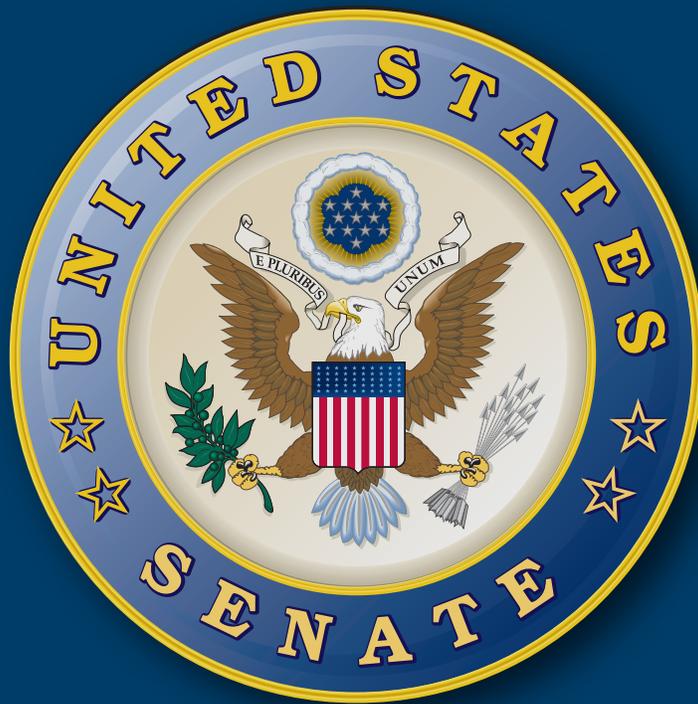


# United States Senate Committee on Finance

## The Savings & Investment Bipartisan Tax Working Group Report



July 2015

July 7, 2015

**MEMORANDUM**

**To:** Chairman Hatch and Ranking Member Wyden

**From:** Savings & Investment Co-Chairs Crapo and Brown

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As co-chairs of the Tax Reform Working Group on Savings and Investment, we present to you this report on behalf of the group, whose membership also includes Senators Burr, Isakson, Heller, Scott, Menendez, Cardin, Casey, and Warner.

We thank Tom Barthold and the staff at the Joint Committee on Taxation (“JCT”) for their hard work on this report, and throughout this process. JCT staff provided assistance in the preparation of this report. In particular, the summary of data on plan access and participation, descriptions of present law and descriptions of specific policy proposals were prepared with the substantial assistance of the staff of the JCT.

JCT also guided many staff-level discussions and information sessions. In addition, our group’s process included meetings and discussions with key stakeholder groups, academics and other policy experts, as well as relevant policy staff at the Treasury Department. The co-chairs also held a number of private discussions, were briefed by JCT and led a roundtable discussion for the full Committee.

The Savings and Investment Working Group had jurisdiction over the tax treatment of capital gains and dividends, financial products, defined benefit pension plans, and private retirement savings accounts. While options were considered in each of the four areas, given the Committee’s directive that the working groups should develop consensus, bipartisan policy solutions strictly within the confines of the tax code elements assigned to each group, our initial review led us to focus on the area of private retirement savings. Though this system has been a success story, it also has many clear shortcomings that have been identified by policymakers in both parties as well as a broad coalition of market participants and advocates. Specifically, the working group identified three key goals for policy makers to pursue: 1) increasing access to tax deferred retirement savings, 2) increasing participation and levels of savings, and 3) discouraging leakage while promoting lifetime income.

Many strong, bipartisan proposals have been introduced in Congress and there is a general consensus from this working group that such proposals should be given strong consideration as the Finance Committee moves forward with fiscally-responsible tax legislation. This report does note that there are differences among the members, not only as to which particular proposals a member may support, but also in what forum that consideration should be given (i.e. stand-alone retirement savings legislation or only as part of comprehensive tax reform). As such, while individual members may have already indicated personal support by co-sponsoring some of the related legislation, the working group does not endorse any of the specific proposals identified in the report, as introduced.

This report provides an overview of the data related to retirement plan access and participation. The report then addresses, with respect to each of the three goals mentioned above: (1) current law, (2) the questions our group sought to address based on some shortcomings we have

identified with current law, and (3) some concepts and proposals we have identified that seek to address these shortcomings.

Members of this group recognize that there are other important issues in our group’s portfolio that were not likely to result in consensus recommendations in this working group format. Nevertheless, members of this group would hope that these areas will still be addressed as the Committee moves forward with further efforts to reform the tax code.

We stand ready to continue working with you – and the original sponsors of these proposals we have identified – to further develop these and other important measures as our Committee moves forward.

**Data on Retirement Plan Access and Participation**

According to the National Compensation Survey (“NCS”),<sup>1</sup> in 2014, 65 percent of U.S. workers employed in the private sector had access to a qualified retirement plan and 48 percent of workers participated in a plan. This translates to a take-up rate of 75 percent, meaning 75 percent of workers with access to a qualified retirement plan chose to participate. Take-up rates were stable at 75 or 76 percent over the four-year period, 2011 to 2014. These take-up rates indicate that while a large percentage of employees participate in an employer plan if available to them, some employees do not.

**Table 1.–Retirement benefits: Access, Participation and Take-Up Rates in the Private Sector (percentage of workers)**

Year	Access <sup>1</sup>	Employee Participation <sup>1</sup>	Take-Up Rate <sup>2</sup>
2011	64	49	76
2012	65	48	75
2013	64	49	76
2014	65	48	75

Source: Bureau of Labor Statistics, National Compensation Survey Data, 2011-2014.

<sup>1</sup> Access and participation rates are expressed as a percentage of all workers.

<sup>2</sup> Take-up rates are employee participation rates as a percentage of those workers with access.

