

**DESCRIPTION OF H.R. 1994,
THE “SETTING EVERY COMMUNITY UP FOR RETIREMENT
ENHANCEMENT (SECURE) ACT OF 2019”**

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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup on April 2, 2019 of H.R. 1994, the “Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019.” This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

¹ This document may be cited as follows: Joint Committee on Taxation, “*Description of H.R. 1994, the “Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019”* (JCX-11-19), April 1, 2019. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references herein are to the Internal Revenue Code of 1986, as amended (herein “Code”), unless otherwise stated.

TITLE I – EXPANDING AND PRESERVING RETIRMENT SAVINGS

A. Increase in 10 Percent Cap for Automatic Enrollment Safe Harbor After First Plan Year

Present Law

Section 401(k) plans

A qualified defined contribution plan may include a qualified cash or deferred arrangement, under which employees may elect to have contributions made to the plan (referred to as “elective deferrals”) rather than receive the same amount as current compensation (referred to as a “section 401(k) plan”).² The maximum annual amount of elective deferrals that can be made by an employee for a year is \$19,000 (for 2019) or, if less, the employee’s compensation.³ For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is increased by \$6,000 (for 2019) (called catch-up contributions).⁴ An employee’s elective deferrals must be fully vested. A section 401(k) plan may also provide for employer matching and nonelective contributions.

Automatic enrollment

A section 401(k) plan must provide each eligible employee with an effective opportunity to make or change an election to make elective deferrals at least once each plan year.⁵ Whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including the adequacy of notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections.

Section 401(k) plans are generally designed so that an employee will receive cash compensation unless the employee affirmatively elects to make elective deferrals to the section 401(k) plan. Alternatively, a plan may provide that elective deferrals are made at a specified rate (referred to as a “default rate”) when an employee becomes eligible to participate unless the employee elects otherwise (that is, affirmatively elects not to make contributions or to make contributions at a different rate). This plan design is referred to as automatic enrollment.

² Elective deferrals generally are made on a pretax basis and distributions attributable to elective deferrals are includible in income. However, a section 401(k) plan is permitted to include a “qualified Roth contribution program” that permits a participant to elect to have all or a portion of the participant’s elective deferrals under the plan treated as after-tax Roth contributions. Certain distributions from a designated Roth account are excluded from income, even though they include earnings not previously taxed.

³ Sec. 402(g).

⁴ Sec. 414(v).

⁵ Treas. Reg. sec. 1.401(k)-1(e)(2)(ii).

Nondiscrimination test and automatic enrollment safe harbor

An annual nondiscrimination test, called the actual deferral percentage test (the “ADP” test) applies to elective deferrals under a section 401(k) plan.⁶ The ADP test generally compares the average rate of deferral for highly compensated employees to the average rate of deferral for nonhighly compensated employees and requires that the average deferral rate for highly compensated employees not exceed the average rate for nonhighly compensated employees by more than certain specified amounts. If a plan fails to satisfy the ADP test for a plan year based on the deferral elections of highly compensated employees, the plan is permitted to distribute deferrals to highly compensated employees (“excess deferrals”) in a sufficient amount to correct the failure. The distribution of the excess deferrals must be made by the close of the following plan year.⁷

The ADP test is deemed to be satisfied if a section 401(k) plan includes certain minimum matching or nonelective contributions under either of two plan designs (“401(k) safe harbor plan”), as well as certain required rights and features and satisfies a notice requirement.⁸ One type of 401(k) safe harbor includes automatic enrollment.

An automatic enrollment safe harbor plan must provide that, unless an employee elects otherwise, the employee is treated as electing to make elective deferrals at a default rate equal to a percentage of compensation as stated in the plan and at least (1) three percent of compensation for the first year the deemed election applies to the participant, (2) four percent during the second year, (3) five percent during the third year, and (4) six percent during the fourth year and thereafter. Although an automatic enrollment safe harbor plan generally may provide for default rates higher than these minimum rates, the default rate cannot exceed 10 percent for any year.

Description of Proposal

Under the proposal, the 10-percent limitation on the default rates under an automatic enrollment safe harbor plan is increased to 15 percent after the first year that an employee’s deemed election applies.

Effective Date

The proposal applies to plan years beginning after December 31, 2019.

⁶ Sec. 401(k)(3).

⁷ Sec. 401(k)(8).

⁸ Sec. 401(k)(12) and (13). If certain additional requirements are met, matching contributions under 401(k) safe harbor plan may also satisfy a nondiscrimination test applicable under section 401(m).

B. Rules Relating to Election of Safe Harbor 401(k) Status

Present Law

Section 401(k) plans

A qualified defined contribution plan may include a qualified cash or deferred arrangement, under which employees may elect to have contributions made to the plan (referred to as “elective deferrals”) rather than receive the same amount as current compensation (referred to as a “section 401(k) plan”).⁹ The maximum annual amount of elective deferrals that can be made by an employee for a year is \$19,000 (for 2019) or, if less, the employee’s compensation.¹⁰ For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is increased by \$6,000 (for 2019) (called catch-up contributions).¹¹ An employee’s elective deferrals must be fully vested. A section 401(k) plan may also provide for employer matching and nonelective contributions.

Automatic enrollment

A section 401(k) plan must provide each eligible employee with an effective opportunity to make or change an election to make elective deferrals at least once each plan year.¹² Whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including the adequacy of notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections.

