual participant.

Reports made public information

The contents of the descriptions of plans and reports filed with the Secretary of Labor are to be public information and are to be available for inspection in the Department of Labor. In addition, the Secretary of Labor may use the information and data for statistical and research purposes and for the compiling and publishing of studies as he may deem appropriate. However, information with respect to a plan participant's accrued benefits and nonforfeitable pension rights is to be disclosed only to the extent that information respecting a participant's benefits for old age retirement insurance may be disclosed under the Social Security Act.

Forms to be provided

The Secretary of Labor may require that any information required to be filed with the Labor Department, including statements and schedules attached to the annual report, must be submitted on forms that he may prescribe. The financial statement prepared by the independent qualified accountant and the actuarial statement prepared by the enrolled actuary and the summary of the plan description are not re-

[260] quired to be submitted on forms. However, the Secretary may prescribe the format and content of the accountant's and actuary's statements and of the summary plan description, the summary annual report, and other statements or reports required under title I to be furnished or made available to participants and beneficiaries.

Effective dates

The conference agreement provides that the reporting and disclosure provisions generally are to take effect on January 1, 1975. However, in the case of a fiscal year plan year which begins before January 1, 1975, and ends after December 31, 1974, the Secretary of Labor may by regulation postpone the effective date until the beginning of the first plan year of the plan which begins after January 1, 1975.

II. Participation and Coverage (Secs. 201, 202, and 1011 of the Bill and Secs. 401 and 410 of the Internal Revenue Code)

The House bill provides that an employee cannot be excluded from a plan on account of age or service if the employee is at least 25 years old and has had at least one year of service, or, if he has three years of service, the employee cannot be excluded even though he is not yet 25. The 1-year service requirement (for employees 25 and older) may be extended to 3 years if the plan provides full and immediate vesting for all participants. Under the Senate amendment, an employee cannot be excluded on account of age or service if he has attained age 30 with 1 year of service.

The conference substitute is described below. In general, the substitute follows the rules of the House bill in this area with respect to technical matters.

Plans subject to the provisions

Under title I of the conference substitute (the labor law provisions) the new participation and coverage rules are to be enforced by the Secretary of Labor when participants bring violations to his attention or when cases come to his attention which initially were under consideration by the Secretary of Treasury on which he has previously initiated action. The rules are to apply to employee pension benefit plans of employers or employee organizations established in or affecting interstate commerce. Under this title II (the tax law provisions), the participation and coverage rules are to be administered by the Secretary of the Treasury or his delegate, and the rules apply to tax-qualified pension, profit-sharing, and stock bonus plans.[1]

Exceptions to coverage

The participation and coverage requirements of title I (the labor law provisions) do not apply to governmental plans (including Railroad

[1] The division of administrative responsibility between Labor and Treasury is discussed in Part XII, below "General Provisions Relating to Jurisdiction, Administration, Enforcement: Joint Pension Task Force, Etc." Except where otherwise noted, the regulations with respect to participation, vesting and funding are to be written by the Secretary of the Treasury or his delegate.

[261] Retirement Act plans), church plans (except those electing coverage), plans maintained solely to comply with workmen's unemployment, disability, or compensation laws, plans maintained outside the United States primarily for the benefit of nonresident aliens, employee welfare plans, excess plans (which provide for benefits or contributions in excess of those allowable for tax-qualified plans), unfunded deferred compensation arrangements, plans established by labor organizations (those referred to in sec. 501(c)(5) of the Internal Revenue Code) which do not provide for employer contributions after the date of enactment, and fraternal or other plans of organizations (described in sec. 501(c)(8), 501(c)(9)) which do not receive employer contributions, or trusts described in 501(c)(18) of the Internal Revenue Code. Title I does not apply to buy-out agreements involving retiring or deceased partners (under sec. 736 of the Internal Revenue Code). In addition, title I does not apply to employer or union-sponsored individual retirement accounts (see "Employee Savings for Retirement").

The participation requirements of title II apply only to plans which qualify for certain tax deferral privileges by meeting the standards as to participation and other matters set forth in the Internal Revenue laws. However, governmental plans and church plans which do not elect to come under the new provisions will nevertheless be treated as qualified for purposes of the tax deferral privileges for the employees, if they meet the requirements of present law. Also the rules do not apply to plans of labor organizations (described in sec. 501(c)(5)) or fraternal or other organizations (described in sec. 501(c)(8) or (9)) which do not provide for employer contributions.

Exemption for church plans

As indicated above, both title I and title II exempt church plans from the participation and coverage requirements of the conference substitute (although title II requires these plans to comply with present law in order to be qualified). This exemption does not apply to a plan which is primarily for the benefit of employees engaged in an unrelated trade or business, or (except as noted below) to a multiemployer plan unless all of the participating employers are churches or conventions or associations of churches (rather than merely church-related agencies). However, a multiemployer plan which was in existence on January 1, 1974, and which covers church-related agencies (such as schools and hospitals) is to be treated as a church plan for purposes of the exemption (even though it continues to cover those agencies) for plan years beginning before January 1, 1983, but not for subsequent plan years.

A church plan may make an irrevocable election to be covered under title I and title II (in a form and manner to be prescribed in regulations). A plan which makes this election is to be covered under the bill for purposes of the new participation, vesting, funding and form of benefit rules, as well as the fiduciary and disclosure rules and will also be covered under the plan termination insurance provisions.

[262] *General rule as to participation*

Generally, under title I and title II of the conference substitute, an employee cannot be excluded from a plan on account of age or service if he is at least 25 years old and has had at least one year of service. However, if the plan provides full and immediate vesting for all participants, it may require employees to be age 25, with 3 years of service, in order to participate. As an alternative, any plan which is maintained exclusively for employees of a governmental or tax-exempt educational organization which provides full and immediate vesting for all participants may have a participation requirement of age 30, with 1 year of service.

Maximum age requirement

Under the conference substitute, in general, a plan may not exclude an employee because he is too old. However, because of cost factors, it was decided that in a defined benefit plan it would be appropriate to permit the exclusion of an employee who is within 5 years of attaining normal retirement age under the plan (or older) when he is first employed. (These employees would be counted as part of the employer's work force, however, for purposes of determining whether or not his plan satisfied the breadth-of-coverage requirements.) Of course, if a plan defines normal retirement age as the later of age 65, or the tenth anniversary of the employee's participation in the plan, the plan could not impose a maximum age requirement (because no employee would be within 5 years of normal retirement age when first employed). A "target benefit" plan, as defined in Treasury regulations, could also impose a maximum age requirement (even though it is not a defined benefit plan), because in many respects the pattern of costs and benefits of target benefit plans closely resembles the pattern of costs and benefits of defined benefit plans.

Year of service defined

Under the conference substitute, in general, for purposes of the participation requirements, the term "year of service" means a 12-month period during which the employee has worked at least 1,000 hours. This 12-month period is measured from the date when the employee enters service. Thus, the employee has fulfilled his 1,000-hour-requirement if he has 1,000 hours of work by the first anniversary date of his employment. Under the substitute, the employee (if age 25 or older) would then be admitted to the plan within 6 months or his anniversary date of employment or by the beginning of the first plan year following his first anniversary date, whichever occurred earlier. (Of course, this does not mean that an employee would have to be admitted to the plan if he were lawfully excluded for reasons other than age or service.)

The plan would not be required to admit the employee if he had "separated from the service" before the otherwise applicable admission date. In general, "separated from the service" means the employee was

[263] discharged or quit; it does not mean temporary absence due to vacation, sickness, strike, seasonal layoff, etc.

If the employee did not complete 1,000 hours of service by his first anniversary date, but is still employed, he would start over toward meeting his 1,000 hour requirement. For this purpose, the plan could provide (on a consistent basis) that the relevant 12-month period is either (a) the year between his first anniversary date and his second anniversary date, or (b) the first plan year which began after the individual was first employed. For example, assume the plan is on a calendar year basis, and that an employee begins work on July 1, 1976. Between July 1, 1976, and June 30, 1977, the employee has less than 1,000 hours of service. The plan could provide that the employee would be tested the second time for purposes of participation based on the year from July 1, 1977 through June 30, 1978, or based on the year from January 1, 1977 through December 31, 1977 (but not January 1, 1978 through December 31, 1978).

The regulations with respect to "year of service" are to be written by the Secretary of Labor for purposes of participation and vesting. The term "hour of service" will also be defined in Labor Department regulations.

For purposes of participation (and vesting), in the case of any maritime industry (as defined in Labor Department regulations), 125 days of service are to be treated as the equivalent of 1,000 hours of service, but this rule will not apply to other industries.

Seasonal and part-time workers

In general, the 1,000 hour standard is to apply for purposes of determining whether or not an employee may be excluded from the plan as a seasonal or part-time employee (replacing the 5-month year, 20-hour week standard now in the Internal Revenue Code). However, in the case of seasonal industries where the customary period of employment is less than 1,000 hours, the term "year of service" is to be determined in accordance with Labor Department regulations.

Breaks in service

Under the conference substitute, a 1-year break in service occurs in any calendar year, plan year, or other consecutive 12-month period designated by the plan on a consistent basis (and not prohibited under Labor Department regulations) in which the employee has 500 hours of service or less.

The general rule is that all service with the employer (pre-break and post-break) is to be taken into account for purposes of determining whether the employee has met the participation requirements. However, if an employee has a 1-year break in service, the plan may require a 1-year waiting period before reentry, at which point the employee's pre-break and post-break service are to be aggregated, and the employee is to receive full credit for the waiting period service. For example, if the plan is on a calendar year basis, and an employee who has a 1-year

[264] break in service reenters employment on November 1, 1976, works 200 hours in 1976, and 1700 hours by November 1, 1977, the employee under this provision would be considered as reentering the plan for 1977. As a result, his pre-break and post-break service would be aggregated, and he would advance one year on the vesting schedule for 1977. He would also accrue benefits for that year. (Other rules with respect to break-in-service are explained below in connection with vesting and benefit accrual.)

In the case of a plan which has a 3-year service requirement for participation (because the plan provides 100 percent immediate vesting), the plan may provide that employees who have a 1-year break in service before completing their 3-year service requirement must start over toward fulfilling that requirement after the break in service.

Eligibility—collective-bargaining units, air pilots

Title II of the conference substitute provides that employees who are under a collective bargaining agreement can be excluded for purposes of the breadth-of-coverage requirements (coverage for 70 percent of all employees or 80 percent of all eligible employees if at least 70 percent of all employees are eligible to benefit under the plan, or coverage on a nondiscriminatory basis), if the employees are excluded from the plan and there is evidence that retirement benefits have been the subject of good-faith bargaining. However, if the union employees are covered under the plan, benefits or contributions must be provided for them on a nondiscriminatory basis.

Title II of the substitute provides another exception to the breadth-of-coverage rule. It provides that air pilots represented in accordance with the Railway Labor Act may bargain separately for tax-qualified employee plan benefits, without including other workers within the industry (but only in the case of a plan which covers no employees other than air pilots). In addition, the conferees intend that the joint congressional pension task force study group, created under this legislation, study this area to see whether a similar rule should be applied to other unions or professional groups in the future.

Nonresident aliens

Title II of the conference substitute provides that employees who are nonresident aliens with no United States income from the employer in question are to be excluded for purposes of applying the breadth-of-coverage requirements and for purposes of applying the antidiscrimination rules (whether or not they are covered under the plan).

Predecessor employer

Service with a predecessor employer must be counted for purposes of the plan if the successor employer continues to maintain the plan of the predecessor employer (and, of course, the successor employer cannot evade this requirement by nominally discontinuing the plan). The question of the extent to which such service must be counted in other circumstances is to be determined under regulations.

[265] *Multiemployer plans*

Under the conference substitute, service with any employer who is a member of a multiemployer plan is to be counted for purposes of the plan. The term "multiemployer plan" means a plan maintained pursuant to a collective bargaining agreement, to which more than one employer is required to contribute, and to which no one employer makes as much as 50 percent of the contributions. (This percentage test would become a 75-percent test once the plan qualifies as a multiemployer plan.) Also, the plan must provide that benefits will be payable to each participant, even though his employer subsequently ceases to make contributions under the plan. However, the plan would not be required to provide past service benefits, i.e., benefits for periods before the participant's employer entered the plan. Also, service during a period for which the employer was not a member of the plan would not be required to be counted for participation or vesting purposes.

Additional requirements relating to multiemployer plans may be prescribed in Department of Labor regulations. The conferees intend that a plan not be classified as a multiemployer plan unless it is a collectively bargained plan to which a substantial number of unaffiliated employers are required to contribute. Also, a plan is not to be classified as a multiemployer plan where there is no substantial business purpose in having a multiemployer plan (except to obtain the advantages of multiemployer plan status under this bill).

In addition to employees of employers making contributions to a multiemployer plan, under the conference substitute such a plan may cover employees of labor unions which negotiated the multiemployer plan and employees of the plan itself. For this purpose, the plan would have to satisfy the general breadth-of-coverage and nondiscrimination requirements of the Internal Revenue Code separately with respect to these union or plan employees and collectively (i.e., with respect to all groups of employees covered under the plan), but would not be required to meet the exclusive benefit rules of the tax law. Instead, the exclusive benefit rules would be applied to the beneficiaries of the multiemployer plan as a whole. (Similar treatment for union employees or plan employees would also be available in the case of a single-employer collectively bargained plan.)

H.R. 10 plans

In general, the provisions of present law which allow a 3-year service requirement for participation (but do not allow the plan to impose an age requirement), and require 100 percent immediate vesting, would continue to govern owner-employee H.R. 10 plans (those for sole proprietors and 10 percent owners and their employees). However, certain provisions of this bill, such as the rules with respect to year of service and breaks in service are also to apply for purposes of the H.R. 10 plans.

[266] *Affiliated employers*

Title II of the conference substitute provides that in applying the breadth-of-coverage and antidiscrimination rules (as well as the vesting rules and the limitations on contributions and benefits), employees of all corporations who are members of a "controlled group of corporations" (within the meaning of sec. 1563(a) of the Internal Revenue Code of 1954) are to be treated as if they were employees of the same corporation. A comparable rule is to be provided in the case of partnerships and proprietorships which are under common control (as determined under regulations). The conferees agree with the interpretation of these provisions, as expressed in the Ways and Means Committee report (No. 93–807).

Effective dates [2]

Under the conference substitute the changes made in the bill with respect to participation and vesting are to apply to new plans in plan years beginning after the date of enactment. For plans in existence on January 1, 1974, the general effective date of these provisions is to be plan years beginning after December 31, 1975.

The general effective date of plan years beginning after December 31, 1975 applies in the case of collectively bargained plans in the same manner as in the case of other plans. However, in order that the opening up of the contract to comply with the requirements of this bill will not require negotiations with respect to other matters, the conference substitute provides that a collective bargaining contract, in existence on January 1, 1974, which does not expire until after the general effective date for existing plans, may be reopened solely for the purpose of allowing the plan to meet the requirements of this bill, without having to be opened for any other purpose. Where it is necessary, as a result of this bill, to modify an employee benefit plan, it is the conferees' understanding that it is not an unfair labor practice under the National Labor Relations Act for a party to a collective bargaining agreement to refuse to bargain regarding matters unrelated to the modification required by this bill, provided this refusal is not otherwise an unfair labor practice. In addition, the changes required to be made in a plan are not themselves to be treated as constituting the expiration of a contract for purposes of any other provisions of this bill which depend on the date of the expiration of a contract.

Finally, the conference substitute provides that if a plan, adopted pursuant to a collective bargaining agreement in effect on January 1, 1974, contains a clause: (1) which provides supplementary benefits which are in the form of a lifetime annuity and refer to not more than one-third of the basic benefit to which the employees generally are entitled; or (2) which provides that a 25-year service employee is to be treated as a 30-year service employee, if that right is granted by

[2] Because of the interrelationship of the effective date provisions for participation and vesting, this discussion deals with the effective dates for both.

[267] a contractual agreement which is based on medical evidence as to the effects of working in an adverse environment for an extended period of time (such as workers in foundries or workers in asbestos plants), then the application of the accrued benefit provision of this bill to those benefits is to be delayed until the expiration of the collective bargaining agreement (but no later than plan years beginning after December 31, 1980). For purposes of applying the effective date rules, the conferees agree with the statements appearing in the paragraph beginning at the bottom of page 51, and in the first full paragraph on page 52 of the Ways and Means Committee report (No. 93–807). This explanation relates to situations where a collective bargaining agreement is to be treated as having terminated, and as to how the effective date rules are to be applied to a plan which includes some employees covered under one or more collective bargaining agreements, and also employees not covered under any such agreement.

An existing plan which would be entitled to a delayed participation vesting, funding, etc. provision is to be permitted to elect to have all those provisions apply sooner. Any such election is to be made under regulations, must apply with respect to all the provisions of the Act, and is to be irrevocable.

III. Vesting and Related Rules (Secs. 203–209, 1012, 1015, 1021, 1022, and 3032 of the Bill, and Secs. 401, 411, and 414 of the Internal Revenue Code.)

Under the House bill a plan was required to meet one of three minimum vesting schedules. First, a plan could provide a graded vesting standard, under which the employee must be at least 25 percent vested in his accrued benefit after 5 years of covered service, with 5 percent additional vesting for each of the next 5 years, and 10 percent additional vesting for each year thereafter (so that the employee was 100 percent vested after 15 years of service). Second, a plan could provide that each employee must be 100 percent vested after 10 years of service. Third, a plan could provide for a "rule of 45," under which each employee with 5 years or more of service would be 50 percent vested when the sum of his age and his years of service equaled 45, with 10 percent additional vesting for each year thereafter.

Under the Senate amendment, plans generally were required to comply with the first of these alternatives, the graded vesting schedule. However, plans which were already using the 10-year/100-percent vesting schedule were permitted to continue to use that method.

The conference substitute is described below.

Plans subject to the provisions; exceptions from coverage; exemption for church plans

The rules in these areas are the same as the corresponding rules discussed above under Participation and Coverage.

[268] *General rules*

Under the conference substitute [1] plans must provide full and immediate vesting in benefits derived from employee contributions.

With respect to employer contributions, the plan (except class year plans) must meet one of three alternative standards. Two of those, the 5- to 15-year graded standard and the 10-year/100-percent standard are the same as provided in the House bill (and briefly described above). The third standard under the conference substitute is a modification of the House-bill "rule of 45". As under the House rule, under the modified rule of 45, an employee with 5 or more years of covered service must be at least 50 percent vested when the sum of his age and years of covered service total 45, and there must be provision for at least 10 percent additional vesting for each year of covered service thereafter. Unlike the House bill, however, each employee with 10 years of covered service (regardless of his age) must be at least 50 percent vested and there must be provision for 10 percent additional vesting for each year of service thereafter.

In addition, all plans would have to meet the requirement of present law that an employee must be 100 percent vested in his accrued benefit when he attains the normal or stated retirement age (or actually retires).

Service credited for vesting purposes

Generally, under the conference substitute, once an employee becomes eligible to participate in a pension plan, all his years of service with an employer (including preparticipation service, and service performed before the effective date of the Act) are to be taken into account for purposes of determining his place on the vesting schedule. However, the plan may ignore periods for which the employee declined to make mandatory contributions, and periods for which the employer did not maintain the plan or a predecessor plan, as defined in Treasury regulations (i.e., if the plan provides past service credits for purposes of benefit accrual, it must also provide past service credits for purposes of participation and vesting).

Generally, the plan may also ignore service performed before age 22; however, if a plan elects to use the rule of 45, service before age 22 may be ignored only if the employee was not a participant in the plan during the years before age 22.

The plan may also exclude part-time or seasonal service (i.e., generally years when the employee had less than 1,000 hours of service).

Also, if the employee has had a "break in service", his service performed prior to the break may be ignored to the extent permitted under the "break in service" rules (discussed below).

[1] Unless otherwise indicated, the rules with respect to vesting appear in both title I and title II of the conference substitute. Unless otherwise indicated, the regulations with respect to vesting are to be written by the Secretary of the Treasury, or his delegate.

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[269] Service performed prior to January 1, 1971, may be ignored by the plan, unless (and until) the employee has at least 3 years of service after December 31, 1970.

Year of service defined

In general, under the conference substitute, the rules with respect to "year of service", seasonal and part-time employees, etc., are the same for purposes of the vesting schedule as they are for purposes of participation (i.e., generally 1,000 hours of service except for seasonal industries, where the customary work year is less than 1,000 hours). However, the relevant year for purposes of applying the vesting schedule may be any 12-month period provided under the plan (plan year, calendar year, etc.) regardless of the anniversary date of the participant's employment (even though the anniversary date is the measuring point for purposes of the participation requirements for an employee's first year).

For purposes of benefit accrual, in general, the plan may use any definition of the term "year of service" which the plan applies on a reasonable and consistent basis (subject to Department of Labor regulations). (Of course, the "year" for benefit accrual purposes cannot exceed the customary work year for the industry involved.) However, the plan must accrue benefits for less than full time service on at least a pro rata basis. For example, if a plan requires 2,000 hours of service for a full benefit accrual (50 weeks of 40 hours each) then the plan would have to accrue at least 75 percent of a full benefit for a participant with 1,500 hours of service. Generally, a plan would not be required to accrue any benefit for years in which the participant had less than 1,000 hours of service. In the case of industries or occupations where the customary year is less than 1,000 hours (for example, the tuna fishing industry, or the winter season employees of a ski lodge), the rules with respect to benefit accrual would be determined under Department of Labor regulations. As previously indicated a special rule is provided for the maritime industries.

Breaks in service

Under the conference substitute, a 1-year break in service occurs in any calendar year, plan year, or other consecutive 12-month period designated by the plan and applied on a consistent basis (and not prohibited under Labor Department regulations) in which the employee has no more than 500 hours of service. For example, if the plan is on a calendar year basis, and the employee works 1,000 hours in 1976, 501 hours in 1977, 501 hours in 1978, and 1,000 hours or more in 1979, the employee would not have a break in service (although the plan would not be required to accrue benefits or give vesting schedule credit for 1977 or 1978).

The rules with respect to breaks in service for vesting and benefit accrual purposes may be summarized as follows:

[270] (1) If an employee has a 1-year break in service, the plan may require (for administrative reasons) a 1-year waiting period before his pre-break and post-break service must be aggregated under the plan. However, once the employee has completed this waiting period, he must receive credit for that year (for purposes of vesting and accrued benefit).

(2) In the case of an individual account plan (including a plan funded solely by individual insurance contracts, as well as a "target benefit plan") if any employee has a 1-year break in service, his vesting percentage in pre-break benefit accruals does not have to be increased as a result of post-break service.

(3) Subject to rules (1) and (2), once an employee has achieved any percentage of vesting, then all of his pre-break and post-break service must be aggregated for all purposes.

(4) For all nonvested employees (and subject to rules (1) and (2)), the employee would not lose credits for pre-break service until his period of absence equaled his years of covered service. Under this "rule of parity" for example, if a nonvested employee had three years of service with the employer, and then had a break in service of 2 years, he could return, and after fulfilling his 1-year reentry requirement, he would have 4 years of covered service, because his pre-break and post-break srevice would be aggregated.[2]

For years beginning prior to the effective date of the vesting provisions, a plan may apply the break-in-service rules provided under the plan, as in effect from time to time. However, no plan amendment made after January 1, 1974, may provide for break-in-service rules which are less beneficial to any employee than the rules in effect under the plan on that date, unless the amendment complies with the break-in-service rules established under this bill.

The principles of some of the rules outlined above may be illustrated as follows: For example, assume a plan is on a calendar year basis, and an employee with a 1-year break in service reenters employment on November 1, 1976, works 200 hours in 1976, and 1,700 hours by November 1, 1977. In this case, the employee would be eligible to reenter the plan on November 1, 1977, his pre-break and post-break service would be aggregated, he would advance one year on the vesting schedule for 1977, and he would also accrue benefits for 1977. On the other hand, if the employee reentered employment on March 1, 1976, worked 1,700 hours before December 31, 1976, and was not separated from service by March 1, 1977, he would be eligible to reenter the plan on March 1, 1977, advance one year on the vesting schedule for his 1976 service, and the plan would have to provide at least a partial benefit accrual for 1976.

Predecessor employer

The rules concerning service with a predecessor employer are the same for purposes of vesting and benefit accrual as the rules for purposes of participation, discussed above.

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[2] Also, in the case of a defined benefit plan, the employee would have at least 3 years of accrued benefits under the plan (2 years of accrued benefits due to his pre-break participation and 1 year of benefits accrued with respect to the 1 year reentry period).

[271] *Multiemployer plans*

Under the conference substitute, service with any employer, for any year in which the employer is a member of the plan, is to be counted for purposes of vesting as if all employers who are parties to the plan were a single employer.

Permitted forfeitures of vested rights

Under the conference substitute, except as outlined below, an employee's rights, once vested, are not to be forfeitable for any reason. An employee's rights to benefits attributable to his own contributions may never be forfeited.

(1) The plan may provide that an employee's vested rights to benefits attributable to employer contributions may be forfeited on account of the employee's death (unless a "joint and survivor" annuity is to be provided).

(2) Also, the plan may provide that payment of benefits attributable to employer contributions may be suspended for any period in which the employee is reemployed by the same employer under whose plan the benefits are being paid (in the case of a single employer plan). In the case of a multiemployer plan, however, a suspension of benefit payments is permitted when the employee is employed in the same industry, in the same trade or craft and also in the same geographical area covered under the contract, as was the case immediately before he retired. Regulations with respect to the suspension of benefits are to be prescribed by the Department of Labor.

(3) A plan amendment may reduce an employee's vested or nonvested accrued benefit attributable to employer contributions, but only for the current year, and only if the amendment is adopted within 2½ months from the close of the plan year in question (without regard to any extensions). In the case of a multiemployer plan, the retroactive amendment may effect the current year, and the two immediately preceding years (thus, a multiemployer plan amendment adopted by December 31, 1978, could effect plan benefits for 1976, if the plan was on a calendar year). However, no plan amendment which reduces accrued benefits is permitted unless the Secretary of Labor has 90 days prior notice of the proposed amendment, and approves it (or fails to disapprove it). No such approval is to be granted, except to prevent substantial economic hardship, including a serious danger that the plan will be terminated unless the amendment is allowed. In addition, it must be found that the economic hardship cannot be overcome by means of a funding variance. Subject to these rules, no plan amendment may retroactively reduce the accrued benefit of any participant (whether or not that benefit is vested).

(4) A plan may provide that an employee's rights to benefits from employer contributions may be forfeited where the employee is less than 50 percent vested in these benefits and withdraws all or any part of his own mandatory contributions to the plan. However, the plan must also provide a "buy back" rule, i.e., that the employee's forfeited benefits will be fully restored if the employee repays the withdrawn contributions (with interest of 5-percent per annum, compounded annually) to the plan.

[272] In the case of a plan which does not provide for mandatory contributions after the date of enactment, the plan may provide, in this case, that the employee will forfeit a proportionate part of his pre-date-of-enactment accrued benefits derived from employer contributions even if he is 50 percent or more vested in these benefits. Also, the plan is not required to have a "buy back" clause with respect to the withdrawal of pre-enactment contributions. Additional regulations in this area are to be prescribed by the Secretary of the Treasury, or his delegate.

(5) A plan may provide for the "cash out" of an employee's accrued benefit. In other words, the plan may pay out, in a lump sum, the entire value of an employee's vested accrued benefit. (However, portability is available to the employee because other provisions of the bill permit the employee to reinvest in an individual retirement account on a tax-sheltered basis.) If the plan does make such a cash-out, then the plan would not be required to vest the employee in his accrued benefits which are not vested at the time he separates from the service, if the employee is later reemployed. (However, the employee's pre-break service would have to be taken into account for all other purposes, subject to the break-in-service rules, e.g., for purposes of his place on the vesting schedule.)

A cash-out could be made from the plan without the employee's consent only if the payment (a) was made due to the termination of the employee's participation in the plan, (b) constituted the value of the employee's entire interest in the plan, and (c) did not exceed an amount (to be prescribed in regulations by the Secretary of the Treasury or his delegate), based on the reasonable administrative needs of the plan, and, in any event, not in excess of $1,750 (with respect to the value of the benefit attributable to the employer's contributions). Despite the foregoing provision, generally, the conferees prefer that all amounts contributed for retirement purposes be retained and used for those purposes. Thus, a plan could provide for no cash-out, or the employee's collective bargaining unit might wish to bargain for such a provision.

A higher cash-out could be made with the employee's consent. However, even these voluntary cash-outs could only be made if the employee terminated his participation in the plan, or under other circumstances to be prescribed in regulations.

Moreover, the plan must provide, in all cases (except where a distribution equal to the value of the full accrued benefit is made), that all accrued benefits must be fully restored (except to the extent provided under the break-in-service rules) if the employee repays the amount of the cash-out, with interest. Repayment of an involuntary cash-out would have to be allowed under the plan at any time after the employee reentered employment under the plan, and repayment of voluntary cash-outs would have to be allowed under circumstances to be prescribed in regulations. However, an individual account plan

[273] would not be required to permit repayment after the employee had a one year break in service.

Accrued benefit

Under the conference substitute, the term "accrued benefit" refers to pension or retirement benefits. The term does not apply to ancillary benefits, such as payment of medical expenses (or insurance premiums for such expenses), or disability benefits which do not exceed the normal retirement benefit payable at age 65 to an employee with comparable service under the plan, or to life insurance benefits payable as a lump sum.

Also, the accrued benefit does not include the value of the right to receive early retirement benefits, or the value of social security supplements or other benefits under the plan which are not continued for any employee after he has attained normal retirement age. However, an accrued benefit may not be reduced on account of increasing age or service (except to the extent of social security supplements or their equivalents).

In the case of a plan other than a defined benefit plan, the accrued benefit is to be the balance in the employee's individual account.

In the case of a defined benefit plan, the accrued benefit is to be determined under the plan, subject to certain requirements. In general, the accrued benefit is to be defined in terms of the benefit payable at normal retirement age. Normal retirement age generally is to be the age specified under the plan. However, it may not be later than age 65 or the tenth anniversary of the time the participant commenced participation, whichever last occurs. No actuarial adjustment of the accrued benefit would be required, however, if an employee voluntarily postponed his own retirement. For example, if the plan provided a benefit of $400 a month payable at age 65, this same $400 a month benefit (with no upward adjustment) could also be paid by the plan to an individual who voluntarily retired at age 68.

Each defined benefit plan is to be required to satisfy one of three accrued benefit tests (which limit the extent of "back-loading" permitted under the plan).

The three percent test.—Under this alternative each participant must accrue, for each year of participation, at least 3 percent of the benefit which is payable under the plan to a participant who begins participation at the earliest possible entry age and serves continuously until age 65, or normal retirement age under the plan, whichever is earlier. This test is to be applied on a cumulative basis (i.e., any amount of "front loading" is permitted). Also, in the case of a plan amendment, the test would be cumulative. For example, assume that a plan provided a flat benefit of $200 a month payable at age 65 during the first 10 years of an individual's participation, then amended to provide a flat benefit of $400 a month; the participant's accrued benefit at the end of his 11th year of participation would equal $132 (3 percent of $400, times 11 years of service.)

[274] In addition, if a plan elects this alternative, and if the plan provides a given benefit to a person who is employed when he attains retirement age, who has a given amount of service, then any employee who has that amount of service, even though he leaves before retirement age, would be entitled to this same benefit when he reaches retirement age. For example, if the plan is based on compensation and provides a 40 percent of salary benefit for an employee who served at least 20 years and is still employed at age 65, then the plan must provide that an employee who served 20 years from age 35 to age 55 would be entitled to that same 40 percent of compensation benefit (beginning at normal retirement age or age 65).

133⅓ percent test.—Under this alternative, the plan is to qualify if the accrual rate for any participant for any later year is not more than 133⅓ percent of his accrual rate for the current year. Thus, (unlike the House bill) the conference substitute permits an unlimited amount of "front loading" under this test. The accrual rate can be based on either a dollar or percentage rate. In applying these rules, a plan amendment in effect for the current year is to be treated as though it were in effect for all plan years. (For example, if a plan provides a one percent rate of accrual for all participants in 1976, and is amended to provide a 2 percent rate of accrual for all participants in 1977, the plan will meet this test, even though 2 is more than 1⅓ times 1). Also, if the plan has a scheduled increase in the rate of accruals, which will not be in effect for any participant until future years, this scheduled increase will not be taken into account for purposes of the backloading rules until it actually takes effect. Also, in applying the 133⅓ percent test, social security benefits and all other factors used to compute benefits under the plan will be treated as remaining constant, at current year levels, for all future years.

Pro rata rule.—As a third alternative, the conference substitute contains a modified version of the rule contained in the Senate amendment. Under this test, for purposes of determining the accrued benefit, the retirement benefit is to be computed as though the employee continued to earn the same rate of compensation annually that he had earned during the years which would have been taken into account under the plan (but not in excess of 10), had the employee retired on the date in question. This amount is then to be multiplied by a fraction, the numerator of which is the employee's total years of active participation in the plan up to the date when the computation is being made, and the denominator of which is the total number of years of active participation he would have had if he continued his employment until normal retirement age. This test is cumulative in the sense that unlimited front loading is permitted. For purposes of this test, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant at current year levels for all future years. Also for purposes of this rule the term "normal retirement age" would be defined as set forth above, and the test would apply only to the benefit payable at, or after, normal retirement age

[275] (i.e., it would not take account of subsidized early retirement (to the extent such a benefit does not exceed the benefit payable at normal retirement age) and social security supplements.)[3]

A plan is not to be treated as failing to meet the tests solely because the accrual of benefits under the plan does not become effective until the employee has two continuous years of service, measured from the anniversary date of employment.

In the case of a plan funded exclusively through the purchase of insurance contracts, the accrued benefit is to be the cash surrender value of the contract (determined as though the funding requirements with respect to the plan had been fully satisfied).

In the case of a variable annuity plan, the accrued benefit is to be determined in accordance with regulations to be prescribed by the Secretary of the Treasury or his delegate.

Benefits accrued in the past

Generally, the vesting rules of the conference substitute are to apply to all accrued benefits, including those which accrued before the effective date of the provisions (subject, however, to the break-in-service rules discussed above). However, many plans now in existence have no accrued benefit formula for the past, thus making it impossible in these cases to determine what the employee is vested in. To deal with this situation, the conference substitute provides that the accrued benefit under a plan for years prior to the effective date of the vesting provisions for any participant is to be not less than the greater of (1) the accrued benefit under the provisions of the plan (as in effect from time to time), or (2) an accrued benefit which is not less than one-half of the benefit which would have accrued under one of the three back-loading tests described above.

The plan may choose which of the 3 standards it wishes to apply for the past (subject to the antidiscrimination rules); however, the same standard must be applied to all the plan's participants on a consistent basis. The plan is not required to choose, for the past, the same test which it applies in the future.

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[3] For example, assume a social security offset plan providing a benefit equal to 2 percent of high-3 years compensation per year of service with the employer, minus 30 percent of the primary social security benefit, with a normal retirement age of 65. Assume also an employee who began employment at age 25, and terminated employment at age 45, 100 percent vested, with high-3 years pay of $19,000, $20,000, and $21,000. At the time the employee separates from service the primary social security benefit payable to him at age 65 (under the social security law as an effect when he terminates) would be $6,000 if he continued to work with the employer at his same annual rate of compensation until normal retirement age. His accrued benefit under the plan would equal $7,100. (If the employee had remained in service until age 65, he would have 40 years service, times 2 percent per year (80 percent), times $20,000 average high-3 years compensation ($16,000), minus 30 percent of the $6,000 primary social security benefit payable to the employee at age 65 under then current law ($16,000 minus $1,800 equals $14,200) times 20/40ths (20 years of service over 40 total years from age 25 to age 65) equals $7,100.)

In the case of a plan amendment, the rule would work as follows. Assume an individual begins participation at age 25 in a plan which provides 1 percent of high-three-years pay during his first 10 years of service. In the 11th year the plan amends to provide 2 percent of pay for all future years of service. The employee separates from service at the end of the 11th year (and is 100 percent vested). His accrued benefit would equal 19.25 percent of average high-three-years pay (10 (years of participation) times 1 percent per year, 30 (years of projected participation) times 2 percent per year, times 11/40ths (11 years of participation over 40 total years between age 25 and age 65)).

[276] *Changes in vesting schedule*

The conference substitute provides that if, at any time in the future, the plan changes its vesting schedule, the vesting percentage for each participant in his accrued benefit accumulated to the date when the plan amendment is adopted (or the date the amendment becomes effective, if later) cannot be reduced as a result of the amendment. In addition, as a further protection for long service employees, any participant with at least 5 years of service may elect to remain under the pre-amendment vesting schedule with respect to all of his benefits accrued both before and after the plan amendment.