Note: All workers = 100 percent. Rates are rounded to the nearest percent. As a result, take-up rates may not be exactly equal to the employee participation rate divided by the access rate as presented in this table.

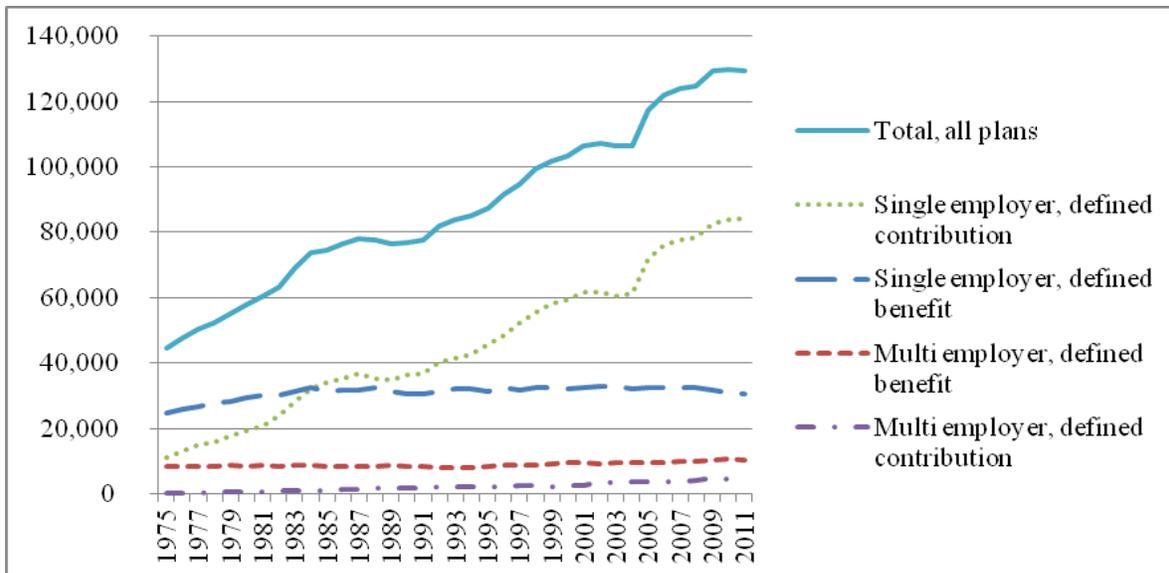
Figure 1 below shows that the number of participants in private-sector single-employer defined contribution plans has consistently increased since at least 1975 and up to 2011, while the

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<sup>1</sup> The National Compensation Survey (“NCS”) is an annual survey conducted by the U.S. Department of Labor, Bureau of Labor Statistics (“BLS”). Each release contains data on civilian, private industry, and state and local government workers in the United States. Excluded are federal government workers, the military, agricultural workers, private household workers, and the self-employed.

number of participants in private-sector single-employer defined benefit plans has held steady over this same period. Both defined contribution and defined benefit plan participation rates have remained steady for those in multiemployer plans. Almost all of the total rise in plan participation over this period can be attributed to the increase in private-sector single-employer defined contribution plan participation.

**Figure 1.—Number of Private-Sector Plan Participants by Type of Plan 1975-2011 (thousands)**



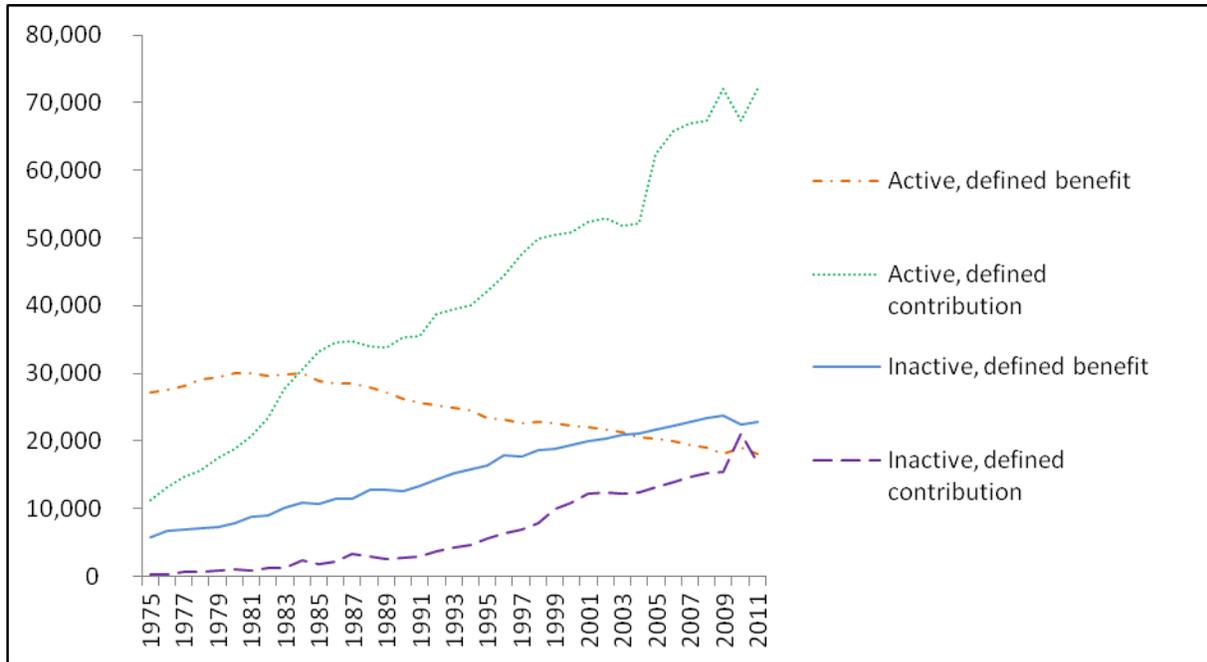
Source: Form 5500 filings with the U.S. Department of Labor.