Section 401(k) plans are generally designed so that an employee will receive cash compensation unless the employee affirmatively elects to make elective deferrals to the section 401(k) plan. Alternatively, a plan may provide that elective deferrals are made at a specified rate when an employee becomes eligible to participate unless the employee elects otherwise (that is, affirmatively elects not to make contributions or to make contributions at a different rate). This plan design is referred to as automatic enrollment.

⁹ Elective deferrals generally are made on a pretax basis and distributions attributable to elective deferrals are includible in income. However, a section 401(k) plan is permitted to include a “qualified Roth contribution program” that permits a participant to elect to have all or a portion of the participant’s elective deferrals under the plan treated as after-tax Roth contributions. Certain distributions from a designated Roth account are excluded from income, even though they include earnings not previously taxed.

¹⁰ Sec. 402(g).

¹¹ Sec. 414(v).

¹² Treas. Reg. sec. 1.401(k)-1(e)(2)(ii).

Nondiscrimination test

General rule and design-based safe harbors

An annual nondiscrimination test, called the actual deferral percentage test (the “ADP” test) applies to elective deferrals under a section 401(k) plan.¹³ The ADP test generally compares the average rate of deferral for highly compensated employees to the average rate of deferral for nonhighly compensated employees and requires that the average deferral rate for highly compensated employees not exceed the average rate for nonhighly compensated employees by more than certain specified amounts. If a plan fails to satisfy the ADP test for a plan year based on the deferral elections of highly compensated employees, the plan is permitted to distribute deferrals to highly compensated employees (“excess deferrals”) in a sufficient amount to correct the failure. The distribution of the excess deferrals must be made by the close of the following plan year.¹⁴

The ADP test is deemed to be satisfied if a section 401(k) plan includes certain minimum matching or nonelective contributions under either of two plan designs (“401(k) safe harbor plan”), described below, as well as certain required rights and features and satisfies a notice requirement.¹⁵

Safe harbor contributions

Under one type of 401(k) safe harbor plan (“basic 401(k) safe harbor plan”), the plan either (1) satisfies a matching contribution requirement (“matching contribution basic 401(k) safe harbor plan”) or (2) provides for a nonelective contribution to a defined contribution plan of at least three percent of an employee’s compensation on behalf of each nonhighly compensated employee who is eligible to participate in the plan (“nonelective basic 401(k) safe harbor plan”). The matching contribution requirement under the matching contribution basic 401(k) safe harbor requires a matching contribution equal to at least 100 percent of elective contributions of the employee for contributions not in excess of three percent of compensation, and 50 percent of elective contributions for contributions that exceed three percent of compensation but do not exceed five percent, for a total matching contribution of up to four percent of compensation. The required matching contributions and the three percent nonelective contribution under the basic 401(k) safe harbor must be immediately nonforfeitable (that is, 100 percent vested) when made.

Another safe harbor applies for a section 401(k) plan that include automatic enrollment (“automatic enrollment 401(k) safe harbor”). Under an automatic enrollment 401(k) safe harbor, unless an employee elects otherwise, the employee is treated as electing to make elective deferrals equal to a percentage of compensation as stated in the plan, not in excess of 10 percent

¹³ Sec. 401(k)(3).

¹⁴ Sec. 401(k)(8).

¹⁵ Sec. 401(k)(12) and (13). If certain additional requirements are met, matching contributions under 401(k) safe harbor plan may also satisfy a nondiscrimination test applicable under section 401(m).

and at least (1) three percent of compensation for the first year the deemed election applies to the participant, (2) four percent during the second year, (3) five percent during the third year, and (4) six percent during the fourth year and thereafter.¹⁶ Under the automatic enrollment 401(k) safe harbor, the matching contribution requirement is 100 percent of elective contributions of the employee for contributions not in excess of one percent of compensation, and 50 percent of elective contributions for contributions that exceed one percent of compensation but do not exceed six percent, for a total matching contribution of up to 3.5 percent of compensation (“matching contribution automatic enrollment 401(k) safe harbor”). The rate of nonelective contribution under the automatic enrollment 401(k) safe harbor plan is three percent, as under the basic 401(k) safe harbor (“nonelective contribution automatic enrollment 401(k) safe harbor”). However, under the automatic enrollment 401(k) safe harbors, the matching and nonelective contributions are allowed to become 100 percent vested only after two years of service (rather than being required to be immediately vested when made).

Safe harbor notice

The notice requirement for a 401(k) safe harbor plan is satisfied if each employee eligible to participate is given, within a reasonable period before any year, written notice of the employee's rights and obligations under the arrangement and the notice meets certain content and timing requirements (“safe harbor notice”). To meet the content requirements, a safe harbor notice must be sufficiently accurate and comprehensive to inform an employee of the employee's rights and obligations under the plan, and be written in a manner calculated to be understood by the average employee eligible to participate in the plan. A safe harbor notice must provide certain information, including the plan's safe harbor contributions, any other plan contributions, the type and amount of compensation that may be deferred under the plan, how to make cash or deferred elections, the plan's withdrawal and vesting provisions, and specified contact information. In addition, a safe harbor notice for an automatic enrollment 401(k) safe harbor must describe certain additional information items, including the deemed deferral elections under the plan if the employee does not make an affirmative election and how contributions will be invested.