Allocations between employee and employer contributions

The House bill and the Senate amendment are quite similar in the rules they apply in allocating contributions between those made by the employee and the employer and the conference substitute follows the House bill as to technical matters in the case of this provision. In addition, the substitute makes a clarifying amendment which provides (in the case of a defined benefit plan), that the accrued benefit attributable to employee contributions can never be less than the sum of those contributions (computed without interest). This assures that the employee will at least be vested in his own contributions to the plan, on a dollar-for-dollar basis. (Thus, for example, in the case of an individual insurance contract, employer contributions to the plan must at least absorb the load factor, but, of course, payment of the load factor by the employer would not cause the plan to be treated as a plan which was not funded solely through the purchase of insurance contracts.

Discrimination

Under the conference substitute the rules of the House bill are adopted with respect to the relationship of the minimum vesting standards of the bill to the antidiscrimination rules of present law (sec. 401 (a) (4) of the Internal Revenue Code). In general, a plan which meets the vesting requirements provided in this substitute is not to be considered as discriminatory, insofar as its vesting provisions are concerned, unless there is a pattern of abuse under the plan (such as the firing of employees before their accrued benefits vest) or there has been (or there is reason to believe there will be) an accrual of benefits or forfeitures tending to discriminate in favor of employees who are officers, shareholders or who are highly compensated.

In the past, however, the law in this area has been administered on a case-by-case basis, without uniform results in fact situations of a similar nature. As a result, except in cases where actual misuse of the plan occurs in operation, the Internal Revenue Service is directed not to require a vesting schedule more stringent than 40 percent vesting after 4 years of employment with 5 percent additional vesting for each of the next 2 years, and 10 percent additional vesting for each of the following five years. Also, this more rapid vesting would generally not be required except in a case where the rate of likely turnover for officers, shareholders, or highly compensated employees was substantially

[277] less (perhaps as much as 50 percent less) than the rate of likely turnover for rank-and-file employees. Of course, where there is a pattern of firing employees to avoid vesting, the limitations described above would not apply. Also, it generally is not intended that any plan (or successor plan of a now existing plan) which is presently under a more rapid vesting schedule should be permitted to cut back its vesting schedule as a result of this statement.

In addition, the conferees have directed the joint pension task force study group to examine problems of the interrelationship of the vesting and the antidiscrimination rules carefully. The conferees also expect the Treasury or the Internal Revenue Service to supply information with respect to patterns of benefit loss for different categories of plans (as designated by the task force) under the minimum vesting schedules prescribed under this legislation, and such other information as the task force study group may require. In other words, the experimental rules outlined above (40 percent vesting after 4 years, etc.) are intended to apply only until the responsible congressional committees can review the situation after receiving the report of the task force study group.

Moreover, the conferees intend that the antidiscrimination rules of present law in areas other than the vesting schedule are not to be changed. Thus, the present antidiscrimination rules with respect to coverage, and with respect to contributions and benefits are to remain in effect. Also, the antidiscrimination rules may be applied with respect to benefit accruals.

The conference substitute contains a technical rule to be applied in the case of target benefit plans (and other defined contribution plans), which provides that regulations may establish reasonable earnings assumptions and other factors for these plans in order to prevent discrimination.

Plan termination

Under the conference substitute, as under present law, all accrued benefits in a qualified pension plan must become fully vested (in accordance with the rules of the bill concerning allocation of assets upon plan termination and to the extent then funded) in the event of a plan termination, or the complete discontinuance of contributions under the pension plan. Under the substitute, this rule is no longer to apply to cases where employers have not made contributions to plans covered under the funding requirements of the bill, because the bill reaches this problem by imposing an excise tax on underfunding. However, the rule of full immediate vesting is still to apply in the case of a termination, or partial termination of a plan, and in the case of the discontinuance of contributions to plans which are not subject to the new funding requirements (e.g., profit-sharing plans, church plans, and government plans). Also, the substitute contains a provision to make clear that the vesting requirements under the bill are not intended to operate to overturn rules which require that, in the event

[278] of plan termination, the benefits under the plan are not to be distributed in a manner that discriminates in favor of officers, shareholders, or highly compensated employees.

Class year plans

Under the substitute, the minimum vesting requirements are satisfied in the case of a class year plan if the plan provides for 100 percent vesting of the benefits derived from employer contributions within 5 years after the end of the plan year for which the contributions were made. Also, under the substitute, forfeitures with respect to employer contributions would be permitted on a class-year-by-class-year basis, for any year for which the employee withdraws his own mandatory contributions to the plan, if he is less than 50 percent vested with respect to that year. For purposes of these rules, withdrawals will be applied to the earliest year for which the employee has made contributions which have not yet been withdrawn.

Recordkeeping requirements

Under the conference substitute, in the case of a single employer plan, the employee, once each year, is to be entitled to request his plan administrator to furnish a statement as to his vesting and accrued benefit status. A similar statement is to be supplied automatically when a vested employee terminates his coverage under the plan. In the case of multiemployer plans, the recordkeeping and information supplying duties are to be performed by the plan administrator and, to the maximum extent practicable (in light of their different circumstances), multiemployer plans are to meet the same standards in this area as single employer plans (in accordance with regulations to be prescribed by the Secretary of Labor or his delegate).

Variations

Under the conference substitute, a variation is to be available with respect to the vesting schedule (for benefits attributable to employer contributions) and the accrued benefit rules for plans in existence on January 1, 1974. Under this procedure, a variation is to be allowed only if it is found by the Secretary of Labor that application of the rules of the bill would increase the cost of the plan to such an extent that there would be a substantial danger that the plan would be terminated, or that there would be a substantial reduction in benefits provided under the plan, or in the compensation of the employees. Also, it would have to be determined that the application of the vesting schedule requirements, or accrued benefit requirements, or discontinuance of the plan, would be adverse to the interest of the plan participants as a whole. Finally, it would have to be determined that the hardship described above could not be sufficiently mitigated by the granting of a funding variance.

The variation with respect to benefit accruals is not to apply for any year except years (not in excess of 7) during which the variation is in effect. (For example, there could be not variation with respect to the rules for benefits accrued in the past.)

No plan may receive a vesting variation unless application is made (in accordance with regulations to be prescribed by the Secretary of

[279] Labor or his delegate) within two years after the date of enactment of this bill. The variation would be granted for an initial period not to exceed 4 years. Plans can receive one additional variation (for a period not to exceed 3 years), but application for the additional variation would have to be made at least one year prior to the expiration of the initial variation period.

During the period when a variation is in effect, there can be no plan amendment which has the effect of increasing plan liabilities because of benefit increases, changes in accruals, or changes in the rate of vesting, except to a de minimis extent (in accordance with regulations to be prescribed by the Secretary of Labor).

Amounts designated as employee contributions

To clarify present law, the substitute provides that amounts contributed to a qualified plan in taxable years beginning after December 31, 1973, are to be treated as employee contributions if they are designated as employee contributions under the plan. This rule does not apply, however, to government "pick-up" plans, where the contribution is paid by the government, with no withholding from the employee's salary, and these amounts would be treated as employer contributions, no matter how designated under the plan.

Joint and survivor annuities

Under the conference substitute, when a plan provides for a retirement benefit in the form of an annuity, and the participant has been married for the one-year period ending on the annuity starting date, the plan must provide for a joint and survivor annuity. The survivor annuity must be not less than half of the annuity payable to the participant during the joint lives of the participant and his spouse.

In the case of an employee who retires, or who attains the normal retirement age, the joint and survivor provision is to apply unless the employee elected otherwise.

In the case of an employee who is eligible to retire prior to the normal retirement age under the plan, and who does not retire, the joint and survivor provisions need not be applicable under the plan, unless the employee made an affirmative election. Moreover, the plan need not make this option available until the employee is within 10 years of normal retirement age. (Of course, a plan may provide that a joint and survivor annuity is to be the only form of benefit payable under the plan, and in this case, no election need be provided.)

These rules should help to avoid the situation where an employee who had not yet retired might have his own retirement benefit reduced as a result of inaction on his part and should also help to prevent adverse selection as against the plan.

The employee is to be afforded a reasonable opportunity, in accordance with regulations, to exercise his election out of, (or, before normal retirement age, possibly into) the joint and survivor provision before the annuity starting date (or before he becomes eligible for early retirement). The employee is to be supplied with a written explanation of the joint and survivor provision, explained in layman's language, as well as the practical (dollar and cents) effect on him

[280] (and his or her spouse) of making an election either to take or not to take the provision. At the same time, regulations in this area should take cognizance of the practical difficulties which certain industries (particularly those having multiemployer plans) may have in contacting all of their participants.

To prevent adverse selection the plan may provide that any election, or revocation of an election, is not to become effective if the participant dies within some period of time (not in excess of two years) of the election or revocation (except in the case of accidental death where the accident which causes death occurs after the election).

Also, the conferees agree with the statements in the Ways and Means Committee report (No. 93–807) to the effect that the bill does not require the plan to "subsidize" the joint and survivor feature (although the plan is permitted to do so) and that plans may make reasonable actuarial adjustments to take account of the possibility that total costs of the plan otherwise might be increased because of adverse selection.

Alienation

Under the conference substitute, a plan must provide that benefits under the plan may not be assigned or alienated. However, the plan may provide that after a benefit is in pay status, there may be a voluntary revocable assignment (not to exceed 10 percent of any benefit payment) by an employee which is not for purposes of defraying the administrative costs of the plan. For purposes of this rule, a garnishment or levy is not to be considered a voluntary assignment. Vested benefits may be used as collateral for reasonable loans from a plan, where the fiduciary requirements of the law are not violated.[4]

Social security benefits of terminated participants

The conference substitute codifies the current administrative practice which provides that qualified plans may not use increases in social security benefits or wage base levels to reduce employee plan benefits that are already in pay status. A similar protection is also extended against reductions in plan benefits where social security benefit levels (or wage base levels) are increased after the individuals concerned are separated from service prior to retirement. This requirement also applies to plans covered under title I (even if the plan is not qualified). A similar principle will apply in the case of an individual receiving disability benefits under social security and also under an employer plan.

Integration with Social Security

As discussed above, title I and title II of the conference substitute provide that plans may not use increases in social security benefit levels to decrease plan benefits in the case of retirees, or individuals who separate from service prior to retirement. The conference substitute also provides (consistent with the Ways and Means Committee report) for a two-year study, by the Congress, of the issues involved in the integration of private pension plans with social security.

Consequently, the substitute provides, in effect, that until July 1, 1976, pension plans may not increase their level of integration by tak-

[4] This rule will not apply to irrevocable assignments made before the date of enactment and the plan provision required under this rule need not be adopted prior to January 1, 1976 (so long as the plan complies with the substance of this rule after enactment).

[281] ing into account changes in the social security wage base, or in social security benefit levels after 1971. Thus, in general, plans may integrate in accordance with Rev. Rul. 71-446, 1971-2 C.B. 187. (For example, an excess plan would integrate in accordance with section 3 of that ruling, and the tables set forth therein.) Of course, plans which do not satisfy the integration requirements as to form, but do in operation satisfy the requirements of Rev. Rul. 771-446, will be permitted to integrate under the conference substitute.

Certain plans, which are currently integrated above 1971 levels, are permitted to retain their current levels of integration (as in effect on June 27, 1974), but would not be permitted an increase. (For example, a unit benefit excess plan which now provides 1 percent of pay in excess of $11,000 per year of future service could remain at this level, but could not change to take account of a wage base higher than $11,000.)

To prevent undue hardship, in the case of plans which are automatically keyed to changes in the social security wage base or benefit levels (for example, a unit benefit excess plan now at the $13,200 wage base in effect on June 27, 1974), the plan is not required to amend until June 30, 1975, but any such amendment must be retroactive to January 1, 1975, and must provide that the plan does not take account of any changes in the social security wage base or in social security benefit levels which may occur after June 27, 1974.

For purposes of the rules with respect to retirees, or other individuals who have separated from service, any change in the plan after June 30, 1976, which takes account of the increases in the social security wage base or benefit levels which are temporarily frozen under these provisions, may not be used to reduce plan benefits otherwise payable to individuals who retire, or separate from service, between June 27, 1974 and June 30, 1976.

Payment of benefits

Under the conference substitute, a plan is generally required to commence benefit payments (unless the participant otherwise elects) not later than the 60th day after the close of the plan year in which the latest of the following events occurs:

(1) the participant attains age 65 (or any earlier normal retirement age specified under the plan),

(2) ten years have elapsed from the time the participant commenced participation in the plan, or

(3) the participant terminates his service with the employer.

Also, if the plan permits an employee who has not separated from service to receive a subsidized early retirement benefit if he meets certain age and service requirements, the plan must also permit an employee who fulfills the service requirement, but separates from service before he meets the age requirement, to receive benefit payments, on an actuarially reduced basis, when the separated employee meets the age requirement. For example, if the plan provides a benefit of $100 a month at age 65, or at age 55 for employees with 30 years of service who are still employed on their 55th birthday, then an employee who separates from service at age 50 with 30 years service, would have the right to draw down an actuarially reduced benefit (perhaps $50 a

[282] month) at age 55. The actuarial adjustments are to be made in accordance with regulations to be prescribed by the Secretary of the Treasury, or his delegate.

Comparability of plans having different vesting provisions under the antidiscrimination rules

The conference substitute provides that highly mobile employees, such as engineers, are permitted to trade off high benefits which might be available under one retirement plan of their employer for their right to participate in another plan with lower benefits, but more rapid vesting.

Protection of pension rights under Government contracts

Under the conference substitute, the Secretary of Labor is to undertake a study of steps which can be taken to ensure that professional, scientific, technical, and other personnel employed under Federal contracts are protected against loss of their pensions resulting from job transfers or loss of employment. The Secretary of Labor is to report to Congress on this subject within two years after the date of enactment of the bill and is, if feasible, to develop recommendations for Federal procurement regulations to safeguard pension rights in the situations in question within one year after filing his report. These regulations are to become effective unless either House of Congress adopts a resolution of disapproval within 120 days after the proposed regulations are submitted to the Congress. Any such disapproval is to be referred to the Labor Committee of the relevant House.

Effective dates

The effective dates of the provisions with respect to participation and vesting are discussed above under "Participation and Coverage."

IV. Funding (Secs. 301–306, 1013, and 1014 of the Bill and Secs. 412, 413, and 4971 of the Internal Revenue Code)

The House bill would provide new minimum funding standards for plans of employers (or employee organizations) in interstate commerce (title I) and for tax-qualified plans (title II). Under the House version of the bill, the new minimum funding standard would require that currently-created costs be funded currently, and that costs attributable to already existing liabilities, past service liabilities created under plan amendments, and experience losses be amortized over stated periods of time. The House funding standards generally are based on accrued liabilities and not only on vested liabilities. However, if the funding requirements are higher under a second general standard which is based on "vested" liabilities, this standard would apply in lieu of the other rules. Where the funding requirements would create financial hardship, and certain standards are met, the Secretary of the Treasury or Secretary of Labor could permit variances in meeting the funding requirements.

The Senate amendment is basically similar to the House bill, but differs somewhat with respect to some of the periods of time allowed for amortizing past service cost and with respect to several technical provisions. Also, the Senate amendment does not include a second general funding standard based upon "vested" liabilities.

[283] Generally, the conference substitute follows the House bill with respect to amortization periods and with respect to technical aspects, but modifies the House bill in other respects.

General rule as to funding

The conference substitute establishes new minimum funding requirements for plans of employers and unions in or affecting interstate commerce (title I) and qualified plans (title II) so these plans will accumulate sufficient assets within a reasonable time to pay benefits to covered employees when they retire. Of course, contributions generally may be greater than these minimum requirements if the employer so desires. (However, there may be limits on the ability to currently deduct these larger contributions, under the tax laws.) The new requirements generally are not to apply to profit-sharing or stock bonus plans, governmental plans, certain church plans, plans with no employer contributions, and certain insured plans. Under the tax provisions, once a plan or trust has been tax qualified, the minimum funding requirements will apply, and they are to continue to apply to the plan or trust, even if it later loses its qualified status. If a plan loses its qualified status, the deduction rules for nonqualified plans are to apply even though the minimum funding standard continues to apply to the plan.

Generally, under the new funding requirements, the minimum amount that an employer is to contribute annually to a defined benefit pension plan includes the normal costs of the plan plus amortization of past service liabilities, experience losses, etc. Except as described below (under "Variances—alternative funding methods"), minimum amortization payments required by the conference substitute are calculated on a level payment basis—including interest and principal—over stated periods of time and are based on all accrued liabilities. Generally, initial past service liabilities and past service liabilities arising under plan amendments are to be amortized over no more than 30 years (40 years for the unfunded past service liabilities on the effective date of these new funding rules, in the case of existing plans), and experience gains and losses are to be amortized over no more than 15 years. However, generally experience gains and losses need not be calculated more often than every three years. With respect to multiemployer plans, past service liabilities generally may be amortized over no more than 40 years, and experience losses over no more than 20 years. Following the Senate amendment, the conference substitute does not include a second general minimum funding standard based only on "vested" liabilities.

If an employer would otherwise incur substantial business hardship, and if application of the minimum funding requirements would be adverse to plan participants in the aggregate, the Internal Revenue Service may waive the requirement of current payment of part or all of a year's contributions of normal costs, and amounts needed to amortize past service liabilities and experience losses. This waiver is to be available for single employer and multiemployer plans. The amount waived (plus interest) is to be amortized not less rapidly than ratably (including interest) over 15 years, and no more than 5 waivers may be granted for any 15 consecutive years. Also, the Secretary of Labor may

[284] extend the amortization period for amortization of past service costs up to an additional 10 years, on a showing of economic hardship.

For money purchase pension plans, the minimum amount that an employer is to annually contribute to the plan generally is the amount that must be contributed for the year under the plan formula. For purposes of this rule, a plan (for example, a so-called Taft-Hartley plan) which provides an agreed level of benefits and a specified level of contributions during the contract period is not to be considered a money purchase plan if the employer or his representative participated in the determination of the benefits. On the other hand, a "target benefit plan" is to be treated as a money purchase plan for purposes of the minimum funding rules.

Under the new funding rules, generally each covered plan is to maintain a new account called a "funding standard account." This account is to aid both the taxpayer-employer and the Government in administering the minimum funding rules. The account also is used to assure that a taxpayer who has funded more than the minimum amount required is properly credited for that excess and for the interest earned on the excess. Similarly, where a taxpayer has paid too little, the account is to assist in enforcing the minimum funding standard, and to assure that the taxpayer is charged with interest on the amount of underfunding.

Each year the funding standard account is to be charged with the liabilities which must be paid to meet the minimum funding standard. Also, each year the funding standard account is to be credited with contributions under the plan and with any other decrease in liabilities (such as amortized experience gains). If the plan meets the minimum funding requirements as of the end of each year, the funding standard account will show a zero balance (or a positive balance, if the employer has contributed more than the minimum required). If the minimum contributions have not been made, the funding standard account will show a deficiency (called an "accumulated funding deficiency"). If there is an accumulated funding deficiency, an excise tax is to be imposed on the employer who is responsible for making contributions to the plan. Also, the responsible employer may be subject to civil action in the courts on failure to meet the minimum funding standards.

The differences between the House bill and the conference substitute are described below.

Additional funding standard

The conference substitute, following the Senate amendment, does not include an additional funding standard which would require a contribution of the first year's payment under a 20-year amortization schedule of unfunded vested liabilities.

Reasonable actuarial assumptions

The conference substitute combines the rules relating to actuarial assumptions of the House bill and of the Senate amendment and requires that, for purposes of the minimum funding standard, all plan costs, liabilities, rates of interest, and other factors under the plan are to be determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable. Actuarial assumptions are to take into account the experience of the plan and reasonable expecta-

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[285] tions. These assumptions are expected to take into consideration past experience as well as other relevant factors.

In addition, under the conference substitute, the actuarial assumptions in combination are to offer the actuary's best estimate of anticipated experience under the plan. The conferees intend that under this provision a single set of actuarial assumptions will be required for all purposes (e.g., for the minimum funding standard, reporting to the Department of Labor and to participants and beneficiaries, financial reporting to stockholders, etc.).

Treatment of certain changes as experience gains or losses

The House bill does not indicate how funding is to be provided where there is a change in liabilities arising from changes in actuarial assumptions used. The Senate amendment would include such changes in liabilities as experience gains or losses. Under the conference substitute, changes in plan liabilities resulting from changes in actuarial assumptions are to be amortized over a 30-year period.

Definition of experience gain or loss

Under the conference substitute (following title II of the House bill and the Senate amendment) experience gain or loss is the difference between the anticipated experience of the plan and the actual experience.

The conferees understand that certain plans are maintained pursuant to collectively bargained agreements which provide for a predetermined level of contributions over a period longer than 12 months, such as a specified dollar amount per hour of covered service by an employee or a specified dollar amount per ton of coal mined. It is intended that, for the funding requirements to be workable in these cases, employers generally must be allowed to base their contributions on the bargained and agreed upon basis during the period to which the collective bargaining agreement relates (but generally for not more than three years). Under such a plan, if the actuarial assumptions were reasonable and the actuarial calculations were correct as of the beginning of the term of the agreement, and the agreed upon contributions were made when required during the term of the agreement, it is intended that there would be no deficiency in the funding standard account for the term of the collectively bargained agreement (limited as indicated above). This would be the case even if the amount of contributions were less than what was reasonably expected at the beginning of the term of the agreement (for example, because the hours worked or the tons of coal mined were less than reasonably anticipated). In this case, it is expected that any difference between the reasonably anticipated contributions and actual contributions would be treated as an experience loss which could be made up under the next agreement by adjustment of the contribution rate (or by adjustment of the level of benefits).

Change in funding method or plan year

The conference substitute (following the House bill and Senate amendment) provides that a change in a plan's funding method (or plan year) can be used to determine plan costs and liabilities only if the change is approved by the administering Secretary. (Note that this

[286] requirement of prior approval does not apply to use of the alternative minimum funding standard, described below.) The conferees intend that a change in funding method or plan year also is to be reported to the Pension Benefit Guaranty Corporation in order that the Corporation may be fully apprised of events which may adversely affect the funding status of a plan.

Full funding limitation

Both the House bill and the Senate amendment include special provisions establishing the minimum amount to be funded where the difference between plan liabilities and plan assets is smaller than the amount otherwise required to be contributed under the minimum funding requirement for the year. Generally, these provisions are substantially the same; the conference substitute follows the House bill in the technical aspects. However, the conferees wish to clarify statements in the House report with respect to the time at which plan liabilities and plan assets are to be valued for purposes of determining the full funding standard. Generally, the conferees intend that assets and liabilities are to be valued at the usual time used by the plan for such valuations, if done on a consistent basis and in accordance with regulations.

Retroactive plan amendments

The House bill generally would allow limited amendments of plans which retroactively decrease plan benefits (without the approval of the Secretary of Labor), and also would allow other plan amendments which retroactively decrease plan benefits, with the approval of the Secretary of Labor. The Senate amendment included no similar provisions.

The conference substitute generally allows limited retroactive plan amendments, but only with the approval of the Secretary of Labor.

Under the conference substitute, plan amendments that reduce plan benefits may be made after the close of the plan year, and yet apply to that year if they are made within 2½ months after the end of the plan year. However, since a single plan year is not a workable standard for multiemployer plans, with respect to multiemployer plans, an amendment may be made under the conference substitute within 2 years of the close of the plan year.

To protect participants, amendments made under this provision are not to decrease vested benefits of any participant determined as of the time the amendment is adopted. In addition, such a retroactive amendment cannot reduce the accrued benefit (whether or not vested) of any participant determined as of the beginning of the first plan year to which the amendment applies. Moreover, such an amendment is not to retroactively reduce the accrued benefit of any participant, unless there would otherwise be an accumulated funding deficiency for all or part of the plan year in question, the funding deficiency could not be avoided through the implementation of any other reasonably available alternative (including amortization of experience losses or a waiver of the funding requirement), and the funding deficiency was not primarily attributable to the failure by employers to discharge contractual obligations to make contributions under the plan (e.g., failing to contribute a required amount per hour of work of plan participants).

[287] Under the conference substitute, the plan administrator is to notify the Secretary of Labor of any amendment which retroactively decreases plan liabilities, before the amendment goes into effect. The amendment can then go into effect only if the Secretary has approved it, or if the Secretary does not disapprove it within 90 days after notice is filed. It is expected that within the 90-day period the Secretary may notify the plan of a tentative disapproval, if he needs more information or more time before making a final determination. The Secretary of Labor is not to approve any retroactive amendment unless he determines that it meets the requirements discussed above and determines that it is necessary because of substantial business hardship.

Three-year determination of gains and losses

Under the House bill, experience gains and losses would be determined every three years (more frequently in particular cases as required by regulations). Under the Senate amendment, an annual determination of gains and losses and an annual valuation of liabilities would be required.

The conference substitute follows the rules of the House bill. The conferees intend that regulations may be issued to require a determination of gains and losses and valuation of a plan's liabilities more frequently than every three years with respect to situations where there is a need for more frequent review. For example, the regulations might provide that a determination of experience gains and losses would be made more frequently than every three years by plans which have sustained substantial experience gains or losses for several periods in succession.

Year-by-year waivers

Title II of the House bill and the Senate amendment both provide that the Secretary of the Treasury may waive all or part of the minimum funding requirement for a plan year if an employer is unable to satisfy this requirement without incurring substantial business hardship.

The conference substitute follows the House bill with respect to the technical aspects and with respect to the number of variances that may be granted in any consecutive period of years. In addition, under the conference substitute, it is made clear that this waiver is to be available for employers contributing to a multiemployer plan. For multiemployer plans, the Secretary of Treasury may waive part or all of the funding requirements if at least 10 percent of the employers contributing to the plan demonstrate that they would experience substantial business hardship without the waiver, and if applying the minimum funding standard would be adverse to the interests of plan participants as a whole.

Variances—extension of amortization periods

The House bill would allow the Secretary of Labor to extend the amortization periods for funding past service liabilities or experience gains and losses of plans for an additional ten years, in cases of substantial business hardship. (Under the labor provisions of the House bill, this would be available for all plans under the general variance provision; under the tax provisions this would be available only for

[288] multiemployer plans.) A similar provision is included under the Senate amendment.

Under the conference substitute, the Secretary of Labor may extend the amortization period for unfunded past service liabilities and experience gains and losses for both multiemployer and single employer plans. These periods may be extended up to an additional ten years where there would otherwise be a substantial risk that the plan might be terminated or a substantial risk that pension benefit levels or employee compensation might be limited. Additionally, to grant an extension of time the Secretary must find that (1) the extension would carry out the purposes of the Act, (2) the extension would provide adequate protection for participants and beneficiaries, and (3) not granting the extension would be adverse to the interests of plan participants and beneficiaries as a whole.

Variances—alternative funding methods

Title I of the House bill provides that the Secretary of Labor may prescribe an alternative minimum funding method for multiemployer or single employer plans in certain cases of hardship. The Senate amendment does not include any similar provision. The conference substitute does not include a general provision allowing the Secretary of Labor to prescribe an alternative minimum funding method. However, the substitute provides an alternative method for a multiemployer plan to satisfy the minimum requirements for funding past service liabilities existing as of 12 months after the first date on which the minimum funding standards apply to the plan. This alternative method may be used only by multiemployer plans which were in existence on January 1, 1974, if (on that date) the contributions under the plan were based on a percentage of pay.

Under this alternative, an eligible plan may elect to fund, over the relevant amortization period, the applicable past service liabilities with contributions that are a level annual percentage of the aggregate pay of all participants under the plan (instead of funding these liabilities with level dollar payments) over the appropriate amortization period. The minimum amount to be paid under this alternative is the interest (at the rate otherwise used by the plan in determining its liabilities) on initial past service liabilities and past service liabilities created by plan amendment. Also, this interest assumption, by itself, must be a reasonable rate; and the assumption with respect to aggregate pay must, by itself, be a reasonable assumption. This is necessary because these two assumptions have a key role, individually, in determining the amount that will be contributed to a plan under this alternative amortization method.

Limit on increase in benefits during variance

The House bill provides that while a variance is in effect the plan cannot be amended to increase liabilities by an increase in benefits, a change in the accrual of benefits, or a change in the rate of vesting. A similar limitation is included in the Senate amendment.

The conference substitute generally follows the House bill in its technical aspects and limits plan amendments which increase liabilities where there has been a year-by-year waiver, or an extension of time to amortize past service costs or experience gains and losses. This

[289] limitation is to apply until the waived amount has been fully amortized or until the extension of time for amortization is no longer in effect. Also, under the conference substitute, benefits may not be increased if there has been a plan amendment which retroactively decreased plan benefits within the preceding 12 months (24 months in the case of multiemployer plans). However, the conference substitute makes it clear that reasonable, *de minimis* increases in plan liabilities are to be allowed, under regulations of the Secretary of Labor. (It is expected that the regulations will indicate the types of plan amendments considered *de minimis* for this purpose.) Also, amendments are to be allowed even though they increase plan liabilities if they are required as a condition of tax qualification. Further, amendments which merely repeal (in whole or in part) a previous retroactive decrease in benefits are to be allowed.

Alternative minimum funding standard

Under title II of the House bill, the same funding method and assumptions would be used for determining the minimum amount that must be contributed to a plan and for determining the maximum amount for which a current tax deduction is available. The Senate amendment does not include a similar requirement.

The conference substitute generally follows the rules of the House bill in requiring the funding method used by a plan to be the same for purposes of determining the minimum amount to be contributed and the maximum deduction for contributions. However, the conference substitute also would allow the use of an alternative minimum funding standard in order that there may be some leeway between the minimum required contributions and the maximum deductible contributions.

Under the alternative funding standard, generally the minimum amount to be contributed to a plan is (1) the excess (if any) of the value of accrued benefits over the value of plan assets, plus (2) normal cost. Under this standard, plan assets are to be annually valued at fair market value and plan liabilities are to be valued on the same basis as the Pension Benefit Guaranty Corporation would have computed them if the plan terminated. These valuation methods are used because this minimum funding standard is similar to a "termination test" funding standard. When the financial status of a plan is examined on a termination basis, it is considered appropriate to use fair market valuations rather than valuations which tend to spread out fluctuations in value. In addition, under this standard normal cost is to be the lesser of normal cost as determined under the method used by the plan or normal cost under the unit credit method.

The alternative standard generally is to be available only for plans using funding methods which provide contributions which are no less than the contributions required under the entry age normal method. In this case, plan participants and beneficiaries will have the protection of a relatively faster build-up of plan assets in the early years of the plan than under, *e.g.*, the unit credit method.

On electing to use the alternative method, a plan must maintain an alternate funding standard account. The account will be charged with normal costs plus the excess of accrued benefits over assets (but not

[290] less than zero), and will be credited with contributions. There is to be no carryover of contributions over the minimum required from one year to another, because this amount automatically will become part of the next year's calculation in determining whether liabilities are greater than assets (that is, excess contributions will become part of plan assets for purposes of the next year's calculation). On the other hand, any shortfall of contributions less than the amount required will be carried over from year to year (with interest added) and an excise tax will be payable on these amounts (or on the funding deficiency as shown by the basic funding standard account, if smaller).

A plan that chooses to use the alternative funding method is to maintain both an alternative funding standard account and the basic funding standard account. The basic funding standard account will be charged and credited under the usual rules, but an excise tax generally will not be owed on any "deficiency" shown in that basic account. A plan making this choice is required to maintain both accounts because the minimum funding requirement will be the minimum required contribution under either account, whichever is the lesser.

The requirement under the alternative method could become higher than under the basic method if there was a substantial decrease in the market value of the assets, or if there was a substantial increase in plan liabilities (as through a plan amendment). If the minimum required contributions are lower under the basic standard than under the alternative standard, it is expected that the plan will switch back to the basic funding method.

If a plan switches back from the alternate funding standard to the basic funding standard, generally there is to be a 5-year amortization of the excess of charges over credits that have built up in the basic funding standard account over the years in which the alternative funding standard has been used. This will give the employer a reasonable period of time to fund the amounts that otherwise would have been contributed under the basic funding method, but were not contributed while the alternative funding method was being used. However, to the extent that excess charges (over contributions) have been previously built up in the alternate funding standard account, these are not to be amortized over 5 years, but instead are to be contributed immediately if the excise tax on underfunding is to be avoided. When an employer switches back from the alternative funding standard to the basic funding standard, the employer ceases to maintain the alternate minimum funding standard account. If the employer in some subsequent year returns to the alternate standard, a new account with a zero balance is to be established.

Timing of contributions

The conference substitute clarifies the intent of both the House bill and the Senate amendment, that contributions made after the close of a plan year may relate back to that plan year for purposes of the minimum funding standards. Under the conference substitute, the contribution may relate back to the plan year if it is made within 2½ months after the close of that plan year, plus any extension granted by the Internal Revenue Service up to an additional 6 months (for a maximum of 8½ months after the end of the year).

[291] *Coverage and exemptions from coverage*

Under title I of the House bill, pension plans of employers in interstate commerce and pension plans of employee organizations with members in interstate commerce generally are covered by the minimum funding rules. Under title II, the new minimum funding rules apply to plans which are, or have been determined to be, tax-qualified. The Senate amendment is substantially the same as title II of the House bill, and in addition reaches substantially the same result as title I of the House bill by generally requiring all plans in interstate commerce to qualify under the tax laws. The conference substitute follows the House bill.

Under the conference substitute, government plans, including plans financed by contributions required under the Railroad Retirement Act, are to be exempt from the new funding requirement but they must meet the requirements of present law (sec. 401(a)(7) of the Internal Revenue Code). The conferees intend that no changes are to be made in the application of the present funding requirements of the Internal Revenue Code to government plans. Although present law establishes a "safe haven rule" for payment of normal cost plus interest on past service costs, it is not intended that this safe haven rule become a requirement for government plans, but that (as under present Regs. § 1.401–6(c)(1)) the determination on whether a plan has terminated is to be made on "all the facts and circumstances in the particular case." Thus, it is intended that there be no change in the application of present law to government plans.

The conference substitute exempts church plans from the new funding requirement if they meet the requirements of present law. However, church plans which elect to be covered under the participation, vesting, and termination insurance provisions are also to be covered by the new funding requirements.

The conference substitute excludes from the minimum funding rules plans established and maintained outside the United States if they are primarily for the benefit of persons substantially all of whom are nonresident aliens. This is specifically provided in the title I provisions, while under title II, such plans would have no need to seek tax deferral qualification.

The conference substitute excludes from the minimum funding rules of title I unfunded plans maintained by the employer primarily to provided deferred compensation for select management or highly compensated employees (under title II, such plans do not seek tax qualification). The conferees intend that this exemption is to include "consultant contracts" for retired management employees. Additionally, the substitute exempts from the funding rules plans adopted by a partnership exclusively for the benefit of a partner pursuant to section 736 of the Internal Revenue Code.

Under the conference substitute, plans which have not provided for employer contributions at any time after the date of enactment are to be exempt from the minimum funding rules (i.e., plans of unions funded exclusively by contributions of the union members).

An exemption is also provided for profit-sharing and stock bonus plans; however, money purchase pension plans and other individual account plans generally are not excluded from the minimum funding rules.

[292] It is intended that plans generally are to be considered money purchase pension plans which meet the "definitely determinable" standard where the employer's contributions are fixed by the plan, even if the employer's obligation to contribute for any individual employee may vary based on the amount contributed to the plan in any year by the employee. For example, it is expected that a matching plan which provides that an employer will annually contribute up to 6 percent of an employee's salary, but that this contribution will be no more than the employee's own (nondeductible) contribution, will meet the "definitely determinable" criteria. In this case, the employer's contributions are set by the plan, will not vary with profits, and cannot be varied by the employer's action (other than by a plan amendment). (Of course, the plan must meet the nondiscrimination and other requirements of the Code to be qualified.)

Plans funded exclusively by the purchase of certain qualified level premium individual insurance contracts also are not to be subject to the minimum funding requirements. Additionally, the conference substitute makes it clear that where, instead of buying a series of such individual contracts, the employer holds a group insurance contract under which each employee's plan benefit is funded in the same manner as if individual contracts were purchased, the situation is to be treated the same as where there are individual insurance contracts. This generally will be available where the employer's premium is based on the sum of the level premiums attributable to each employee, where an employee's accrued benefit at any point in time is comparable to what would be provided under an individual contract, and as otherwise determined by regulations.

Supplemental unfunded plans which provide benefits in excess of limitations on contributions and benefits under the Internal Revenue Code and plans which are for the highly paid are to be excluded from the new funding standard. In addition, plans established by fraternal societies or other organizations described in section 501(c) (8) or (9) of the Internal Revenue Code are to be exempt if no employer contributions are made to the plan. Also, trusts which are part of plans described in section 501(c)(18) of the Code are to be exempt from the funding standards of title I (the standards of title II do not apply because those plans are not qualified plans).

With respect to the civil enforcement of the funding requirements, see "Labor and Tax Administration and Enforcement," "*Labor Department*" (Part VII, below). The excise tax provisions on underfunding in the conference substitute are the same as those in the House bill. However, before sending a notice of deficiency with respect to the first level (and second level) tax, the Internal Revenue Service is to notify the Secretary of Labor and provide him reasonable opportunity to obtain a correction of the funding deficiency, or to comment on the imposition of these taxes. The Service will be able to waive (or abate) the second level, but not the first level, tax upon a correction of underfunding that is obtained by the Secretary of Labor.