Note: The term “Participants” refers to active, retired, and separated vested participants not yet in pay status. The number of participants also includes double counting of workers in more than one plan. For Form 5500 Short Form filers, this number may also include deceased participants whose beneficiaries are receiving or are entitled to receive benefits. Excludes plans covering only one participant.

Figure 2 below shows trends from 1975 to 2011 in the number of participants by active and inactive status. Active participants are current employees who participate in an employer’s retirement plan. Inactive participants are former employees who still have an accrued benefit or account balance under an employer’s retirement plan, including retirees receiving benefits. The numbers of inactive participants in defined benefit and defined contribution plans both increased over this period, though there are larger numbers of inactive participants in defined benefit plans than defined contribution plans throughout. Between 1975 and 2011, the number of active participants in defined benefit plans decreased and the number of active participants in defined contribution plans increased. The percent of active participants in defined benefit plans relative to active participants in defined contribution plans declined relatively sharply over this period.

The data in Figure 2 also show that a decreasing proportion of defined benefit participants are active participants (and an increasing proportion of defined benefit participants are inactive). Consistent with overall patterns, an increasing proportion of defined contribution participants are active participants (and a decreasing proportion of defined contribution participants are inactive).

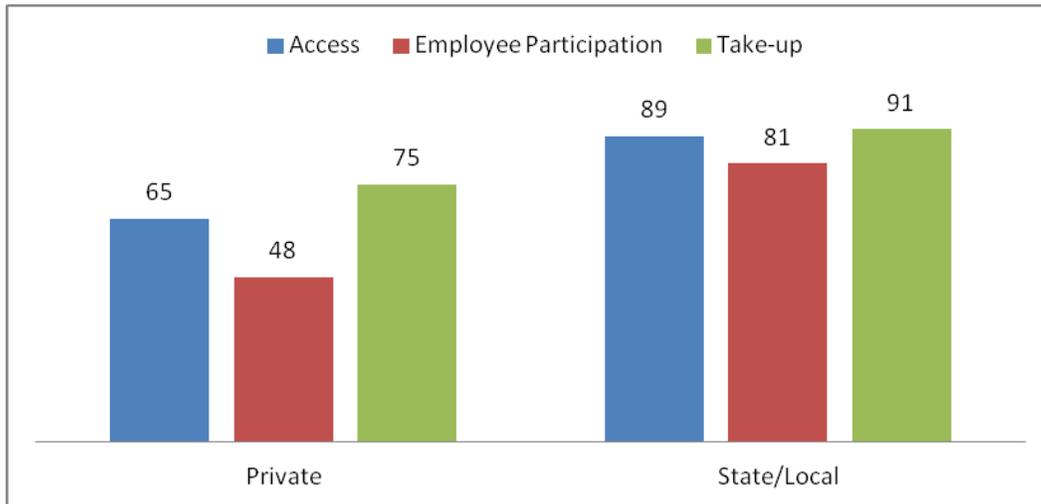
**Figure 2.—Number of Private-Sector Participants by Active or Inactive Status and Type of Plan 1975-2011 (thousands)**



Source: Form 5500 filings with the U.S. Department of Labor.

Rates of access and participation in qualified retirement plans vary by a number of worker and industry characteristics. Figure 3 shows that access rates are lower in the private sector than they are in the state and local government sector. In addition, rates of employee participation are lower in the private sector than in the government sector. As a result, the take-up rate in the private sector is 75 percent compared to a 91 percent take-up rate in the state and local government sector.

**Figure 3.—Access, Participation, and Take-up Rates by Sector in 2014  
(percentage)**

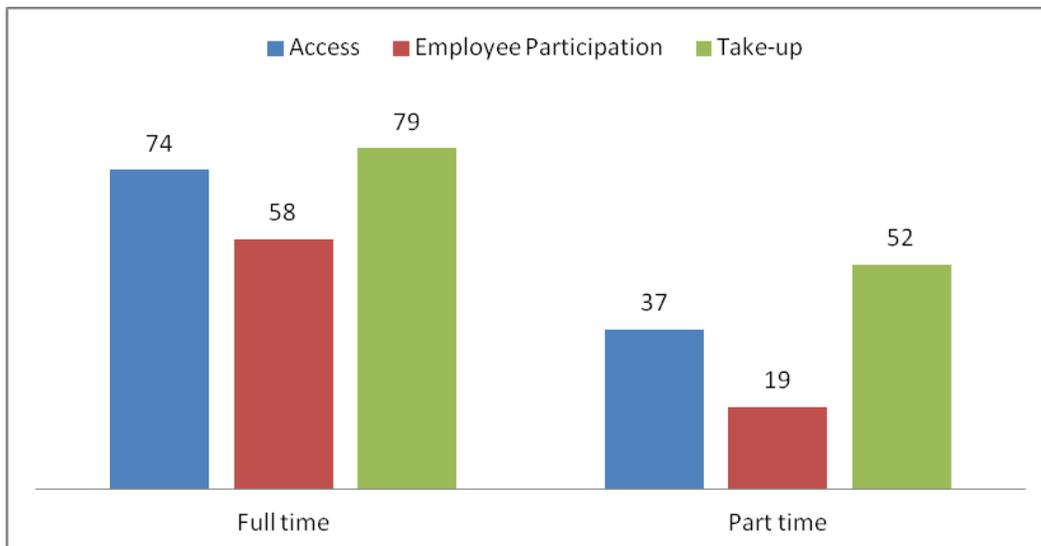


Source: Bureau of Labor Statistics, National Compensation Survey Data, 2014.