Delay in adopting nonelective 401(k) safe harbor

Generally the plan provisions for the requirements that must be satisfied to be a 401(k) safe harbor plan must be adopted before the first day of the plan year and remain in effect for an entire 12-month plan year. However, in the case of a nonelective 401(k) safe harbor plan (but not the matching contribution 401(k) safe harbor), a plan may be amended after the first day of the plan year but no later than 30 days before the end of the plan year to adopt the safe harbor plan provisions including providing the 3 percent of compensation nonelective contribution. The plan must also provide a contingent and follow-up notice. The contingent notice must be provided before the beginning of the plan year and specify that the plan may be amended to include the safe harbor nonelective contribution and, if it is so amended, a follow-up notice will be provided.

¹⁶ These automatic increases in default contribution rates are required for plans using the safe harbor. Rev. Rul. 2009-30, 2009-39 I.R.B. 391, provides guidance for including automatic increases in other plans using automatic enrollment, including under a plan that includes an eligible automatic contribution arrangement.

If the plan is amended, the follow-up notice must be provided no later than 30 days before the end of the plan year stating that the safe harbor nonelective contribution will be provided.

Description of Proposal

In general

The proposal makes a number of changes to the rules for the nonelective contribution 401(k) safe harbor.

Elimination of notice requirement

The proposal eliminates the safe harbor notice requirement with respect to nonelective 401(k) safe harbor plans. However, the general rule under present law requiring a section 401(k) plan to provide each eligible employee with an effective opportunity to make or change an election to make elective deferrals at least once each plan year still applies. As described above, relevant factors used in determining if this requirement is satisfied include the adequacy of notice of the availability of the election and the period of time during which an election may be made.

Delay in adopting provisions for nonelective 401(k) safe harbor

Under the proposal, a plan can be amended to become a nonelective 401(k) safe harbor plan for a plan year (that is, amended to provide the required nonelective contributions and thereby satisfy the safe harbor requirements) at any time before the 30th day before the close of the plan year.

Further, the proposal allows a plan to be amended after the 30th day before the close of the plan year to become a nonelective contribution 401(k) safe harbor plan for the plan year if (1) the plan is amended to provide for a nonelective contribution of at least four percent of compensation (rather than at least three percent) for all eligible employees for that plan year and (2) the plan is amended no later than the last day for distributing excess contributions for the plan year (generally, by the close of following plan year).

Effective Date

The proposal applies to plan years beginning after December 31, 2019.

C. Increase in Credit Limitation for Small Employer Pension Plan Startup Costs

Present Law

A nonrefundable income tax credit is available for qualified startup costs of an eligible small employer that adopts a new qualified retirement plan, SIMPLE IRA plan, or SEP (referred to as an eligible employer plan), provided that the plan covers at least one nonhighly compensated employee.¹⁷ Qualified startup 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 (1) a flat dollar amount of \$500 per year or (2) 50 percent of the qualified startup 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, with the year preceding the first plan year.

An eligible employer is an employer that, for the preceding year, had no more than 100 employees, each 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 a single employer for purposes of these requirements.¹⁸ All eligible employer plans of an employer are treated as a single plan.

No deduction is allowed for the portion of qualified startup costs paid or incurred for the taxable year equal to the amount of the credit.

Description of Proposal

The proposal changes the calculation of the flat dollar amount limit on the credit. The flat dollar amount for a taxable year is the greater of (1) \$500 or (2) the lesser of (a) \$250 multiplied by the number of nonhighly compensated employees of the eligible employer who are eligible to participate in the plan or (b) \$5,000. As under present law, the credit applies for up to three years.

Effective Date

The proposal applies to taxable years beginning after December 31, 2019.

¹⁷ A nonhighly compensated employee is an employee who is not a highly compensated employee as defined under section 414(q).

¹⁸ Sec. 52 (a) or (b) and 414(m) or (o).

D. Small Employer Automatic Enrollment Credit

Present Law

Small employer startup credit

A nonrefundable income tax credit is available for qualified startup costs of an eligible small employer that adopts a new qualified retirement plan, SIMPLE IRA plan or SEP (referred to as an eligible employer plan), provided that the plan covers at least one nonhighly compensated employee.¹⁹ Qualified startup 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 (1) a flat dollar amount of \$500 per year or (2) 50 percent of the qualified startup 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, with the year preceding the first plan 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 a single employer for purposes of these requirements.²⁰ All eligible employer plans of an employer are treated as a single plan.

No deduction is allowed for the portion of qualified startup costs paid or incurred for the taxable year equal to the amount of the credit.

Automatic enrollment

A qualified defined contribution plan may include a qualified cash or deferred arrangement under which employees may elect to have plan contributions (“elective deferrals”) made rather than receive cash compensation (commonly called a “section 401(k) plan”). A SIMPLE IRA plan is an employer-sponsored retirement plan funded with individual retirement arrangements (“IRAs”) that also allows employees to make elective deferrals.²¹ Section 401(k) plans and SIMPLE IRA plans may be designed so that the employee will receive cash compensation unless the employee affirmatively elects to make elective deferrals to the plan. Alternatively, a plan may provide that elective deferrals are made at a specified rate (when the employee becomes eligible to participate) unless the employee elects otherwise (*i.e.*, affirmatively elects not to make contributions or to make contributions at a different rate). This alternative plan design is referred to as automatic enrollment.

¹⁹ Sec. 45E. A nonhighly compensated employee is an employee who is not a highly compensated employee as defined under section 414(q).