Maximum deduction limitation

The substitute generally provides that deductions are to be allowed to the extent of contributions required to meet the minimum funding standards. In addition, the present "5 percent" method allowing

[293] deductions of not in excess of 5 percent of the annual compensation of covered employees is repealed. Also, the "normal cost" method allowing deductions for normal cost, plus 10 percent of unfunded past service cost, is to be amended to allow deductions for contributions of normal cost, plus amortization over 10 years. Further, deductible limits are to be determined under the funding method and actuarial assumptions used for the minimum funding rules.

Generally, under the substitute, the maximum deduction is to be limited to the required contribution where a plan is subject to the full funding limitation. However, a special election is available under the substitute with regard to deductions if a plan becomes fully funded as a result of an amendment that decreases plan liabilities (benefits payable under the plan). This election is available only with respect to plan amendments that are negotiated through the collective bargaining process. Under this election, the maximum amount deductible generally will be normal cost under the plan less the amount needed to amortize over 10 years (principal plus interest) the decrease in plan liabilities as a result of the plan amendment. However, if a plan is fully funded without regard to the collectively bargained decrease in liabilities, no deduction is to be allowed. If a plan elects this provision, the amounts deductible in future years for contributions to the plan will be decreased (pursuant to regulations) by the amount required for a 10-year amortization of the collectively bargained decrease in liabilities.

A special rule is provided with respect to plans of regulated public utilities doing business in 40 States and furnishing certain telephone or other communications services which are rate regulated. (This rule also applies to plans of other companies which are members of a controlled group that includes such a public utility doing business in 40 States.) Under this provision, if the Secretary of the Treasury finds that the plan is a collectively bargained plan, the rules described above for deductions where there have been decreases in liabilities on account of plan amendments would apply to decreases in plan liabilities as a result of an increase in benefits under Title II of the Social Security Act.

Effective dates

In the case of new plans, the funding provisions are to apply to the first full plan year beginning after the date of enactment of the bill. For example, if a plan was established on October 1, 1974, but its plan year is a calendar year, the new provisions are to apply to the plan year beginning January 1, 1975.

Generally, in the case of plans existing on January 1, 1974, the new funding provisions are to become applicable for plan years beginning after December 31, 1975. In the case of collectively bargained plans (both single employer and multiemployer plans) existing on January 1, 1974, the effective date would be delayed until the termination of the contract existing on January 1, 1974, but not later than plan years beginning after December 31, 1980. Where an employer has plans which involve both collective bargaining unit employees and other employees, the effective dates applicable to collectively bargained plans are to govern if (on January 1, 1974) at least 25 percent of the

[294] plan participants are members of the employee unit covered by the collectively bargained agreement. (This is described more fully in connection with the effective dates for participation.)

Where a qualified plan does not meet the funding requirements of existing law because of vesting or participation requirements made applicable by the substitute and where the funding requirements of the conference substitute do not become applicable until a later time than the vesting or participation requirements, then to the extent that failure to meet the funding requirements of existing law is attributable to these new vesting or participation requirements, no plan is to be disqualified in this interim period on the grounds of underfunding.

The effective date for the rules with respect to maximum deduction limits is the same as the effective date for the funding rules generally.

V. Fiduciary Responsibility (Secs. 401–414 and 2003 of the Bill and Sec. 4975 of the Internal Revenue Code)

House bill and Senate amendment

The House bill generally includes rules governing the responsibility of plan fiduciaries only in the labor provisions of the bill (title I). The labor provisions establish rules governing the basic responsibilities of plan fiduciaries, the structure of plan administration, and also establish certain transactions as "prohibited transactions." (Present law under the Internal Revenue Code has similar prohibited transaction rules, which were unchanged by the House bill.)

Under the House bill, all plan fiduciaries must act, with respect to the plan, in accordance with a "prudent man" rule. In addition, plan fiduciaries generally must diversify plan investments (with certain exceptions for profit-sharing plans, etc., that invest in employer securities) and must act for the exclusive benefit of the plan participants and beneficiaries. The House bill also provides that all plans must be in writing, that plan assets generally are to be held in trust, and that trustees generally are to have the exclusive authority to manage and control plan assets. However, asset management in certain circumstances may be delegated to qualified investment managers. The bill also provides that plan trustees may allocate their responsibilities if the plan so provides and that in this event generally only the persons to whom responsibilities have been allocated would be liable for a surcharge.

Under the House bill, fiduciaries generally are prohibited from dealing on behalf of a plan with persons known to be parties-in-interest unless the dealings are for adequate consideration. Also, the bill generally prohibits fiduciaries from dealing with plan assets for their own accounts, receiving consideration from other parties dealing with the plan in a transaction involving the plan, or acting in a transaction involving the plan on behalf of a person who is adverse to the plan.

Under the House bill, a fiduciary is to be personally liable for losses to the plan resulting from violations of the fiduciary responsibility rules.

The Senate amendment includes rules governing fiduciary responsibility in both the labor and tax provisions. The labor provisions of the amendment, as in the case of the House bill, deal with the basic

[295] responsibility of fiduciaries, plan administrators, and structure; also and these provisions would establish certain transactions as prohibited transactions. Fiduciaries (and parties-in-interest) are to be personally liable under the labor provisions for losses sustained by a plan that result from a violation of these rules. The tax provisions of the amendment also establish prohibited transaction rules (which are nearly identical to the rules in the labor provisions) which are to be enforced through an excise tax on parties-in-interest.

The Senate amendment rules governing the basic responsibilities of plan fiduciaries (*e.g.*, acting with prudence and for the exclusive benefit of participants and beneficiaries) are similar to the rules of the House bill.

With respect to plan administration, the amendment does not require plan assets generally to be held in trust nor does it require that assets be administered by trustees. The amendment would, however, deem plan assets to be held in trust. Also, the Senate amendment does not include provisions similar to those of the House bill with respect to allocation of responsibilities among trustees.

Under both the labor and tax provisions of the Senate amendment, plan fiduciaries generally are prohibited from engaging in specified transactions with parties-in-interest whether or not these transactions are for adequate consideration. However, the amendment provides for administrative variances from these prohibitions if certain conditions are met, and also would provide statutory exemptions for, *e.g.*, paying reasonable compensation to parties-in-interest for services rendered to the plan which are necessary for the plan's operation. The amendment also would prohibit a fiduciary from dealing with the plan assets on his own account, receiving consideration from other parties dealing with the plan, and acting on behalf of a person adverse to the plan.

Fiduciary responsibility rules, in general

The conference substitute establishes rules governing the conduct of plan fiduciaries under the labor laws (title I) and also establishes rules governing the conduct of disqualified persons (who are generally the same people as "parties in interest" under the labor provisions) with respect to the plan under the tax laws (title II). This division corresponds to the basic difference in focus of the two departments. The labor law provisions apply rules and remedies similar to those under traditional trust law to govern the conduct of fiduciaries. The tax law provisions apply an excise tax on disqualified persons who violate the new prohibited transaction rules; this is similar to the approach taken under the present rules against self-dealing that apply to private foundations.

The labor provisions deal with the structure of plan administration, provide general standards of conduct for fiduciaries, and make certain specific transactions "prohibited transactions" which plan fiduciaries are not to engage in. The tax provisions include only the prohibited transaction rules and apply only to disqualified persons, not fiduciaries (unless the fiduciary is otherwise a disqualified person and the transaction involved him, or the fiduciary benefited from the transaction). To the maximum extent possible, the prohibited transaction rules are identical in the labor and tax provisions, so they will apply in

[296] the same manner to the same transaction. (However, there are some differences, such as not prohibiting under the tax law an act to which the tax sanction cannot appropriately apply.)

Coverage of the labor provisions

The labor fiduciary responsibility rules generally apply to all employee benefit plans (both retirement plans and welfare plans) in or affecting interstate commerce. The usual exceptions for government plans, church plans (which do not elect to have the participation, vesting, funding, and insurance rules apply), workmen's compensation plans, and nonresident alien plans apply here as well as to the other parts of the labor provisions. In addition, the labor fiduciary rules do not apply to an unfunded plan primarily devoted to providing deferred compensation for a select group of management or highly compensated employees. For example, if a "phantom stock" or "shadow stock" plan were to be established solely for the officers of a corporation, it would not be covered by the labor fiduciary rules. Also, a deferred compensation arrangement solely for retiring partners (under sec. 736 of the Internal Revenue Code) is to be exempt from the fiduciary responsibility rules. Additionally, the fiduciary responsibility rules do not apply to a so-called excess benefit plan which is unfunded.

Since mutual funds are regulated by the Investment Company Act of 1940 and, since (under the Internal Revenue Code) mutual funds must be broadly held, it is not considered necessary to apply the fiduciary rules to mutual funds merely because plans invest in their shares. Therefore, the substitute provides that the mere investment by a plan in the shares of a mutual fund is not to be sufficient to cause the assets of the fund to be considered the assets of the plan. (However, a plan's assets will include the shares of a mutual fund held by the plan.)

The substitute also provides that a mutual fund is not to be considered a fiduciary or a party-in-interest merely because a plan invests in its shares, except that the mutual fund may be a fiduciary or party-in-interest if it acts in connection with a plan covering the employees of the investment company, the investment adviser, or its principal underwriter.

An insurance company also is not considered to hold plan assets if a plan purchases an insurance policy from it, to the extent that the policy provides payments guaranteed by the company. If the policy guarantees basic payments but other payments may vary with, *e.g.*, investment performance, then the variable part of the policy and assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules. (However, such assets need not be held in trust under the fiduciary responsibility rule.)

Additionally, it is understood that assets placed in a separate account managed by an insurance company are separately managed and the insurance company's payments generally are based on the investment performance of these particular assets. Consequently, insurance companies are to be responsible under the general fiduciary rules with respect to assets held under separate account contracts, and the assets of these contracts are to be considered as plan assets (but need not be

[297] held in trust). However, to the extent that insurance companies place some of their own funds in these separate accounts to provide for contingencies, this separate account "surplus" is not to be subject to the fiduciary responsibility rules.

These rules are to apply with respect to insurance policies issued by an insurance company, or by an insurance service or insurance organization. The conferees understand that some companies that provide, *e.g.*, health insurance, are not technically considered as "insurance companies." It is intended that these companies are to be included within the terms "insurance service or insurance organization."

Structure of plan administration

Establishment of plan.—Under the labor provisions of the conference substitute, every covered employee benefit plan (both retirement and welfare plan) is to be established and maintained in writing. A written plan is to be required in order that every employee may, on examining the plan documents, determine exactly what his rights and obligations are under the plan. Also, a written plan is required so the employees may know who is responsible for operating the plan. Therefore, the plan document is to provide for the "named fiduciaries" who have authority to control and manage the plan operations and administration. A named fiduciary may be a person whose name actually appears in the document, or may be a person who holds an office specified in the document, such as the company president. A named fiduciary also may be a person who is identified by the employer or union, under a procedure set out in the document. For example, the plan may provide that the employer's board of directors is to choose the person who manages or controls the plan. In addition, a named fiduciary may be a person identified by the employers and union acting jointly. For example, the members of a joint board of trustees of a Taft-Hartley plan would usually be named fiduciaries.

Plan contents.—Under the labor provisions of the substitute, each plan is to provide a procedure for establishing a funding policy and method to carry out the plan objectives. This procedure is to enable the plan fiduciaries to determine the plan's short- and long-run financial needs and communicate these requirements to the appropriate persons. For example, with a retirement plan it is expected that under this procedure the persons who manage the plan will determine whether the plan has a short-run need for liquidity, (*e.g.*, to pay benefits) or whether liquidity is a long-run goal and investment growth is a more current need. This in turn is to be communicated to the persons responsible for investments, so that investment policy can be appropriately coordinated with plan needs. Also, the plan documents are to set out the basis for contributions to and payments from the plan. Thus, the plan is to specify what part (if any) of contributions are to come from employees and what part from employers. Also, it is to specify the basis on which payments are to be made to participants and beneficiaries.

It is customary for those who manage and control the plan to allocate their responsibilities and, within limits, designate others to carry out the daily management of the plan. The conference substitute establishes special rules which will enable fiduciaries to continue to allocate and delegate their responsibilities. However, alloca-

[298] tion or delegation is to be allowed only if the plan provides for it (or provides procedures for it) in accordance with the terms of the substitute, as discussed below.

Each plan also is to provide a procedure for amendments and for identifying who can amend the plan. Additionally, following common practice, a plan may provide that a person may serve in more than one fiduciary capacity under the plan, including service both as administrator and trustee. As described below, the plan may also provide for the hiring of investment (and other) advisers and investment managers.

Establishment of trust.—The labor provisions of the substitute generally provide that all plan assets are to be held in trust by trustees and also provide that the trustees are to manage and control the plan assets. Also, the plan trustees are to be appointed in the plan or trust documents or appointed by a named fiduciary. However, in order that persons who act as trustees recognize their special responsibilities with respect to plan assets, trustees are to accept appointment before they act in this capacity.

If the plan provides that the trustees are subject to the direction of named fiduciaries, then the trustees are not to have the exclusive management and control over the plan assets, but generally are to follow the directions of the named fiduciary. Therefore, if the plan sponsor wants an investment committee to direct plan investments, he may provide for such an arrangement in the plan. In addition, since investment decisions are basic to plan operations, members of such an investment committee are to be named fiduciaries. (For example, the plan could provide that the investment committee is to consist of the persons who serve as the president, vice-president for finance, and comptroller of the employer.) If the plan so provides, the trustee who is directed by an investment committee is to follow that committee's directions unless it is clear on their face that the actions to be taken under those directions would be prohibited by the fiduciary responsibility rules of the bill or would be contrary to the terms of the plan or trust.

In addition (as discussed below), to the extent that the management of plan assets is delegated to a special category of persons called "investment managers", the trustee is not to have exclusive discretion to manage and control the plan assets, nor would the trustee be liable for any act of such investment manager.

A trust is not to be required in the case of plan assets which consist of insurance (including annuity) contracts or policies issued by an insurance company qualified to do business in a State (or the District of Columbia). The same exemption will apply to the new section 403(b) custodial account arrangement involving investment in mutual funds, since these are treated as amounts contributed for an annuity contract under the tax law. Although these contracts need not be held in trust, nevertheless, the person who holds the contract is to be a fiduciary and is to act in accordance with the fiduciary rules of the substitute with respect to these contracts. For example, this person is to prudently take and keep exclusive control of the contracts, and is to use prudent care and skill to preserve this property.

To the extent that plan assets are held by an insurance company they need not be held in trust. However, to the extent the substitute

[299] treats assets held by an insurance company as "plan assets", the insurance company is to be treated as a fiduciary with respect to the plan, and is to meet the fiduciary standards of the conference substitute.

The labor provisions of the substitute also provide that the assets of H.R. 10 plans (plans for the self-employed and their employees) and individual retirement accounts need not be held in trust to the extent they are held in custodial accounts qualified under the Internal Revenue Code. It is recognized that the substitute generally amends the Internal Revenue Code to make use of custodial accounts more available for all plans, and that this is expected to decrease the cost of asset administration for many plans. Custodial accounts also may be used by all plans under the labor provisions. However, a plan (which is not exempt from the trust requirements) that uses a custodial account also will have to have a trustee (who can be the plan administrator or sponsor). The plan trustee will have the responsibility for investment decisions with regard to the assets and the custodian will (as under present practice) merely retain custody of these assets. Since the plan sponsor could be the trustee, the costs of plan administration will remain as low as with the present custodial account arrangements, but the plan also would have a responsible person in charge of investment decisions.

A trust also is not to be required for a plan not subject to the participation, vesting and funding provisions of title I, and the plan termination insurance provisions, to the extent provided by the Secretary of Labor.

Liability for breach of co-fiduciary responsibility, in general.—Under the labor provisions of the conference substitute, a fiduciary of a plan is to be liable for the breach of fiduciary responsibility by another fiduciary of the plan if he knowingly participates in a breach of duty committed by the other fiduciary. Under this rule, the fiduciary must know the other person is a fiduciary with respect to the plan, must know that he participated in the act that constituted a breach, and must know that it was a breach. For example, A and B are co-trustees, and the terms of the trust provide that they are not to invest in, *e.g.*, commodity futures. If A suggests to B that B invest part of the plan assets in commodity futures, and if B does so, A, as well as B, is to be liable for the breach.

In addition, a fiduciary is to be liable for the breach of fiduciary responsibility by another fiduciary of the plan, if he knowingly undertakes to conceal a breach committed by the other. For the first fiduciary to be liable, he must know that the other is a fiduciary with regard to the plan, must know of the act, and must know that it is a breach. For example, A and B are co-trustees, and B invests in commodity futures in violation of the trust instrument. If B tells his co-trustee A of this investment, A would be liable with B for breach of fiduciary responsibility if he concealed this investment.

Also, if a fiduciary knows that another fiduciary of the plan has committed a breach, and the first fiduciary knows that this is a breach, the first fiduciary must take reasonable steps under the circumstances to remedy the breach. In the second example above, if A has the authority to do so, and if it is prudent under the circumstances, A may be required to dispose of the commodity futures acquired by B. Al-

[300] ternatively, the most appropriate steps in the circumstances may be to notify the plan sponsor of the breach, or to proceed to an appropriate Federal court for instructions, or bring the matter to the attention of the Secretary of Labor. The proper remedy is to be determined by the facts and circumstances of the particular case, and it may be affected by the relationship of the fiduciary to the plan and to the co-fiduciary, the duties and responsibilities of the fiduciary in question, and the nature of the breach.

A fiduciary also is to be liable for the loss caused by the breach of fiduciary responsibility by another fiduciary of the plan if he enables the other fiduciary to commit a breach through his failure to exercise prudence (or otherwise comply with the basic fiduciary rules of the bill) in carrying out his specific responsibilities. For example, A and B are co-trustees and are to jointly manage the plan assets. A improperly allows B to have the sole custody of the plan assets and makes no inquiry as to his conduct. B is thereby enabled to sell the property and to embezzle the proceeds. A is to be liable for a breach of fiduciary responsibility.

Allocation of duties of co-trustees.—Under the conference substitute, if the plan assets are held by co-trustees, then each trustee has the duty to manage and control those assets. For example, shares of stock held in trust by several trustees generally should be registered in the name of all the trustees, or in the name of the trust. In addition, each trustee is to use reasonable care to prevent his co-trustee from committing a breach of fiduciary duty.

Although generally each trustee must manage and control the plan assets, nevertheless, under the substitute specific duties and responsibilities with respect to the management of plan assets may be allocated among co-trustees by the trust instrument. For example, the trust instrument may provide that trustee A is to manage and control one-half of the plan assets, and trustee B is to manage and control the other half of the plan assets.

Also, the trust instrument may provide that specific duties may be allocated by agreement among the co-trustees. In this case, however, the conferees intend that the trust instrument is to specifically delineate the duties that may be allocated by agreement of the co-trustees and is to specify a procedure for such allocation. Also, the trustees must act prudently in implementing such an allocation procedure.

If duties are allocated among co-trustees in accordance with the substitute, a trustee to whom duties have not been allocated is not to be liable for any loss that arises from acts or omissions of the co-trustee to whom such responsibilities have been allocated.

However, a co-trustee will be liable notwithstanding allocation if he individually fails to comply with the other fiduciary standards. For example, a co-trustee would be liable on account of his own acts if he did not act in accordance with the prudent man standard and thereby caused the plan to suffer a loss. In addition, the general rules of co-fiduciary liability are to apply. Therefore, for example, if a trustee had knowledge of a breach by a co-trustee, he would be liable unless he made reasonable efforts to remedy the breach.

Under the substitute, it is made clear that if plan assets are held in separate trusts a trustee of one trust is not responsible as a co-trustee of the other trust.

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[301] The conferees understand that under certain circumstances, trustees (and other fiduciaries) in discharging their responsibilities in accordance with the prudent man rule will hire agents to perform ministerial acts. In this case, the liability of the trustees (and other fiduciaries) for acts of their agents is to be established in accordance with the prudent man rule.

Allocation and delegation of duties other than the management of plan assets.—The substitute also provides for the allocation and delegation by fiduciaries of duties that do not involve the management and control of plan assets.[1] However, in order that participants and beneficiaries, etc., may readily determine who is responsible for managing a plan, the substitute generally provides that only "named fiduciaries" will be able to allocate or delegate their responsibilities.

Under the substitute, if the plan so provides, named co-fiduciaries may allocate their specific responsibilities among themselves, and named fiduciaries may delegate all or part of their duties (which do not involve asset management) to others. The substitute also provides that upon proper allocation or delegation fiduciaries will not be liable for the acts or omissions of the persons to whom duties have been allocated or delegated.

Allocation or delegation (and the consequent elimination of liability) can only occur under specific circumstances. The plan must specifically allow such allocation or delegation, and the plan must expressly provide a procedure for it. For example, the plan may provide that delegation may occur only with respect to specified duties, and only on the approval of the plan sponsor or on the approval of the joint board of trustees of a Taft-Hartley plan. Also, in implementing the procedures of the plan, plan fiduciaries must act prudently and in the interests of participants and beneficiaries. The fiduciaries also must act in this manner in choosing the person to whom they allocate or delegate their duties. Additionally, they must act in this manner in continuing the allocation or delegation of their duties.

In order to act prudently in retaining a person to whom duties have been delegated, it is expected that the fiduciary will periodically review this person's performance. Depending upon the circumstances, this requirement may be satisfied by formal periodic review (which may be by all the named fiduciaries who have participated in the delegation or by a specially designated review committee), or it may be met through day-to-day contact and evaluation, or in other appropriate ways. Since effective review requires that a person's services can be terminated, it may be necessary to enter into arrangements which the fiduciary can promptly terminate (within the limits of the circumstances).

Even though a named fiduciary has properly delegated his duties in accordance with the substitute, he may still be liable for the acts of a co-fiduciary if he breaches the general rules of co-fiduciary liability by, *e.g.*, knowingly concealing a breach of a co-fiduciary.

Investment managers, investment committees, etc.—Under the substitute, if the plan so provides, a person who is a named fiduciary with respect to the control or management of plan assets may appoint

[1] For example, these rules would govern the allocation or delegation of duties with respect to payment of benefits.

[302] a qualified investment manager to manage all or part of the plan assets. (However, in choosing an investment manager, the named fiduciary must act prudently and in the interests of participants and beneficiaries, and also must act in this manner in continuing the use of an investment manager.) In this case, the plan trustee would no longer have responsibility for managing the assets controlled by the qualified investment manager, and the trustee would not be liable for the acts or omissions of the investment manager. Also, as long as the named fiduciary had chosen and retained the investment manager prudentially, the named fiduciary would not be liable for the acts or omissions of the manager. Under the substitute, a qualified investment manager may be an investment adviser registered under the Investment Advisers Act of 1940, a bank (as defined in that Act), or an insurance company qualified to perform investment management services under State law in more than one State. To be qualified, the investment manager also must acknowledge in writing that he is a plan fiduciary.

As described above (*Establishment of trust*) the plan may also provide that the trustee is to be subject to the direction of named fiduciaries with respect to investment decisions. In this case, if the trustee properly follows the instructions of the named fiduciaries, the trustee generally is not to be liable for losses which arise out of following these instructions. (The named fiduciaries, however, would be subject to the usual fiduciary responsibility rules and would be subject to liability on breach of these rules.)

In addition, a plan may provide that named fiduciaries (or fiduciaries to whom duties have been properly delegated) may employ investment and other advisers. However, a fiduciary cannot be relieved of his own responsibilities merely because he follows the advice of such a person. (Also, investment advisers would be fiduciaries under the substitute.)

Basic fiduciary rules

Prudent man standard.—The substitute requires that each fiduciary of a plan act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in conducting an enterprise of like character and with like aims. The conferees expect that the courts will interpret this prudent man rule (and the other fiduciary standards) bearing in mind the special nature and purpose of employee benefit plans.

Under the Internal Revenue Code, qualified retirement plans must be for the exclusive benefit of the employees and their beneficiaries. Following this requirement, the Internal Revenue Service has developed general rules that govern the investment of plan assets, including a requirement that cost must not exceed fair market value at the time of purchase, there must be a fair return commensurate with the prevailing rate, sufficient liquidity must be maintained to permit distributions, and the safeguards and diversity that a prudent investor would adhere to must be present. The conferees intend that to the extent that a fiduciary meets the prudent man rule of the labor provisions, he will be deemed to meet these aspects of the exclusive benefit requirements under the Internal Revenue Code.

[303] Under the conference substitute, plan fiduciaries also must act in accordance with plan documents and instruments to the extent that they are consistent with the requirements established in the bill.

Exclusive benefit for employees.—Under the conference substitute each fiduciary of a plan must act solely in the interests of the plan's participants and beneficiaries and exclusively to provide benefits to these participants and beneficiaries (or to pay reasonable plan administrative costs).

Since the assets of the employee benefit plan are to be held for the exclusive benefit of participants and beneficiaries, plan assets generally are not to inure to the benefit of the employer. However, the conference substitute allows an employer's contributions to be returned to him in certain limited situations.

An employer's contributions can be returned within one year after they are made to the plan, if made as a mistake of fact. (For example, an employer may have made an arithmetical error in calculating the amounts that were to be contributed to the plan.) Also, if an employer contributes to a plan on the condition that the plan is tax-qualified or on the condition that a current tax deduction is allowed for the contribution, and it is later determined that the plan is not qualified (or the deduction is not allowed), the contribution can be returned if the plan provides for it. In this case, the contribution can be returned within one year after the disallowance of qualification or deduction. With regard to a disallowance of deductions, contributions can be returned only to the extent of the amount for which a deduction is denied. (For example, if $100 is contributed on the condition it is deductible and $20 is later determined not to be deductible, only $20 could be returned, and not $100.) Also with respect to qualification, contributions can be returned on the denial of initial or of continuing qualification (in the case of contributions made after *e.g.*, a plan amendment).

An employer's contributions under an H.R. 10 plan also can be returned to the employer to the extent permitted to avoid payment of an excise tax on excess contributions.

Under the labor (but not the tax) provisions of the substitute, the transfer or distribution of the assets of a welfare plan on termination of the plan is to be in accordance with the terms of the plan except as otherwise prescribed by regulations of the Secretary of Labor. It is intended that the Secretary of Labor would allow the terms of the plan (or in the case of a plan subject to collective bargaining, the collective bargaining agreement) to govern such distribution or transfer of assets except to the extent that implementation of the terms of the plan or agreement would unduly impair the accrued benefits of the plan participants or would not be in the best interests of the plan participants. Where such distribution or transfer is incidental to the merger of one multiemployer plan with another, it is expected that the Secretary of Labor would disallow the distribution or transfer only where the merger would reasonably be expected to jeopardize the ability of the plan to meet its obligations or would otherwise not be in the best interests of the plan participants.

Also, under the labor (but not the tax) provisions of the substitute, on termination of a pension plan to which the plan termination insurance provisions do not apply, the assets of the plan are to be allocated

[304] in accordance with the provisions under the plan termination insurance title of the Act governing such allocation (as if the plan were covered by termination insurance), except as otherwise provided in regulations prescribed by the Secretary of Labor. It is intended that regulations by the Secretary of Labor in this case would be similar to the regulations governing the distribution of assets on termination of a welfare plan as described above.

Diversification requirement.—The substitute requires fiduciaries to diversify plan assets to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. It is not intended that a more stringent standard of prudence be established with the use of the term "clearly prudent." Instead, by using this term it is intended that in an action for plan losses based on breach of the diversification requirement, the plaintiff's initial burden will be to demonstrate that there has been a failure to diversify. The defendant then is to have the burden of demonstrating that this failure to diversify was prudent. The substitute places these relative burdens on the parties in this matter, because the basic policy is to require diversification, and if diversification on its face does not exist, then the burden of justifying failure to follow this general policy should be on the fiduciary who engages in this conduct.

The degree of investment concentration that would violate this requirement to diversify cannot be stated as a fixed percentage, because a prudent fiduciary must consider the facts and circumstances of each case. The factors to be considered include (1) the purposes of the plan; (2) the amount of the plan assets; (3) financial and industrial conditions; (4) the type of investment, whether mortgages, bonds or shares of stock or otherwise; (5) distribution as to geographical location; (6) distribution as to industries; (7) the dates of maturity.

A fiduciary usually should not invest the whole or an unreasonably large proportion of the trust property in a single security. Ordinarily the fiduciary should not invest the whole or an unduly large proportion of the trust property in one type of security or in various types of securities dependent upon the success of one enterprise or upon conditions in one locality, since the effect is to increase the risk of large losses. Thus, although the fiduciary may be authorized to invest in industrial stocks, he should not invest a disproportionate amount of the plan assets in the shares of corporations engaged in a particular industry. If he is investing in mortgages on real property he should not invest a disproportionate amount of the trust in mortgages in a particular district or on a particular class of property so that a decline in property values in that district or of that class might cause a large loss.

The assets of many pension plans are managed by one or more investment managers. For example, one investment manager, A, may be responsible for 10 percent of the assets of a plan and instructed by the named fiduciary or trustee to invest solely in bonds; another investment manager, B, may be responsible for a different 10 percent of the assets of the same plan and instructed to invest solely in equities. Such arrangements often result in investment returns which are quite favorable to the plan, its participants, and its beneficiaries. In these circumstances, A would invest solely in bonds in accordance with his instruc-

[305] tions and would diversify the bond investments in accordance with the diversification standard, the prudent man standard, and all other provisions applicable to A as a fiduciary. Similarly, B would invest solely in equities in accordance with his instructions and these standards. Neither A nor B would incur any liability for diversifying assets subject to their management in accordance with their instructions.

The conferees intend that, in general, whether the plan assets are sufficiently diversified is to be determined by examining the ultimate investment of the plan assets. For example, the conferees understand that for efficiency and economy plans may invest all their assets in a single bank or other pooled investment fund, but that the pooled fund itself could have diversified investments. It is intended that, in this case, the diversification rule is to be applied to the plan by examining the diversification of the investments in the pooled fund. The same is true with respect to investments in a mutual fund. Also, generally a plan may be invested wholly in insurance or annuity contracts without violating the diversification rules, since generally an insurance company's assets are to be invested in a diversified manner.

(With respect to special rules regarding diversification of assets and investment in employer securities, etc., by certain individual account plans, see "Employer securities and employer real property," below.)

Certain individual account plans.—Under the substitute, a special rule is provided for individual account plans where the participant is permitted to, and in fact does, exercise independent control over the assets in his individual account. In this case, the individual is not to be regarded as a fiduciary and other persons who are fiduciaries with respect to the plan are not to be liable for any loss that results from the exercise and control by the participant or beneficiary. Therefore, if the participant instructs the plan trustee to invest the full balance of his account in, *e.g.*, a single stock, the trustee is not to be liable for any loss because of a failure to diversify or because the investment does not meet the prudent man standards. However, the investment must not contradict the terms of the plan, and if the plan on its face prohibits such investments, the trustee could not follow the instructions and avoid liability.

The conferees recognize that there may be difficulties in determining whether the participant in fact exercises independent control over his account. Consequently, whether participants and beneficiaries exercise independent control is to be determined pursuant to regulations prescribed by the Secretary of Labor. The conferees expect that the regulations will provide more stringent standards with respect to determining whether there is an independent exercise of control where the investments may inure to the direct or indirect benefit of the plan sponsor since, in this case participants might be subject to pressure with respect to investment decisions. (Because of the difficulty of ensuring that there is independence of choice in an employer established individual retirement account, it is expected that the regulations will generally provide that sufficient independent control will not exist with respect to the acquisition of employer securities by participants and beneficiaries under this type of plan.) In addition, the conferees expect that the regulations generally will require that for there to be

[306] independent control by participants, a broad range of investments must be available to the individual participants and beneficiaries.

Transfer of assets outside of the United States.—In order to prevent "runaway assets," the labor provisions of the substitute generally prohibit a fiduciary from transfering or maintaining the indicia of ownership of any plan assets outside the jurisdiction of the district courts of the United States. However, such a transaction may be permitted under regulations issued by the Secretary of Labor.

It is recognized that investment in securities of foreign companies and governments have been and may well continue to be in the best interests of plan participants in appropriate circumstances and with proper safeguards, and that the physical transfer of securities back and forth overseas may involve unduly high cost and impose unreasonable limitations on the investment of plan funds in such securities. The basic objective of the requirement that the indicia of ownership remain within the jurisdiction of a United States District Court is to preclude frustration of adequate fiduciary supervision and remedies for breach of trust. However, the risk of misappropriation of plan assets or their removal beyond the effective process of an American court is minimal where the assets are under the management or control of a bank, trust company or similar institution which is subject to adequate regulation and examination by State or Federal supervisory agencies. Such an institution would be responsive to legal process and to the traditional principles of fiduciary responsibility under trust law. Accordingly, it is contemplated that the Secretary of Labor will, as a general rule, grant an exemption to such institutions meeting standards that would assure the safety of plan assets. It is further contemplated that the Secretary will issue temporary regulations authorizing institutions with a history of investing pension funds in foreign securities as a matter of policy to continue to do so pending formal action on an application for exemption.

Prohibited transactions

In general.—The conference substitute prohibits plan fiduciaries and parties-in-interest from engaging in a number of specific transactions. Prohibited transaction rules are included both in the labor and tax provisions of the substitute. Under the labor provisions (title I), the fiduciary is the main focus of the prohibited transaction rules. This corresponds to the traditional focus of trust law and of civil enforcement of fiduciary responsibilities through the courts. On the other hand, the tax provisions (title II) focus on the disqualified person. This corresponds to the present prohibited transaction provisions relating to private foundations.[2]

The prohibited transactions, and exceptions therefrom, are nearly identical in the labor and tax provisions. However, the labor and tax provisions differ somewhat in establishing liability for violation of prohibited transactions. Under the labor provisions, a fiduciary will only be liable if he knew or should have known that he engaged in a prohibited transaction. Such a knowledge requirement is not included

[2] Generally, the substitute defines a prohibited transaction as the same type of transaction that constitutes prohibited self-dealings with respect to private foundations, with differences that are appropriate in the employee benefit area. As with the private foundation rules, under the substitute, both direct and indirect dealings of the proscribed type are prohibited.

[307] in the tax provisions. This distinction conforms to the distinction in present law in the private foundation provisions (where a foundation's manager generally is subject to a tax on self-dealing if he acted with knowledge, but a disqualified person is subject to tax without proof of knowledge).

Under the labor provisions a fiduciary will be liable for losses to a plan from a prohibited transaction in which he engaged if he would have known the transaction involving the particular party-in-interest was prohibited if he had acted as a prudent man. The type of investigation that will be needed to satisfy the test of prudence will depend upon the particular facts and circumstances of the case. In the case of a significant transaction, generally for a fiduciary to be prudent he must make a thorough investigation of the other party's relationship to the plan to determine if he is a party-in-interest. In the case of a normal and insubstantial day-to-day transaction, it may be sufficient to check the identity of the other party against a roster of parties-in-interest that is periodically updated.

In general, it is expected that a transaction will not be a prohibited transaction (under either the labor or tax provisions) if the transaction is an ordinary "blind" purchase or sale of securities through an exchange where neither buyer nor seller (nor the agent of either) knows the identity of the other party involved. In this case, there is no reason to impose a sanction on a fiduciary (or party-in-interest) merely because, by chance, the other party turns out to be a party-in-interest (or plan).

The labor prohibitions affect "parties-in-interest", and the tax prohibitions affect "disqualified persons." The two terms are substantially the same in most respects, but the labor term includes a somewhat broader range of persons, as described below.

Coverage.—The prohibited transaction rules under the labor provisions apply to all plans to which the general labor fiduciary rules apply, as described above. The tax law prohibited transaction rules apply to all qualified retirement plans (under secs. 401, 403(a), and 405(a) of the Internal Revenue Code) and to all qualified individual retirement accounts, individual retirement annuities, and individual retirement bonds (under secs. 408 and 409 of the Code). In addition, the tax law rules are to continue to apply even if the plan, etc., should later lose its tax qualification.

The tax law prohibited transaction provisions follow the labor provisions with respect to whether the assets of an insurance company or mutual fund are to be considered the assets of a plan. Also, the tax provisions exclude from the new prohibited transaction rules government plans, and church plans which have not elected coverage under the new participation, vesting, funding and insurance provisions. (The latter plans, if they are qualified plans, will be subject to present law.)

Party-in-interest transactions.—Under the substitute, the direct or indirect sale, exchange, or leasing of any property between the plan and a party-in-interest [3] (with exceptions subsequently noted) is a prohibited transaction. Under this rule, the transaction is pro-

[3] Hereafter, the term "party-in-interest" will include the term "disqualified person" unless otherwise indicated.