Note: All workers=100 percent. Access and participation rates are expressed as a percentage of all workers. Take-up rates are employee participation rates as a percentage of those workers with access.

The data in Figure 4 show that access, employee participation, and take-up rates in the private sector are significantly higher for full time workers than for part time ones. Overall take-up rates are only 52 percent for part time workers, compared to a 79 percent take-up rate for full time workers.

**Figure 4.—Access, Participation, and Take-up Rates in the  
Private Sector by Full-time Status in 2014  
(percentage)**



Source: Bureau of Labor Statistics, National Compensation Survey Data, 2014.

Note: All workers=100 percent. Access and participation rates are expressed as a percentage of all workers. Take-up rates are employee participation rates as a percentage of those workers with access.

## **Increasing Access to Plans**

**Open Multiple Employer Plans (MEPs):** To enable small employers to sponsor high-quality, low-cost plans, the working group recommends that the Committee consider proposals that allow employers to join open multiple employer plans. MEPs allow businesses to share administrative and other responsibilities associated with providing retirement plans to their employees. Unfortunately, current law hinders the formation of MEPs by requiring a “nexus” between employers who wish to join a MEP. Senator Hatch, Senator Collins, Senator Nelson, and former Senator Harkin have all proposed waiving this requirement for small businesses with fewer than 500 employees so they can share retirement plan administrative burdens by forming MEPs. This would limit the administrative burden associated with running a plan, allowing small employers to benefit from the economies of scale that larger employers are able to achieve. Encouraging MEP participation could also promote more competition among providers of small business retirement plans and increase the quality of the investment products available to employees, while potentially reducing fees.

### *Current Law:*

Under current law, qualified retirement plans are of two general types: (1) defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts, and (2) defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses. These types apply for purposes of the Internal Revenue Code of 1986 (the “Code”) and the Employee Retirement Income Security Act of 1974 (“ERISA”).

Qualified retirement plans are also categorized by the number of employers that maintain the plan and the type of employees covered by the plan. Plans fall into one of three types: single-employer plans, multiemployer plans, and multiple-employer plans. These types also apply for purposes of the Code and ERISA.

A single-employer plan is a plan maintained by one employer. Members of controlled groups and affiliated service groups are treated as one employer for this purpose. A single-employer plan may cover employees who are also covered by a collective bargaining agreement (“collectively bargained employees”), pursuant to which the plan is maintained (a “collectively bargained plan”). An employer may maintain separate plans for collectively and noncollectively bargained employees, or they may be covered by the same plan.

Multiemployer plans (also known as “Taft-Hartley” plans) are plans maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers (that is, entities that are not members of the same controlled group or affiliated service group) and to which the employers are required to contribute under the collective bargaining agreement(s).

Multiemployer plans commonly cover collectively bargained employees in a particular industry. A multiemployer plan is not operated by the contributing employers; instead, it is governed by a board of trustees (“joint board”) consisting of labor and employer representatives.

A multiple-employer plan is a single plan in which two or more unrelated employers participate, but that is not a multiemployer plan. A multiple-employer plan may cover noncollectively bargained employees or collectively bargained employees.

Some qualification requirements are applied to a multiple-employer plan on a plan-wide basis. For this purpose, all employees covered by the plan are treated as employees of all employers participating in the plan. For example, an employee's service with all participating employers is taken into account in applying the vesting requirements under the Code (and ERISA). Other requirements, such as the nondiscrimination requirements under the Code, are applied separately to each portion of the plan covering the employees of an employer. Because a multiple-employer plan is a single plan, even if a violation of a qualification requirement applies only with respect to a portion of the plan covering the employees of one employer, the violation potentially causes disqualification of the entire plan.

Historically, multiple-employer defined benefit and defined contribution plans have been maintained by employers in the same industry. Similar to the structure of multiemployer plans, in general, these multiple-employer plans are governed by a committee or board, which is responsible for operation of the plan and compliance with Code and ERISA requirements. More recently, in accordance with IRS guidance, the multiple-employer plan structure is used by professional employer organizations ("PEOs") to cover employees working for PEO clients, as well as the PEOs own employees, under a qualified defined contribution plan.

In some cases, an entity, such as a financial institution, has established a plan intended to be a multiple-employer plan and offered participation in the plan to unrelated employers. This structure is often referred to as an "open" multiple-employer plan, or "open MEP." In such a case, the Department of Labor has held that, in order for the plan to be considered a multiple-employer plan under ERISA (that is, one plan, rather than a collection of single-employer plans), the participating employers must share some employment-based common nexus or other genuine organizational relationship that is unrelated to the provision of benefits.

***Proposals to Expand Open MEPs: S. 1270, 113<sup>th</sup> Congress (sponsored by Chairman Hatch); S. 1970, 113<sup>th</sup> Congress (sponsored by Sens. Collins and Nelson); S. 1979, 113<sup>th</sup> Congress (sponsored by Sens. Harkin and Brown)***

These bills contain proposals to expand access to multiple-employer defined contribution plans by unrelated employers. Although the specifics of the different proposals vary to some extent, the proposals all allow a plan established by a "designated plan provider" or "pooled plan provider" to be treated as a multiple-employer plan, regardless of whether the participating employers share any other nexus or common interest.

The proposals also include the following elements:

- A professional service provider is designated under the terms of the plan to perform all administrative duties reasonably necessary to ensure that the plan meets applicable qualification requirements and each participating employer meets its responsibilities.
- The provider is required to register with the IRS or DOL and is subject to credentialing requirements and oversight.

- The provider may have fiduciary responsibility under ERISA to the extent responsibility is not delegated to a participating employer.
- Each employer bears fiduciary responsibility for the selection and monitoring of the provider and for the investment of assets attributable to the employer's employees (if not delegated to another fiduciary), but not for plan assets as a whole.
- The failure of a Code requirement with respect to the portion of the plan covering employees of a particular employer causes disqualification of only that portion of the plan, which may be spun off from the plan.
- Additional reporting is required, including a list of participating employers and an estimate of the percentage of assets attributable to contributions by each employer.