²⁰ Sec. 52 (a) or (b) and 414(m) or (o).

²¹ Sec. 408(p).

Description of Proposal

Under the proposal, an eligible employer is allowed a credit of \$500 per year for up to three years for startup costs for new section 401(k) plans and SIMPLE IRA plans that include automatic enrollment, in addition to the plan startup credit allowed under present law. An eligible employer is also allowed a credit of \$500 per year for up to three years if it converts an existing plan to an automatic enrollment design.

Effective Date

The proposal applies to taxable years beginning after December 31, 2019.

E. Certain Taxable Non-Tuition Fellowship and Stipend Payments Treated as Compensation for IRA Purposes

Present Law

There are two general types of individual retirement arrangements (“IRAs”): traditional IRAs and Roth IRAs.²² The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount (\$6,000 for 2019); and (2) the amount of the individual's compensation that is includible in gross income for the year.²³ In the case of an individual who has attained age 50 by the end of the year, the dollar amount is increased by \$1,000. In the case of a married couple, contributions can be made up to the dollar limit for each spouse if the combined compensation of the spouses that is includible in gross income is at least equal to the contributed amount.

An individual may make contributions to a traditional IRA (up to the contribution limit) without regard to his or her adjusted gross income. An individual may deduct his or her contributions to a traditional IRA if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual or the individual's spouse is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income over certain levels.²⁴

Individuals with adjusted gross income below certain levels may make contributions to a Roth IRA (up to the contribution limit).²⁵ Contributions to a Roth IRA are not deductible.

As described above, an individual's IRA contributions generally cannot exceed the amount of his or her compensation that is includible in gross income. Subject to the rule for spouses, described above, an individual who has no includible compensation income generally is not eligible to make IRA contributions, even if the individual has other income that is includible in gross income.²⁶

Description of Proposal

Under the proposal, an amount includible in an individual's income and paid to the individual to aid the individual in the pursuit of graduate or postdoctoral study or research (such

²² Secs. 408 and 408A.

²³ Sec. 219(b)(2) and (5), as referenced in secs. 408(a)(1) and (b)(2)(B) and 408A(c)(2). Under section 4973, IRA contributions in excess of the applicable limit are generally subject to an excise tax of six percent per year until withdrawn.

²⁴ Sec. 219(g).

²⁵ Sec. 408A(c)(3).

²⁶ Under a special rule in section 219(f)(1), alimony that is includible in gross income under section 71 is treated as compensation for IRA contribution purposes.

as a fellowship, stipend, or similar amount) is treated as compensation for purposes of IRA contributions.

Effective Date

The proposal applies to taxable years beginning after December 31, 2019.

F. Repeal of Maximum Age for Traditional IRA Contributions

Present Law

An individual may make deductible contributions to a traditional IRA up to the IRA contribution limit if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.²⁷ If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income ("AGI") for the taxable year over certain indexed levels.²⁸ To the extent an individual cannot or does not make deductible contributions to a traditional IRA, the individual may make nondeductible contributions to a traditional IRA (without regard to AGI limits). Alternatively, subject to AGI limits, an individual may make nondeductible contributions to a Roth IRA.²⁹

An individual who has attained age 70½ by the close of a year is not permitted to make contributions to a traditional IRA.³⁰ This restriction does not apply to contributions to a Roth IRA.³¹ In addition, employees over age 70½ are not precluded from contributing to employer-sponsored plans.

Description of Proposal

The provision repeals the prohibition on contributions to a traditional IRA by an individual who has attained age 70½.

Effective Date

The proposal applies to contributions made for taxable years beginning after December 31, 2019.

²⁷ Sec. 219.

²⁸ Sec. 219(g).

²⁹ Sec. 408(o). The annual contribution limit for IRAs is coordinated so that the maximum amount that can be contributed to all of an individual's IRAs (both traditional and Roth) for a taxable year is the lesser of a certain dollar amount (\$6,000 for 2019) or the individual's compensation.

³⁰ Sec. 219(d)(1).

³¹ Sec. 408A(c)(4).

G. Qualified Employer Plans Prohibited From Making Loans Through Credit Cards and Other Similar Arrangements

Present Law

Employer-sponsored retirement plans may provide loans to participants. Unless the loan satisfies certain requirements in both form and operation, the amount of a retirement plan loan is a deemed distribution from the retirement plan. Among the requirements that the loan must satisfy are that the loan amount must not exceed the lesser of 50 percent of the participant's account balance or \$50,000 (generally taking into account outstanding balances of previous loans), and the loan's terms must provide for a repayment period of not more than five years (except for a loan specifically to purchase a home) and for level amortization of loan payments to be made not less frequently than quarterly.³² Thus, if an employee stops making payments on a loan before the loan is repaid, a deemed distribution of the outstanding loan balance generally occurs. A deemed distribution of an unpaid loan balance generally is taxed as though an actual distribution occurred, including being subject to a 10-percent early distribution tax, if applicable. A deemed distribution is not eligible for rollover to another eligible retirement plan. Subject to the limit on the amount of loans, which precludes any additional loan that would cause the limit to be exceeded, the rules relating to loans do not limit the number of loans an employee may obtain from a plan. Some arrangements have developed under which an employee can access plan loans through the use of a credit card or similar mechanism.