[308] hibited whether or not the property involved is owned by the plan or party-in-interest, and the prohibited transaction includes sales, etc., from the party-in-interest to the plan, and also from the plan to the party-in-interest. Also, following the private foundation rules of the tax law, a transfer of property by a party-in-interest to a plan is treated as a sale or exchange if the property is subject to a mortgage or a similar lien which the party-in-interest placed on the property within 10 years prior to the transfer to the plan or if the plan assumes a mortgage or similar lien placed on the property by a party in interest within 10 years prior to the transfer. This rule prevents circumvention of the prohibition on sale by mortgaging the property before transfer to the plan.

The conference substitute also generally prohibits the direct or indirect lending of money or other extension of credit between a plan and parties-in-interest. For example, a prohibited transaction generally will occur if a loan to a plan is guaranteed by a party-in-interest, unless it comes within the special exemption for employee stock ownership plans.

It is intended that prohibited loans include the acquisition by the plan of a debt instrument (such as a bond or note) which is an obligation of a party-in-interest. (However, the transition rules described below establish special rules for certain debt instruments held by a plan before July 1, 1974.) Similarly, it is intended that it would be a prohibited transaction (in effect a loan by the plan to the employer) if the employer funds his contributions to the plan with his own debt obligations.

With certain exceptions described below, the direct or indirect furnishing of goods or services or facilities between a plan and a party-in-interest also is prohibited. This would apply, for example, to the furnishing of personal living quarters to a party-in-interest.

The substitute prohibits the direct or indirect transfer of any plan income or assets to or for the benefit of a party-in-interest. It also prohibits the use of plan income or assets by or for the benefit of any party-in-interest. As in other situations, this prohibited transaction may occur even though there has not been a transfer of money or property between the plan and a party-in-interest. For example, securities purchases or sales by a plan to manipulate the price of the security to the advantage of a party-in-interest constitutes a use by or for the benefit of a party-in-interest of any assets of the plan.

The labor provisions and the tax provisions differ slightly on the wording with respect to this latter prohibition. The labor provision prohibits such use of the plan's "assets", and the tax provision prohibits use of the plan's "income or assets". (This same difference appears with respect to other prohibited transactions, as well.) The conferees intend that the labor and tax provisions are to be interpreted in the same way and both are to apply to income and assets. The different wordings are used merely because of different usages in the labor and tax laws. In addition, even though the term "income" is used in the tax law, it is intended that this is not to imply in any way that investment in growth assets (which may provide little current income) is to be prohibited where such investment would otherwise meet the prudent man and other rules of the substitute.

[309] Since the subsitute prohibits both direct and indirect transactions, it is expected that where a mutual fund, *e.g.*, acquires property from a party-in-interest as part of the arrangement under which the plan invests or retains its investment in the mutual fund, this is to be a prohibited transaction.

Employer securities and employer real property.—The labor provisions also generally prohibit the direct or indirect acquisition by the plan (or holding by the plan) of securities of the employer or real property leased to the employer, except if otherwise allowed. This prohibition (and the exceptions to it) is described in detail below.

Additional prohibitions.—The substitute generally prohibits a fiduciary from dealing with the income or assets of a plan in his own interest or for his own account. However, this does not prohibit the fiduciary from dealings where he has an account in the plan and the dealings apply to all plan accounts without discrimination.

The substitute also prohibits a fiduciary from receiving consideration for his own personal account from any party dealing with the plan in connection with the transaction involving the income or assets of the plan. This prevents, *eg.*, "kickbacks" to a fiduciary.

In addition, the labor provisions (but not the tax provisions) prohibit a fiduciary from acting in any transaction involving the plan on behalf of a person (or representing a party) whose interests are adverse to the interests of the plan or of its participants or beneficiaries. This prevents a fiduciary from being put in a position where he has dual loyalties, and, therefore, he cannot act exclusively for the benefit of a plan's participants and beneficiaries. (This prohibition is not included in the tax provisions, because of the difficulty in determining an appropriate measure for an excise tax.)

Administrative exemptions or variances.—The conferees recognize that some transactions which are prohibited (and for which there are no statutory exemptions) nevertheless should be allowed in order not to disrupt the established business practices of financial institutions which often performs fiduciary functions in connection with these plans consistent with adequate safeguards to protect employee benefit plans. For example, while brokerage houses generally would be prohibited from providing, either directly or through affiliates, both discretionary investment management and brokerage services to the same plan, the conferees expect that the Secretary of Labor and Secretary of the Treasury would grant a variance with respect to these services (and other services traditionally rendered by such institutions), provided that they can show that such a variance will be administratively feasible and that the type of transaction for which an exemption is sought is in the interest of and protective of the rights of plan participants and beneficiaries. Thus, variances might be granted to brokers or their affiliates to act as investment managers if the Secretary determines that such arrangements are in the interests of plan participants and beneficiaries and that satisfactory safeguards are provided, including *e.g.*, such protections as the monitoring of the investment manager's decisions by a person with appropriate investment experience, as specified by the Secretaries, who is not affiliated with the broker. The conferees did not grant a statutory exemption to brokers for this type of multiple service because of the difficulty of establishing

[310] precise statutory standards for protecting against potential abuses. The conferees note that the general issue of institutional investment management by brokers is under consideration in separate legislation, and expect that any action taken by the Secretaries on requests for variances under this Act will be consistent with the outcome of such legislation.

In addition, the conferees recognize that some individual transactions between a plan and party-in-interest may provide substantial independent safeguards for the plan participants and beneficiaries and may provide substantial benefit to the community as a whole, so that the transaction should be allowed under a variance. For example, it is understood that the pension plan of a major corporation with its principal office in Dayton, Ohio, has become committed to invest in a joint venture that will own an office building in a downtown redevelopment area in Dayton. This building is to be a key element of the redevelopment project. The joint venture will lease a portion of this building to the employer that established and maintained this pension plan. Under the general rules, this would be a prohibited indirect lease between the plan and a party-in-interest. However, it is understood that the transaction has substantial safeguards that ensure that the transaction will inure to the benefit of the plan participants and beneficiaries. For example, there are other major investors in the joint venture at this time so the joint venture will seek an adequate rate of return. Additionally, it is understood that the building has another major tenant and the terms of the lease for this tenant and for the employer are substantially identical. Furthermore, it is understood that the rental under these leases is generally higher than the rental for similar space now available in the area. Also, the City of Dayton will have a major investment in the land (and in a superstructure), so that the City will have an independent financial interest in ensuring that the transaction is financially sound.

Under this transaction, each party in the joint venture is to share in profits and losses in proportion to its capital contribution. Therefore, this is not a "tax shelter" transaction with an attempted shift of early period losses away from a tax-exempt entity to taxable entities. Also, it is understood that while the joint venture will borrow to finance the acquisition of the building, neither the joint venture nor the plan (nor any other joint venturer) is to be "personally liable" on the mortgage debt. Therefore, if the transaction were to fail, the plan's liability would be limited to the funds advanced to the joint venture.

It is expected that in this situation, because of the substantial safeguards for the plan and its participants and beneficiaries, because of the lack of "tax abuse" aspects, because the transaction became binding before the conferees' decisions were announced, and because of the importance of the project to the entire community of Dayton, Ohio, that the Secretary of the Treasury and Secretary of Labor will grant a variance to the transaction for its whole term.

Under the substitute, variances may be conditional or unconditional and may exempt a transaction from all or part of the prohibited transaction rules. In addition, variances may be for a particular transaction or for a class of transactions, and may be allowed pursuant to rulings or regulations. A variance from the prohibited transaction rules is to

[311] have no effect with respect to the basic fiduciary responsibility rules requiring prudent action, diversification of investments, actions exclusively for the benefit of participants and beneficiaries, etc. (This is the case with respect to all statutory exemptions from the prohibited transaction rules as well.)

Under the substitute, the Secretary of Labor and the Secretary of the Treasury each must establish a procedure for allowing variances, but neither the Secretary of Labor nor the Secretary of the Treasury is to be required to grant a variance. Variances are to be granted only when each Secretary separately determines that the transaction in question is an appropriate case for a variance. Thus, for example, the Secretary of Labor may refuse to grant a variance if the transaction would constitute an abuse of the labor laws, even though the Secretary of the Treasury may be willing to grant a variance in the particular situation. Similarly, the Secretary of the Treasury may, for example, refuse to grant a variance if the transaction would constitute a tax abuse even though the Secretary of Labor may be willing to grant a variance in the same situation.

In addition, variances are not to be allowed unless each Secretary finds that the transaction is in the interests of the plan and its participants and beneficiaries, that it does not present administrative problems, and that adequate safeguards are provided for participants and beneficiaries.

Although the Secretary of Labor and the Secretary of the Treasury are to separately determine whether a variance is to be provided, they are to coordinate their activities. It is expected that the Secretaries of Labor and Treasury will develop an administrative procedure to allow one application for a variance and that the two departments will coordinate their activities with respect to this single application to prevent unneeded delays and duplication of effort by the applicant.

Before allowing a variance, adequate notice (including publication in the Federal Register) is to be given interested persons, who are to have an opportunity to present their views. In the case of a variance from the prohibitions against a fiduciary dealing with plan assets for his own account, acting on behalf of an adverse party to the plan, or receiving consideration for his personal account, there is to be a hearing and a determination on the record that the conditions required for granting a variance are met. (However, the Secretary of the Treasury may accept the record of a Department of Labor hearing, if he wishes, and make his determination with respect to the variance on the facts presented in that record.)

Exemption for loans to participants and beneficiaries.—Following current practice, the substitute does not prohibit a loan by a plan to a participant or beneficiary in certain circumstances. To be permitted, such loans must be made in accord with specific provisions in the plan governing such loans. In addition, a reasonable interest rate must be charged and the loan must be adequately secured. Such loans must be made available to all participants on a reasonably equivalent basis. Consequently, the plan could not unreasonably discriminate between applicants on the basis of, e.g., age or sex; but the plan could make distinctions on the basis of, e.g., credit worthiness or financial need. Also, such loans cannot be made available to highly-compensated employees in an amount greater than the amount available to other

[312] employees. The conferees intend that this will allow a plan to lend the same percentage of a person's vested benefits to participants with both large and small amounts of accrued vested benefits. (However, the percentage is to be consistent with the requirements of adequate security.) The conferees also intend that a plan may provide that the same dollar amounts may be loaned to participants and beneficiaries without regard to the amount of their vested benefits if adequate security is otherwise provided. For example, a plan could provide for loans to participants and beneficiaries in an amount up to, *e.g.*, $30,000 to buy a house (even if the $30,000 is greater than the amount of the participant's or beneficiary's vested benefits) if the loan is adequately secured by, *e.g.*, a first mortgage on the house.

Exemption for services, etc.—The substitute allows a party-in-interest to furnish to a plan office space, legal services, accounting services, or other similar services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid for these services, etc. It is expected that such arrangements will allow the plan to terminate the services, etc., on a reasonably short notice under the circumstances so the plan will not become locked into an arrangement that may become disadvantageous. It is also expected that the compensation arrangements will allow for changes so the plan will not be locked into a disadvantageous price.

The substitute also specifically allows the plan to pay a fiduciary or other party-in-interest reasonable compensation (or reimbursement of expenses) for services rendered to the plan if the services are reasonable and necessary. However, to prevent double payment, this does not apply with regard to a fiduciary who is receiving full-time pay from an employer or association of employers (with employees covered by the plan) or from a union (with members covered by the plan), except for the reimbursement of expenses properly and actually incurred and not otherwise reimbursed.

The substitute also makes it clear that a party-in-interest may serve as a fiduciary in addition to being an officer, employee, agent or other representative of a party-in-interest.

Exemption for loans to employee stock ownership plans.—Under the substitute, certain loans or extensions of credit from a party-in-interest to an employee stock ownership plan are not to be prohibited. The conferees understand that it is common practice for these plans to purchase the employer's stock from major shareholders (or from the employer). The proceeds to pay for the purchase often are obtained by the plan from an unrelated lender with a guarantee of repayment by the shareholder. In this case, the substitute does not prohibit the party-in-interest from guaranteeing the loan (or from providing his assets as collateral for the loan). In addition, the conferees understand that it is common practice for a party-in-interest to sell his stock in the employer to these plans and take back a purchase money note from the plan. The substitute also does not prohibit such a loan if the only collateral given by the plan for the loan consists of qualifying employer's securities.

These exceptions to the prohibited transaction rules are to be allowed if the transaction is for the benefit of the plan participants and beneficiaries (and, not, e.g., primarily to benefit the party-in-interest

[313] who is selling the stock), and if the interest rate charged on the loan to the plan remains at not more than a reasonable interest rate.

Although these transactions normally are for the benefit of plan participants and beneficiaries, the conferees recognize that there may be potential problems. For example, the interest rate should not be too high and the purchase price of the stock from the party-in-interest should not be too high, so that plan assets might be drained off. Also, the terms of the note between the party-in-interest and the plan should not allow the party-in-interest to call the note at his convenience, which might put undue financial strain on the plan. Because of such potential problems, the conferees intend that all aspects of these transactions will be subject to special scrutiny by the Department of Labor and Internal Revenue Service to ensure that they are primarily for the benefit of plan participants and beneficiaries.

This exception from the prohibited transaction rules is to be available only for employee stock ownership plans and not for other plans. The conferees understand that the basic element common to all employee stock ownership plans is that they are qualified stock bonus plans designed to invest primarily in qualifying securities of the employer whose employees are covered by the plan. In addition it is understood that a qualified money purchase pension plan designed to invest primarily in such securities of the employer may be coupled with such a qualified stock bonus plan (and that a profit-sharing plan sometimes may be used). Furthermore, it is understood that a frequent characteristic of some employee stock ownership plans is that they leverage their purchase of qualifying employer securities as a way to achieve transfers in the ownership of corporate stock and other capital requirements of a corporation and that such a plan is designed to build equity ownership of shares of the employer corporation for its employees in a nondiscriminatory manner.

The conferees intend that the exemption from the prohibited transaction rules with respect to loans to employee stock ownership plans is to apply only in the case of loans (and guarantees) used to leverage the purchase of qualifying employer securities (and related business interests).

Exemption for bank deposits.—In certain cases the prohibited transaction rules of the substitute do not prevent a bank or similar institution (e.g., a savings and loan association or credit union) which is a plan fiduciary from investing all or part of the plan's assets in deposits with the bank, etc., if the deposits bear a reasonable interest rate. This exemption is allowed if the plan covers only employees of the bank, etc., or employees of its affiliates. In this case, it would be contrary to normal business practice for a bank to invest its plan assets in another bank.

A deposit with a bank, etc., fiduciary also is not prohibited if it is expressly authorized by the plan or is specifically authorized by a fiduciary (other than the bank or an affiliate of the bank) who is expressly empowered by the plan to direct that this investment be made. In this case, there is no conflict of interest involving the bank fiduciary upon a deposit with the bank, etc.

This exception, as all other exceptions to the prohibited transaction rules, is not to affect the applicability of the prudent man, diversi-

[314] fication, etc., rules. However, it is expected that generally these rules will not be violated if all plan assets in an individual account plan are invested in a federally-insured account, so long as the investments are fully insured. (If an individual's account balance is greater than the amount covered by Federal insurance, this will not violate the prudence and diversification requirements if the individual participant or beneficiary has control over his account and determines, for himself, that the assets should be so invested.)

Exemptions for purchase of insurance.—The substitute does not prohibit a plan from purchasing life insurance, health insurance, or annuities from the employer that maintains the plan if the employer is an insurer qualified to do business in a State (or the District of Columbia). In this case, it would be contrary to normal business practice to require the plan of an insurance company to purchase its insurance from another insurance company. This exemption is available only if no more than adequate consideration is paid for the insurance by the plan.

This exemption also applies to the purchase of life insurance, health insurance, and annuities from an insurer that is wholly-owned, directly or indirectly, by the employer establishing the plan (or is wholly owned by a party-in-interest with respect to the employer establishing a plan). This rule applies if the total premiums and annuity considerations written by all such wholly-owned insurers for life insurance, health insurance, and annuity premiums purchased by all employers which are parties-in-interest and their plans are not more than 5 percent of the total premiums and annuity considerations written for all lines of insurance by these insurers. (In computing this 5 percent figure, all premiums and annuity considerations written by an insurance company for a plan which it maintains are to be excluded from both the numerator and the denominator of the fraction.) This exception also is allowed only if no more than adequate consideration is paid for the insurance.

The conferees understand that for some purposes, certain insurance contracts may be considered as securities. However, the substitute provides that insurance contracts are not to be considered as "employer securities" to the extent that the exception described above from the prohibited transaction requirements would apply to the purchase of insurance contracts by a plan. (Otherwise, the rules with respect to employer securities might, as a practical matter, prevent this exemption from operating as it is intended.)

Exemption for ancillary bank services.—Unless otherwise specifically allowed by statutory or administrative exemption, generally a fiduciary is not to be able to provide "multiple services" to a plan. (However, the prohibition against providing multiple services is not to apply to parties-in-interest, who are not fiduciaries.) This rule was adopted because of the potential problems inherent in situations where persons who can act on behalf of a plan also are in a position to personally benefit at the expense of the plan in exercising that authority. However, as indicated above, it is expected that administrative exemptions will be established for sound commercial and financial practices where there are adequate safeguards. Also, the substitute provides some limited statutory exemptions from the general rule.

[315] Under the substitute, a bank or similar financial institution (such as a savings and loan association or credit union) which is supervised by Federal or State authorities, is not prohibited from providing multiple ancillary services in certain limited circumstances. First, no more than reasonable compensation can be charged by the bank, etc., for these services. Also the bank, etc., must have established adequate internal safeguards to assure that its provision of ancillary services is in accord with sound banking and financial practice, as determined by Federal and State banking authorities. In addition, the bank's action must be in accordance with binding specific guidelines issued by the bank that will prevent the bank from providing ancillary services in an unreasonable or excessive manner or in a manner that would be inconsistent with the best interests of the plan's participants and beneficiaries. Such guidelines are to be subject to, and not inconsistent with, coordinated regulations of the Secretaries of Labor and Treasury, which are to be issued after consultation with State and Federal banking authorities. The bank's guidelines must be reported to the Department of Labor and Internal Revenue Service, and must be reported to each plan to which multiple services are provided. Of course, if the bank does not follow the guidelines, the exemption will not be available.

Placing plan funds in noninterest bearing checking accounts is an example of the type of an ancillary service that might be provided by a bank that is a plan fiduciary. However, a number of short-term investment vehicles have been developed recently so that such cash balances should be kept to the very minimum necessary for the current operations of the plan. Therefore, it is expected that adequate guidelines and procedures to prevent unreasonable cash balances will require the bank to invest plan funds in such vehicles to the maximum extent feasible. Also, in determining whether a plan pays more than reasonable compensation for its checking account services, the interest available on an alternate use of the funds is to be considered. It is also expected that proper procedures and guidelines will keep to a minimum the amount of discretion on the part of the bank, etc., in determining the amount of cash balances. The conferees intend that such limitation of discretion is to be included in guidelines that govern other ancillary services that may be provided by banks, etc.

Exemption for conversion of securities.—Under the substitute a plan may hold or acquire certain employer securities. Since some of these securities may be convertible (*e.g.*, from bonds to stock) the substitute would not prohibit such a conversion to the extent provided in regulations if the plan receives at least fair market value under the conversion. It is expected that a conversion will be permitted if all the securities of the class held by the plan are subject to the same terms and such terms were determined in an arm's-length transaction, so that conversions cannot be tailored to apply only to a particular plan. Similarly, it is intended that a conversion generally will not be permitted if all but an insignificant percentage of unrelated holders of such securities do not exercise such conversion privileges. Also, it is intended that any acquisition of employer securities pursuant to a conversion privilege must be within the limits established by the general rules governing the acquisition and holding of employer securities, discussed below.

[316] *Exemption for certain pooled investment funds.*—The conferees understand that it is common practice for banks, trust companies and insurance companies to maintain pooled investment funds for plans. If the bank, etc., is the plan trustee and invests the plan assets in its pooled fund (rather than managing the assets individually) this would be considered a purchase of investment units in the fund and would be prohibited under the general rules. However, since generally the net effect of pooling plan assets is to achieve more efficient investment management, in certain circumstances the substitute allows the purchase and sale of interests in a pooled fund maintained by a bank, etc., which is a plan fiduciary.

To be allowed, no more than reasonable compensation may be paid by the plan in the purchase (or sale) and no more than reasonable compensation may be paid by the plan for investment management by the pooled fund. In addition, it generally is inappropriate for the bank, etc., to make the decisions with respect to investment in a pooled fund because of a potential conflict of interest. Therefore, this exception is allowed only if the transaction is specifically permitted by the plan or if a plan fiduciary (other than the bank, etc., or its affiliates) who has authority to manage and control the plan assets specifically permits such investment.

Banks, etc., that operate such pooled investment funds are, of course, plan fiduciaries. As fiduciaries they must act, *e.g.*, for the exclusive benefit of participants and beneficiaries. Therefore, a bank, etc., cannot use pooled funds as a place to dump unwanted investments which were initially made on its own (or another's) behalf.

Exemptions for owner-employees, etc.—The substitute retains the prohibited transaction rules (but not the disqualification sanction) of present law (sec. 503(g) of the Internal Revenue Code) with respect to owner-employees. Consequently, under the substitute the exceptions from the prohibited transaction rules described above generally will not apply with respect to sales, loans, payments for services, etc., between a plan and an owner-employee with regard to that plan. Also, since shareholder employees of subchapter S corporations are generally treated as owner-employees, the same limitations apply with respect to shareholder-employees. Additionally, these limitations apply to participants and beneficiaries of (and employers who establish and maintain) individual retirement accounts, individual retirement annuities, and individual retirement bonds, since these persons generally have the same type of control with respect to a plan as do owner-employees.

Exemptions for distribution of plan assets.—It is not a prohibited transaction for a plan to distribute its assets in accordance with the provisions of the plan and in the case of a pension plan if the distribution is in accord with the allocation of assets rules under the termination insurance provisions of the substitute.

Also, a distribution of assets from a welfare (or pension) plan, as described above in "Basic fiduciary rules", is exempt from the labor provisions as to prohibited transactions.

Employer securities and employer real property

Eligible individual account plans.—The labor provisions of the substitute generally limit the acquisition and holding by a plan of

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[317] employer securities and of employer real property (combined) to 10 percent of plan assets. (Employer securities are securities issued by an employer with employees covered by the plan or its affiliates. Employer real property is real property which is leased by a plan to an employer (or its affiliates) with employees covered by the plan.)

However, a special rule is provided for individual account plans which are profit-sharing plans, stock bonus plans, employee stock ownership plans, or thrift or savings plans, since these plans commonly provide for substantial investments in employer securities or real property. Also, money purchase plans which were in existence on the date of enactment, and which invested primarily in employer securities on that date are to be treated the same way as profit-sharing, etc., plans. (However, employer-established individual retirement accounts are not to be eligible individual account plans.)

In recognition of the special purpose of these individual account plans, the 10 percent limitation with respect to the acquisition or holding of employer securities or employer real property does not apply to such plans if they explicitly provide for greater investment in these assets. In addition, the diversification requirements of the substitute and any diversification principle that may develop in the application of the prudent man rule is not to restrict investments by eligible individual account plans in qualifying employer securities or qualifying employer real property.

These exceptions apply only if the plan explicitly provides for the relevant amount of acquisition or holding of qualifying employer securities or qualifying real property. For example, if a profit-sharing plan is to be able to invest half of its assets in qualifying employer securities, the plan must specifically provide that up to 50 percent of plan assets may be so invested. In this way, the persons responsible for asset management, as well as participants and beneficiaries, will clearly know the exten to which the plan can acquire and hold these assets. Plans in existence on the date of enactment will have one year from January 1, 1975, to be amended to comply with this requirement. If the plan does not comply within one year (but, *e.g.*, complies 2 years after January 1, 1975), then during the interim period, the plan will be subject to the 10 percent rule as well as the diversification requirement. This means, generally, that the plan will not be able to acquire any additional employer securities or employer real property during this period (and preparation should be made for divestiture of half of the excess of employer securities and real property by January 1, 1980.)

Under the substitute, only "qualifying" employer securities may be acquired and held by individual account plans under the rules described above. Stock of the employer will constitute qualifying securities. Also, certain debt will be qualifying employer securities if it is traded on a national securities exchange or has a price otherwise established by independent persons, and if the plan holds no more than a quarter of the issue and independent persons hold at least one-half of the issue. (Qualifying employer debt securities essentially are debt securities that meet the present rules of section 503(e) of the Internal Revenue Code.)

Also, under the substitute only "qualifying" employer real property may be acquired and held by eligible individual account plans under

[318] the rules described above. Real property which is leased to an employer is qualifying employer real property if a substantial number of the parcels are distributed geographically and if each parcel of real property and the improvements on it are suitable (or adaptable without excessive cost) for more than one use.[4] For example, the plan might acquire and lease to the employer multipurpose buildings which are located in different geographical areas. It is intended that the geographic dispersion be sufficient so that adverse economic conditions peculiar to one area would not significantly affect the economic status of the plan as a whole. All of the qualifying real property may be leased to one lessee, which may be the employer or an affiliate of the employer.

To the extent that an eligible individual account plan can acquire qualifying employer securities, it may acquire these securities from parties-in-interest if the acquisition is for adequate consideration and no commission is charged in the transaction. (The conferees intend that if a purchase is made from an underwriter who assumes the risks of market fluctuations after the award date, the underwriter's margin is not to be regarded as a "commission.") A similar exception from the prohibited transaction rules (in both the labor and tax provisions) is available for the acquisition from an employer of qualifying employer real property, the leasing of such property to the employer (or its affiliate) and the sale of such real property back to the employer on termination of the lease for adequate consideration. However, real property is not qualifying employer real property unless it is leased to the employer. Therefore, except for qualifying leasebacks, a plan generally is prohibited from acquiring real property from the employer.

Other plans.—Under the substitute, a plan other than an eligible individual account plan cannot acquire any employer securities or real property if immediately after doing so the plan would hold more than 10 percent of the fair market value of its assets in employer securities or real property. The acquisition rules apply not only to the purchase of employer securities, etc., but also to acquisition in other ways such as by exercise of warrants or by acquisition on default of a loan where the stock was made security for the loan. Also, these plans (as eligible individual account plans) are not to acquire any employer securities or employer real property other than qualifying employer securities or qualifying employer real property.

In addition, if a plan holds more than 10 percent of the fair market value of its assets in employer securities and real property on January 1, 1975, it is to dispose of enough of these assets to bring its holdings of employer securities, etc. to no more than 10 percent of plan assets on or before December 31, 1984.

In general, the 10 percent holding rule will be met on the first date after January 1, 1975 (and on or before December 31, 1984) that a plan holds no more than 10 percent of the fair market value of its assets in employer securities or employer real property. Thus, if a plan on January 1, 1975, holds qualifying employer securities and qualifying em-

[4] Qualifying employer real property includes the real property and related personal property.

[319] ployer real property worth $200,000 and has total assets worth $1,000,000, the plan must bring its employer securities, etc., down to 10 percent of plan assets. If, *e.g.*, there is a substantial market rise in the value of the plan's other assets in the year 1976, so all plan assets are now worth $2,000,000, but employer securities are still worth $200,000, then the holding requirement has been met and from that time on, only the acquisition rule will affect the plan. (Under the acquisition rule, the plan could not acquire any more qualifying employer securities in 1976, since immediately after the acquisition more than 10 percent of plan assets would be invested in employer securities.) Also, if the fair market value of other plan assets decrease to $1,500,000 in 1977, so the plan has $200,000 of employer securities and $1,500,000 total assets, the plan will not violate the holding (or acquisition) rules, since it met the holding rules in 1976.

Under the substitute, a plan is not required to dispose of more qualifying employer securities than would bring its holdings down to 10 percent of the fair market value of assets on the date of enactment. Thus, if a plan had $200,000 of employer securities and $1,000,000 total assets on date of enactment, it would satisfy the 10 percent holding rule when it had employer securities of $100,000, even if its total assets had dropped to $900,000.

The substitute allows a special election for calculating the 10 percent holding rule (but not the 10 percent acquisition rule). Under this election, the 10 percent holding rule is met if on or before December 31, 1984, the value of employer securities which are held on January 1, 1975, is no greater than 10 percent of the fair market value of plan assets on January 1, 1975, plus employer contributions to the plan made after December 31, 1974, and prior to January 1, 1985. For this purpose, employer contributions are to be included only to the extent of the growth in the value of plan assets (other than employer securities) from January 1, 1975, through December 31, 1984. Election to make this provision applicable must be made prior to January 1, 1976, and the election is irrevocable once it is made. For purposes of this rule, employer securities held on January 1, 1975, are to include employer securities the ownership of which is derived solely from the employer securities held on January 1, 1975, or from the exercise of rights derived from such ownership under regulations to be prescribed by the Secretary of Labor. This election is to be available only for a plan which holds no employer real property, and does not acquire employer real property until after December 31, 1984.

A plan must be half-way toward meeting the 10-percent rule by December 31, 1979. The maximum percentage of assets that a plan may have in employer securities and employer real property on that date is to be established by regulations (which are to be issued by December 31, 1976). Generally, it is expected that the regulations will provide that the maximum percentage of assets that a plan may have in employer securities and real property on (or before) December 31, 1979, is to be determined by adding 10 percent to half of the percentage of employer securities, etc., held by the plan on January 1, 1975 in excess of 10 percent. For example, if 15 percent of the plan's assets are in employer securities on January 1, 1975, generally it is expected that the plan

[320] must have reduced its percentage of employer securities to 12½ per-percent on or before December 31, 1979. (That is, $10 + \frac{(15-10)}{2} = 12\frac{1}{2}$.)

If securities are qualifying employer securities they generally can be acquired or held notwithstanding the prohibited transaction rules, if acquisition is for adequate consideration and no commission is charged and if acquisition is allowed by the employer securities rules. However (except as noted above for eligible individual account plans), acquisition and holding of these assets must also meet the rules of prudence, diversification, etc. Therefore, if the diversification and prudence rules require that less than 10 percent of plan assets are to be held in employer securities and employer real property, the lower limit is to govern. Furthermore, the exclusive benefit rule also may apply. Thus, while a plan may be able to acquire employer securities or real property under the employer securities rules, the acquisition must be for the exclusive benefit of participants and beneficiaries. Consequently, if the real property is acquired primarily to finance the employer, this would not meet the exclusive benefit requirements.

Generally these rules apply only to the holding (or acquiring) of qualified employer securities or qualified employer real property. Under the general prohibited transaction rules, a plan is not to hold (or acquire) any other employer securities or employer real property (since this would be a prohibited loan or lease, respectively). Of course, the general transition rules discussed below will apply to employer securities or real property held on July 1, 1974.

Civil liability

Fiduciaries.—Under the labor provisions (but not the tax provisions) of the substitute, a fiduciary who breaches the fiduciary requirements of the bill is to be personally liable for any losses to the plan resulting from this breach. Such a fiduciary is also to be liable for restoring to the plan any profits which he has made through the use of any plan asset. In addition, such a fiduciary is to be subject to other appropriate relief (including removal) as ordered by a court. The place and manner of bringing civil actions against a fiduciary is described below.

Generally, a plan fiduciary is not to be liable for any breach of fiduciary duty if it occurred before he became a fiduciary or after he was no longer a fiduciary.

Party-in-interest.—A party-in-interest who engages in a prohibited transaction with respect to a plan that is not qualified (at the time of the transaction) under the Internal Revenue Code may be subject to a civil penalty of up to 5 percent of the amount involved in the transaction. If the transaction is not corrected after notice from the Secretary of Labor, the penalty may be up to 100 percent of the transaction.

Exculpatory provisions and liability insurance.—Under the substitute, exculpatory provisions which relieve a fiduciary from liability for breach of the fiduciary responsibility rules are to be void and of no effect. (However, this is not to affect the fiduciary's ability to allocate or delegate his responsibilities, as described above.)

The substitute also provides, however, that a plan may purchase insurance for itself and for its fiduciaries to cover liability or loss re-

[321] sulting from their acts or omissions if the insurance permits recourse by the insurer against the fiduciaries in case of a breach of fiduciary responsibility. Also, under the substitute, a fiduciary may purchase insurance to cover his own liability, and an employer or union may purchase liability insurance for plan fiduciaries (and these policies need not provide for recourse).

Excise tax on prohibited transactions

In general.—As indicated above, the substitute establishes an excise tax on disqualified persons who participate in specific prohibited transactions respecting a pension plan. The tax applies with respect to a plan which has qualified after the effective date of the prohibited transaction provisions (or has been determined to qualify by the Secretary of the Treasury under section 401, 403(a), or 405(a) of the Code) and with respect to a qualified individual retirement account, bond or annuity (under sections 408 or 409). The prohibited transaction rules and excise tax sanctions are to continue to apply even if the plan, etc., should later lose its tax qualification.

This excise tax generally follows the same procedures as the tax on self-dealing enacted in 1969 Tax Reform Act with respect to private foundations. The tax is at two levels; initially, disqualified persons who participate in a prohibited transaction are to be subject to a tax of 5 percent of the amount involved in the transaction per year. A second tax of 100 percent is imposed if the transaction is not corrected after notice from the Internal Revenue Service that the 5-percent tax is due.

Following present law with respect to private foundations, under the substitute where a fiduciary participates in a prohibited transaction in a capacity other than that, or in addition to that, of a fiduciary, he is to be treated as other disqualified persons and subject to tax. Otherwise, a fiduciary is not to be subject to the excise tax.

The first-level tax is owed for each taxable year (or part of a year) in the period that begins with the date when the prohibited transaction occurs and ends on the earlier of the date of collection or the date of mailing of a deficiency notice for the first-level tax (under section 6212 of the Internal Revenue Code). The first-level tax is imposed automatically without regard to whether the violation was inadvertent.

If more than one person is liable for the excise tax as a result of a particular prohibited transaction, they all are to be jointly and severally liable. For example, if the prohibited transaction involves $100,000, all disqualified persons who participated in the transaction will be jointly and severally liable for the first-level tax of $5,000 (per year in the taxable period) and also jointly and severally liable for the second-level tax of $100,000.

The excise tax on a prohibited transaction is dependent upon the amount involved in the transaction. The substitute provides that the amount involved is the greater of the fair market value of the property (including money) given or received in a transaction. However, with regard to services which are necessary to the operation of the plan and which generally may be paid for if the compensation is not excessive, the amount involved generally is the excess compensation. For the first-level tax, the amount involved in a prohibited transaction is valued as of the date of the transaction. However, for the second-level tax,

[322] the amount involved is valued at the highest fair market value during the correction period. The higher valuation is used for the second-level tax so the person subject to tax will not delay returning the amount involved to the trust in order to earn income with this amount.

A prohibited transaction may be corrected to avoid a second-level tax at any time before the 90th day after the Internal Revenue Service mails a notice of deficiency with respect to the second-level tax. However, the 90-day period may be extended by any period within which a deficiency cannot be assessed (because of petitions to the Tax Court), and may also be extended for a period which the Internal Revenue Service determines is both reasonable and necessary to correct the prohibited transaction.

To correct a prohibited transaction, the transaction must be undone to the extent possible, but in any case the final position of the plan must be no worse than it would have been if the disqualified person were acting under the highest fiduciary standards. The higher valuation to be used in computing any second-level tax that might be applicable is also the valuation to be used in correcting the transaction. In other words, correction requires that the plan receive the benefit of whatever bargain turns out to have been involved in the transaction.

Before sending a notice of deficiency with respect to the first level and second level taxes, the Internal Revenue Service is to notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of these taxes. However, the Service will be able to waive (or abate) only the second level tax (and not the first level tax) upon a correction that is obtained by the Secretary of Labor.

Voluntary retroactive application.—Under present law, if a prohibited transaction occurs, a plan (and trust) loses its exemption from taxation. If a trust is disqualified because of an act of the trustee and the employer, then the income tax imposed on the trust may be paid out of funds otherwise available to provide employees' retirement benefits and the sanction may then fall on innocent employees. To correct this problem in the future, the substitute eliminates disqualification and instead would impose an excise tax sanction for a violation of the prohibited transactions provisions.

The substitute also makes the excise tax sanction available—on a wholly voluntary basis—instead of the disqualification sanction in the case of plans which have engaged in prohibited transactions in (open) years before the effective date of the new prohibited transactions. Therefore, if a disqualified person with respect to a plan elects to be subject to and pays the excise tax, the plan and trust are not to be disqualified. For purposes of this application of the excise tax, the prohibited transactions are to be defined by present section 503 (b) or (g) of the Code and the amount involved is to be the amount that would be determined under new section 4975 of the Code. Since the tax is to be wholly voluntary, the joint and several liability provisions of new section 4975 are not to apply (unless there is an election by several disqualified persons to this effect). Also, the first-level tax that is to be paid under this provision will be owed for taxable periods calculated under new section 4975. Thus, if the prohibited transaction (under present section 503) occurred in 1972 and is corrected in 1974,

[323] the first-level tax will be owed for 1972, 1973, and 1974. As under new section 4975, the second-level tax will be owed only if the transaction is not corrected within the time allowed by that section.