**Start-up and matching credits and safe harbors for small businesses that offer a plan:**

Current law provides a tax credit of up to \$500 per year, for three years, for start-up costs related to qualified small employer retirement plans. However, the uptake rate on this credit has historically been very weak. The total credit value claimed by taxpayers usually totals half a million dollars annually. Both Chairman Hatch and President Obama have proposed enhanced start-up credits for small employers that elect to offer retirement plans. Specifically, Chairman Hatch has proposed increasing the size of the current maximum credit for small employers who adopt a new qualified plan from \$500 to \$5,000. Similarly, the President has proposed providing any employer with 100 or fewer employees who offers an auto-Individual Retirement Account (“IRA”) a \$3,000 tax credit. The President also proposes to triple the existing “start-up” credit, so small employers who newly offer a retirement plan would receive a \$4,500 tax credit. Small employers who already offer a plan and add auto-enrollment would get an additional \$1,500 tax credit. Automatic enrollment plans make the default option for all employees a direct deposit from each paycheck to an employee--provided defined contribution plan or an IRA. The working group encourages consideration of proposals to increase the value of the credit for all plans and to further increase the credit for employers who offer automatic enrollment plans.

**Auto Enrollment:** Current law provides a safe harbor for automatic enrollment plans, under which an employer may “match” employee contributions of up to six percent of pay. Senators Collins and Nelson propose an additional safe harbor for these plans to allow employers to match employee contributions of up to 10 percent of pay. For the smallest businesses – those with fewer than 100 employees – Senators Collins and Nelson propose offsetting the cost of this additional match by providing a new tax credit equal to the increased match. The working group recommends considering proposals to expand the safe harbor for automatic enrollment plans and providing a new credit to further help small employers offer matching contributions.

*Current Law:*

Present law provides a nonrefundable income tax credit for qualified start-up costs of an eligible small employer that adopts a new qualified retirement plan, SIMPLE IRA plan, or SEP, provided that the plan covers at least one employee who is not highly compensated. Qualified start-up costs are expenses connected with the establishment or administration of the plan or retirement-related education for employees with respect to the plan. The credit is the lesser of \$500 per year

or 50 percent of the qualified start-up costs. The credit applies for up to three years, beginning with the year the plan is first effective, or, at the election of the employer, the preceding year.

An eligible employer is an employer that, for the preceding year, had no more than 100 employees with compensation of \$5,000 or more. In addition, the employer must not have had a plan covering substantially the same employees as the new plan during the three years preceding the first year for which the credit would apply. Members of controlled groups and affiliated service groups are treated as single employers for purposes of these requirements.

The Code applies nondiscrimination requirements to tax-favored retirement plans of private employers, which limit the extent to which a plan can discriminate in favor of - that is, provide greater benefits to - highly compensated employees (including owners) compared with employees who are not highly compensated. These requirements generally compare the benefits provided under the plan to the group of highly compensated employees with the benefits provided to the group of employees who are not highly compensated.

Certain types of tax-favored retirement plans, such as 401(k) plans, allow employees to elect whether to make contributions to the plan and how much to contribute (subject to limits). The nondiscrimination test for a 401(k) plan generally requires calculating and comparing average rates of contributions made by highly compensated employees and by employees who are not highly compensated. The Code also provides safe harbors under which a 401(k) plan automatically meets these nondiscrimination requirements if it provides for employer contributions that match employee contributions (“matching contributions”) or employer contributions made regardless of whether an employee contributes (“nonelective contributions”) *at specified levels*.

***Proposals to Expand Start-up Credit:*** S. 1270, 113<sup>th</sup> Congress (sponsored by Chairman Hatch): The proposal retains the credit as 50 percent of costs, but provides a \$500 minimum credit and increases the maximum credit to the lesser of (1) \$250 multiplied by the number of participants who are not highly compensated employees, or (2) \$5,000.

***President’s FY 2016 budget proposal:*** The proposal retains the credit as 50 percent of costs, but increases the amount of the maximum credit to \$1,500 per year. In addition, if the new plan adopted by a small employer includes automatic enrollment, the credit is increased by \$500 per year for up to three years. This \$500 per year credit is available also to a small employer that adds an automatic enrollment feature to an existing plan. Finally, a small employer that offers an automatic payroll deduction IRA program is allowed a nonrefundable credit for expenses associated with the arrangement up to \$1,000 per year for the first three years of the arrangement, as well as an additional credit of \$25 per employee up to \$250 per year for six years.

***Proposals to Expand Safe Harbor and Provide a Matching Credit:*** S. 1270, 113<sup>th</sup> Congress (sponsored by Chairman Hatch) and S. 1970, 113<sup>th</sup> Congress (sponsored by Sens. Collins and Nelson): These bills provide a new plan design, a “secure deferral” plan. The proposal includes a nondiscrimination safe harbor for a 401(k) plan with an automatic enrollment feature that meets certain requirements with respect to default employee contribution rates and employer matching contribution rates. Specifically, the default employee contribution rates must be

between six percent and ten percent for the first year, increasing as required to reach at least eight percent the next year and at least ten percent in subsequent years, with no maximum rate. Matching contributions must be at least 100 percent of an employee's contributions up to one percent of compensation, 50 percent of an employee's contributions between one and six percent of compensation, and 25 percent of an employee's contributions over six percent and up to ten percent of compensation.