Description of Proposal

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 applicable to qualified retirement plans, and is therefore a deemed distribution.

Effective Date

The proposal applies to loans made after the date of enactment.

³² Sec. 72(p).

H. Portability of Lifetime Income Options

Present Law

Distribution restrictions for accounts under employer-sponsored plans

Types of plans and contributions

Tax-favored employer-sponsored retirement plans under which individual accounts are maintained for employees include qualified defined contribution plans, tax-deferred annuity plans (referred to as “section 403(b)” plans), and eligible deferred compensation plans of State and local government employers (referred to as “governmental section 457(b)” plans).³³

Contributions to a qualified defined contribution plan or section 403(b) plan may include some or all of the following types of contributions:

- pretax elective deferrals (that is, pretax contributions made at the election of an employee in lieu of receiving cash compensation),
- after-tax designated Roth contributions (that is, elective deferrals made on an after-tax basis to a Roth account under the plan),
- after-tax employee contributions (other than designated Roth contributions),
- pretax employer matching contributions (that is, employer contributions made as a result of an employee’s elective deferrals, designated Roth contributions, or after-tax contributions), and
- pretax employer nonelective contributions (that is, employer contributions made without regard to whether an employee makes elective deferrals, designated Roth contributions, or after-tax contributions).

Contributions to a governmental section 457(b) plan generally consist of pretax elective deferrals and, if provided for under the plan, designated Roth contributions.

Restrictions on in-service distributions

The terms of an employer-sponsored retirement plan generally determine when distributions are permitted. However, in some cases, statutory restrictions on distributions may apply.

Elective deferrals under a qualified defined contribution plan are subject to statutory restrictions on distribution before severance from employment, referred to as “in-service”

³³ Secs. 401(a), 403(a), 403(b), 457(b) and (e)(1)(A).

distributions.³⁴ In-service distributions of elective deferrals (and related earnings) generally are permitted only after attainment of age 59½ or termination of the plan. In-service distributions of elective deferrals (but not related earnings) are also permitted in the case of hardship.³⁵

Other distribution restrictions may apply to contributions under certain types of qualified defined contribution plans. A profit-sharing plan generally may allow an in-service distribution of an amount contributed to the plan only after a fixed number of years (not less than two).³⁶ A money purchase pension plan generally may not allow an in-service distribution before attainment of age 62 (or attainment of normal retirement age under the plan if earlier) or termination of the plan.³⁷

Elective deferrals under a section 403(b) plan are subject to in-service distribution restrictions similar to those applicable to elective deferrals under a qualified defined contribution plan, and, in some cases, other contributions to a section 403(b) plan are subject to similar restrictions.³⁸ Deferrals under a governmental section 457(b) plan are subject to in-service distribution restrictions similar to those applicable to elective deferrals under a qualified defined contribution plan, except that in-service distributions under a governmental section 457(b) plan apply until age 70½ (rather than age 59½).³⁹

Distributions and rollovers

A distribution from an employer-sponsored retirement plan is generally includible in income except for any portion attributable to after-tax contributions, which result in basis.⁴⁰ Unless an exception applies, in the case of a distribution before age 59½ from a qualified

³⁴ Sec. 401(k)(2)(B). Similar restrictions apply to certain other contributions, such as employer matching or nonelective contributions required under the nondiscrimination safe harbors under section 401(k).

³⁵ The Bipartisan Budget Act of 2018, Pub. L. No. 115-123 (“BBA”), amends certain hardship distribution rules applicable to 401(k) plans, effective for plan years beginning after December 31, 2018. One such amendment under BBA section 41114 permits earnings on elective deferrals under a section 401(k) plan, as well as qualified nonelective contributions and qualified matching contributions (and attributable earnings), to be distributed on account of hardship.

³⁶ Rev. Rul. 71-295, 1971-2 C.B. 184, and Treas. Reg. sec. 1.401-1(b)(1)(ii). Similar rules apply to a stock bonus plan. Treas. Reg. sec. 1.401-1(b)(1)(iii).

³⁷ Sec. 401(a)(36) and Treas. Reg. secs. 1.401-1(b)(1)(i) and 1.401(a)-1(b).

³⁸ Secs. 403(b)(7)(A)(ii) and 403(b)(11).

³⁹ Sec. 457(d)(1)(A).

⁴⁰ Secs. 402(a), 403(b)(1) and 457(a)(1). Under section 402A(d), a qualified distribution from a designated Roth account under an employer-sponsored plan is not includible in income.

retirement plan or a section 403(b) plan, any amount included in income is subject to an additional 10-percent tax, referred to as the “early withdrawal” tax.⁴¹

A distribution from an employer-sponsored retirement plan generally may be rolled over on a nontaxable basis to another such plan or to an individual retirement arrangement (“IRA”), either by a direct transfer to the recipient plan or IRA or by contributing the distribution to the recipient plan or IRA within 60 days of receiving the distribution.⁴² If the distribution from an employer-sponsored retirement plan consists of property, the rollover is accomplished by a transfer or contribution of the property to the recipient plan or IRA.

Investment of accounts under employer-sponsored plans

Qualified defined contribution plans, section 403(b) plans, and governmental section 457(b) plans commonly allow employees to direct the manner in which their accounts are invested. Employees may be given a choice among specified lifetime investments, such as a choice of specified mutual funds, and, in some cases, may be able to direct the investment of their accounts in any product, instrument or investment offered in the market.