Since this is to be a relief provision, no liability is to be imposed under the labor provisions of the substitute on a person who may be a plan fiduciary after January 1, 1975, if he fails to pay the tax and the plan is disqualified. Consequently, any decision to pay or not to pay this optional tax is to be deemed to have been made before January 1, 1975, and, therefore, to be made before the substitute would establish any duties on plan fiduciaries.

Definitions

The substitute defines "fiduciary" as any person who exercises any discretionary authority or control respecting management of a plan, exercises any authority or control respecting the management or disposition of its assets or has any discretionary authority or responsibility in the administration of the plan. Under this definition, fiduciaries include officers and directors of a plan, members of a plan's investment committee and persons who select these individuals. Consequently, the definition includes persons who have authority and responsibility with respect to the matter in question, regardless of their formal title. The term "fiduciary" also includes any person who renders investment advice for a fee and includes persons to whom "discretionary" duties have been delegated by named fiduciaries.

While the ordinary functions of consultants and advisers to employee benefit plans (other than investment advisers) may not be considered as fiduciary functions, it must be recognized that there will be situations where such consultants and advisers may because of their special expertise, in effect, be exercising discretionary authority or control with respect to the management or administration of such plan or some authority or control regarding its assets. In such cases, they are to be regarded as having assumed fiduciary obligations within the meaning of the applicable definition.

The labor definition of a "party-in-interest" includes the following general categories. (1) Plan administrators, officers, fiduciaries, trustees, custodians, counsel and employees. (2) Persons providing services to a plan. (3) The employer, its employees, officers, directors, or 10-percent shareholders. (4) Controlling or controlled parties or parties under common control (and their employees, officers, directors, or 10-percent shareholders). (Under the substitute, "control" is generally defined at 50-percent ownership. However, the Secretary of Labor and Secretary of Treasury may, by regulation, reduce this percentage.) (5) Employee organizations with members covered by the plan, its employees, its officers and directors and its affiliates (6) Certain relatives and partners of parties-in-interest are also treated as parties-in-interest.

Under the tax provisions, the same general categories of persons are disqualified persons, with some differences. Although fiduciaries are disqualified persons under the tax provisions, they are to be subject to the excise tax only if they act in a prohibited transaction in a capacity other than that of a fiduciary. Also, only highly-compensated employees are to be treated as disqualified persons, not all employees of an employer, etc.

[324] *Prohibition against certain persons holding office*

The labor provisions of the substitute prohibit a person who is convicted of certain specified crimes from serving as a plan administrator, fiduciary, officer, trustee, custodian, counsel, agent, employee or consultant of a plan for five years after conviction or five years after the end of imprisonment, whichever is later. However, such a person may serve as an administrator, etc., of a plan if his citizenship rights have been fully restored or if the United States Board of Parole determines that his service would not be contrary to the purposes of the labor provisions of the substitute.

Corporations and partnerships are not to be barred from acting as plan administrators, etc., without a determination from the Board of Parole that such service would be inconsistent with the labor provisions of the substitute.

No one is to knowingly permit another to serve as a plan administrator, etc., in violation of this provision. Those who violate this provision may be fined up to $10,000 and also may be imprisoned for up to one year. This provision is to apply to crimes committed before the date of enactment.

Bonding

The labor provisions of the substitute generally require every fiduciary of an employee benefit plan (and every person who handles funds or other property of a plan) to be bonded. This provision generally is identical to present section 13 of the Welfare and Pension Plans Disclosure Act and it is intended that the construction given to the bonding requirements before enactment of the substitute would continue. Generally, the amount of the bond is to be not less than 10 percent of the funds handled and not less than $1,000 (nor more than $500,000, except as otherwise required by the 10 percent rule or as prescribed by the Secretary of Labor). The substitute would not require a bond if plan benefits are paid only from the general assets of a union or employer. A bond also is not to be required for a domestic trust or insurance corporation subject to State or Federal supervision or examination if it has capital and surplus combined in excess of $1 million (or such other higher amount determined by the Secretary of Labor). However, a special rule is provided for banks or other financial institutions exercising trust powers if their deposits are not insured by the Federal Deposit Insurance Corporation. In this case a bond will not be required if the corporation meets bonding (or similar requirements) of State law which the Secretary of Labor determines are at least equivalent to bonding requirements imposed on banks under Federal law.

It is expected that regulations to be prescribed by the Secretary of Labor under this provision would include procedures for exempting plans where other bonding arrangements of the employer, employee organization, investment manager or other fiduciaries or the overall financial condition of the plan or the fiduciaries meet specified standards deemed adequate to protect the interests of the beneficiaries and participants, including bonds subject to a reasonable maximum for professional investment managers supervising large aggregations of clients' funds.

[325] *Effective date and transition rules*

Generally, the new fiduciary responsibility rules are to take effect on January 1, 1975. However, with respect to any plan which is covered by plan termination insurance and which terminates before January 1, 1975, the fiduciary rules are to take effect on the date of enactment of the bill.

Under the labor provisions, the Secretary of Labor may postpone until January 1, 1976, the effective date with respect to the requirements for establishing a plan and establishing a trust, the rules regarding liability for breach by a co-fiduciary (other than the rules allowing delegation of asset management functions to an investment manager) and the rules prohibiting exculpatory clauses. The Secretary of Labor may allow such a delay only for plans in existence on the date of enactment and only if he determines (on application of the plan) that the delay is (1) necessary to amend the plan instrument, and (2) not adverse to the plan participants and beneficiaries.

To prevent undue hardship, the substitute also provides transition rules for situations where employee benefit plans are now engaging in activities which do not violate current law, but would be prohibited transactions under the substitute.

One of the transition rules permits the leasing or joint use of property involving a plan and a party in interest under a binding contract in effect on July 1, 1974 (or pursuant to renewals of the contract), to continue for 10 years beyond that date until June 30, 1984. For this transition rule to apply, the lease or joint use must remain at least as favorable to the plan as an arm's-length transaction with an unrelated party and must not otherwise be a prohibited transaction under present law. A similar 10-year transition rule applies to loans or other extensions of credit under a binding contract in effect on July 1, 1974 (and renewals thereof), where the loan remains as favorable as an arm's-length transaction with an unrelated party and is not prohibited under present law.

The substitute allows a plan to sell property, at arm's-length terms, to a party in interest where the property is now under a lease or joint use which qualifies for the 10-year transition rule described above. Sales of this type must occur before July 1, 1984. This transition rule is provided because it appears that such leases are not uncommon and in such cases often a party in interest is the best available buyer.

The substitute allows a fiduciary to provide multiple services to a plan until June 30, 1977, if he ordinarily and customarily furnishes services on June 30, 1974. Under this provision, such a fiduciary would not be limited to providing these services to plans which he served on that date, but he could take on new customers after that date. Under the substitute, multiple services also can be provided until June 30, 1977, if they were being provided under a binding contract in effect on July 1, 1974 (or under renewals of such a contract). It is intended that under this provision fiduciaries can continue to provide such services for the next three years in order that they might continue their business during the pendency of and application for a variance from the prohibited transaction rules. However, these services can only be provided under the transition rules if the price is at least an arm's-length price during the whole transition period and if

[326] they would not constitute a prohibited transaction under current section 503 of the Internal Revenue Code.

The substitute permits a plan to dispose of excess employer securities or employer real property owned by the plan on June 30, 1974, and at all times thereafter to a party-in-interest if the holding of such property would violate the rules governing holding of employer securities and real property, and if the sale, etc., is at fair market value.

VI. Labor and Tax Administration and Enforcement (Secs. 501–516 and 1041–1052 of the Bill and Secs. 7476 and 7802 of the Internal Revenue Code.)

Labor Department

Criminal penalty.—Under the bill as passed by the House, any person who willfully violates any of the provisions in title I of the Act, makes any statement in any report required to be filed or to be kept under that title knowing that it is false or misleading in any material fact, or forges or counterfeits or passes as true any document knowing it was forged or counterfeit for the purpose of influencing the acts of the Secretary of Labor is guilty of a crime which is punishable by a fine of up to $10,000 and 5 years of imprisonment, or both. If the act is committed by someone other than an individual the fine may be up to $200,000.

The bill as passed by the Senate did not contain comparable provisions but did provide for a fine of up to $1,000 and 6 months imprisonment, or both, for willful violation of the disclosure provisions.

Under the conference agreement, any person who willfully violates any provisions in title I of the bill relating to reporting and disclosure may be fined not more than $5,000 or imprisoned for more than 1 year, or both, except that in the case of a violation by a person other than an individual the fine may not exceed $100,000. The conference agreement retains present criminal provisions of Title 18, U.S.C. relating to false statements, bribery, kickbacks, embezzlement, etc., in connection with employee benefit plans.

Civil penalty for failure to disclose.—Under the bill as passed by the House, if a plan administrator fails or refuses to furnish a participant or a beneficiary with a copy of the latest annual report (or such other information that is required to be furnished under the Act) within 30 days after a request for it, the administrator may be personally liable to the participant or beneficiary for up to $50 a day from the date of the failure and a court, in its discretion, may grant such other relief as it deems proper. The bill as passed by the Senate contains no comparable provision but relies upon the existing provisions of law to impose liability on the plan administrator. Under the conference agreement the administrator may be personally liable to the participant or beneficiary for up to $100 per day from the date of the failure and the court may in its discretion order such other relief as it deems proper.

Civil actions by participants and beneficiaries.—In addition, under the bill as passed by both the House and Senate, civil action may be brought by a participant or beneficiary to recover benefits due under the plan, to clarify rights to receive future benefits under the plan, and for relief from breach of fiduciary responsibility.

[327] Under the conference agreement, civil actions may be brought by a participant or beneficiary to recover benefits due under the plan, to clarify rights to receive future benefits under the plan, and for relief from breach of fiduciary responsibility. The U.S. district courts are to have exclusive jurisdiction with respect to actions involving breach of fiduciary responsibility as well as exclusive jurisdiction over other actions to enforce or clarify benefit rights provided under title I. However, with respect to suits to enforce benefit rights under the plan or to recover benefits under the plan which do not involve application of the title I provisions, they may be brought not only in U.S. district courts but also in State courts of competent jurisdiction. All such actions in Federal or State courts are to be regarded as arising under the laws of the United States in similar fashion to those brought under section 301 of the Labor-Management Relations Act of 1947. The U.S. district courts are to have jurisdiction of these actions without regard to the amount in controversy and without regard to the citizenship of the parties. In any action brought by a participant or beneficiary, the court may allow reasonable attorney's fees or costs to either party. An action in the U.S. district court may be brought in the district where the plan is administered or where the breach of fiduciary duty took place, or where a defendant resides or may be found. Process may be served in any other district where a defendant resides or may be found. If a participant or beneficiary brings an action in Federal court to enforce rights under title I, he is to provide a copy of the complaint to the Secretary of Labor and the Secretary of Treasury by certified mail. A copy is not required to be provided in any action which is solely for the purpose of recovering benefits under the plan. The Secretary of Labor or the Secretary of Treasury, or both, are to have the right to intervene in any action at their discretion.

Civil actions by the Secretary of Labor.—Under the bill as passed by the House, the Secretary of Labor may bring suit for breach of fiduciary responsibility and to enjoin any act or practice which violates the provisions of title I of the Act. The Secretary of Labor may also intervene in actions brought under the Act by participants and beneficiaries.

Under the bill as passed by the Senate, the Secretary of Labor may petition the court for an order requiring the return of assets transferred from a retirement fund, requiring the payment of benefits to a participant or beneficiaries, restraining conduct violating the fiduciary rules, and granting such other appropriate relief including the removal of a fiduciary. The Secretary is also authorized to bring suit when he believes that an employee benefit fund is being or has been administered in violation of the Act or the governing documents of the retirement fund. In addition, the bill as passed by the Senate authorizes the Secretary of Labor to intervene at his discretion in actions brought under the Act by participants or beneficiaries.

The conference agreement generally conforms to the provisions as passed by the House. The Secretary of Labor may bring an action for breach of a fiduciary duty or to enjoin any act or practice which violates the provision of title I of the Act or to obtain any other appropriate relief to enforce any provision of that title. In the case of a transaction by a party in interest with respect to a plan which is

[328] not qualified under the Internal Revenue Code, the Secretary of Labor may assess a civil penalty not to exceed 5 percent of the amount of the transaction. If not corrected, an additional penalty of not more than 100 percent of the transaction may be imposed.

In the case of any plan which has been found by the Internal Revenue Service to be a qualified employee benefit plan under the Internal Revenue Code (or with respect to any plan which has a pending application for a determination to be so qualified), the Secretary of Labor is not to bring an action for equitable relief with respect to a violation of the participation, vesting and funding standards of title I unless he is requested to do so either by the Secretary of the Treasury or by one or more participants, beneficiaries, or fiduciaries of the plan.

Benefit claim procedure.—The bill as passed by the House contains no provisions providing for procedures for resolving disputes between the plan administrator and participants or beneficiaries. Under the bill as passed by the Senate each pension plan is required to establish a procedure for a review of disputes between the plan administrator and participants or beneficiaries and afford an opportunity for arbitration of any dispute. Under the conference agreement every employee benefit plan is required to provide adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied, setting forth the specific reasons for denial written in a manner calculated to be understood by the participant. In addition, the plan administrator is required to afford a reasonable opportunity to any participant or beneficiary whose claim for benefits has been denied for a full and fair review of this decision by the plan administrator.

Investigatory authority.—Under the bill as passed by the House, the Secretary of Labor, where he has reasonable cause to believe that violations of the provisions of this bill have been committed, may enter places, inspect accounts and question persons to the extent he deems necessary in order to determine whether any provision of title I has been or is about to be violated. The Secretary is authorized to request the filing of supporting schedules of information and to publish and report on any investigation to interested persons or government officials.

Under the bill as passed by the Senate, the Secretary may enter premises and inspect records and accounts but he may make no more than one examination of books and records per year unless he has reasonable cause to believe that there was a violation of title I. The bill as passed by the Senate also authorizes the Secretary to require the filing of supporting schedules of information. The Secretary of Labor is further authorized to make arrangements with the Secretary of Treasury to prevent duplication of effort regarding investigation of violations relating to fiduciaries.

Under the conference agreement, the Secretary of Labor is to have the power in order to determine whether there have been violations or there are about to be violations of any provision of title I to make an investigation. In connection with the investigation, he may require the submission of reports, books and records, and the filing of supporting data, but no plan may be required to submit such books, records or supporting data more than once annually unless the Secretary has reasonable cause to believe there may exist a violation under title I.

[329] The Secretary also may enter places and inspect records and accounts and question those persons he deems necessary to enable him to determine the facts relative to the investigation if he has reasonable cause to believe there may exist a violation under title I. The Secretary is authorized to make available to persons covered by the plan and to any department or agency of the United States information concerning any matter which has been the subject of the investigation.

Subpoena power.—Under the bill as passed by the House, the Secretary of Labor is given the same powers of subpoena as are given to the Federal Trade Commission. The bill as passed by the Senate contains the same provisions as that passed by the House and in addition provides that the Secretary of Labor may delegate his auditing and investigation functions with respect to insured banks acting as fiduciaries to appropriate Federal banking agencies. The conference agreement adopts the provisions of the bill as passed by the Senate.

Appropriations authorized, etc.—Under the bill as passed by the House and the Senate, there is authorized appropriations of such sums as may be necessary to enable the Secretary of Labor to carry out his functions and duties under the bill. In addition, under the bill as passed by the Senate, the Secretary of Labor is authorized to increase the number of supergrade positions in the Department of Labor. Under the conference agreement the Secretary of Labor is authorized to add one additional position in the GS–18 level in the Department of Labor and to place 20 additional positions in the GS–16 and 17 level in the Department of Labor.

Service of process.—Under the bill as passed by the House, subpoena or other legal process of a court upon a trustee or plan administrator constitutes service on the plan. In addition, a plan may sue or be sued as an entity. The bill as passed by the Senate does not contain comparable provisions. The conference agreement basically adopts the provisions as passed by the House but provides that where a plan does not designate in its plan description an individual as agent for service of legal process, service upon the Secretary of Labor is to constitute adequate service. In that case the Secretary upon receipt of service of process is to notify the administrator or any trustee of the pending action within 15 days after he is served.

Enforcement of judgment.—The bill as passed by the House provides that a money judgment under title I of the Act against the plan is to be enforceable only against the plan as an entity and not against any other person unless that person's liability is established in his individual capacity. The bill as passed by the Senate did not contain a comparable provision. Under the conference agreement the House provisions are adopted.

Government representation.—Both the House bill and the Senate amendment provide for the Secretary of Labor to be represented by attorneys appointed by him in civil actions arising under the Act, except for litigation before the Supreme Court and the Court of Claims. The conference agreement adds the qualification that "all such litigation shall be subject to the direction and control of the Attorney General." The new language was added in order to make clear that even though litigation is conducted by Labor Department attorneys, there is to be authority in the Attorney General to resolve

[330] those situations where two or more agencies of the Federal government have varying positions with respect to issues in litigation and, in such situations, to assure that the government takes uniform positions before the courts. In addition, the Attorney General is to have authority concerning the presentation to the courts of the government's position with respect to such issues of general importance as the constitutionality of Federal laws. Under the conference agreement, it is intended that in civil litigation involving the Secretary of Labor under this bill, the Secretary, in the normal course, will be represented in court by the Solicitor of Labor and his attorneys, with appropriate arrangements being made between the Secretary of Labor and the Attorney General with respect to the active involvement of the Justice Department in the types of situations discussed above.

Reports to Congress.—Under the bill as passed by the House, the Secretary of Labor is to report annually to the Congress regarding the administration of title I. This report is to include an explanation of the variances granted, a status report on any plan operating with a variance and its progress in achieving compliance with the Act, the projected date for terminating the variance and information, and recommendations for further legislation in connection with matters covered by title I. Under the conference agreement, the provisions of the bill as passed by the House generally are adopted.

Cooperation between agencies.—Under the bill as passed by both the House and the Senate, the Secretary of Labor is authorized to cooperate with other agencies and make agreements for mutual assistance. In addition, under the bill as passed by the House, the Attorney General is authorized to receive from the Secretary of Labor for appropriate action evidence which has been developed that warrants consideration for criminal prosecution under Federal law. Under the conference agreement, the provisions for cooperation of other agencies including the authorization for the Attorney General to receive matters relating to criminal prosecution is adopted.

Administrative matters.—Under the bill as passed by the House, the Administrative Procedure Act is applicable to the provisions of title I. In addition, no employee of the Department of Labor is to administer or enforce title I with respect to any employee organization of which he is a member or employer organization in which he has an interest. The bill as passed by the Senate does not add any comparable provisions. Under the conference agreement, the provisions of the bill as passed by the House are adopted.

Interference with rights.—Under the bill as passed by both the House and the Senate, it is unlawful to interfere with the attainment of any rights to which a participant or beneficiary may become entitled or to coercively interfere through the use of fraud, force, or violence with any participant or beneficiary for the purpose of preventing him from exercising any right to which he is or may become entitled to under the plan or title I. The penalties and degrees of proof for violations of the provisions are somewhat different. Under the conference agreement, the participant or beneficiary may bring a civil action against any person who interferes with his rights which are protected under the Act. In addition, any person who willfully uses

[331] fraud, force, violence or threats to restrain, coerce or intimidate any participant or beneficiary for purposes of interfering with the participant's or beneficiary's rights under the plan or title I of the Act is to be fined $10,000 or imprisoned for not more than 1 year, or both.

Advisory Council.—Under the bill as passed by both the House and the Senate, there is established an Advisory Council on Employee Welfare and Pension Benefit Plans. Under the conference agreement, the Council is to consist of 15 members appointed by the Secretary of Labor. Not more than 8 members are to be of the same political party. The Council is to be made up of members who are to be representatives of employee organizations and employers, and members from the fields of insurance, corporate trusts, actuarial counseling, investment counseling, investment management, and accounting, and from the general public. Members are generally to serve for terms of 3 years, are to advise the Secretary of Labor with respect to the carrying out of his functions under the bill and are to submit to the Secretary recommendations as to the administration of the provisions of the bill.

Tax Court declaratory judgment proceedings

Both the House bill and the Senate amendment provide a procedure for obtaining a declaratory judgment with respect to the tax-qualified status of an employee benefit plan. Under both the House and Senate versions of the bill, jurisdiction to issue a declaratory judgment is given to the United States Tax Court. This remedy is available only if the Internal Revenue Service has issued a determination as to the status of the plan which is adverse to the party petitioning in the Tax Court, or has failed to issue a determination but the petitioner has exhausted his administrative remedies inside the Internal Revenue Service.

The differences between the bill as passed by both the House and the Senate are technical in nature. For example, the Senate amendment provides that the burden of proof is to be on the petitioner (the employer, plan administrator, or employee) as to those grounds set forth in the Internal Revenue Service determination; the burden of proof is to be on the Service as to any other grounds that the Service relies upon in the court proceeding (e.g., if the Service does not issue a determination as to the plan, then the Service is to have the burden of proof as to every ground as to which it relies). On the other hand, the House bill does not make specific provisions for burden of proof.

Under the conference agreement, the House provision is accepted with a number of amendments. The Pension Benefit Guaranty Corporation is permitted to be a petitioner, on the same basis as other petitioners. Employees are permitted to be petitioners if they qualify as interested parties under Treasury regulations and have exhausted their administrative remedies. It is contemplated that only those employees who are entitled to petition the Secretary of Labor under section 3001 of this Act are to be treated as interested parties. It is contemplated that the question as to who bears the burden of proof will be determined by the Tax Court under its existing rule-making authority. Under the existing Tax Court rules the taxpayer has the burden of proof as to matters in the notice of deficiency. As to matters raised by the Service at the time of the Tax Court hearing, the Service has the burden. It is expected that rules similar to these will be adopted by the Tax Court.

[332] Under the House bill, the declaratory judgment provisions are to take effect on January 1, 1978. The bill as passed by the Senate provides that the declaratory judgment provisions are to take effect on January 1, 1975.

Both the House and Senate bills authorize the assignment of the declaratory judgment proceedings provided in this bill to be heard by commissioners of the Tax Court. They also authorize a commissioner to enter a decision of the court in these proceedings. The conference substitute provides for this same procedure, but in doing so the conferees wish to make clear that it is not intended that this be construed as indicating that all of these proceedings should be heard by commissioners and decisions entered by them rather than by the judges of the court. Instead, it is intended to provide more flexibility to the Tax Court in the use of commissioners in these types of cases. It is anticipated, for example, that if the volume of these cases should be large, that the Tax Court will expedite the resolution of these cases by authorizing commissioners to hear and enter decisions in cases where similar issues have already been heard and decided by the judges of the court or in other cases where, in the discretion of the court, it is appropriate for the commissioners to hear and decide cases.

Under the conference agreement, the declaratory judgment provisions are to take effect with respect to petitions filed more than one year after the date of enactment.

Administering office in Internal Revenue Service

Under the bill as passed by both the House and the Senate, there is established an Office of Employee Plans and Exempt Organizations, in the Internal Revenue Service, headed by an Assistant Commissioner of Internal Revenue, to administer the tax provisions with regard to employee benefit plans and other exempt organizations.

The House bill does not provide a compensation schedule for the employees of the new Office of Employee Plans and Exempt Organizations. The bill as passed by the House authorizes appropriations for this office in the amount of $20 million for fiscal year 1974 and $70 million for each fiscal year thereafter. However, the bill as passed by the House neither imposes nor earmarks any specific revenue source for this authorization of appropriations.

The bill as passed by the Senate provides for the Assistant Commissioner in charge of this office to be classified as GS–18 and that this is to be in addition to the number of positions at that level otherwise authorized for the Internal Revenue Service. Also the bill as passed by the Senate authorizes for the Service an additional 20 positions at the level of GS–17 and 16. The Senate amendment authorizes appropriations for each of the fiscal years 1974, 1975, and 1976 in the amount of $35 million plus one-half of the revenue of the private foundation investment income tax (under section 4940 of the Code). For each fiscal year thereafter the bill as passed by the Senate authorizes appropriations of amounts equal to the collections of a new excise tax on employee benefit plans ($1 per participant per plan per calendar year, beginning with 1974) plus one-half of the private foundation investment income tax collections.

The conference agreement accepts the Senate provision authorizing the Assistant Commissioner Office of Employee Plans and Exempt

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[333] Organizations to be classified as a GS–18 and providing to the Service an additional 20 positions in the level of GS–16 and 17. However, the conference agreement does not accept the Senate provision authorizing a new tax on employee benefit plans of $1 per participant. In place of the authorization of the new excise tax on participants, the conference provides a permanent authorization for fiscal year 1975 and for each fiscal year thereafter of an amount equal to the revenues from the private foundation investment income taxes if the rate of such tax was 2 percent plus an amount equal to that 2-percentage-point figure or $30,000,000, whichever is the larger.

Under the House bill, the provisions regarding the new office are to take effect 90 days after the date of enactment. Under the bill as passed by the Senate, no specified effective date is provided. The conference agreement accepts the House provision.

VII. Contributions on Behalf of Self-Employed Individuals and Shareholder-Employees (Sec. 2001 of the Bill and Secs. 401, 404, 1379, and 4972 of the Code)

Under the House bill the maximum limitations on deductions for self-employed individuals would be increased from 10 percent of their self-employment income, not to exceed $2,500, up to 15 percent of their self-employment income, not to exceed $7,500. In any event, a minimum of $750 would be deductible by self-employed individuals, without regard to the percentage limitations. The Senate amendment, although containing a number of technical differences, is generally similar to the House bill in this area.

The conference substitute is described below. Generally, the substitute in this case follows the House bill with respect to technical matters.

Specific contribution limits on proprietorships, partnerships, or subchapter S corporations

The conference substitute increases the maximum deductible contribution on behalf of self-employed persons to the lesser of 15 percent of earned income or $7,500. The same change is made as to excludable contributions on behalf of subchapter S corporation shareholder-employees. In applying the percentage limitation, not more than $100,000 of earned income may be taken into account. Self-employed persons (but not shareholder-employees) are permitted to set aside up to $750 a year out of earned income, without regard to the percentage limitation.

Defined benefit limits for proprietorships, partnerships, and subchapter S corporations

The substitute authorizes Treasury regulations to allow self-employed persons and shareholder-employees in effect to translate the 15-percent/$7,500 limitations on contributions into approximately equivalent limitations on benefits which individuals can receive under a defined benefit plan. In this respect, the substitute contains a table (based on certain interest and mortality rates) which will serve as a guideline for regulations. The Treasury Department may, by regulations, modify this table from time to time for years beginning after

[334] December 31, 1977, to take account of changes in interest and mortality rates which occur after 1973.

The conference substitute also contains technical rules to prevent an individual from obtaining unintended high benefit accruals late in his career merely by establishing a "token plan" early in his career.

A plan which covers owner-employees is not permitted to use the defined benefit provisions unless it provides benefits for all participants on a nonintegrated basis (i.e., without taking social security benefits into account).

Excess contributions

Present law provides that excess contributions to an H.R. 10-plan on behalf of an owner-employee must be repaid from the plan and provides, in the case of a willful excess contribution, that the owner-employee is barred from participating in a qualified plan for 5 years. The conference substitute repeals these provisions and, in lieu thereof, the substitute imposes an excise tax of 6 percent on excess contributions to plans for the self-employed. The tax is payable by the employer who maintains the plan.

In the case of a defined contribution plan (for example, a money purchase pension plan) excess contributions include amounts contributed for the self-employed person in excess of the 15-percent/$7,500 limitations. (However, the tax would never exceed 6% of the assets of the account). In the case of a defined benefit plan, the tax is imposed where the plan is fully funded at the close of the employer's taxable year, and is imposed on the amount that has not been deductible for the taxable year or any prior taxable year. Also, in the case of either type of plan, excess contributions include voluntary contributions by owner-employees in excess of the allowable amount of such contributions.

The tax applies for the year in which the excess contribution is made and for every subsequent year that the excess contribution is outstanding. The excess contribution may be eliminated (so as to stop the running of the tax) in one of two ways—either by repayment of the excess contribution from the plan (which would reduce or eliminate the tax for subsequent years), or by a carryover of the excess payment and applying it against the amount allowable in the next year (or a subsequent year).

In the case of a defined benefit plan, the repayment would have to be made to the employer. In the case of a defined contribution plan, the repayment could be made either to the employer or to the employee (but, as under present law, a distribution could generally not be made to the employee from a money purchase plan until he attained retirement age). An excess voluntary contribution would be repaid to the owner-employee who made it. Of course, any distribution made to eliminate an excess contribution would not be in violation of the exclusive benefit rules of present law, or the fiduciary standards imposed under this bill.

The excess contribution could also be eliminated through means of a carryover. For example, if contributions of $10,000 were made to a plan (where voluntary contributions were not permitted) on behalf of a self-employed person (who was entitled to the full $7,500 deduction) the $2,500 excess contribution could be purged in the next year if

[335] the contribution made on behalf of the individual in that year were limited to $5,000. In this case, the 6-percent tax would be imposed, but only once, because the excess contribution had been eliminated in the second year. Also in the second year the individual would be entitled to a deduction of $7,500 ($5,000 of contributions in that year, plus the $2,500 carryover). Of course, there would be no tax on underfunding under these circumstances even if the plan were a money purchase plan, the terms of which required a $7,500 contribution for the individual in the second year.

Premature distributions

The conference substitute increases the tax on premature distributions to 10 percent of the amount of the premature distribution (instead of 10 percent of the marginal regular tax on the premature distribution, as under present law).

Withdrawing of voluntary contributions by owner-employees

The conference substitute allows an owner-employee to withdraw his own voluntary contributions to an H.R. 10-plan before retirement without penalty. It also contains a technical amendment which repeals the "stacking" rules of section 72(m)(1) (i.e., the rules which determine the order in which different categories of income are deemed to be distributed). The conferees intend that distributions from an H.R. 10-plan to an owner-employee be treated first as repayments of any excess contributions made on his behalf, and second as withdrawals of voluntary contributions.

Effective dates

In general, the amendments with respect to H.R. 10-plans are to apply to taxable years beginning after December 31, 1973. The rule with respect to the $100,000 contribution base limitation is to apply to taxable years beginning after December 31, 1975, or, if earlier, the first year in which contributions under the plan exceed the deductible contribution limits of present law. The rules facilitating the use of defined benefit plans for the self-employed are to apply to taxable years beginning after December 31, 1975. The rules with respect to excess contributions are to apply to contributions made in taxable years beginning after December 31, 1975, and the rules with respect to premature distributions are to apply to distributions made in taxable years beginning after December 31, 1975. The rule permitting withdrawal of voluntary contributions by owner-employees is to apply to taxable years ending after the date of enactment.

VIII. Tax Deductions for Individual Retirement Accounts (Sec. 2002 of the Bill and Secs. 219, 408, 409, 4973, 4974, and 6693 of the Internal Revenue Code)

Under the House bill, individuals not covered by qualified or government pension plans (or sec. 403(b) annuity contracts) would be permitted to take a deduction of up to 20 percent of their earned income, not to exceed $1,500, for retirement savings. This amount could be set aside in a special trusteed or custodial account with a bank, savings and loan, or credit union, used to purchase an annuity contract, or invested in qualified retirement bonds. This amount could not be

[336] drawn down without penalty before age 59½ (except in case of death or disability) and payment of benefits from the account would have to begin by age 70½. An individual could establish the account himself, or, alternatively, an employer or labor union could maintain accounts of this type for employees or members.

The provisions of the Senate amendment are similar in most respects. However, under the Senate amendment the allowable deduction could not exceed 15 percent of earned income, not to exceed $1,500. Moreover, under the Senate amendment, the assets of the account could be invested in life insurance contracts. Also, there is no provision in the Senate amendment for union-sponsored accounts.

The rules of the conference substitute are described below. In general it follows the House bill, except that the conference substitute accepts the Senate limitation of 15 percent—$1,500.

Deductions for contributions to IRA's

Under the conference substitute, the maximum annual deduction is to be $1,500, or 15 percent of compensation, whichever is less. Consequently, the percentage limitation for contributions to individual retirement accounts is the same as the percentage limitation for contributions to H.R. 10 plans (although the H.R. 10 plan has a $7,500 limitation on the amount which may be set aside in order to provide an incentive for the self-employed to establish qualified plans which will also benefit their employees).

This deduction is to be available to any individual who is not an active participant in a qualified or government plan, or a section 403(b) contract (available to employees of certain types of tax-exempt organizations) and is to be available whether or not the taxpayer itemizes his other deductions. The individual may himself make payments into such an account or this may be done by his employer or his union. If both husband and wife are eligible, each can make contributions to his or her own individual retirement account.

The conferees agree with the statement appearing in the report of the House Committee on Ways and Means (No. 93–807) that if an employee is given the option to elect not to be covered by a qualified, etc., plan and he so elects, generally he will not be treated as being an active participant in the plan for purposes of the retirement savings deduction. The conferees also agree with the statement in this report that where an employee who elects out of a qualified plan can elect later to become an active participant in it and can receive benefits for all prior years (for which he elected out) upon payment of, e.g., all mandatory contributions plus interest for prior periods, the employee is to be treated as being an active participant in the plan for the prior years with respect to which he pays the required amount and accrues benefits.

Requirements for an IRA

Under the conference substitute, the assets of an individual retirement account may be invested in a trusteed or custodial account with a bank, savings and loan, or credit union, or in an annuity contract, or in a qualified retirement bond.

In addition, the substitute allows a retirement savings deduction for amounts paid under certain life insurance endowment contracts (which will be treated as individual retirement annuities) to the

[337] extent the amounts paid are properly allocable to retirement savings. However, only the retirement saving element in the contract, and not the part of the premium used to purchase life insurance, is to be deductible. For example, if a premium of $1,000 were paid under a qualified endowment contract, and $200 of this amount were allocable (under regulations) to the cost of the life insurance element, and $800 to the retirement savings aspect of the contract, then $800 would be allowed as a retirement savings deduction (if the individual were eligible for a deduction of this amount).

Under the conference substitute, the total amounts payable under qualified endowment contracts cannot be greater than $1,500 per year. However, an individual may contribute (and deduct) the difference between his maximum allowable retirement savings deduction and the retirement savings element under an endowment contract through another funding medium (such as a trusteed bank account). Under the conference substitute the insurance companies are to provide (before the close of the year) every individual who has purchased a qualified endowment contract with a statement as to the portion of the premiums which is deductible and the portion which is not deductible, as well as any other information required under regulations. A similar statement must be furnished to the Internal Revenue Service.

Insurance contracts are restricted to endowment contracts in order a provide a substantial savings element. The endowment contract also must be issued by a life insurance company qualified to sell insurance in the jurisdiction where the contract is sold (and may include no insurance element other than life insurance). In addition, the contract must mature no later than the taxable year in which the individual attains age 70½. The conferees intend that for an endowment contract to qualify, the premiums payable under the contract (for any given maturity value) are not to increase over the life of the contract, the cash surrender value of the contract at the maturity date is to be not less than the death benefit payable under the contract at any time, and the death benefit at some point during the life of the contract must exceed the greater of the cash value or the sum of the premiums paid under the contract.

Distributions from qualified endowment contracts are to be taxable as ordinary income to the extent allocable to retirement savings, and are to be taxed as life insurance proceeds to the extent allocable to life insurance. When a contract has matured, the full value of the contract will constitute retirement savings, and all amounts payable under a matured contract are to be taxed as ordinary income to the recipient (whether or not he is the individual who made contributions to the account and whether or not that individual is alive at the time the payments are made from the account).

Under the conference substitute, the assets of an individual retirement account may not be commingled with other property, except in a common trust fund or investment fund (i.e., a group trust), solely for the purposes of diversifying investments, under rules similar to those established in Rev. Rul. 56–267, 1956–1 C.B. 206. Also, following Rev. Rul. 56–267, the conferees intend that, solely for purposes of diversification of investments, the assets of qualified individual retirement accounts may be pooled with the assets of qualified section 401(a)

[338] trusts, without adversely affecting the tax-qualification of either the individual retirement accounts or the section 401(a) trusts. The conferees intend that the group trust itself will be entitled to exemption from tax under the Internal Revenue Code in accordance with the rules of Rev. Rul. 56-267.

The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the Federal securities laws to individual retirement accounts or the application to them of the laws relating to common trusts or investment funds maintained by any institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation.

The conferees understand that the Internal Revenue Service anticipates developing a prototype individual retirement account which would include a full disclosure of all the material elements governing the retirement savings deduction. This prototype plan would qualify under the requirements for an individual retirement account. Other plans would be required to seek prior approval from the Internal Revenue Service and the conferees expect that one of the requirements for approval would be a disclosure statement of all the material elements governing the retirement savings deduction. The conferees also expect the Internal Revenue Service to develop a pamphlet which sets forth the restrictions and limitations with regard to the individual retirement accounts, including, for example, the penalties for premature distributions, the fact that the account is not eligible for estate and gift tax advantages or the lump-sum distribution rules that qualified plans are entitled to. It is the hope of the conferees that such pamphlet would receive wide distribution so that individuals would be fully informed on the restrictions and limitations of such an account. Also, in accordance with regulations to be prescribed by the Secretary of Treasury or his delegate, there is to be disclosure of such matters as load factors for insurance contracts and earnings factors for individual retirement accounts. These required disclosures are to be made in layman's language, and civil penalties are imposed under the substitute for failure to adequately disclose.