Both bills include a new credit for a small employer maintaining a secure deferral arrangement. S. 1270 provides a credit for three years in the amount of ten percent of the matching and nonelective contributions provided by the employer to employees who are not highly compensated, with an annual maximum credit of \$10,000. S. 1970 provides a credit, for the first five years a non-highly compensated employee participates in the plan, in the amount of matching contributions provided to the employee, up to two percent of the employee's compensation.

### **Increasing Participation and Contribution Levels**

**Allow Part-Time Workers to Enroll in Plans:** The working group encourages consideration of proposals that allow long-term, part-time employees to contribute to employee-sponsored retirement plans. Only 37 percent of part-time workers have access to a workplace retirement plan. That is partly because employers offering retirement plans are allowed to exclude employees who work less than 1,000 hours per year, no matter how long they've worked for the employer. The Administration has proposed to expand access for part-time workers by requiring employers who offer plans to permit employees who have worked for the employer for at least 500 hours per year for 3 years or more to make voluntary contributions to the plan.

#### *Current Law:*

Under current law, qualified retirement plans commonly require an employee to reach a specified age or complete a specified period of service in order to be eligible for coverage under the plan. However, a qualified retirement plan of a private employer generally cannot exclude an employee from coverage on the basis of age or service once the employee has attained age 21 and completed a year of service (that is, a 12-month period in which the employee has worked at least 1,000 hours). A similar rule applies under ERISA. Employees can be excluded from plan coverage on other bases, such as job classification, as long as the other basis is not an indirect age or service requirement.

Certain types of tax-favored retirement plans, such as 401(k) plans, allow employees to elect whether to make contributions to the plan and how much to contribute (subject to limits). In addition to the age and service requirements described above, a 401(k) plan cannot require an employee who otherwise meets the eligibility requirements for coverage under the plan to complete more than a year of service in order to be eligible to elect to contribute to the plan.

Plans of private employers are subject to vesting requirements under the Code and ERISA. Under the vesting requirements, the portion of plan benefits attributable to the employee's contributions must be nonforfeitable (or fully vested) at all times. In the case of a defined contribution plan, the portion of plan benefits attributable to the employee's contributions is the

portion of the employee's account balance consisting of those contributions and earnings thereon.

Two alternative minimum vesting schedules apply to the portion of an employee's account balance under a defined contribution plan that is attributable to matching or nonelective contributions. Under the first vesting schedule, this portion of the employee's account must be fully vested after the completion of no more than three years of service (referred to as "three-year cliff vesting"). Under the second vesting schedule (referred to as "graduated vesting"), this portion of the employee's account must become vested at a rate of at least 20 percent a year after the completion of two to six years of service.

As discussed, the Code applies nondiscrimination requirements to tax-favored retirement plans of private employers, which limit the extent to which a plan can provide greater benefits to highly compensated employees (including owners) compared with employees who are not highly compensated. The nondiscrimination test for a 401(k) plan generally requires calculating and comparing average rates of contributions made by highly compensated employees and by employees who are not highly compensated.

In applying the nondiscrimination requirements, employees under age 21 and with less than a year of service who are excluded from coverage under the plan ("excludable employees") may be disregarded. If a plan covers any employees in this group, nondiscrimination tests are applied by either (1) taking excludable employees into account when testing the entire plan, or (2) applying the tests separately to benefits provided to the group of excludable employees.

***Proposals to Allow Part-Time Workers to Enroll in Plans: President's FY 2016 budget proposal and H.R. 2117, 113<sup>th</sup> Congress (sponsored by Rep. Neal)***

Under these proposals, a "long-term part-time" employee cannot be excluded from coverage under a 401(k) plan on the basis of not having completed a year of service. A long-term part-time employee is an employee who has worked at least 500 hours per year with the employer for at least three consecutive years. An employee who meets this service requirement but is under age 21 could continue to be excluded from the plan.

The proposals do not require employer matching or nonelective contributions to be provided for long-term part-time employees. However, if such contributions are made, a year in which the employee works at least 500 hours is counted as a year of service in applying the vesting requirements.

For purposes of nondiscrimination testing, long-term part-time employees are treated as similar to excludable employees.

**Savings Match:** The working group suggests the Finance Committee consider proposals along the lines of H.R. 2117 and S. 1970 (as filed in the 113<sup>th</sup> Congress). The group also supports consideration of provisions, including those in these bills, which promote efforts to reach additional middle-income families.

*Current Law:*

Under current law, a nonrefundable tax credit is available for eligible individuals who make qualified retirement savings contributions, referred to as the “saver’s credit.” Subject to adjusted gross income (“AGI”) limits, the credit is available to individuals who are 18 or older, other than individuals who are full-time students or claimed as dependents on other individuals’ returns. The AGI limits for 2015 (as indexed for inflation) are \$61,000 for married individuals filing joint returns, \$45,750 for head-of-household filers, and \$30,500 for single individuals and married individuals filing separate returns.

For purposes of the credit, qualified retirement savings contributions include (1) elective contributions to a 401(k) plan or similar employer-sponsored plan, a SIMPLE IRA, or a SEP IRA; (2) contributions to the individual’s traditional or Roth IRA; and (3) voluntary after-tax employee contributions to a tax-favored employer-sponsored retirement plan. The maximum amount of qualified retirement savings contributions taken into account for purposes of the credit is \$2,000. The amount of any contribution eligible for the credit is reduced by distributions received by the individual (or by the individual’s spouse if the individual files a joint return with the spouse) from any plan or IRA to which eligible contributions can be made during the taxable year for which the credit is claimed, the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date for filing the individual’s return for the year. Distributions that are rolled over to another retirement plan do not affect the credit.

The credit is a percentage of the individual’s qualified retirement savings contributions up to \$2,000. The credit percentage depends on the AGI of the individual, varying from 10 percent to 50 percent, as shown in the table below. The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability.