The investment options under a particular employer-sponsored retirement plan may change at times.⁴³ Similarly, a plan that allows employees to direct the investment of their accounts in any product, instrument or investment offered in the market may be amended to limit the investments that can be held in the plan. In these cases, employees may be required to change the investments held within their accounts.

The terms of some investments impose a charge or fee when the investment is liquidated, particularly if the investment is liquidated within a particular period after acquisition. For example, a lifetime income product, such as an annuity contract, may impose a surrender charge if the investment is discontinued.

If an employee has to liquidate an investment held in an employer-sponsored retirement plan because of a change in investment options or a limit on investments held in the plan, the employee may be subject to a charge or fee as described above. In addition, restrictions on in-service distributions may prevent the employee from preserving the investment through a rollover.

⁴¹ Sec. 72(t).

⁴² Secs. 402(c), 402A(c)(3), 403(b)(8) and 457(e)(16).

⁴³ In the case of a plan subject to ERISA, a participant’s exercise of control over the investment of the assets in his or her account by choosing among the investment options offered under the plan does not relieve a plan fiduciary from the duty to prudently select and monitor the investment options offered to participants. 29 C.F.R. sec. 2550.404c-1(d)(2)(iv) (2010); *Tibble v. Edison International*, No. 13-550, 135 S. Ct. 1823 (2015). The duty to monitor investment options may result in a change in the options offered.

Description of Proposal

Under the proposal, if a lifetime income investment is no longer authorized to be held as an investment option under a qualified defined contribution plan, section 403(b) plan, or governmental section 457(b) plan, except as otherwise provided in guidance, the plan does not fail to satisfy the Code requirements applicable to the plan solely by reason of allowing (1) qualified distributions of a lifetime income investment, or (2) distributions of a lifetime income investment in the form of a qualified plan distribution annuity contract. Such a distribution must be made within the 90-day period ending on the date when the lifetime income investment is no longer authorized to be held as an investment option under the plan.

For purposes of the proposal, a qualified distribution is a direct trustee-to-trustee transfer to another employer-sponsored retirement plan or IRA.⁴⁴ A lifetime income investment is an investment option designed to provide an employee with election rights (1) that are not uniformly available with respect to other investment options under the plan and (2) that are rights to a lifetime income feature available through a contract or other arrangement offered under the plan (or under another employer-sponsored retirement plan or IRA through a direct trustee-to-trustee transfer). A lifetime income feature is (1) a feature that guarantees a minimum level of income annually (or more frequently) for at least the remainder of the life of the employee or the joint lives of the employee and the employee's designated beneficiary, or (2) an annuity payable on behalf of the employee under which payments are made in substantially equal periodic payments (not less frequently than annually) over the life of the employee or the joint lives of the employee and the employee's designated beneficiary. Finally, a qualified plan distribution annuity contract is an annuity contract purchased for a participant and distributed to the participant by an employer-sponsored retirement plan or an employer-sponsored retirement plan contract.⁴⁵

Effective Date

The proposal applies to plan years beginning after December 31, 2019.

⁴⁴ For this purpose, an employer-sponsored retirement plan or IRA means such a plan or IRA that is an eligible retirement plan under section 402(c)(8)(B).

⁴⁵ For this purpose, an employer-sponsored retirement plan contract is an annuity contract distributed from an eligible retirement plan described in section 402(c)(8)(B) other than an IRA or individual retirement annuity.

I. Treatment of Custodial Accounts on Termination of Section 403(b) Plans

Present Law

Tax-sheltered annuities (section 403(b) plans)

Section 403(b) plans are a form of tax-favored employer-sponsored plan that provide tax benefits similar to qualified retirement plans. Section 403(b) plans may be maintained only by (1) charitable tax-exempt organizations, and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities). Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans. Employers may make nonelective or matching contributions to such plans on behalf of their employees, and the plan may provide for employees to make pretax elective deferrals, designated Roth contributions (held in designated Roth accounts)⁴⁶ or other after-tax contributions. Generally section 403(b) plans provide for contributions toward the purchase of annuity contracts or provide for contributions to be held in custodial accounts for each employee. In the case of contributions to custodial accounts under a section 403(b) plan, the amounts must be invested only in regulated investment company stock.⁴⁷ Contributions to a custodial account are not permitted to be distributed before the employee dies, attains age 59½, has a severance from employment, or, in the case of elective deferrals, encounters financial hardship.

A section 403(b) plan is permitted to contain provision for plan termination and that allow accumulated benefits to be distributed on termination.⁴⁸ In order for a plan termination to be effectuated, however, all plan assets must be distributed to participants.

Rollovers

A distribution from a section 403(b) plan that is an eligible rollover distribution may be rolled over to an eligible retirement plan (which include another 403(b) plan, a qualified retirement plan, and an IRA).⁴⁹ The rollover generally can be achieved by direct rollover (direct payment from the distributing plan to the recipient plan) or by contributing the distribution to the eligible retirement plan within 60 days of receiving the distribution (“60-day rollover”).⁵⁰

⁴⁶ Sec. 402A.

⁴⁷ Sec. 403(b)(7).

⁴⁸ Treas. Reg. sec. 1.403(b)-10(a).

⁴⁹ Sec. 403(b)(8). Similar rules apply to distributions from qualified retirement plans and governmental section 457(b) plans.