Requirements for an IRA annuity

Under the conference substitute, retirement savings may also be invested in annuity contracts. This may be an individual annuity contract, or a joint and survivor contract for the benefit of the individual and his spouse. The annual premium for the contract is not to exceed $1,500, and the contract is to be nontransferable and is not to be used as security for a loan. Also, distributions from the account must begin by the end of the year in which the individual attains age 70½.

Employer and union-sponsored IRA's

Under the substitute, employers and labor unions (and other employee associations) are to be able to establish individual retirement accounts for their employees or members. There is no requirement that the accounts must be established on a nondiscriminatory basis (since any employee not covered under an employer-sponsored account could establish his own account) but, of course, if the employer also main-

[339] tains a qualified plan, he cannot satisfy the coverage requirements with respect to that plan by taking into account the fact that employees not covered under the plan are covered by individual retirement accounts. Even if the contributions are made by the employer, these amounts constitute income to the employee, and are subject to FICA and FUTA taxes. However, employer contributions are not to be subject to withholding for income tax purposes if it is reasonable for the employer to believe that the employee will be entitled to receive a deduction for the contribution.

Taxation of distributions—in general

Generally, the individual is to have a zero basis in his individual retirement account and the proceeds are to be fully taxable when distributed. These distributions are not to be eligible for capital gains treatment, or the special averaging rules applicable to lump-sum distributions from qualified plans (although the general averaging rules of sec. 1301 are to be available). Also, the amounts in individual retirement accounts are not to be excluded from tax for purposes of estate and gift tax.

Premature distributions

In the event of a premature distribution (or deemed distribution) from the account before the individual attains age 59½, the individual's tax on this amount is to be increased by 10 percent of the total distribution (except in the case of death or disability, or distributions of excess contributions made within the time for filing the individual's tax return for the year in which the excess contributions occur).

If an individual borrows money from an individual account (or from a group trust in which the account assets were invested) the entire account of the individual is disqualified, earnings on the account are no longer tax-exempt, and the participant is then to be taxed as if he had received a distribution of the fair market value of all the assets in his account. (If he borrows money, using his interest in the account as security, the portion used as security is to be treated as a distribution.) A similar result (i.e., deemed distribution of the entire account) would follow if the individual borrowed money from the insurance company issuing an annuity or endowment contract, or otherwise used the contract as security for a loan. Clearly, if the assets of the account were invested in such a way as to provide for the direct and immediate benefit of the participant (for example, if the account were used for a downpayment on the house where he lived) then the entire account would be deemed to be distributed. Of course, in the case of any deemed distribution from an individual retirement account, the amount of the distribution would not be includible in income a second time in a later year when the amount was actually distributed. (Questions of the order in which income is distributed where only part of the account is disqualified are to be determined under regulations.)

An individual may invest directly in an endowment contract but does not receive a deduction for the part of the premium which is allocable to life insurance protection. Thus, where the assets of an individual retirement account are invested in a qualifying endowment contract for the participant, this transaction is to be treated as an auto-

[340] matic rollover by the account, and only the amount of the assets which are allocable to the purchase of life insurance protection under the endowment contract are to be deemed to be distributed to the participant. This amount would be includible in income by the participant, but would not be subject to the 10 percent tax on premature distributions.

Application of prohibited transaction and other taxes to IRA's

Generally, an individual retirement account is to be exempt from Federal tax, but the unrelated business income of the account, if any, is to be subject to tax (under sec. 511).

Under the House bill, individual retirement accounts generally would be subject to the prohibited transaction rules of present law. However, with respect to prohibited transactions, the conference substitute (generally following the Senate amendment) replaces present law with an excise tax on prohibited transactions (instead of using disqualification as a sanction) and changes the existing prohibited transaction rules. Consequently, the conference substitute applies the new prohibited transaction rules applicable to an owner-employee (e.g., no borrowing from the account is permitted) to individual retirement accounts, with respect to transactions involving the employer or union sponsor of the account, or other parties in interest.

However, if an individual participant engages in an unauthorized transaction with his individual retirement account then, as indicated previously, the sanction, in general, is disqualification of the account. In this case the assets of the account are to be deemed to be distributed, and the appropriate taxes, including the 10 percent additional tax on premature distributions, are to apply. However, the individual is not to be subject to the prohibited transaction excise taxes (of sec. 4975).

Thus, where there is a union or employer-sponsored account, and there is an individual retirement account trust covering more than one employee, only the employee who engages in the prohibited transaction is to be subject to disqualification of his separate account. However, if the employer (or union) sponsoring the account is the party engaging in a prohibited transaction, then the employer (or other party) will be liable for the excise tax, but the individual participants will not.

Excess contributions

In general, where contributions in excess of the deductible limits are made to an individual retirement account, no deduction is allowed for the excess amount, and this amount will be subject to a 6 percent tax for the year in which it is made, and each year thereafter, until there is no excess. The distribution is not to be includible in income if the excess is distributed to the individual on or before the due date for filing the employee's tax return for the year in question (including extensions). If the distribution occurs after that date, however, the distribution is to constitute taxable income to the employee (because his basis in his account is always zero) and will also give rise to a 10-percent additional tax if the distribution occurs before the employee is 59½.

The excess contribution may be removed by a distribution, or by underutilizing the allowable deduction limits for a later year. For

[341] example, if an employee contributed $3,000 in one year, and nothing the second year, then a 6 percent tax on $1,500 would be imposed only once (assuming the employee was entitled to a full $1,500 contribution for both years). (Similarly, if the participant withdrew the $1,500 excess contribution in the year in which the contribution was made, the 6 percent excise tax would be imposed only for that year.) Also (to prevent undue hardship resulting from bad investment experience), the tax may never exceed 6 percent of the assets in the account (but a decline in the asset value of the account does not remove the excess contribution and the 6 percent tax will be imposed until the excess contribution has been distributed or eliminated by underutilization of allowable contributions in a subsequent year).

A similar tax is to be imposed on excess contributions for section 403(b) plan investments in mutual fund stock (which are permitted under the conference substitute). (Section 403(b) allows deductions of up to 20 percent of salary, without regard to discrimination requirements, in the case of employees of educational and certain other types of exempt organizations.) However, the 6 percent tax is not imposed on section 403(b) annuity contracts, since earnings on annuity contracts are not taxable until distributed, even when the annuities are purchased outside the scope of a qualified plan.

No retirement savings deduction is to be allowed for contributions made during or after the year in which the individual attains age 70½, and contributions of an individual after attaining this age are to be treated as excess contributions.

Excise tax on excess accumulations

Under the conference substitute, distribution of the assets of an individual retirement account must begin by the year in which the participant attains age 70½, and must be distributed no less rapidly than ratably over his lifetime (or the lives of the participant and his spouse). To enforce this requirement, the substitute imposes an excise tax of 50 percent on the amount, if any, by which the amount of the distributions from the account fail to equal the minimum distribution required for the year in order to satisfy the age 70½ payout requirements.

Tax-free rollovers to facilitate pension transfers

To facilitate portability of pensions—or their transfer with the employee as he changes jobs—the conference substitute provides that money or property may be distributed from a tax-qualified plan or from an individual retirement account to the plan participant, on a tax-free basis, if the same money or property is reinvested by the participant within 60 days in a qualifying individual retirement account.

In the case of distributions from a qualified plan, the distribution must be a lump-sum distribution (see Part X, Lump-Sum distributions) to qualify as a tax-free rollover.

Amounts received from a qualified plan may also be transferred to another qualified plan through the medium of an individual retirement account (with the consent of the individual's new employer) but in this case the conduit retirement account must consist of nothing but assets transferred from a qualified plan (and the earnings on this

[342] amount) to prevent a situation where retirement savings might indirectly obtain tax advantages not intended. (These qualified plan distributions may also be reinvested directly in the qualified plan of the individual's new employer on a tax-free basis, if the reinvestment occurs within 60 days after the individual receives the distribution.) However, an individual may have one individual retirement account for transferred savings from a qualified plan and another which represents a normal individual account set aside. For similar reasons, if the individual retirement account contains assets transferred from an H.R. 10 plan, on behalf of a self-employed person, no rollover is permitted from that retirement account to a qualified corporate plan.

Also, in the case of rollovers from a qualified plan, the amount contributed to the individual retirement account is to be the amount received, less the amount contributed to the plan by the individual as an employee contribution. (This is because the employee must always have a zero basis in his individual retirement account.)

Under the committee substitute, rollovers are permitted to and from qualifying investments in individual retirement bonds (discussed below) on the same basis as investments in other types of individual retirement accounts and annuities. At age 70½, the individual must cash in his bonds (since the proceeds of the bonds will be deemed to be distributed in full) but the assets may be rolled over into an investment which will satisfy the age 70½ payment requirements.

Tax-free rollovers between individual retirement accounts may occur only once every three years.

Qualified retirement bonds

Deductible employee savings may be invested in a special retirement bond to be issued by the Federal Government. Generally, the rules governing retirement bonds are closely comparable to the rules governing other forms of qualifying individual retirement savings. Thus, the bonds may be cashed prior to age 59½, but, except in the case of a rollover, the individual is generally to be subject to a 10 percent penalty tax (unless the bonds are cashed due to death or disability). However, the bond may be redeemed within 12 months of its purchase without penalty (and without payment of interest) and in this case the individual is not to be entitled to a deduction for the contribution.

The bonds are to cease to bear interest when the individual attains age 70½, and the proceeds of the bonds are to be deemed to be distributed in that year (whether or not the bonds are actually cashed in). However, as discussed above, the individual may roll the proceeds over into another qualifying form of individual retirement investment.

Other rules

The conference substitute provides that the proceeds of individual retirement accounts, etc., are to constitute retirement income for purposes of the retirement income credit. The substitute also includes the provisions of the Senate amendment that if a retirement account or annuity is transferred pursuant to a divorce settlement, the transfer is not to be taxable.

Effective dates

The deduction for retirement savings is to be available for taxable years beginning after December 31, 1974. The tax-free rollover of

[343] assets between qualified plans applies to transfers after the date of enactment.

IX. Overall Limitations on Contributions and Benefits

(Sec. 2004 of the Bill and Secs. 401, 403 and 415 of the Internal Revenue Code)

Under the House bill, in general, in the case of defined benefit plans, the pension which may be paid from a qualified plan with respect to any individual may not exceed 100 percent of his compensation in his high three years of employment or $75,000, whichever is the lesser. In the case of defined contribution plans, the annual additions to an individual's account may not exceed the lesser of $25,000, or 25 percent of his compensation. (Both the $75,000 amount and the $25,000 amount referred to above are subject to cost-of-living allowances.) If an employee is under both a defined benefit plan and a defined contribution plan then the sum of (1) the percentage utilization of the maximum limit under the defined benefit plan, and (2) the percentage utilization of the maximum limit under the defined contribution plan, cannot exceed 140 percent.

Under the Senate amendment, benefits under a defined benefit plan are limited to 75 percent of the participant's high-three-consecutive-years of compensation, taking into account no more than $100,000 of compensation per year. A closely comparable limitation is provided for defined contribution plans, so that deductible contributions may not exceed amounts sufficient to fund a pension for the employee equal to 75 percent of his average high-three-years of compensation (not in excess of the first $100,000 in any one year). Where an employer had both a defined benefit plan and a defined contribution plan, the maximum benefit payable under the defined benefit plan would have to be reduced in proportion to the amount of the benefit which was funded through the defined contribution plan.

The conference substitute closely follows the provisions of the House bill. The detailed provisions of the conference substitute are discussed below.

Coverage of limitations

The conference substitute imposes an overall limitation (described below) on the contributions and benefits which are allowable under qualified pension, profit-sharing, and stock bonus plans and annuities (including H.R. 10-plans in cases where the overall limits are lower than the H.R. 10-plan limits). The overall limitation also applies to annuity contracts or mutual fund arrangements for employees of educational, charitable, etc., organizations or of public schools (i.e., sec. 403(b) annuities), as well as individual retirement accounts, annuities and retirement bonds.

Application to defined benefit plans

Under the conference substitute, in general, the highest annual benefit which can be paid (in the form of a straight-life annuity) out of a defined benefit plan to a participant is not to exceed the lesser of (a) $75,000, or (b) 100 percent of the participant's average compensation

[344] in his high-three-years of employment. (Both of these ceilings are to be adjusted to reflect cost-of-living increases.)

In the event of retirement before age 55, the $75,000 ceiling (but not the 100 percent ceiling) is to be scaled down on an actuarial basis (but not below $10,000). In general, there is no required scale down for preretirement ancillary benefits (such as medical, death and disability), but there would have to be an adjustment for post-retirement ancillary benefits, such as term-certain annuities, post-retirement death benefits, or a guaranteed payment for a period of years.

If a benefit were paid in the form of a joint and survivor annuity for the benefit of the participant and his spouse, the value of this feature would not be taken into account unless the survivor benefit were greater than the joint benefit.

Upward adjustments in the benefit schedule would be permitted to reflect any employee contributions to the plan, including rollover contributions from another qualified plan or from an individual retirement account.

Also the substitute would provide a *de minimis* rule, which would allow a qualified plan to pay an annual retirement benefit of up to $10,000 per annum, notwithstanding the 100-percent limitation; or the required adjustment for certain ancillary benefits, to any employee who had not participated in a qualified defined contribution plan of the employer.

As a further adjustment to the rules described above, the maximum allowable defined benefit would have to be scaled down proportionately for an employee with less than 10 years of service.

Application to defined contribution plans

In the case of a defined contribution plan, the annual additions for the year are not to exceed the lesser of $25,000 (subject to an annual cost-of-living increase) or 25 percent of the participant's compensation from the employer. The term "annual additions" means the sum of (a) the employer's contributions, (b) the lesser of (i) one-half of all the employee's contributions, or (ii) the employee's contributions in excess of 6 percent of his compensation, and (c) any forfeitures which are added to the employee's account. Annual additions do not include rollovers from a qualified plan or individual retirement account. If forfeitures for a particular year could cause the plan not to meet these requirements with respect to a particular employee, these forfeitures must be reallocated to other participants in the plan (i.e., they may not be held in a suspense account), but regulations are to provide for the situation where none of the employees in the plan are eligible to receive forfeitures.

For purposes of the overall limitation, target benefit plans (i.e., plans where the employer establishes a target benefit for his employees, but where the employee's actual pension is based on the amount in his individual account) are to be treated as defined contribution plans. If the plan is a hybrid, i.e., part target benefit and part defined benefit, the plan will be treated as a defined contribution plan, for purposes of those rules, to the extent that benefits under the plan are based on the individual account of the participant. In the case of other plans which have characteristics both of a defined benefit plan and a defined contribution plan (such as a defined contribution plan with a guaranteed

[345] benefit, or certain variable annuity plans) the Secretary or his delegate may prescribe regulations applying the limitations to the defined benefit of the plan, and the part of the plan in which benefits are based on individual account balances.

Application of limitation to combinations of plans

Under the substitute, where an employer has two or more plans, the overall ceiling is to be computed, in general, by aggregating similar plans (defined contribution or defined benefit) to determine if the limitation for that type of plan has been met on an overall basis (i.e., for purposes of this test a 1.0 fraction is used). If an employer maintains a defined benefit plan and a defined contribution plan, each plan would be subject to the limit appropriate to that type of plan ($75,000 or 100 percent benefits for the defined benefit plan, $25,000 or 25 percent contributions for the defined contribution plan); in addition, the two plans must be combined in computing the overall limitation.

To achieve this purpose, the substitute establishes a formula (to be applied each year to each employee) under which a defined benefit plan fraction for the year is added to a defined contribution plan fraction. Each fraction indicates what portion the participant has used of the maximum permitted limit for the kind of plan involved. If the sum of these fractions exceeds 1.4 then one or more of the plans will be disqualified.

The order in which plans are to be disqualified is to be determined under regulations. The regulations are to provide that no terminated plan may be disqualified until all other plans of the employer have been disqualified. However (unlike the House bill), the substitute does not require that plans having the fewest number of participants must be disqualified before plans having more participants because, in some cases, such a rigid rule might result in lower qualified plan benefits for the employees viewed as a whole.

Plans of all corporations, partnerships, or proprietorships which are under common control must be aggregated (using a 50-percent common control test).

Application of limitations to section 403(b) annuities for teachers or employees of tax-exempt organizations

In general, section 403(b) annuities are to be treated as defined contribution plans for purposes of the limitations. Thus, such plans would be subject to the 25 percent/$25,000 limitations which apply to other defined contribution plans, and also are to be subject to the limitations of present law under section 403(b) (20 percent of includable contributions, times years of service, minus all tax excludable contributions by the employer for annuities for prior taxable years).

However, under present law, certain categories of employees covered under section 403(b), such as teachers, typically have a pattern of low contributions in the early stages of their careers, with relatively high "catch-up" contributions made late in their careers. (Often section 403(b) plans operate on a salary-reduction basis.) In order to make allowance for this problem, the conference substitute provides teachers, hospital employees, and employees of home health care institutions (which are tax-exempt and which the Secretary of Health, Education and Welfare has classified as a home health agency for pur-

[346] poses of medicare) with a choice of three alternative rules which permit a significant amount of "catch up." The individual may elect the alternative he wishes to use (in a time and manner to be prescribed in regulations) and the election, once made, is to be irrevocable.

Under the first alternative (which may be used only once) at the time an employee separates from service he may use the catch-up rules of section 403(b) for the 10-year period ending on the date of his separation, without regard to the 25-percent limitation of section 415 (in other words, his exclusion allowance would equal 20 percent of current compensation, times 10, minus employer contributions already made for annuities for the 10-year period). The $25,000 limitation would apply, however.

Under the second alternative, which could be used each year by the employee, catch-up contributions otherwise permitted under section 403(b), could equal the lesser of 25 percent of current compensation, plus $4,000, or his exclusion allowance computed under section 403(b), but the deductible amount under this alternative could never exceed $15,000 for any one year.

For purposes of the overall limitations (sec. 415) in applying either of these two alternatives, the employee is not to be required to combine contributions to a 403(b) contract (which the participant would be deemed to control) with contributions by his employer to a qualified plan which he does not control (for example, a State wide plan for teachers). (Of course, the combination rules under section 403(b) of present law would not be changed.)

Under the third alternative, however, the employee would be permitted to come under the overall limitation (sec. 415) for all purposes (and the exclusion allowance of sec. 403(b) would not apply). This would mean that the employee would be covered under the overall limitation rules on combination plans, including the 1.4 fraction. For purposes of the combination rules both the employer and the employee would be deemed to have control of the 403(b) contract, but such a contract (which is to be treated as a defined contribution plan) could be combined with a State wide defined benefit plan, and benefits under the two plans, considered together, could equal 1.4 times the amount which could be provided under either plan when viewed separately.

If contributions to provide a section 403(b) annuity exceed the allowable limitations, the excess amounts must be included in income by the employee. Also, the employee's exclusion allowance under section 403(b) is to be reduced by the amount of the excess contribution (even though it was not excludable from the employee's income). If amounts are contributed for the purchase of mutual fund stock (which is permitted under another provision of the conference substitute), these amounts are to be subject to the 6 percent tax on overfunding until the excess is eliminated (see discussion above on individual retirement accounts). This tax is not imposed on contributions for annuity contracts, since earnings on these contracts are not taxed to the individual (until distributed) even when the annuity is not covered under section 403(b).

Treatment of benefits or contributions over the limitations

The House bill provided that benefits or contributions in addition to those allowable under qualified plans may be paid or accrued under

[347] a qualified plan, if the contributions by the employer for the additional benefits were not deductible until they were includible in income by the employee.

The Senate amendment provided, in effect, that no retirement benefits could be paid, except from a qualified plan.

To avoid technical difficulties, the conference substitute omits both provisions. The conferees intend that, for tax purposes, additional benefits may not be paid from a qualified plan. However, for purposes other than tax law, a qualified plan and a plan providing additional benefits may be treated as one plan by the employer.

Applications of limitation where records not available

Under the conference substitute, the Treasury is authorized to prescribe reasonable assumptions which may be used by the employer in cases where the facts needed to compute the overall limitation are not known.

Application of limitation to existing cases

The conference substitute contains a provision which provides that an individual who is an active plan participant on or before October 2, 1973, may receive a pension equal to the lesser of (a) 100 percent of his annual compensation on that date (or on the date he separated from service with the employer), or (b) the benefit payable under the terms of the plan as in effect on that date (assuming no later change in compensation). If the regular rules of the (sec. 415) provision result in a higher limit (due to pre-retirement cost-of-living-increases, for example) than that allowable under this transition provision, the individual is to be entitled to the higher limitation. If an individual covered under this feature is also covered under a defined contribution plan, contributions may continue to be made to the defined contribution plan, to the extent that prior contributions to this plan (or other plans of the same employer), plus the defined benefit available under this feature (which may exceed 1.0 for these purposes), do not exceed the 1.4 fraction. In the case of a participant who separated from the service of the employer prior to October 2, 1973, the benefit allowed under this feature cannot exceed the indivdual's vested benefit on the date when he separated from service.

Aggregate deduction limits in the case of profit-sharing and pension plans, etc.

The conference substitute provides that carryover deductions of excess contributions in a combination pension and profit-sharing plan may not exceed 25 percent of aggregate compensation for any year (present law allows 30 percent). Also, the carryover of unused aggregate contribution limitations to a profit-sharing plan for any year is not to exceed 25 percent (compared to 30 percent under present law).

Timing of contributions

Under the substitute, contributions by cash basis taxpayers which are made by the time for filing the tax return for the year in question may be treated as paid in the year in question.

Effective dates

The new rules with respect to limitations on corporate plans are to apply to years beginning after December 31, 1975. (For purposes of

[348] this provision the term "year" is to be defined in regulations.) In applying the limitations, contributions or accruals which occur before the effective date must, of course, be taken into account. For example, an employee with an accrued benefit of $60,000 on December 31, 1975, could accrue an additional benefit of $15,000 after that date (for a total benefit of $75,000) assuming that this was not in excess of the 100-percent limitation.

X. Lump-Sum Distributions (Sec. 2005 of the Bill and Sec. 402(e) of the Code)

General rule

Both the House bill and the Senate amendment treat the post–1973 taxable portion of a lump-sum distribution from a qualified pension, profit-sharing or stock bonus plan as ordinary income taxed under an averaging device which treats it as if it were received evenly over a period of years. Under the House bill, this special averaging treatment provides the treatment which would be applicable if the amount were spread over a period of 10 years, while the Senate amendment provides the treatment which would be applicable if it were spread over 15 years. Both the House and Senate versions treat the portion of the payment attributable to the pre–1974 period as long-term capital gain.

The conference substitute accepts the 10-year averaging period provided under the House bill. Both the House bill and the Senate amendment compute the ordinary income portion under the same general type of averaging device and this same general procedure is used in the conference substitute. The ordinary income portion is to be computed without regard to the taxpayer's other income (i.e., in effect it is taxed entirely separately as if this were the only income received by the individual). The tax rate schedule to be used in this separate-treatment approach is the schedule provided in the Code for unmarried individuals (whether or not the taxpayer is married). If the plan participant has service both before 1974 and after 1973, the amount attributed to the post–1973 service is the total taxable distribution times a fraction, the numerator of which is calendar years of active participation after 1973 and the denominator of which is total years of active participation. It is understood that the Treasury Department will provide regulations for allocating fractions of years for plan participants who have both pre–1974 and post–1973 value in lump-sum distributions.

The taxable portion of a distribution is to be the portion of the distribution attributable to employer contributions and to income earned on the account. The portion of the distribution representing the employee's contributions remains nontaxable.

Definition of a lump-sum distribution

The House bill would change the requirements used in determining what qualifies as a lump-sum distribution. The Senate amendment makes no changes in the existing rules on this subject. The conferees have accepted the new House rules.

Under existing law, a distribution generally is treated as a lump-sum distribution if it clears the employee's balance in a single trust, even though there are other trusts in that plan and even though the

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[349] employee receiving the distribution is a participant in several plans maintained by the same employer. The conference substitute retains the requirement that an employee's entire account be distributed. For this purpose, however, all trusts which are part of a plan are to be treated as a single trust. Furthermore, for this purpose all plans of a given category (the categories are pension plans, profit-sharing plans, and stock bonus plans) maintained by an employer are to be treated as a single plan.

The conference substitute also follows the House bill in permitting a distribution to an employee (common-law definition of an employee) after he attains age 59½ to be treated as a lump-sum distribution entitled to the special averaging and partial capital gain treatment, even though the recipient has not left his employment. Under present law, the age 59½ rule applies only to self-employed persons. This change from existing law is a part of the effort to eliminate to the extent feasible the distinctions between taxation of lump-sum distributions to regular employees and to the self-employed, as discussed below.

Multiple lump-sum distributions in one taxable year

The House bill requires that a taxpayer who wishes to use the special averaging and capital gains treatment described above for one lump-sum distribution must use that treatment for the aggregate of the lump-sum distributions he receives in the same taxable year. The Senate amendment and existing law contain no comparable provision. The conference substitute accepts the House rule.

Aggregation of distributions over six years

Both the House bill and the Senate amendment require that the lump-sum distributions received by an individual during a taxable year be aggregated with all lump-sum distributions to that recipient during his five prior taxable years, but only for purposes of determining the tax brackets in which the income is to be taxed. However, the House bill limits this five-year "lookback" rule to lump-sum distributions made after 1973. No similar provision is contained in the Senate amendment.

The conferees accepted this rule enunciated in both the House and Senate versions and also accepted the House bill restriction limiting the lookback aggregation to distributions made after 1973.

Treatment of distributions of annuity contracts

Both the House bill and the Senate amendment provide that a distribution of an annuity contract is to remain nontaxable, but must be included in the six-year aggregation computation described above in order to determine the tax bracket rates on a taxable lump-sum distribution. The House bill provides the annuity contract is to be included in the aggregation computation at its fair market value, while the Senate amendment fixes the value as the cash surrender value as of the time of the distribution.

The conference substitute, as in both the House and Senate versions, includes an annuity contract distribution within the aggregation computation, but continues to treat the annuity contract distribution itself as nontaxable.

[350] The conference substitute provides that the value of an annuity contract for the purposes of the aggregation rule referred to above is to be its current actuarial value. Normally this will be sufficiently close to the cash surrender value of the annuity so that, under Treasury regulations, the cash surrender value (disregarding any loan on the policy) would be treated as the "current actuarial value". However, if the cash surrender value is artificially reduced, Treasury regulations may provide for a simplified method of determining the cash surrender value the annuity would normally carry. If the annuity contract has no cash surrender value, its current actuarial value is to be the present value of the payments anticipated under the annuity contract, computed with regard to the life expectancy of the recipient (and the life expectancy of the recipient's spouse, unless the recipient elects not to take the annuity as a joint and survivor annuity). The present value of these anticipated payments is to be determined under tables to be issued by the Treasury Department.

Recipients eligible for lump-sum distributions

The House bill provides that the only recipients of lump-sum distributions who may elect the special averaging treatment are individuals, estates, and trusts. The Senate amendment (and present law) place no restrictions on who may use the special averaging treatment. The conference substitute generally accepts the restrictions of the House bill, but with modifications in the case of lump-sum distributions to trusts.

Under the conference substitute, a lump-sum distribution may be made to multiple trusts, but, if this occurs, the tax paid on account of the distribution is to be the tax payable as if the entire distribution were made to one recipient, with the tax liability apportioned among the multiple trusts in accordance with the relative amounts received by each.

In cases of distributions to individuals and estates (in which instances an entire lump-sum distribution must be made to one recipient) the recipient is to make an election as to whether to claim the special averaging treatment. (The personal representative of the employee is to make the election if distributions are made to multiple trusts). This election is of significance because, as discussed below, only one election may be made with respect to an employee who has attained age 59½.

As under the House bill, the conference substitute provides that an employee must generally be regarded as the recipient, for purposes of the requirement of aggregation of all lump-sum distributions in a period of six taxable years, even if he or she causes the distribution to be made to a trust, if the employee retains such an interest in the trust as would require his taxation as the substantial owner of the trust under the present tax rules, even if the grantor of the trust is technically the employer or plan.[1]

In the House bill, a trust would be allowed to elect the special averaging treatment only if (1) the use of the trust would not affect the includibility of the distribution in the employee's gross estate, and

[1] If the lump-sum distribution is made to a recipient other than a trust during the employee's lifetime, it is intended that the usual assignment-of-income and constructive receipt rules are to apply to determine whether the employee is to be liable for the tax upon the distribution.

[351] (2) the trust would be sole recipient of the entire balance to the credit of the employee. These provisions were not adopted by the conferees.

As indicated above, attainment of age 59½ is made a criterion of eligibility for a regular employee (as well as for a self-employed person, as under present law) for the special averaging lump-sum treatment under the conference substitute. It was not considered necessary, however, to specify that a beneficiary is entitled to the special averaging and partial capital gain treatment for a distribution on account of the death of an employee *after* his retirement (as well as before).[2]

Number of elections

The House bill allows the special averaging treatment to be elected freely until the employee attains age 59½, after which time only one election may be made with respect to that employee. The Senate amendment does not have an election procedure. As is the case under present law, the Senate version makes the treatment mandatory for lump-sum distributions and does not limit the number of times this special treatment may be used.

The conferees followed the House bill in allowing only one election with respect to an employee after he has attained age 59½. Thus, if an employee has made one election after attaining age 59½, he may not thereafter obtain the special averaging treatment for another distribution. As under present law, however, an employee, or his beneficiary, who is barred from the special averaging treatment by an earlier election may nevertheless gain the partial capital gain treatment for pre-1974 value if the distribution is made on account of the employee's death or separation from service. In addition, such an employee who receives a distribution because of attaining age 59½ may also receive the partial capital gains treatment although he is barred from the special averaging for the ordinary income portion.

A recipient who elects this special averaging treatment may still elect the usuual income averaging provided under sec. 1301.[3] A taxpayer who surrenders an annuity may use the normal 5-year income averaging and also may use the special averaging for lump-sum distributions.

Lump-sum distributions to the self-employed

Under the House bill, the same 10-year ordinary income averaging may be elected for distributions on account of plan participation by self-employed persons as may be elected on account of the participation of regular employees. (Under present law, lump-sum distributions to self-employed persons are taxed under special 5-year averaging provisions.) There is no comparable Senate provision.

The conferees accepted the House provision eliminating the distinction of treatment between regular employees and the self-employed in this respect. If they elect the special averaging treatment, self-employed persons are also entitled to capital gain taxation on the pre-1974 value of their lump-sum distributions.

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[2] Thus, no change in present law is intended by the deletion of references to this in sections 402(a)(2) and 403(a)(2)(A)(iii) of the code.

[3] H. Rept. 93–807, p. 150, which indicates that a common-law employee who uses the special averaging provided under present law may nevertheless also use the regular five-year income averaging for his other income and capital gain, is incorrect. Under the conference substitute, however, both types of income averaging may be used concurrently by both regular employees and the self-employed.

[352] *Computation of tax in lump-sum distribution*

It is recognized that the computation of tax due on a lump-sum distribution with an annuity lump-sum distribution, as reflected in the reports of the House Ways and Means Committee and the Senate Finance Committee, is incorrect in that it subtracts the entire minimum distribution allowance from the amount of the annuity, instead of subtracting only that portion of the minimum distribution allowance that is proportionate to the amount of the annuity distribution as compared with the total distribution. This incorrectly increases the tax on the taxable distribution because it minimizes the tax attributable to the annuity distribution. The less the tax attributable to the annuity distribution, the larger is the tax attributable to the taxable distribution.

The correct computation is as follows:

First example.—On December 31, 1975, A terminates his services and receives a lump sum distribution of $65,000 from a qualified plan. The distribution includes employer securities with a fair market value of $25,000 and a basis of $10,000. A has been participating in the plan since January 1, 1966. The plan is noncontributory. A is married; both A and his wife are 50. Their only other income is A's salary of $15,000 and his salary from a second job ($5,000). Their itemized deductions are $3,000. Their average base period income (for purposes of regular income averaging) from the preceding four years (1971 through 1974) is $14,000.

The tax on the portion of the distribution which is not treated as a long-term capital gain is computed as follows:

Net distribution ($65,000 total distribution less $15,000 unrealized appreciation on employer securities)	$50,000
Less: Minimum distribution allowance: 50 percent of first $20,000	$10,000
Reduced by: 20 percent of net distributions in excess of $20,000	6,000
	4,000
Distribution less allowance	46,000

The tax on $\frac{1}{10}$th of the distribution less allowance computed from the tax rate schedule for single taxpayers is $816.00.

Multiply this amount by 10: $8,160.00.

Then, multiply by the fraction,

$$\frac{\text{Years of participation in plan after 1973}}{\text{Total years of participation}} = \frac{2}{10} = 0.2$$

which yields $1,632.00.

Thus, the tax on the ordinary income portion of the distribution is $1,632.00.

The amount of the distribution taxed as a long-term capital gain is the amount of the net distribution multiplied by the fraction,

$$\frac{\text{Years of participation before 1974}}{\text{Total years of participation}} = \frac{8}{10} = 0.8$$

Net distribution	$50,000
Capital gains element	40,000

The capital gains element is taxed along with other income (exclusive of the ordinary income element) in the normal way. The tax on the taxable income of $35,500 ($15,000 salary from first job, plus $5,000 from second job, plus $40,000 capital gains element of lump-

[353] sum distribution, less $20,000 capital gains exclusion, less $3,000 itemized deductions, less two $750 personal exemptions) is calculated using the tax rate schedule for married taxpayers filing joint returns. In this case the alternative tax on capital gains is not available, but the regular-five-year income averaging provisions are.

Ordinary tax	$10,130.00
Tax—Using regular income averaging [1]	8,828.00

[1] As indicated above, average base period income is $14,000.

Selecting the tax computation method which yields the smallest amount of tax, A uses the regular five-year income averaging method and has a tax of $8,828.00.

Finally, A combines the tax on the capital gains portion of the distribution and his salary, with the tax on the ordinary income portion of the distribution:

Tax on salary and capital gains portion of distribution	$8,828.00
Tax on ordinary income portion of distribution	1,632.00
Total 1975 income tax	10,460.00

A's basis in the employer securities is $10,000.

Second example.—On December 31, 1976, A receives a distribution from a qualified plan with respect to his second job. In this case the distribution is a nontransferable annuity contract, the value of which is $6,000; and a cash distribution of $4,000 financed solely by the employer. A had participated in the plan since January 1, 1967. Mr. and Mrs. A's only other income in 1976 is A's salary of $25,000 and interest of $3,000 on the $40,000 cash received in the prior lump-sum distribution. They have itemized deductions of $2,100. Mr. and Mrs. A's 1976 tax is computed as follows:

First, compute the tax on the portion of the distribution which is not treated as a long-term capital gain and which is taxed separately.

Step 1:		
1976 cash distribution		$4,000
1976 annuity contract		6,000
Prior year net distribution		50,000
Total		60,000
Less: Minimum distribution allowance: 50 percent of first $20,000		$10,000
Reduced by: 20 percent of net distribution in excess of $20,000		8,000
Total		2,000
		58,000

Ten times the tax on one-tenth of $58,000 (from the rate schedule for single taxpayers) is $10,680.

Step 2:		
1976 annuity		$6,000
Minimum distribution allowance from step 1	$2,000	
Portion of minimum distribution allowance attributable to annuity distribution		
$\frac{\$6,000}{60,000} \times \$2,000 = \$200$	200	
Remainder		5,800

[354] Ten times the tax on one-tenth of $5,800 (from the rate schedule for single taxpayers) is $820.

Step 3: $10,680.00—$820=$9,860

Step 4:

Determine ordinary income and capital gains elements of A's distribution and his prior year distribution. The ordinary income element of A's latest distribution is determined by multiplying the cash distribution of $4,000 by:

$$\frac{\text{Years of participation in plan after 1973}=\frac{3}{10}=0.3}{\text{Total years of participation}}$$

Thus, A's ordinary income element is $1,200. $10,000 of Mr. A's prior distribution of $50,000 was ordinary income.

Thus, the tax on the ordinary income element is the fraction of the tax from Step No. 3 which the ordinary income elements of the 1976 and prior year distributions bear to the entire distributions.

$$\left.\frac{\$1,200+\$10,000}{\$4,000+\$50,000}\right\}\times\$9,860=\$2,045.04$$

Step 5:

The tax on the ordinary income element of A's 1975 distribution from their 1975 income tax income return was $1,632.00. Subtracting that from the tax calculated in Step No. 4 yields the tax on the ordinary income element of A's latest distribution:

$$\$2,045.04-\$1,632.00=\$413.04$$

Second, compute the tax on all other income, including the capital gains portion of the distribution.