**Table 1.—Credit Rates for Saver’s Credit  
(for 2015)**

<b>Joint Filers</b>	<b>Head of Household</b>	<b>All Other Filers</b>	<b>Credit Rate</b>
\$0 – \$36,500	\$0 – \$27,375	\$0 – \$18,250	50 percent
\$36,501 – \$39,500	\$27,376 – \$29,625	\$18,251 – \$19,750	20 percent
\$39,501 – \$61,000	\$29,626 – \$45,750	\$19,751 – \$30,500	10 percent

***Proposal to Expand the Saver’s Credit: H.R. 2117, 113<sup>th</sup> Congress***

Under the proposal, the saver’s credit is made refundable. The amount of the credit is changed to 50 percent of eligible contributions up to a specified dollar amount (“eligible contribution amount”) for each eligible individual with AGI not exceeding a certain level (“AGI level”). The eligible contribution amount is \$500 initially and increases to \$1,500 over 10 years, with indexing thereafter. The AGI level for the first year is \$65,000 for joint filers (\$48,750 for head-of-household and \$32,500 for single or married taxpayers filing separately), with indexing thereafter. The credit is phased out for an individual over the next \$20,000 of AGI for joint filers (\$15,000 for head-of-household and \$10,000 for single or married taxpayers filing separately).

The credit is doubled to 100 percent of contributions up to the eligible contribution amount if the individual agrees to have the entire credit amount contributed directly to an IRA or tax-favored employer-sponsored retirement plan. In that case, the credit is treated as a pretax contribution (and thus is includible in income when distributed), but does not count against contribution limits applicable to the IRA or employer-sponsored plan. If the credit is contributed to an employer-sponsored plan, the credit amount is treated as an employer contribution for purposes of nondiscrimination testing.

**Clarifications Related to Church Plans:** Most church retirement plans are exempt from ERISA and are instead subject to special laws and regulations that reflect the distinctive issues that church plans confront. Church retirement plans are subject to stringent state and federal laws and other regulations, including state fiduciary standards, state contract law, and Code requirements. Because of their unique status, however, federal legislative and regulatory changes can unintentionally result in uncertainty or compliance issues for church plans. The working group supports consideration of the technical changes made by S. 952, introduced by Senator Cardin and Senator Portman in the 113th Congress, to alleviate this uncertainty and to ensure continued participation in church plans and retirement security for church plan beneficiaries.

**Improvements Related to S-ESOP Plans:** S Corporation Employee Stock Ownership Plans, or S-ESOPs, have a track record of providing retirement security for employee-owners of both small and large businesses. S. 1212, introduced by Senators Cardin and Roberts, contains several provisions to further encourage employee-ownership in S corporations, including extending the gain-deferral provisions of Code section 1042 to sales of employer stock to S-ESOPs, providing resources to small businesses contemplating making the transition to an ESOP, and ensuring that SBA-certified small businesses do not lose their status by becoming employee owned. The working group supports consideration of these bipartisan proposals; S. 1212 currently has 18 bipartisan cosponsors in addition to Senators Cardin and Roberts, including 9 Republicans, 7 Democrats, and two Independents.

### **Preserving Savings and Making Them Last through Retirement**

**Exclusion of Annuity Payments:** Senators from both parties have proposed allowing a percentage of otherwise taxable lifetime annuity payments received by an individual from an IRA or any type of defined contribution plan to be excluded from gross income. Such an exclusion would be phased out at higher levels of income. The working group supports consideration of this approach.

**Portability of Lifetime Income:** As individuals often have several jobs over the course of a career, one key feature of a defined contribution plan is the ability of plan participants to roll over the savings that have accrued in their retirement accounts. In order to encourage long-term, lifetime savings, the working group has heard strong arguments that defined contribution plans should be encouraged to offer annuities or other installment products as investment options, so that participants can buy these products gradually over their careers, thus eliminating the risk of making one large annuity or installment product purchase when interest rates are low. For example, Chairman Hatch has proposed treating a defined contribution plan's discontinuance of

a lifetime income investment option as a distributable event, allowing affected participants to rollover the lifetime income investment to an IRA or other plan.

The terms of an employer-sponsored retirement plan generally determine when distributions are permitted. However, in some cases, current law Code requirements may prohibit distributions before an employee terminates employment (referred to as “in-service” distributions). For example, in-service distributions generally are not permitted with respect to contributions made to a plan at the election of an employee and earnings thereon.

*Current Law:*

A distribution from an employer-sponsored retirement plan is generally includible in gross income, except to the extent the distribution is a recovery of basis under the plan, or if the amount of the distribution is contributed to another eligible retirement plan, including an IRA, in a tax-free rollover. A tax-free rollover can be made by a plan-to-plan transfer (that is, a direct payment from the distributing plan to the recipient plan) or by the employee’s contribution of the amount of the distribution to the eligible retirement plan within 60 days of receiving the distribution (“60-day rollover”).

If an employee’s account (or portion of an account) under a defined contribution plan is invested in a lifetime income product and that product is discontinued as a permissible investment option of the plan, restrictions on in-service distributions may prevent the employee from obtaining a distribution of the investment or transferring the investment to another retirement plan or an IRA. In that case, the employee may have to liquidate the investment and possibly incur fees or forfeit a portion of the amount invested.

***Proposals on Lifetime Income Portability: S. 1270, 113th Congress (sponsored by Chairman Hatch) and President’s FY 2016 budget proposal***

Under these proposals, when a lifetime income investment held within an employee’s account under an employer-sponsored retirement plan is no longer an authorized investment under the plan, the plan could permit the distribution of the investment to the employee by means of a plan-to-plan transfer to another employer-sponsored retirement plan or an IRA, without regard to whether a distribution would otherwise be permitted. Thus, these proposals allow an in-service transfer of the investment to another employer-sponsored retirement plan or an IRA.