⁵⁰ Under section 402(c)(11), any distribution to a beneficiary other than the participant’s surviving spouse is only permitted to be rolled over to an IRA using a direct rollover; 60-day rollovers are not available to nonspouse beneficiaries.

Amounts that are rolled over are usually not included in gross income. Generally, a distribution of any portion of the balance to the credit of a participant is an eligible rollover distribution with exceptions, for example, certain periodic payments, required minimum distributions, and hardship distributions.⁵¹

Roth conversions

Distributions from section 403(b) plans may be rolled into a Roth IRA.⁵² Distributions from these plans that are rolled over into a Roth IRA and that are not distributions from a designated Roth account must be included in gross income. Further, a section 403(b) plan that allows employees to make designated Roth contributions may also allow employees to elect to transfer amounts held in accounts that are not designated Roth accounts into designated Roth accounts, but the amount transferred must be included in income as though it were distributed.⁵³

Approved nonbank trustees required for IRAs

An IRA can be a trust, a custodial account, or an annuity contract. The Code requires that the trustee or custodian of an IRA be a bank (which is generally subject to Federal or State supervision) or an IRS approved nonbank trustee, that an annuity contract be issued by an insurance company (which is subject to State supervision), and that an IRA trust or custodial account be created and organized in the United States.

In order for a trustee or custodian that is not a bank to be an IRA trustee or custodian, the entity must apply to the IRS for approval. Treasury Regulations list a number of factors that are taken into account in approving an applicant to be a nonbank trustee.⁵⁴ The applicant must demonstrate fiduciary ability (ability to act within accepted rules of fiduciary conduct including continuity and diversity of ownership), capacity to account (experience and competence with other activities normally associated with handling of retirement funds), and ability to satisfy other rules of fiduciary conduct which includes a net worth requirement. Because it is an objective requirement that may be difficult for some applicants to satisfy, the net worth requirement is the most significant of the requirements for nonbank trustees.

To be approved, the entity must have a net worth of at least \$250,000 at the time of the application. There is a maintenance rule that varies depending on whether the trustee is an active trustee or a passive trustee and that includes minimum dollar amounts and minimum amounts as

⁵¹ Sec. 402(c)(4). Treas. Reg. sec. 1.402(c)-1 identifies certain other payments that are not eligible for rollover, including, for example, certain corrective distributions, loans that are treated as deemed distributions under section 72(p), and dividends on employer securities as described in section 404(k).

⁵² Sec. 408A(d)(3). Similar rules apply to qualified retirement plans and governmental section 457(b) plans.

⁵³ Sec. 402A(d)(4). Similar rules apply to qualified retirement plans and governmental section 457(b) plans.

⁵⁴ Treas. Reg. sec. 1.408-2(e).

a percentage of assets held in fiduciary accounts. A special rule is provided for nonbank trustees that are members of the Security Investor Protection Corporation (“SIPC”).

Description of Proposal

Under the proposal, the Secretary of the Treasury is directed to issue guidance within six months after the date of enactment to provide that, if an employer terminates a section 403(b) plan under which amounts are contributed to custodial accounts, the plan administrator or custodian may distribute an individual custodial account in kind to a participant or beneficiary of the plan and the distributed custodial account must be maintained by the custodian on a tax-deferred basis as a section 403(b)(7) custodial account, similar to the treatment of fully-paid individual annuity contracts under Revenue Ruling 2011-7,⁵⁵ until amounts are actually paid to the participant or beneficiary. In addition, such guidance must provide that (1) the section 403(b)(7) status of the distributed custodial account is generally maintained if such account thereafter adheres to the requirements of section 403(b) in effect at the time of the account’s distribution, and (2) a custodial account is not considered distributed to the participant or beneficiary if the employer has any material retained rights under the account (the employer, however, is not treated as retaining material rights simply because the custodial account was originally opened under a group contract).

The proposal directs such guidance to apply retroactively for taxable years beginning after December 31, 2008.

Effective Date

The proposal is effective upon date of enactment.

⁵⁵ 2011-10 I.R.B. 534 (March 7, 2011).

J. Clarification of Retirement Income Account Rules Relating to Church-Controlled Organizations

Present Law

Assets of a tax-sheltered annuity plan (“section 403(b)” plan), generally must be invested in annuity contracts or mutual funds.⁵⁶ However, the restrictions on investments do not apply to a retirement income account, which is a defined contribution program established or maintained by a church, or a convention or association of churches, to provide benefits under the plan to employees of a religious, charitable or similar tax-exempt organization.⁵⁷

Certain rules prohibiting discrimination in favor of highly compensated employees, which apply to section 403(b) plans generally, do not apply to a plan maintained by a church or qualified church-controlled organization.⁵⁸ For this purpose, church means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches, and includes a qualified church-controlled organization. A qualified church-controlled organization is any church-controlled tax-exempt organization other than an organization that (1) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities that are sold at a nominal charge substantially less than the cost of providing the goods, services, or facilities, and (2) normally receives more than 25 percent of its support from either governmental sources, or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities that are not unrelated trades or businesses, or from both. Church-controlled organizations that are not qualified church-controlled organizations are generally referred to as “nonqualified church-controlled organizations.”

In recent years, a question has arisen as to whether employees of nonqualified church-controlled organizations may be covered under a section 403(b) plan that consists of a retirement income account.