Step 6:

In Step No. 4, the ordinary income element of the distribution was calculated as $1,200. Therefore, the long-term capital gains element is:

$$\$4,000.00-\$1,200=\$2,800.00$$

Step 7:

The capital gains element is taxed along with other income in the regular manner.

Capital gains element	$2,800
Less: 50 percent of net long-term capital gain	1,400
Total	1,400
Salary	25,000
Interest	3,000
Adjusted gross income	29,400
Less: Itemized deductions	2,100
Less: Personal exemptions (2×$750)	1,500
Taxable income	25,800

The tax on $25,800 is calculated using the tax rate schedule for married taxpayers filing joint returns. In this case, neither the alternative tax on capital gains nor the regular five-year income averaging provision is available.

Ordinary tax	$6,308.00

[355] *Third*, A combines the tax on the capital gains portion of the distribution and his other income, with the tax on the ordinary income portion of the distribution.

Step 8:	
Tax on capital gains portion of distribution and on other income	$6,308.00
Tax on ordinary income portion of distribution	413.04
Total 1976 income tax	6,721.04

If in the examples above, A has attained age 59½, he may elect to treat only one of the distributions as a lump-sum distribution qualifying for ten-year averaging. In computing the tax liability on the distribution which he elects to qualify for ten-year averaging, A will not aggregate any distribution (except in the case of a distribution of an annuity contract) made after attaining age 59½ which is not treated as a lump-sum distribution for purposes of the ten-year averaging.

XI. Salary Reduction and Cash or Deferred Profit-Sharing Plans (Sec. 2006 of the Bill)

Under present law, in general, an employee's contributions to a qualified retirement plan maintained by his employer are not tax deductible. In the case of a salary reduction plan, or a cash or deferred profit-sharing plan, however, the Internal Revenue Service has permitted employees to exclude from income certain amounts contributed by their employers to the plan, even where the source of these amounts is the employee's agreement to take salary or bonus reductions, or forego salary increases.

On December 6, 1972, the Service issued proposed regulations which would have changed this result in the case of salary reduction plans, and which called into question the continued viability of the treatment of cash and deferred profit-sharing plans.

In order to allow time for congressional study of these areas, the conference substitute provides for a temporary freeze of the status quo. Thus, contributions to plans in existence on June 27, 1974, are to be governed under the law as it was applied prior to January 1, 1972. This treatment is to continue at least through December 31, 1976, or (if later) until regulations are issued in final form in this area, which would change the pre-1972 administration of the law. These regulations, if issued, are not to be retroactive for purposes of the social security taxes or the Federal withholding taxes, and are not to be retroactive prior to January 1, 1977, for Federal income tax purposes.

In the case of plans not in existence on June 27, 1974, contributions made on a salary reduction basis, or made, at the employee's option, to a cash or deferred profit-sharing plan, are to be treated as employee contributions (until January 1, 1977, or until new regulations are prescribed in this area). This will prevent a situation where a new plan might begin in reliance on pre-1972 law while Congress has not yet determined what the law should be in the future.

Generally a plan will be treated as having been established on June 27, 1974, if the plan had been reduced to writing and had been adopted and approved by the directors on or before that date, even if contributions had not yet been made to the plan on a salary reduction basis.[1] New participants may, of course, be added to an existing plan in the normal course of business.

[1] Where shareholder approval is required for formal adoption of the plan, such shareholder approval must also have occurred by June 27, 1974.

[356] Also to be covered under these principles are so-called cafeteria plans, under which the employees may have a choice between certain fringe benefits, some of which would constitute taxable income to the employee, whereas other forms of benefit might not. Thus, existing cafeteria plans also are to be governed under pre-1972 law until at least January 1, 1977. However, in the case of new plans, the value of any benefits selected under a cafeteria plan are to be includable in income until at least January 1, 1977 (or, if later, until new regulations in this area have been promulgated). In general, the same rules to be applied in determining whether or not a salary reduction plan was in existence on June 27, 1974, are also to be applied to cafeteria plans. Of course, minor plan amendments (such as changing the plan to allow cash payments to cover cases of breakage, i.e., where two alternative benefits available under the cafeteria plan do not have exactly the same value) would not cause an existing plan to be classified as a new plan for purposes of these rules.

The conferees agree with the statements in the Ways and Means Committee report (No. 93–807) to the effect that there should be no inferences drawn from this action as to whether or not the pre-1972 application of the law is, or is not, correct, or as to whether new regulations in this area should, or should not, be issued, or as to what these regulations, if any, should provide.

XII. General Provisions Relating to Jurisdiction, Administration, Enforcement; Joint Pension Task Force, Etc. (Sec. 3001–3004, 3021–3022, 3031, 3041–3043 of the Bill)

General provisions relating to jurisdiction, administration and enforcement

Under the bill and amendment as passed by the House and the Senate jurisdiction with respect to the requirements for plans seeking tax benefits under the Internal Revenue Code is basically with the Internal Revenue Service. In addition, the bill and amendment as passed by the House and the Senate provides jurisdiction to the Secretary of Labor to enforce standards for plans which do not seek special tax benefits under the Internal Revenue Code, and to enforce certain standards as they apply to tax-qualified plans.

Under the conference substitute, procedures are established which will provide a significant and appropriate role in the enforcement of the participation, vesting, and funding standards to both the Department of Labor and the Internal Revenue Service (with respect to plans which seek qualification under the Internal Revenue Code) without a duplication of effort on the part of the two departments. In addition to the specific areas of the conference substitute where areas of jurisdiction are delegated to one department or the other, the conference substitute provides general guidelines for the coordination of administration and enforcement.

The administration of qualified plans is separated into two stages: first, the stage when the plan seeks from the Internal Revenue Service initial qualification of entitlement to special tax benefits under the

[357] Internal Revenue Code; second, the operational stage with respect to the continued eligibility of the plan for the special tax benefits.

Initial stage jurisdiction.—In determining whether a pension, profit-sharing, or stock bonus plan or a trust which is a part of such a plan, is initially entitled to the special tax benefits provided under the tax law, the Secretary of the Treasury is to require that the person applying for the initial qualification of the plan is to provide, in addition to any materials and information which would generally be necessary for the administration of the tax laws, such other forms and information as may reasonably be made available at the time of the determination as the Secretary of Labor may require. The Secretary of the Treasury is also to require that the applicant for a determination provide evidence that any employee who is an interested party with respect to the plan has been notified of the request for a determination. Also the Secretary of the Treasury is to notify the Secretary of Labor and the Pension Benefit Guaranty Corporation when he receives an application for a determination as to the tax status of a plan.

The Secretary of the Treasury when he makes a determination with respect to a plan or trust is to notify the Secretary of Labor of his determination and furnish to the Secretary of Labor the forms and information submitted for the Secretary of Labor. For this purpose a determination includes a determination that a plan is, or is not, qualified for the special tax benefits under the Internal Revenue Code. The Secretary of the Treasury is also to notify the Secretary of Labor if a request for a determination is withdrawn.

Under the conference substitute, the Secretary of the Treasury is to afford the Secretary of Labor an opportunity to comment on the initial determination in any case involving the participation or vesting standards in which the Secretary of Labor requests such an opportunity. It is expected that the two departments will set up procedures implementing this procedure in a manner which affords the Secretary of Labor an ample opportunity to comment but which does not cause undue delay in the granting of initial determinations. A request by the Secretary of Labor to comment upon an application for an initial determination is to be made only upon the request (in writing) of the Pension Benefit Guaranty Corporation or on the request of 10 employees (or 10 percent of the employees if lesser) who would be viewed as interested parties under the plan. A copy of the request submitted to the Secretary of Labor is to be transmitted by him to the Secretary of the Treasury within 5 business days of its receipt.

If the Secretary of Labor does not submit comments on behalf of such groups of employees within 30 days after receiving a petition from the necessary number of interested employees, the Secretary of the Treasury is to afford these interested employees a reasonable opportunity to comment upon the initial request for a determination. The above procedure for enabling employees to comment upon an application for a determination is not the exclusive means by which employees may participate in the determination proceedings. Employees may of course proceed on their own through the declaratory judgment provisions which are provided in the bill. The Pension Benefit Guaranty Corporation and the Secretary of Labor (upon petition by the required number of employees) may intervene in any

[358] declaratory judgment proceedings in the Tax Court whether the proceedings are brought on behalf of the employer or interested employees. In addition, the Pension Benefit Guaranty Corporation is to be entitled to bring a suit for a declaratory judgment under rules to be prescribed by the Tax Court.

If a plan is qualified by the Secretary of the Treasury, the plan is to be treated as meeting the initial requirements of the Secretary of Labor with respect to participation and vesting.

The above outlined procedures apply not only to the initial qualification of a plan which seeks the special tax benefits provided under the Internal Revenue Code but apply to a request for an IRS determination with respect to any amendment to the terms of a plan or a trust which seeks a favorable determination from the Internal Revenue Service.

Operational stage jurisdiction.—The conference substitute also provides procedures for the exercise of the respective jurisdictional authority of the departments with respect to plans qualified for special tax treatment under the Internal Revenue Code during their operation. The Secretary of the Treasury in carrying out the administration of the Internal Revenue Code with respect to any plan or trust is to examine the plan to determine whether the plan satisfies the requirements relating to minimum participation standards and minimum vesting standards (in secs. 410(a) and 411 of the Code).

The Secretary of the Treasury is to notify the Secretary of Labor before commencing any proceedings to determine whether the plan or trust is in compliance with the minimum vesting and participation standards. While the notice need not be made prior to the time the Internal Revenue Service begins an audit or a review of a plan to verify that the minimum standards have been satisfied, it is expected that if in the course of a review or audit doubts or questions are raised by the Internal Revenue Service as to whether the plan has met the minimum standards, the Secretary of the Treasury is to notify the Secretary of Labor. Notification is to be made prior to the time the Internal Revenue Service issues a 30-day letter of an intention to disqualify the plan or trust. Except in cases of jeopardy the Secretary of the Treasury is not to issue a determination that the trust or plan does not satisfy the minimum standards until the expiration of a period of 60 days after the date on which he notifies the Secretary of Labor. This period of time is provided for the Secretary of Labor so that, if he chooses to do so, he may examine the plan to determine whether he should begin to take any action to compel compliance under those portions of the participation and vesting provisions of the bill in which he has jurisdiction or to coordinate any action he may be required to take by reason of a complaint from a participant or beneficiary. This 60-day period may be extended by the Secretary of the Treasury if he determines that an extension of this period would enable the Secretary of Labor to obtain compliance with the requirements of the law during this extended period. In order to assist the Secretary of Labor in deciding whether he should seek compliance with the requirements of the law the Secretary of the Treasury is to provide the Secretary of Labor with copies of any notices which he issues to the plan administrator with respect to the minimum participation and vesting standards.

[359] The Secretary of the Treasury in administering the provisions relating to taxes on the failure to meet minimum funding standards (sec. 4971 of the Internal Revenue Code) is to notify the Secretary of Labor before imposing any tax on an employer. In addition, prior to the imposition of the tax, in other than jeopardy situations, the Secretary of the Treasury is to afford the Secretary of Labor an opportunity to comment on the appropriateness of imposing the tax. After consultation with the Secretary of Labor, the Secretary of the Treasury may in appropriate cases waive or abate the 100 percent excise tax on failure to satisfy the minimum funding standards. In order to coordinate their respective responsibilities under the funding standards, it is anticipated that both Secretaries will consult with each other as is needed with respect to the provisions relating to minimum funding standards, both those provided in the Internal Revenue Code and the funding standards provided by title I. As part of this coordination, at the request of the Secretary of Labor or the Pension Benefit Guaranty Corporation, the Internal Revenue Service is to initiate an immediate investigation with respect to any liability for the tax on failure to meet the minimum funding standards.

If the Secretary of Labor or the Pension Benefit Guaranty Corporation seek compliance on any case involving the construction or application of the minimum participation, vesting or funding standards, a reasonable opportunity is to be afforded to the Secretary of the Treasury to review and comment upon any proposed pleadings or briefs before they are filed. Of course, the Secretary of Labor need not obtain the approval of the Secretary of the Treasury and the Secretary of the Treasury may intervene and file his own pleadings or briefs in any case.

The Secretary of the Treasury in carrying out the provisions relating to tax on prohibited transactions (sec. 4975 of the Internal Revenue Code) is to inform the Secretary of Labor before imposing the tax under that section. In addition, the Secretary of Labor is to be afforded an opportunity, in other than jeopardy situations to comment on the appropriateness of imposing the tax. After consultation with the Secretary of Labor, the Secretary of the Treasury may in appropriate cases waive or abate the 100 percent excise tax on failure to correct a self-dealing violation. It also is anticipated that both Secretaries will consult as is needed with respect to the provisions relating to prohibited transactions (including the exemptions which may be provided therefrom) in order to coordinate the rules applicable under these standards. To best coordinate these rules the two Secretaries may want to set up a board to review and coordinate these rules. As part of this coordination, the Internal Revenue Service at the request of the Secretary of Labor or the Pension Benefit Guaranty Corporation is to initiate an immediate investigation with respect to the liability of any person for the tax on prohibited transactions.

Issuance of regulations.—Under the conference substitute the Department of the Treasury is to prescribe the necessary regulations under the general provisions relating to participation, vesting, and funding except where specific authority is given to the Secretary of Labor to prescribe the regulations. For example, the Secretary of Labor is to prescribe regulations defining what con-

[360] stitutes a year of service for purposes of the participation and vesting standards of the Act. Regulations which are prescribed by the Treasury or Labor Departments in those areas in which jurisdiction is assigned to them are to be binding upon the other department (unless provided otherwise by the bill). Where the final authorization to prescribe regulations under a provision is provided to one department or the other, it is expected that the two departments will consult and coordinate closely with each other in prescribing the necessary regulations which need to be issued under the various provisions of the bill.

Under the conference substitute whenever in the bill the Secretary of the Treasury and the Secretary of Labor are required to carry out provisions relating to the same subject matter, they are to consult with each other in the developing of rules, regulations, practices and forms to the extent possible for the efficient administration of the provisions in order to reduce to the maximum extent practical, duplication of effort, conflicting requirements and the burden of compliance (including the annual reports which must be filed by the plan administrators). The two Secretaries may make arrangements or agreements for cooperation and mutual assistance in the performance of the functions they have under the bill as they find practicable and consistent with the law. The maximum coordination is expected in those areas where one agency has the authority to prescribe regulations and also, of course, where the regulations are to be a cooperative effort of both agencies.

Joint task force and studies

Under the bill, as passed by the House, the Secretary of Labor is to undertake studies relating to private pension plans, including the cost impact of the bill on pension plans, the role of pension plans in providing economic security, the operation of pension plans, and methods of encouraging the growth of the private pension system. In addition, the Committee on Education and Labor and the Committee on Ways and Means are to undertake studies of retirement plans financed or maintained by the United States, or by State and local governments. This study is to include consideration of the adequacy of the participation, vesting, and fiduciary standards, as well as financing and funding methods. In studying whether the funding standards of the bill should be imposed on government plans the study is to take into account the taxing power of the governmental unit maintaining the plan. The two committees are to report the results of the governmental study to the House of Representatives by December 31, 1976.

Under the bill as passed by the Senate, the Secretary of Labor is authorized to undertake the studies relating to employee benefit plans which are generally similar to the studies provided for in the bill as passed by the House. However, the bill as passed by the Senate authorizes the Secretary of Treasury to undertake the study of governmental plans and report to the Committee on Finance and the Committee on Ways and Means by December 31, 1976.

Under the conference substitute the staffs of the Committee on Ways and Means and the Committee on Education and Labor of the House, the Joint Committee on Internal Revenue Taxation, and the Committee on Finance and the Committee on Labor and Public Welfare of the Senate are to carry out duties assigned to the Joint Pension

[361] Task Force. By agreement among the Chairmen of these committees, the Joint Pension Task Force is to be furnished with office space, clerical personnel, actuarial and other consultants, and the supplies and equipment which are necessary for the Task Force to carry out its duties. The Joint Pension Task Force is authorized to engage in specified studies and make a report to the abovementioned committees within 24 months after the date of enactment of the bill. In addition, the Joint Pension Task Force is to study any other matter which any of the committees referred to above may refer to it.

The Joint Pension Task Force is specifically authorized to engage in four studies. First, it is to study and review the three vesting alternatives in the bill to determine the extent of discrimination, if any, among employees in various age groups resulting from the application of these provisions. (The results of this study are to be reported only to the tax committees.) Second, it is to study the means of providing for the portability of pension rights among different pension plans. Third, it is to study the appropriate treatment under the termination insurance provisions of the Act for plans established and maintained by small employers. Fourth, it is to study the effects and desirability of the pre-emption of State law provisions of the bill. In addition elsewhere in this statement it is indicated that the Joint Pension Task Force is to study the effect of the rules in this bill limiting the extent to which antidiscrimination rules may be enforced through additional requirements as to early vesting and the effect on benefits and costs of integrating social security benefits with the benefits payable under retirement plans.

The substitute agreed to by the conferees also provides for a congressional study of retirement plans established and maintained, or financed, by the Government of the United States, by any State (including the District of Columbia), or any political subdivision thereof. The study is to include an analysis of the adequacy of existing levels of participation, vesting, and financing arrangements; existing fiduciary standards; and the unique circumstances affecting mobility of government employees and individuals employed under Federal procurement contracts. In considering whether plans are adequately financed consideration shall be given to the necessity for minimum funding standards as well as the taxing power of the government maintaining the plan. This study is to be submitted not later than December 31, 1976, by the Committee on Education and Labor and the Committee on Ways and Means to the House of Representatives and by the Committee on Finance and the Committee on Labor and Public Welfare to the Senate.

Enrollment of Actuaries

Standards.—The House bill requires that reasonable standards and qualifications are to be established for enrolling actuaries to practice, and specifies the standards that are to be applied for enrolling actuaries to practice. Under the Senate amendment, reasonable standards and qualifications are to be established for enrollment to practice, but the standards to be used are to be determined in regulations.

The conference substitute largely follows the provisions of the House bill. With respect to persons applying for enrollment before

[362] January 1, 1976, the substitute provides that the standards and qualifications are to include a requirement for "responsible actuarial experience relating to pension plans," and deletes the requirement for experience in the "administration" of pension plans. This change is intended only to clarify the application of the standards before January 1, 1976, so that persons who apply for enrollment before that date have responsible actuarial experience (and not only administrative experience) relating to pension plans. With respect to persons who perform actuarial services for smaller and simpler plans, the conferees anticipate that, to the extent feasible, the standards for enrollment will make it possible to use standard actuarial tables and standard earnings assumptions whether or not the actuary's training includes the highest level of actuarial skills. The limited number of persons with a high level of actuarial skills makes it desirable that the standards acceptable for persons examining smaller and simpler plans need not be as restrictive as in the case of those examining the larger plans.

The conference substitute also provides that actuaries may be enrolled on a temporary basis for a limited period. This makes it clear that actuaries can be enrolled almost immediately after enactment of the bill in order that enrolled actuaries will be available to help plans meet the requirements of the new law. The conferees intend that such temporary enrollment is not to be in lieu of any special enrollment standards for persons who apply for enrollment before January 1, 1976, but is only to allow immediate enrollment before the final standards are established.

Procedures.—The House bill provides for separate enrollment of actuaries by the Department of Labor (title I) and the Internal Revenue Service (title II). However, the House bill also provides that standards for enrollment after January 1, 1976, are to be established by joint regulations. The Senate amendment provides for enrollment only before the Internal Revenue Service.

Under the conference substitute, a single standard for enrollment is achieved by directing the Secretary of Labor and the Secretary of Treasury to establish a joint board which will set standards for enrollment and enroll actuaries to practice before the Department of Labor and Internal Revenue Service. In order that enrollment might begin as soon as possible, it is provided than an interim joint board is to be established no later than the last day of the first month following the date of enactment.

The joint board also is to administer the standards for disenrollment of actuaries and is to write the regulations on enrollment (to be approved by the two Secretaries or their delegates). As under the House bill, an actuary can be disenrolled only after notice and hearing, and if there is a finding that he does not comply with the governing rules or regulations, or is shown not to be competent in actuarial matters.

Reports.—Both the House bill and the Senate amendment provide that actuarial reports are to be made separately to the Department of Labor and the Internal Revenue Service. The conference substitute largely follows the provisions of the House bill in the technical aspects. In keeping with the general principle of eliminating, to the maximum extent feasible, duplication of effort in reporting, the con-

[363] ference substitute also requires the Secretaries of Labor and Treasury to take such steps as may be necessary to assure coordination, to the maximum extent feasible, between the actuarial reports they file with the Secretary of Labor and the Internal Revenue Service.

XIII. Plan Termination Insurance (Secs. 4001–4082 of the Bill)

Administering corporation and its organization

Both the House bill and the Senate amendment call for a public corporation named the Pension Benefit Guaranty Corporation to administer the plan termination provisions within (or with) the Department of Labor. The Secretary of Labor would be the chairman of a three-man board of directors. Under the House bill, the other two directors would be other officers or employees of the Department of Labor, while under the Senate amendment, the Secretaries of Commerce and of the Treasury would be the other directors.

The conferees decided, following the Senate amendment, to place the corporation within the Department of Labor under a board consisting of the Secretaries of Labor, Commerce, and the Treasury, with the Secretary of Labor to be chairman of the board. The corporation is to be "within" the Department of Labor in that it is to be quartered there and it is to receive such housekeeping services as it may request from the Labor Department. The board of directors is to establish policy, while the chairman is to be responsible for the overall supervision of the corporation's personnel, organization, and budget practices. The corporation's personnel will be appropriately classified in the usual categories, and they are to be nonpolitical. The conferees contemplate that the corporation may make contractual arrangements for the performance of some of its functions by other agencies, and, in particular, it is anticipated that it may arrange for such functions as recordkeeping to be performed by the Department of Labor insofar as those activities are analogous to the regular duties of the Labor Department. Generally, the other functions of the corporation are to be performed by its own employees, as well as by private parties contracting to perform special duties.

During the temporary start-up period following the date of enactment, the corporation may, in its discretion, make arrangements for performance of any of its functions by other agencies, and, in particular, the Department of Labor.

The conferees also established a seven-man Advisory Committee to advise the corporation on such issues as the investment of funds, appointment of trustees for terminating plans, whether plans should be liquidated immediately through purchase of annuities or continued in operation under a trustee, and on other problems with regard to which the corporation requests advice. The seven members are to be appointed by the President upon the recommendation of the board of directors. Employee organizations and employers are each to have two representatives on the Advisory Committee, with the general public to have three. The President is to designate one of the appointees as chairman.

The Advisory Committee members are to serve staggered, three-year terms, and are to meet at least six times a year. The members may

[364] select employees for the Advisory Committee, but its employees, as well as those of the corporation, are to be appointed in accordance with Civil Service regulations.

Portability assistance

The Pension Benefit Guaranty Corporation is to provide advice and assistance, upon request, to individuals regarding establishing individual retirement accounts or other forms of deductible individual retirement savings, and also regarding the desirability, in particular cases, of transferring an employee's interest in a qualified plan to a form of individual retirement savings upon that employee's separation from service.

Investments, borrowing authority, and tax exemption

Both the House and the Senate versions authorize the corporation to borrow up to $100 million from the Federal Treasury. The conferees expect the program, ultimately, to be self-financing.

The Senate amendment exempts the corporation from Federal taxation (except for social security and unemployment taxes) and from State and local taxation (except that the corporation's real and tangible personal property, other than cash and securities, may be taxed to the same extent according to value as other such property is taxed).

The conferees accepted both the borrowing authority and the tax exemption.

The assets in the corporation's funds representing collections of premiums may be invested in obligations issued or guaranteed by the United States. The assets representing terminated plans in the process of liquidation are to be invested by the trustees of the liquidating plans consistently with investment policies suggested to the corporation by the Advisory Committee.

Premiums

In the establishment of premium rates for plan termination insurance the House bases its rate on a combination of a plan's unfunded insured benefits and its total (whether or not funded) insured benefits. The Senate amendment, on the other hand, initially provides a premium of $1 per year per plan participant. In addition, the Senate amendment provides for collection of the premiums as a tax (therefore by the Internal Revenue Service), while the House bill does not make use of the tax collection procedure but instead the corporation is to bill and collect the premiums from the plans charging interest on unpaid premiums past due.

The conferees decided to require the corporation to establish separate uniform premium rates for single-employer and for multiemployer plans for retirement benefits. Single-employer plans are to pay $1 per plan participant during the first full plan year following enactment (and a prorated amount for any part of a plan year preceding that first full plan year). Multiemployer plans are to pay 50 cents per plan participant during these periods.

For the first fractional part of a year (after enactment) and the first full plan year after the date of enactment, premiums are to be paid within 30 days after the beginning of the period of coverage. The corporation may follow this or another system thereafter.

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[365] In the case of participants in multiemployer plans, no participant is to be counted more than once in computing the per capita ($1 or 50 cents per person) premium. Thus, if, during the course of a plan year, an employee leaves one employer in the multiemployer plan to work for another employer in the plan, the plan need nevertheless pay only one 50-cents premium on account of his participation.

The corporation is directed to establish by regulation appropriate procedures for determining the amount of the premium where there are practical problems such as rapid turnover of participants during a plan year.

During the second full plan year, both single-employer and multiemployer plans may elect to pay a premium determined under the formula of the House bill but not less than one-half of what they would have to pay under the per capita rates. (This rate base for multiemployer plans continues until 1978.) One-half of the premium referred to above is to be determined according to the plan's unfunded insured benefits (but with the premium not to exceed 0.1 percent of unfunded vested benefits for single-employer plans and .025 percent for multiemployer plans). The other half of the premium is to be based on the total insured benefits. In this case the premium is to be fixed at a uniform rate (determined separately for single-employer and multiemployer plans) which is calculated by the corporation to produce the same total yearly revenue as is produced by the premiums on unfunded insured benefits.

In subsequent years the corporation may set premiums using the per capita rate base, the unfunded insured benefits rate base, or the total insured benefits rate base, or any combination of these (subject to the rate limitations above described). If the corporation should want to combine any two or more of these three rate bases, it is to design the bases to produce approximately equal amounts of aggregate premium revenue yearly from each.

The corporation may exceed the rate limitations, produce unequal amounts of aggregate premium income from the different rate bases, or use other rate bases, but only as to plan years beginning after Congress approves these revisions through a special procedure set forth in the conference substitute.

The conferees also decided that the corporation should establish by regulations equitable methods of valuing a plan's assets and benefits for the purpose of setting premium rates.

The basic enforcement mechanism is to be a civil action brought by the corporation for the collection of unpaid premiums past due. There is to be a civil penalty of up to 100 percent of the amount of unpaid premiums to be assessed after 60 days following the due date of the premiums, but application of this penalty may be postponed in cases in which payment of the premiums entails hardship to the plan. The plan is to be liable for both the premiums for coverage of benefits and for any penalty assessed for failure to pay premiums. Besides the penalty, the corporation may also charge interest (at the rate imposed at the time under section 6601(a) of the Internal Revenue Code, or its successor, upon tax underpayments) for unpaid premiums that are past due. Additionally, a court, in any action brought to enforce the insurance provisions, including an action to collect unpaid premiums, may award the corporation all or any part of its costs of litigation.

[366] The corporation may elect to insure nonbasic benefits in covered plans and do this through separate funds. If it does so, uniform premium rates are to be established by the corporation for the risk insured in each category. The term "nonbasic benefits" may include both what are sometimes called ancillary benefits and what are sometimes called supplemental benefits.

As to basic retirement benefits, coverage is to continue although premiums are not paid when due.

As explained subsequently, the corporation is also to provide insurance protection for employer liability upon the termination of plans. In this case the corporation is free to determine the rates in a manner it determines as appropriate. These premiums are to be set at rates sufficient to fund the contingent liability covered. This coverage is not to remain in effect if premiums due are unpaid. For coverage of employer liability, the corporation is to provide regulations to set the appropriate period for which the premiums (which are to be paid by the employer) should be paid. Employers electing this coverage may give notice of their election prior to the coverage period, and the five-year waiting period during which the premiums must be paid before contingent employer liability is covered is to begin with that notification.

Establishment of pension benefit guaranty funds

Under the House bill, separate trust funds were to be established for single-employer plans and for multiemployer plans. In addition, the corporation would be given the option to establish other trust funds, including a fund for employers paying the optional extra premium for coverage against employer liability. The corporation was to have the discretion to grant coverage against this contingent employer liability for employers in single-employer plans. (There was to be no employer liability for employers in multiemployer plans.) Although premium rates were to be established separately to reflect experience and corporation costs for single-employer plans and multiemployer plans, only one trust fund was specifically provided under the Senate amendment. However, authority was granted to establish funds for insurance of contingent employer liability and insurance of other classes of benefits.

Under the conference substitute, four separate revolving funds are specifically established. They are for the basic retirement benefits of single-employer and multiemployer plans and for such nonbasic benefits of single employer and multiemployer plans that the corporation chooses to insure. It is intended that separate accounts will be maintained in the two basic retirement funds for employer liability payments and for premiums paid for employer liability coverage.

The resources of each fund are not to be used to pay the losses or expenses of another fund, and the funds may draw upon the general funds of the Treasury only to the extent of their borrowing authority. The funds are to be self-sufficient and are not to be a charge on the Federal budget.

Among the receipts to be included in each fund are the appropriate portions of premiums, penalties, interest, and other charges; employer liability payments; amounts borrowed from the Treasury; and interest earned by fund assets.

[367] Disbursements are to be made from each fund for payments of insured benefits (including employer contingent liability coverage), repayment to the Treasury of borrowed amounts, operational and administrative expenses, and payments for assets being purchased under certain circumstances from a plan being terminated.

Plans covered

The House bill required mandatory coverage of all plans to which the funding standards of the bill would apply, except that no plan having less than 25 participants (of whom at least 10 must have vested benefits) during any five consecutive years, or any plan with assets covering less than 10 percent of the value of the plan's insured benefits, would be covered. The Senate amendment required mandatory coverage of all qualified plans except money purchase pension plans, profit-sharing plans, stock bonus plans, governmental plans, church plans (other than those electing to be covered), and certain fraternal association plans.

Subject to specific exceptions, the conference substitute requires mandatory coverage of employee pension benefit plans that either affect interstate commerce (and, in the case of nonqualified plans, have for five years met the standards for qualified plans) or that are qualified under the Internal Revenue Code, the so-called 403(b) plans of certain educational and other tax-exempt organizations, and some so-called H.R. 10 plans for the self-employed and their employees. Covered plans must pay the appropriate premium for coverage. As to whether any particular benefit receives insurance coverage, see "Benefits guaranteed," below.

A plan once determined to be a qualified plan by the Internal Revenue Service is a covered plan even if the determination is subsequently deemed erroneous. However, once a qualified plan loses its qualification, benefits thereafter accruing are not insured.

Plans specifically excluded from coverage are:

(1) individual account plans (such as money-purchase pension plans, profit-sharing plans, thrift and savings plans, and stock bonus plans),

(2) governmental plans (including plans set up under the Railroad Retirement Act of 1935 or 1937),

(3) a church plan which has not volunteered for coverage, is not for employees in an unrelated trade or business, and is not a multiemployer plan in which one or more of the employers are not churches or a convention or association of churches,

(4) plans established by fraternal societies or other organizations described in section 501(c)(8), (9), or (18) of the Internal Revenue Code which receive no employer contributions and which cover only members (not employees),

(5) a plan that has not after the date of enactment provided for employer contributions,

(6) nonqualified deferred compensation plans established for a select group of management or highly compensated employees,

(7) a plan outside the United States for nonresident aliens,

(8) a plan primarily for a limited group of highly paid

[368] employees, where the benefits to be paid (or contributions received) are in excess of the limitations set forth in section 415 of the Internal Revenue Code (as added by the conference substitute),

(9) a qualified plan established exclusively for "substantial owners" (defined below),

(10) a plan of an international organization exempt from tax under the International Organizations Immunities Act.

(11) a plan maintained only to comply with workmen's compensation, unemployment compensation, or disability insurance laws,

(12) a plan established and maintained by a labor organization described in section 501(c)(5) of the Internal Revenue Code that does not after the date of enactment provide for employer contributions,

(13) a plan which is a defined benefit plan to the extent it is treated as an individual account plan under section 3(35)(B) of the Act, or

(14) a plan established and maintained by one or more professional service employers that has from the date of enactment not had more than 25 active participants. Once one of these plans has more than 25 active participants, it remains covered although the number of such employees drops to 25 or less.)

Benefits guaranteed

The House bill would provide coverage for benefits required to be vested under the bill's minimum vesting standards (up to the insurance limitations) if the plan providing the benefit had been covered for more than five years prior to the termination. The corporation could elect to cover (subject to certain conditions) nonbasic benefits if both the plans providing them and the plan provisions providing the particular benefits had been in existence for more than five years prior to the termination, or if the plans providing the coverage were tax-qualified. The Senate amendment provided coverage for benefits vested under the plan up to the insurance limitations and without regard to whether they exceeded the vesting required under the bill. The benefits, however, had to have been provided by plan provisions in effect at least three years prior to the termination.

Under the conference substitute, vested retirement benefits guaranteed by the plan (other than benefits vesting only because of the termination) are to be covered to the extent of the insurance limitations except to the extent indicated below. (Nonbasic benefits the corporation had chosen to guarantee are also to be covered. These nonbasic benefits may include that part of annuities in excess of $750 monthly, medical benefits, etc. This coverage is not necessarily to be subject to the phase-in rule limiting coverage of basic retirement benefits.)

One of the principal limitations on the coverage is that it is to be phased in at the rate of 20 percent per year until the plan or benefit is fully covered after it has been in effect for five years. (For this purpose, the period of existence of a successor plan covering substantially the same employees and providing substantially the same benefits is to be added to the period of existence of its predecessor plan in determining how long a benefit has been in effect.)

[369] In determining how long a plan or amendment has been in effect for purposes of the phase-in schedule, the first year following the end of the plan year in which the plan or amendment first becomes effective constitutes the first year (after which 20 percent of the benefit is covered).

The phase-in rule applies to all benefits provided by qualified plans from the date the benefit was provided. In the case of nonqualified plans that affect commerce, the phase-in rule applies only to benefit increases since the original plan benefits must have been in existence for five years when the plan is first covered (after at least five years of meeting all the standards applicable to qualified plans).

In the case of a plan not covered the day after enactment, the five-year phase-in rule is to commence only when the plan is covered.

The benefit coverage of "substantial owners" is not to be phased in. Resultingly, the benefits of substantial owners may be covered only after their plans have been in effect for 5 years, but at that time their benefits may be covered entirely (up to the basic insurance limitation).

In the case of a termination after the date of enactment (after December 31, 1977, in the case of a termination of a multiemployer plan), the phase-in rule is not to apply unless the corporation finds substantial evidence that the plan was terminated for a reasonable business purpose and not for the purpose of obtaining the payment of benefits by the corporation under the bill. For example, if guaranteed benefits had been increased by one or more amendments made during the 5 years before the termination (or if the plan was created during those 5 years), and the employer's financial condition at the time of termination had not deteriorated significantly from his employer's financial condition immediately after the amendment, then no part of the benefit increase attributable to the amendment is to be insured.

If such a termination was for any purpose other than a reasonable business purpose (whether or not the primary purpose) of obtaining insurance benefits, benefits established or increased during the five years prior to termination are to receive no coverage. For the purpose of this provision, a termination to avoid the liability or responsibility imposed under Title IV on an employer is to be considered a termination for a purpose other than a reasonable business purpose.

Guarantee of benefits is not to extend to benefits accrued after the Secretary of the Treasury or his delegate issues a notice of determination that any trust in the plan is no longer tax-qualified (unless the determination is later held erroneous) or after a plan amendment is adopted that causes the Secretary or his delegate to issue a notice of determination that any trust in the plan is not tax-qualified (unless the determination is later held erroneous or unless the amendment is retroactively revoked to comply with the amendment).

Insurance limitations

The House bill limited insurance benefits to the actuarial equivalent of an annuity, beginning at age 65, of $20 per month per year of credited service, regardless of the number of plans in which the employee had been a participant. This maximum amount would be adjusted according to changes in all employees' average wages. No insurance at all would be paid to a "substantial owner," which is defined as

[370] a person who owns a sole proprietorship, more than five percent of a partnership, or five percent of either the entire stock or the voting stock of a corporation.

The Senate amendment would have restricted insurance benefits to the actuarial equivalent of the lesser of 50 percent of average wages during the five years preceding termination or $750 monthly. This maximum was to be adjusted in accordance with changes in the social security contribution and benefit base. The insurance maximum was thus set without regard to the number of plans in which the employee had been a participant, and the insured benefits of an "owner-employee" in the plan during the year of termination or any of the preceding three years were to be reduced by his pro rata share of the accumulated funding deficiency requiring the insurance payments.