**Promoting Lifetime Income:** Some have suggested that annuity provider rules need to be adjusted in order to increase the options individuals have to address the risk of outliving their private retirement savings. Policies that help income last throughout retirement should not only encourage investment in lifetime income products by plan participants, but also encourage lifetime distribution choices in the decumulation phase. The working group supports consideration of policies that encourage retirees to be knowledgeable about and select distributions that provide a stream of income payments over the course of their retirement. Senators Brown, Cantwell, Harkin, and Hatch have proposed a safe harbor with respect to the selection of a lifetime retirement income contract as long as certain requirements are met, including an objective and analytical search to identify insurers that offer lifetime retirement income contracts. This analysis should include a consideration of costs, benefits, and product

features, as well as a review of an insurer's financial capability to satisfy its obligations under the lifetime retirement contract. To satisfy the financial capability requirements, the insurer must be able to show that it is in good standing and appropriately licensed and compliant with state-prescribed financial solvency and auditing requirements. In addition, requiring lifetime income disclosures on benefit statements would aid plan participants in making their choices about how to spend down their retirement savings. Finally, the working group also discussed the potential for proposals that, similar to auto-enrollment features, would automatically place retirees in lifetime savings options upon retirement, with the opportunity to opt-out.

**Leakage:** Also critical to the preservation of savings is the issue of leakage—the use of retirement funds for purposes other than retirement income. While emergency withdrawals may be appropriate in limited circumstances, the working group generally supports proposals that prevent leakage and ensure more secure retirements for taxpayers who take advantage of retirement plans. Bipartisan proposals to prevent leakage, described in more detail below, include:

- A) Extend Rollover Period for Plan Loan Amounts.** When an employee that has taken a loan against their 401(k) plan balance loses or leaves his or her job, he or she generally is put to the choice of defaulting on the outstanding loan and incurring tax penalties or almost immediately repaying the entire outstanding loan balance. Paying back a loan just after leaving a job can be difficult. The working group supports consideration of proposals that extend this rollover period, giving an employee until the end of the tax year to pay back a loan.
  
- B) Allow 401(k) participants to continue to make elective contributions during the six months following a hardship withdrawal.** Currently, after an employee receives a hardship withdrawal from a 401(k) plan, he or she is prohibited from making elective contributions to the plan and all other plans maintained by the employer for at least six months. The loss of both employee contributions and company matching contributions during this period exacerbates the long-term negative effects of leakage on retirement savings. Allowing plan participants to continue to make these contributions would counteract this problem.

*Current Law:*

Current law provides that the distribution from a qualified retirement plan is generally includible in gross income, except to the extent the distribution is a recovery of basis under the plan, or if the amount of the distribution is contributed to another eligible retirement plan in a tax-free rollover. In the case of a distribution to an employee under age 59 ½ that is not rolled over, unless an exception applies, the distribution is subject to a 10-percent early withdrawal tax to the extent that the distribution is includible in gross income.

Qualified retirement plans may provide loans to employees, subject to various requirements. If these requirements are not met, the amount of the loan is a deemed distribution from the plan. A deemed distribution of an unpaid loan balance is generally taxed as though an actual distribution

occurred, including being subject to a 10-percent early withdrawal tax, if applicable. However, a deemed distribution is not eligible for rollover to another eligible retirement plan.

A plan may also provide that, in certain circumstances (for example, on termination of employment), an employee's obligation to repay a loan is accelerated and, if the loan is not repaid, the loan is cancelled and the employee's account balance is offset by the amount of the outstanding loan balance (referred to as a "loan offset"). In the case of a loan offset, an actual distribution equal to the unpaid loan balance occurs (rather than a deemed distribution), and (unlike a deemed distribution) the amount of the distribution is eligible for tax-free rollover to another eligible retirement plan.

The rules allowing plan loans limit the aggregate amount of loans to an employee (generally the lesser of \$50,000 or one-half of the employee's vested account balance), but not the number of loans an employee may obtain from a plan.

Amounts contributed to a 401(k) plan and similar plans at the election of an employee generally may not be distributed before the occurrence of certain events, including financial hardship of the employee. In general, a distribution is made on account of hardship only if the employee has an immediate financial need and a distribution is necessary to satisfy that need. Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy such an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making contributions to the plan for at least six months after receipt of the hardship distribution.

***Proposal on Plan Loans: S. 606, 113<sup>th</sup> Congress (sponsored by Sens. Nelson and Enzi)***

Under the proposal, the period during which a loan offset amount may be contributed to an eligible retirement plan in a tax-free rollover is extended from 60 days after the date of the offset to the due date (including extensions) for filing the federal income tax return for the taxable year in which the plan loan offset occurs (meaning the taxable year in which the amount is treated as distributed from the plan).

Under the proposal, a plan loan that is made through the use of a credit card or similar arrangement does not meet the requirements for loan treatment and is therefore a deemed distribution.

***Proposal on Hardship Distributions: S. 606, 113<sup>th</sup> Congress (sponsored by Sens. Nelson and Enzi)***

The proposal directs the Secretary of the Treasury to revise the hardship regulations to eliminate the requirement that an employee be prohibited from making contributions for any period after the receipt of a hardship distribution in order for the distribution to be deemed necessary to satisfy an immediate and heavy financial need.

***Proposal on Contributions following a Distribution: S. 1270, 113<sup>th</sup> Congress (sponsored by Chairman Hatch)***

Under the proposal, in determining whether a distribution is made upon financial hardship of an employee, the question of whether the employee makes contributions for any period after the distribution is not taken into account. The proposal thus overrides Treasury regulations requiring an employee to be prohibited from making contributions for any a period after the receipt of a hardship distribution in order for the distribution to be deemed necessary to satisfy an immediate and heavy financial need.