In general, the conferees followed the outline of the Senate amendment. However, the limitation is set as the actuarial equivalent of the lesser of 100 percent of the employee's wages during his highest-paid five consecutive years (without regard to temporary absences from participation during that period), or $750 monthly. This amount is adjusted to reflect changes in the social security contribution and benefit base.

In computing the limitation, the guarantee of nonbasic benefits is to be disregarded. In other words, employees are entitled to receive insurance payments for nonbasic benefits although those insured benefits, together with the payment of guaranteed retirement benefits, exceeds the maximum limitation.

The maximum benefit for an "owner-employee" as to each benefit or benefit increase is also limited by a fraction representing the number of years in the 30 years (the period for amortizing an unfunded past service liability for single-employer plans created after January 1, 1974) preceding termination in which the owner-employee was an active plan participant. An owner-employee is defined as a person owning 10 percent of an enterprise, whether a corporation or a partnership, or a sole proprietorship, at any time in the five years preceding the termination.

Employer's contingent liability coverage

The House bill authorized the corporation to insure employers against the contingent liability that could arise against employers to reimburse the corporation for its losses caused by coverage of those employers' terminated plans. The amount of premiums charged for this coverage was to be based upon the actual and projected costs of this coverage. (Since there was to be no employer contingent liability for employers in multiemployer plans, there was no provision for coverage of such employers.)

The Senate amendment mandated the corporation to offer contingent liability coverage that was to be applicable to all electing plans (including both single-employer and multiemployer plans) if the extra premium for the coverage had been paid for each of the five plan years immediately preceding the plan year of the termination. The coverage was not to be granted, however, if the employer remained in the same or in a similar business. The premiums were to be calculated by the corporation at a rate sufficient to fund any contingent liability coverage payments.

[371] Under the conference substitute, coverage of contingent employer liability is mandatory for single and multiemployer plans, but the corporation is instructed to attempt with private insurers to devise within a 36-month period a system under which risks are equitably distributed by the corporation and the private insurers with respect to classes of employers insured by each. The corporation may thereafter require all employers to obtain coverage from the private insurers, the corporation, or both, depending upon the system devised. The corporation is to fix the premiums at a rate sufficient to fund any payment by the corporation required by the coverage. Private insurers are left free to fix the rates of their own premiums, and other terms and conditions of insurance, but the corporation may level any charge upon employers obtaining private insurance that may be necessary to assure that the costs to all employers are reasonable and equitable and to assure the liquidity and adequacy of the corporation's funds used for this purpose. The corporation may not make any coverage payment with respect to contingent liability until the insurance has been in effect, and the premiums have been paid, for more than five years.

The corporation may set the premium levels and collect the premiums (in arrears) for this coverage during any time up to, but not later than, three years after the date of enactment. An employer may then pay premiums for the period since the date of enactment, and this period is to be counted toward completion of the five-year payment of premiums requirement. Once obtained, coverage is to be prospective only, not retroactive.

In making arrangements with private insurers, the corporation is also to consider using private industry guarantees, indemnities, or letters of credit as an alternative or supplement to private insurance.

Termination by plan administrator

The House bill requires an employer or employee organization planning to terminate a plan to first notify the corporation. The Senate amendment requires a 90-day notification period that may be extended by agreement. A notification by the corporation during one of these periods that the plan assets are insufficient is to cause a termination by the corporation under the provisions for a termination by the corporation. If, in the course of an authorized voluntary termination, a plan administrator determines that the plan assets are insufficient, he is required to so notify the corporation, which is then to terminate the plan under the regular proceedings for a termination by the corporation.

The Senate amendment also provides that a change from an insured plan into a money purchase plan, a profit-sharing plan, or a stock bonus plan (none of which may be covered) is to be treated as a voluntary termination (for which authorization from the corporation must first be obtained).

Under the conference substitute, the plan administrator must file notice with the corporation at least 10 days before the date of the proposed termination, and he may pay no benefit under termination procedures of the plan for 90 days after the proposed termination date, unless, in the interim, he receives a notice of determination from the corporation that the plan assets are sufficient to discharge the plan obli-

[372] gations as they fall due. The plan administrator or the corporation is authorized to petition the court for appointment of a trustee to manage the plan under the same procedure by which a trustee may be appointed in the case of an involuntary termination, if the best interest of the participants and beneficiaries would be served by the appointment. In other respects the conferees accepted the substance of the Senate amendment.

A plan termination in the sense that benefits stop accruing (as provided in section 411(d)(3) of the Internal Revenue Code) is not to be termination under the insurance provisions so long as the employer continues to meet the funding standards provided by the substitute.

Date of termination

The termination date of a plan is to be determined by the plan administrator or the corporation, depending upon which terminates the plan and also depending upon whether this date is agreed to by the other party. If there is not agreement between the corporation and the plan administrator, the termination date is to be established by the court. However, in the case of terminations of plans which occur before the date of enactment, the date of termination is to be set by the corporation on the basis of the date on which benefits ceased to accrue or on any other appropriate basis.

Termination by Pension Benefit Guaranty Corporation

Under the House bill, the Secretary of Labor may terminate a plan, after a hearing, (a) if he determines that the plan failed to meet the minimum funding standards, the plan is unable to pay benefits when due, or failure to terminate will cause long-run loss to the corporation, or (b) if the employer or an appropriate employee organization applies to him for authority to terminate. In terminating a plan, the Secretary of Labor must distribute the plan's assets in accordance with the priority schedule contained in the bill. He is permitted to distribute the assets without ending the plan or without appointing a receiver, and also he may order the plan's continuation under a receiver until all benefit liabilities are satisfied. At any time, however, he may wind up the plan (after a hearing) with a distribution of remaining assets.

Under the Senate amendment, the corporation may institute termination proceedings for the causes listed in the House bill or if a distribution in excess of $10,000 is made to an owner-employee (other than on account of death or disability) if, after the distribution, there are unfunded vested liabilities.

Under the conference substitute, the corporation may institute termination proceedings in court if it finds that:

(1) minimum funding standards have not been met,

(2) the plan is unable to pay benefits when due,

(3) a distribution is made to an owner-employee of $10,000 in any 24-month period if not paid by reason of death and if, after the distribution, there are unfunded vested liabilities, or

(4) the possible long-run liability to the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated.

In seeking a termination, the corporation is to apply to the appropriate United States District Court, with notice to the plan, for

[373] appointment of a trustee to administer the plan pending issuance of a termination decree. Unless cause is shown within three days thereafter why a trustee should not be appointed, the appointment is to be made and the trustee is to administer the plan until the corporation decides whether the plan should be terminated. The court may appoint the trustee from a list furnished to the court by the corporation, or it may appoint the existing plan administrator or the corporation itself. Even without the appointment of a trustee, however, the corporation may, with notice to the plan, apply for a termination decree.

If it grants the decree, the court is to order the trustee (after first appointing a trustee, if none has yet been appointed) to terminate the plan.

A trustee with the discretion to commence the final liquidation of the trust must first give the corporation at least 10 days' notice. If the corporation should oppose the trustee's proposal, the court is to resolve the dispute.

In the case of small plans, the corporation may prescribe a simplified procedure and may pool assets of small plans so long as the rights of the participants and employers (including the right to a court decree of termination) are preserved. Furthermore, the corporation may agree with any plan administrator to designate a trustee who, without court appointment, is to have the usual powers of trustees appointed by the court.

If the application for a trustee is rejected by the court, the trustee is to transfer all assets and records of the plan back to the plan administrator within three days. If the corporation fails to apply within 30 days after appointment of the trustee for a termination decree, the trustee is to transfer the assets and records back to the plan administrator. This 30-day period may be extended by agreement or court order.

The corporation may file for termination despite the pendency in any court of bankruptcy, mortgage foreclosure, or equity receivership proceeding, or any proceeding to reorganize, conserve, or liquidate such plan or its property, or any proceeding to enforce a lien against property of the plan. The court may also stay any of these proceedings. In the termination proceedings, the court is to have the exclusive jurisdiction of the plan and its assets with powers of a court in bankruptcy and of a court in a Chapter X proceeding.

The compensation of the trustee is to be approved by the corporation, and, in the case of a trustee appointed by the court, with the consent of the court. Trustees are authorized to employ professional assistance in accordance with regulations to be issued by the corporation.

Reportable events

Under the House bill, certain events indicating possible danger of plan termination must be reported by the plan administrator to the corporation. These events are:

(a) a tax disqualification;

(b) a benefit decrease by plan amendment;

(c) a decrease in active participants to 80 percent of the number at the beginning of the plan year, or 75 percent of the number at the beginning of the previous plan year;

(d) an IRS determination that there has been a plan termination or partial termination for tax purposes;

[374] (e) a failure to meet the minimum funding standards;

(f) inability to pay benefits when due;

(g) a distribution of $10,000 or more in a 24-month period to a "substantial owner," if the plan has unfunded nonforfeitable benefits after the distribution (unless the distribution was made on account of death);

(h) filing of a report preliminary to a merger, consolidation, transfer of assets or liabilities, or a distribution in excess of $25,000 to a participant in any plan year, or the granting by the Secretary of Labor of a hearing in regard to a variation on the bill's standards; or

(i) the occurrence of any other event which the corporation determines may be indicative of a need to terminate the plan.

The Senate amendment is essentially the same as the House bill points through (f). As to point (g), the Senate amendment requires reporting of any distribution of $10,000 or more to an owner-employee (unless the distribution is made on account of death or disability), if the distribution increases or creates unfunded vested liabilities. The Senate amendment does not include provisions corresponding to points (h) and (i) of the House bill.

The Senate amendment provisions requiring the Secretary of Treasury to report certain occurrences to the corporation are essentially the same as those of the House bill. There are no corresponding provisions regarding the Secretary of Labor.

The conference substitute requires the plan administrator to inform the corporation with respect to the same listing of reportable events as listed in the House bill. However, the corporation is authorized to waive the requirement and to require any of the events referred to above to be included in the annual report made by the plan. In addition, any employer in a covered plan who knows, or has reason to know, that a reportable event has occurred is immediately to notify the plan administrator of this event.

Management functions

Under the House bill, the Secretary of Labor is given authority to transfer funds of terminated plans to the corporation for investment and for payment of benefits, as well as to obtain outside financial counsel and to take any other consistent action to assure equitable payments to participants and beneficiaries. The Senate amendment provides that investments of funds of terminated plans are to be handled by the court-appointed trustees.

Under the conference substitute, the trustee is to take over general management of the assets. The Advisory Committee is to make timely recommendations to the corporation regarding investment policy relating to funds of terminated plans and on whether terminating plans, at the time, should be operated as liquidating trusts or liquidated (with the proceeds used to purchase annuities for the participants and beneficiaries). The corporation is to make recommendations to trustees of terminated plans regarding investments and is to direct each trustee whether to operate his plan as a wasting trust or to liquidate it and purchase annuities. If the trustee disagrees with the directive of the corporation, he is authorized to apply to the court for a resolution of the dispute.

[375] *Allocation of assets at termination*

Under the House bill, priorities are provided for distribution of assets upon termination of a plan. In general, net assets (assets less expenses and less those assets irrevocably allocated to individual accounts at least 2 years before termination) are allocated in the following order:

(a) employee contributions,

(b) vested benefits of employees already receiving benefits or entitled to choose early retirement (except for disability),

(c) other vested benefits,

(d) other accrued benefits,

(e) interest on employee contributions,

(f) remaining liabilities proposed in the plan for payment upon termination, and

(g) pro rata to each person entitled to receive a distribution on account of priorities (a) through (f).

The Senate amendment requires that plan assets be distributed according to the following priorities:

(a) voluntary employee contributions,

(b) mandatory employee contributions,

(c) benefits in pay status at least 3 years (at the benefit level existing 3 years before termination),

(d) other insured benefits.

Both the House bill and the Senate amendment also have other provisions regarding allocation within a priority category when the remaining assets are insufficient to satisfy all the benefits in that category, regarding benefits in more than one priority category, and regarding similar related problems.

Under the conference substitute, assets are to be allocated among plan benefits in the levels of priorities stated below:

(1) Voluntary employee contributions,

(2) Mandatory employee contributions,

(3) Equally among individuals in the following two subcategories:

(i) in the case of benefits in pay status three years prior to termination (at the lowest pay level in that period and at the lowest benefit level under the plan during the five years prior to termination) and

(ii) in the case of benefits which would have been in pay status three years prior to termination had the participant been retired (and had his benefits commenced then, at the lowest benefit level under the plan during the five years prior to termination),

(4) All other guaranteed benefits up to the insurance limitations (but irrespective of the limitation to one $750 monthly benefit regardless of the number of plans in which the employee participated) and (on an equal level of priority) benefits that would be so guaranteed except for the special limitation on coverage of a "substantial owner,"

(5) All other (meaning uninsured) vested benefits, and

(6) All other benefits under the plan.

The plan may, under regulations, establish subclasses and categories within these six classes.

Employer liability

Both the House bill and the Senate amendment required employer liability for insurance payments made by the corporation because of

[376] terminations of the employers' plans. The House bill set a limit on employer liability of 50 percent of the employer's net worth, as compared with 30 percent under the Senate amendment. In addition, the House bill did not impose any liability in the case of multiemployer plans.

As previously discussed, both the House bill and the Senate amendment authorized the corporation to insure employers against employer liability, under different sets of conditions.

Under the conference substitute, employer liability is required for employers in both single-employer and multiemployer plans. The employer liability is limited to 30 percent of net worth, with net worth valued as of a date chosen by the corporation, but not more than 120 days prior to the termination.

Net worth is to be computed without taking the contingent employer liability into the calculation. It is determined on the basis chosen by the corporation to reflect best the operating value of the employer, and it is to be increased by any transfers made by the employer prior to the termination that the corporation finds improper.

In determining the employer who may be liable for insurance coverage losses of the corporation, all trades or businesses (whether or not incorporated) under common control are to be treated as a single employer. Trades or businesses under common control may, for this purpose, include partnerships and proprietorships as well as corporations.

If, as a result of the cessation of operations at any facility, more than 20 percent of the participants in a plan are separated from their employment, the employer is to be treated as an employer in a terminating plan that is maintained by more than one employer. Furthermore, in the case of withdrawals of employers in multiemployer plans resulting in substantial reductions of contributions, the corporation may treat the withdrawal as constituting a termination with respect to employees of such employers.

In determining the amount of the corporation's liability, the amount of employer liability (but not the employer's net worth), the application of the lien arising out of employer liability, the appropriate allocation of assets in the event of a termination, the value of the plan's assets, the amount of benefits payable with respect to each participant, the amount of benefits guaranteed with respect to each participant, the present value of the aggregate amount of benefits potentially payable by the corporation, and the fair market value of the plan's assets, the date of determination is to be the date of termination.

In determining the fair market value of a plan's assets, unrealized gain is to be taken into account.

Lien for employer liability

The House bill provides for the imposition of a lien upon all property and rights in property belonging to an employer who is liable to the corporation as a result of a plan termination. Under this provision, the lien would arise if payment were not made after demand for payment was made by the corporation and would be in the amount of the liability including interest. Further, the lien would not be valid against the general Federal tax lien.

[377] The Senate amendment provided that the lien would also be inferior to the special estate and gift tax lien imposed under the Internal Revenue Code and, if arising from an obligation incurred by the employer prior to termination of the plan, a lien or other security interest which is perfected not later than 30 days after termination. The amendment further modifies the House bill by authorizing the corporation to subordinate the lien under certain circumstances.

The conference substitute in general follows the lien imposition provisions of both bills but provides (1) additional rules relating to the period during which the lien will be in existence; (2) that the priority of the lien is to be determined in the same manner as under the Federal tax lien rules to minimize circular priority problems; (3) rules relating to the civil action to foreclose the lien, including the period during which an action must be commenced; and (4) authority for the corporation to release or subordinate the lien under certain circumstances.

More specifically, the revised and added provisions may be explained as follows:

(1) The conference substitute adopts the lien priority rules of the Internal Revenue Code. Generally, these rules provide protection against the lien for a purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor if any such person's title or interest is acquired or perfected before notice of the lien is filed. Protection is also provided for certain other interests even if acquired or perfected after notice of the lien is filed. Generally, if the purchaser or creditor does not have actual notice or knowledge of the lien, this status is provided for a purchaser or a holder of a security interest in a security (stocks, bonds, negotiable instruments, etc.), a purchaser of a motor vehicle, a purchaser of certain household goods or personal effects in a casual sale for less than $250, an insurer which makes a loan secured by a policy issued by it, and a financial institution which makes a passbook loan secured by an account with the institution. This status is also provided for certain retail purchases, possessory liens, real property tax assessments, liens for repairs to a residence, and attorney's liens.

Protection against the lien is also provided with respect to certain advances which are made, after notice of the lien is filed, pursuant to a commercial transaction financing agreement, a real property construction or improvement financing agreement, or an obligatory disbursement agreement.

In the case of bankruptcy or insolvency proceedings, the lien is to be treated in the same manner as a tax due and owing to the United States.

The conference substitute provides that, for purposes of determining the priority between a Federal tax lien and the employer liability lien, each lien is to be treated as a judgment lien arising when notice of that lien is filed. The effect of this is to adopt a "first to file" priority rule with respect to the employer liability lien and the Federal tax lien imposed under section 6321 of the Internal Revenue Code.

(2) The conference substitute provides that the corporation may bring a civil action in a district court of the United States to enforce the employer liability lien or to subject any property belonging to an

[378] employer to the payment of the employer's liability to the corporation. Generally, this action must be commenced within 6 years after the date upon which the plan is terminated or prior to the expiration of any period for collection agreed upon in writing by the corporation and the employer before the expiration of the 6-year period.

(3) The conference substitute provides for both the release and subordination of the lien. The lien may be released or subordinated if the corporation determines, with the consent of the board of directors, that release or subordination of the lien would not adversely affect the collection of liability to the corporation. Under these conditions, the corporation may issue a certificate of release or subordination of the lien with respect to the employer's property or any part thereof.

Recapture of plan payments

The House bill contains no provision for the recovery shortly prior to termination of payments to participants that might be deemed excessive. Under the Senate amendment, certain payments of a terminated plan affecting interstate commerce made during a three-year period prior to termination may be recovered. Payments made on account of death or disability were not to be subject to recovery, and the corporation was authorized to waive recovery of certain amounts when the recovery would have caused substantial hardship.

In the case of a distribution to an owner-employee that exceeds $10,000 and creates or increases unfunded vested liabilities, the three-year lookback period would not begin until the corporation is informed of the distribution (which is a reportable event under both the Senate amendment and the conference substitute).

Under the conference substitute, the trustee may recover all payments to a participant in excess of $10,000 (or the amount he would have received as a monthly benefit under a lifetime annuity commencing at age 65, if greater) made during any twelve-month period within the three years prior to termination.

As under the Senate amendment, the conference substitute provides that there is to be no recovery of payments for after death or death or disability, that the three-year period is not to end, in the case of a distribution to a substantial owner (after which the plan has unfunded vested liabilities), until the corporation is notified of the distribution, and that the corporation is authorized to waive any recovery that would cause substantial economic hardship.

Restoration of plans

Neither the House bill nor the Senate amendment had any specific provision that procedures against a plan in the termination phase might be abandoned by the corporation if the employer and plan enjoyed a favorable reversal of business trends, or if some other factor made termination no longer advisable.

Under the conference substitute, the corporation may cease any termination activities and do what it can to restore the plan to its former status. As a result, a terminated plan being operated by a trustee as a wasting trust may be restored if, during the period of its operation by the trustee, experience gains or increased funding make it sufficiently solvent. The corporation may, when appropriate, transfer

[379] to the employer or plan administrator part or all of the remaining assets and liabilities.

Liability of substantial employer for withdrawal

Since employers in multiemployer plans were not liable for the corporation's losses under the House bill, that bill contained no provision regulating the withdrawal of a substantial employer from a multiemployer plan.

Under the Senate amendment, the plan administrator was to inform the corporation of the withdrawal of a substantial owner (as defined). The corporation could then either require payment into escrow of the substantial owner's potential liability or require deposit of a bond in the amount of 150 percent of the liability. If the plan terminated within five years, the payment or bond was to be forfeited. The corporation could, in the case of a withdrawal causing a significant reduction in plan contributions, require allocation between participants no longer in the plan because of the withdrawal and the remaining participants. The portion of the fund allocable to the departed participants would be treated as a termination. The corporation could waive all these procedures if there were an indemnity agreement between the remaining employers in the plan sufficient to satisfy all plan liabilities.

Under the conference substitute, the plan administrator is required to notify the corporation within 60 days after the withdrawal of a substantial employer from a plan under which more than one employer makes contributions.

The corporation may require the substantial owner either to pay the potential liability (as determined by the corporation) into escrow or to post a bond in 150 percent of the amount of the liability. The liability is normally to be determined as the substantial employer's share (with the substantial employer's share computed according to that employer's proportion of the total employer contributions to the plan within the past five years) of the total plan liability that would have existed if the plan had terminated when the substantial owner withdrew. However, the corporation is also authorized to determine the liability according to any other equitable basis prescribed by it in regulations.

If the plan terminates within five years, the payment or bond is forfeited for the benefit of the plan, but the employer may be refunded any amount not needed to meet the plan's liabilities. If there is no termination, the payment or bond is to be returned to the substantial employer or cancelled.

As alternatives to the bond or escrow payment requirement, the corporation may, if the withdrawal causes a significant reduction in the amount of plan contributions, require the plan fund to be allocated between those participants no longer under the plan because of the withdrawal and those participants still covered. That portion of the fund allocable to participants no longer in the plan is to be treated as a termination, while the remainder is to be a new plan.

The corporation is entitled to waive the use of either of these procedures if there is an indemnity agreement between all the other employers in the plan sufficient to satisfy all plan liabilities.

[380] *Liability of employers on termination of plan maintained by more than one employer*

The House bill did not provide employer liability for employers in multiemployer plans. Under the Senate amendment, the employer liability on termination of a multiemployer plan was to be allocated among the employers who had contributed to the plan during the five years before termination, in proportion to their contributions. The 30-percent of net worth limit on employer liability was to be applied separately to each employer.

Under the conference substitute, the general rule of the Senate amendment is accepted with the three modifications:

1. This particular computation of employer liability is to apply to all plans having more than one employer making contributions at the time of the termination, or at any time within the five plan years preceding the date of termination.

2. The allocation is not to be in accordance with actual contributions made by employers during the last five plan years ending prior to the termination, but according to the amounts *required* to be contributed by each employer during that period.

3. The corporation is authorized to determine the liability of each employer on any other equitable basis prescribed in the corporation's regulations.

This regulatory authority extends in two directions. That is, the corporation is authorized to permit other equitable methods of allocation to be used by the employers in the plan, where such other method of allocation would not increase the likelihood that the entire plan would terminate. Also, the corporation is authorized to require the use of other equitable methods where allocation in proportion to contributions would produce inequitable results. For example, the corporation is authorized to require a different allocation basis if the employers in a plan have agreed on a contribution formula that would have the effect of shifting employer liability from those employers that had net assets to those employers that had little or no net assets.

In this regard, it should be noted that the affiliated employer rules are to apply in this area. That is, if one member of an affiliated group has employer liability, then that liability is to extend to the entire affiliated group. Also, the 30-percent-of-net-assets limit is to apply with respect to the net assets of the entire group.

Effective dates

The House bill applied the provisions on premiums and benefits to plan years beginning after June 1, 1974, for single employer plans. In the case of a multiemployer plan involving a collective bargaining agreement covering more than 25 percent of the total participants, these provisions applied to plan years beginning after the earlier of December 31, 1980, or the date on which the last such agreement relating to that plan terminated (without regard to extensions made after the date of enactment of the bill). Provisions other than those regarding premiums and benefits payable were to take effect on the date of enactment of the bill.

The Senate amendment required premiums to be collectible with respect to plan years beginning after December 31, 1973. The provi-

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[381] sions regarding terminations and corporation and employer liability applied to plan years beginning after December 31, 1976, unless the corporation determined it had sufficient funds to cover earlier terminations. The remaining provisions were to take effect as of the date of enactment of the bill.

Under the conference substitute, benefits payable by single-employer plans are covered with respect to plans terminated after June 30, 1974, provided the usual requirements for coverage are met. Employers do not, however, incur contingent liability coverage for plans terminating between June 30, 1974, and the date of enactment.

These plans are not covered, however, unless they send the Secretary of Labor a notice received by him not later than 10 days after enactment. If reasonable cause is shown for failure to meet this requirement, notice can be received as late as October 31, 1974.

The opportunity to give notice as late as October 31, 1974 (where good cause is shown), is not intended to apply to situations where the failure to give timely notice was the result of inconvenience or inadvertence. In determining where there is reasonable cause shown for not having given notice within the 10-day period, it is intended that the showing be by clear and convincing evidence that it was not reasonably possible to have given the notice within the time allowed.

With respect to multiemployer plans, benefits generally are not covered for plans terminating before January 1, 1978. However, the corporation may, in its discretion, cover the benefits of multiemployer plans that had been maintained for five years prior to a termination after the date of enactment, if the corporation determines that this coverage will not jeopardize the coverage of multiemployer plans terminating after December 31, 1977.

Notwithstanding the usual requirements for coverage (discussed above with respect to coverage of plans and coverage of benefits), the corporation may exercise its discretion to cover multiemployer plans which terminate after the date of enactment and before January 1, 1978, if these plans were maintained for five years prior to termination and if the plans—

(A) have been in substantial compliance with the funding requirements for a qualified plan with respect to the employees and former employees in those employment units on the basis of which the participating employers have contributed to the plan for the preceding five years, and

(B) if the participating employers and employee organization or organizations had no reasonable recourse other than termination.

Where in exercise of its discretion to cover benefits of multiemployer plans that have been in substantial compliance with the funding requirements and had no reasonable alternative to termination, or in exercise of its discretion to cover any multiemployer plan terminating before January 1, 1978, the corporation is to notify the Committee on Education and Labor and the Committee on Ways and Means of the House of Representatives, and the Committee on Labor and Public Welfare and the Committee on Finance of the Senate.

If the corporation decides to exercise its discretion with respect to a multiemployer plan, the corporation—

[382] (A) may establish requirements for the continuation of payments which commenced before January 2, 1974, with respect to retired participants under the plan,

(B) may not make payments with respect to any participant who, on January 1, 1974, was receiving payment of retirement benefits, in excess of the amounts and rates payable with respect to that participant on that date,

(C) may not make payments which are derived, directly or indirectly, from amounts borrowed from the Treasury, and

(D) is to review from time to time these discretionary payments and reduce or terminate them to the extent necessary to allow the corporation to guarantee benefits of multiemployer plans terminating after December 31, 1977, without increasing premium rates.

The premiums for both single-employer and multiemployer plans are to be payable for fractional years beginning with the date of enactment.

If the Pension Benefit Guaranty Corporation finds that a plan (other than a multiemployer plan) has terminated after June 30, 1974, and before the date of enactment (and therefore would be eligible for coverage of benefits under the plan termination insurance provisions, but the employer would not be subject to employer liability under those provisions) then the guarantee of benefits is not to apply unless the corporation finds substantial evidence that the plan was terminated for a reasonable business purpose and not for the purpose of obtaining the payment of benefits by the corporation under this bill or of avoiding employer liability.

Temporary authority for initial period

Under the conference substitute, the corporation may appoint a receiver during the first 270 days after enactment for a plan if (1) the corporation receives notice that a plan is to be terminated, or (2) the corporation determines the plan should be terminated. Within 20 days after the appointment, the corporation must apply to the court for a decree approving the appointment.

If the court rejects the application or the corporation fails to apply within the 20 days, the plan assets are to be transferred back to the plan administrator within three days.

As an alternative to this procedure, the corporation may request the plan administrator to apply to the district court for the appointment of a receiver until the plan can be terminated.

The receiver is to determine whether the plan assets are sufficient to discharge the plan obligations. If the receiver's determination is approved by the corporation and the court, the receiver is to terminate the plan in accordance with the insurance provisions.

The corporation is also to have special temporary powers during the first 270 days after enactment to—

(1) contract for printing without regard to the provisions of chapter 5 of title 44, United States Code,

(2) waive any notice,

[383] (3) extend the 90-day termination notice period (during which the plan administrator who has filed a notice of termination may not terminate the plan unless he receives a notice of sufficiency of plan assets from the corporation) for an additional 90-day period without the agreement of the plan administrator or approval of the court, and

(4) waive or reduce contingent employer liability for plan terminations, the requirements respecting withdrawals of substantial owners from plans, and the requirements respecting the liability of employers on termination of plans maintained by more than one employer if this appears necessary to avoid unreasonable hardship for an employer who was unable, as a practical matter, to continue its plan.

XIV. Additional Items

Preemption of State laws (Sec. 514 of the bill)

Under the substitute, the provisions of title I are to supersede all State laws that relate to any employee benefit plan that is established by an employer engaged in or affecting interstate commerce or by an employee organization that represents employees engaged in or affecting interstate commerce. (However, following title I generally, preemption will not apply to government plans, church plans not electing under the vesting, etc., provisions, workmen's compensation plans, non-U.S. plans primarily for nonresident aliens, and so-called "excess benefit plans.")

The preemption provision will take effect on January 1, 1975, except that preemption with respect to plan termination insurance will take effect on the date of enactment of this bill. However, it will not affect any causes of action that have arisen before January 1, 1975, and it will not affect any act or omission which occurred before that date. In addition, the preemption provisions will not apply to any criminal law of general application of a State.

The preemption provisions of title I are not to exempt any person from any State law that regulates insurance, banking or securities. However, the substitute generally provides that an employee benefit plan is not to be considered as an insurance company, bank, trust company, or investment company (and is not to be considered as engaged in the business of insurance or banking) for purposes of any State law that regulates insurance companies, insurance contracts, banks, trust companies, or investment companies. This rule does not apply to a plan which is established primarily to provide death benefits; such plans, of course, may be regulated under the State insurance, etc., laws.

The substitute provides that the congressional Pension Task Force is to study this provision and report back to the labor committees of the Congress on the results of its study. It is expected that the Pension Task Force will consult closely with State insurance, etc., authorities in the course of this study.

[384] *Collectively bargained plans. (Sec. 1014 of the bill and sec. 413 of the Internal Revenue Code)*

The tax provisions of the substitute provide, in the case of collectively bargained plans, that the vesting requirements are to be applied as if all employers who are parties to the plan are a single employer. Generally the substitute provides similar rules with respect to the application of the participation, discrimination, exclusive benefit, etc. requirements so that the collectively bargained plan generally will be looked to as a unit to see if these requirements are satisfied, rather than testing the requirements on an employer-by-employer basis.

In addition, the tax provisions of the substitute generally provide that, for purposes of these rules, employees of labor unions and of a collectively bargained plan are to be treated as employees of an employer which is a party to the collective bargaining agreement. However, this rule is to apply only if the union, etc. as an employer additionally meets the nondiscrimination and coverage requirements of the tax laws.

The conferees understand that the rules of the substitute are the same as the rules of present law, and it is intended that the substitute merely confirm the rules of present law.

Puerto Rican plans (sec. 1022 of the bill)

Under the conference substitute, a trust which is part of a pension, proft-sharing, or stock bonus plan which is exempt from income taxes under the laws of Puerto Rico, and which is exclusively for the benefit of participants who are Puerto Rican residents, is to be treated as a tax-exempt domestic trust for years after 1973. (Such plans would be subject to title I of the bill but would be exempt from the requirements of title II.)

A plan may elect (in a time and manner to be prescribed in regulations) to be subject to the requirements of a tax-exempt domestic trust for all purposes (including title II). In this case, a Puerto Rican trust which meets the qualification requirements of U.S. tax law may cover U.S. mainland employees of the employer, as well as his Puerto Rican employees. In the case of a trust making this election, the income source rules of subchapter N will apply to trust distributions to the extent provided in regulations. An election, once made, will be irrevocable, and will apply for plan years beginning after the date of the election.

Remedial retroactive plan amendments (Sec. 1023 of the bill and Sec. 401(b) of the Internal Revenue Code)

Under the substitute, retroactive plan amendments which correct a plan that does not meet the requirements for tax qualification are allowed to cure a new plan or to cure an amendment to an existing plan. Such retroactive changes can be made within the time for filing the employer's tax return for the year in which the plan was put into effect or in which the amendment was adopted (or such later time as is designated by the Secretary of the Treasury).

[385] *Mergers and transfers of plan assets (Sec. 1021 of the bill)*

Under the bill as passed by the House, a plan must provide protection to participants in the case of a merger of the plan with another plan or the transfer of assets or liabilities from a plan. The value of benefits to the participant and the extent to which the benefits have been funded is to be protected by comparing what the participant's benefit would be if the plan had terminated immediately before the merger and what the participant's benefits would be under the merged plan had the merged plan been terminated just after the merger. The postmerger termination benefit may not be less than the premerger termination benefit. Further, a plan could not make a lump-sum distribution to a participant or beneficiary if the distribution exceeded the premerger termination benefit. Further, no merger or transfer of assets or liabilities could occur without an actuarial statement indicating compliance with the requirements being filed with the Secretary of the Treasury at least 30 days before the merger or distribution. The bill as passed by the Senate did not contain comparable provisions.

Under the conference agreement, a trust is not to constitute a qualified tax-exempt trust under the tax law, and also is not to satisfy the requirements of title I, unless it provides that in the case of any merger or consolidation of a plan, or any transfer of assets or liabilities of a plan, to any other plan each participant in the plan would receive post merger termination benefits which are equal to or greater than the premerger termination benefits. In the case of multiemployer plans these rules are to apply only to the extent that the Pension Benefit Guaranty Corporation determines that these rules are necessary for the participant's protection. These rules are to apply to mergers or transfers made after the date of enactment of the bill, but the plan provision to this effect does not have to be adopted prior to January 1, 1976.

Registration with Social Security (Sec. 1031 and 1032 of the bill and secs. 6057, 6058, 6652, and 6690 of the Internal Revenue Code)

The substitute generally follows the House bill with respect to registration with Social Security. However, the House bill includes requirements for registration under both the labor and tax provisions. Under the substitute, the registration procedure is included only in the tax provisions, but this procedure applies to all plans to which the vesting standards of the labor provisions apply. In addition, under the substitute the labor provisions as well as the tax provisions require the plan administrator to furnish each person an individual statement giving him the information reported to the government; this is included so the individual may enforce his rights to receive this statement by civil action in the courts.

Under the substitute, each plan which is covered by the vesting requirements of the labor provisions is to file with the Internal Revenue Service an annual statement regarding individuals who have terminated employment in the year in question and who have a right to

[386] a deferred vested benefit in the plan. Also, the plan administrator is to furnish each person an individual statement giving him the same information which is reported to the Government.

The Social Security Administration is to maintain records of the retirement plans in which individuals have vested benefits, and is to provide this information to participants and beneficiaries on their request and also on their application for Social Security benefits.

The provisions governing registration with Social Security are to apply to a multiemployer plan to the extent provided in regulations.

The provisions requiring registration with Social Security are to apply to plan years beginning after December 31, 1975, except that reports need not be made by Social Security for 3 years after that date.

Rules for certain negotiated plans (Sec. 2007 of the bill and Sec. 404(c) of the Internal Revenue Code)

Under the bill as passed by the House, special rules were provided for welfare and benefit plans established before 1954 as a result of an agreement between a union and the government during a period of government operation of the major part of the productive facilities of the industry in which the employer is engaged. The special provisions enable these types of plans to establish two separate trusts—one for the payment of welfare benefits and a second for the payment of retirement benefits. In order to facilitate the restructuring of a welfare and pension plan into two separate plans the bill as passed by the House provides special rules for self-employed individuals who were treated as participants under the plan. The bill as passed by the Senate did not contain provisions pertaining to this manner. The conference substitute accepts the House provision without amendment.

Tax treatment of survivor benefit plans of the uniformed services (Sec. 2008 of the bill and Sec. 122 of the Internal Revenue Code)

The Senate amendment included a provision designed to continue the same tax treatment for servicemen and former servicemen of the United States under the Survivor Benefit Plan (recently enacted in P.L. 92–425) as formerly was available for them under the Retired Serviceman's Family Protection Plan in the case of annuities for surviving spouses or certain child beneficiaries. Under the present tax law, a member or former member of the uniformed services of the United States who receives a reduced amount of retired or retainer pay because of his election to contribute to the program for survivor annuity benefits is not required to include in his gross income the amount of this reduction in his pay. However, the law governing these annuities has recently been changed by the new Survivor Benefit Plan to provide that survivor annuity benefits apply unless the retired serviceman elects not to participate. The amendment conforms the existing tax treatment to this change in the election requirements under the new Survivor Benefit Plan. Thus, where a serviceman (or former serviceman) does not elect out of the new Survivor Benefit Plan and as a result receives reduced retired pay, the amount of the reduction is not

[387] taxed to him. Similar conforming amendments are also made to other provisions of the tax laws.

The conference substitute includes this entire provision from the Senate amendment.

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