Description of Proposal

The proposal clarifies that a retirement income account may cover a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation; an employee of an organization, whether a civil law corporation or

⁵⁶ Sec. 403(b)(1)(A) and (7).

⁵⁷ Sec. 403(b)(9)(B), referring to organizations exempt from tax under section 501(c)(3). For this purpose, a church or a convention or association of churches includes an organization described in section 414(e)(3)(A), that is, an organization, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, provided that the organization is controlled by or associated with a church or a convention or association of churches.

⁵⁸ Sec. 403(b)(1)(D) and (12).

otherwise, that is exempt from tax under section 501 and is controlled by or associated with a church or a convention or association of churches; and an employee who is included in a church plan under certain circumstances after separation from the service of a church, a convention or association of churches, or an organization described above.⁵⁹

Effective Date

The proposal applies to years beginning before, on, or after the date of enactment.

⁵⁹ These individuals are described in sections 414(e)(3)(B) and (E).

K. Qualified Cash or Deferred Arrangements Must Allow Long-Term Employees Working More than 500 But Less than 1,000 Hours Per Year to Participate

Present Law

Qualified retirement plans

Qualified retirement plans are of two general types: defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts; and defined contribution plans which include section 401(k) plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses.

A section 401(k) plan legally is not a separate type of plan, but is a profit-sharing or stock bonus plan⁶⁰ that contains a qualified cash or deferred arrangement under which employees may make elective deferrals.⁶¹ Section 401(k) plans may be designed so that elective deferrals are made only if the employee affirmatively elects them. Alternatively, a section 401(k) plan may provide for “automatic enrollment,” under which elective deferrals are made at a specified rate (referred to as a “default rate”) when an employee becomes eligible to participate unless the employee affirmatively elects not to make contributions or to make contributions at a different rate. Other special rules apply to such arrangements. The maximum annual amount of elective deferrals that can be made by an employee to a section 401(k) plan for a year for 2019 is \$19,000 plus \$6,000 for employees age 50 or older (catch-up contribution amount) or, if less, the employee’s compensation.⁶² Section 401(k) plans may provide for matching contributions, which are made on account of elective deferrals,⁶³ and may provide for employer nonelective contributions.

⁶⁰ Defined contribution plans include money purchase pension plans, profit-sharing plans, and stock bonus plans. Certain pre-ERISA money purchase plans and rural cooperative plans may also include a qualified cash or deferred arrangement. Except for certain grandfathered plans, a State or local governmental employer may not maintain a section 401(k) plan.

⁶¹ Elective deferrals are generally made on a pretax basis, excludable from the participant’s gross income when contributed but includable with attributable earnings when distributed. However, under section 402A, a section 401(k) plan is permitted to include a “qualified Roth contribution program” that permits a participant to elect to have all or a portion of the participant’s elective deferrals under the plan treated as designated Roth contributions. Designated Roth contributions are not excludable from the participant’s gross income when contributed, but qualified distributions of designated Roth contributions and attributable earnings are excluded from gross income (even though the earnings are not previously taxed). A qualified distribution is a distribution made after the end of a specified period (generally five years after the participant’s first designated Roth contribution) and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant’s being disabled.

⁶² Secs. 402(g) and 414(v).

⁶³ Sec. 401(m). Matching contributions can also be made on account of after-tax employee contributions.

Participation requirement

A qualified retirement plan generally can delay participation in the plan based on attainment of age or completion of years of service but not beyond the later of completion of one year of service (that is, a 12-month period with at least 1,000 hours of service) or attainment of age 21.⁶⁴ A plan also cannot exclude an employee from participation (on the basis of age) when that employee has attained a specified age.⁶⁵ Employees can be excluded from plan participation on other bases, such as job classification, as long as the other basis is not an indirect age or service requirement. A plan can provide that an employee is not entitled to an allocation of employer nonelective or matching contributions for a plan year unless the employee completes either 1,000 hours of service during the plan year or is employed on the last day of the year even if the employee previously completed 1,000 hours of service in a prior year. However, once an employee has completed 1,000 hours of service during a plan year, an employee cannot be precluded from making elective deferrals based on a service requirement.⁶⁶

Vesting

Qualified retirement plans are subject to requirements as to the period of service after which a participant's right to his or her accrued benefit must be nonforfeitable (that is, "vested").⁶⁷ Generally, a year of vesting service is only required to be credited if an employee completes 1,000 hours of service during the year.

In the case of a defined contribution plan, a participant's accrued benefit is the balance of his or her account under the plan. The portion of an employee's account balance attributable to employee after-tax contributions and elective deferrals must be nonforfeitable at all times.⁶⁸ Generally, the portion of an employee's account balance attributable to nonelective or matching contributions must become nonforfeitable after the completion of a specified number of years of service in accordance with one of two minimum vesting schedules.⁶⁹ Under the first vesting

⁶⁴ Secs. 401(a)(3) and 410(a)(1). Parallel requirements generally apply to plans of private employers under section 202 of the Employee Retirement Income Security Act of 1974 ("ERISA"). Governmental plans under section 414(d) and church plans under section 414(e) are generally exempt from these Code requirements and from ERISA.

⁶⁵ Sec. 410(a)(2).

⁶⁶ Sec. 401(k)(2)(D).

⁶⁷ Secs. 401(a)(7) and 411. Governmental plans and church plans are generally exempt from these Code requirements. Parallel requirements generally apply to plans of private employers under sections 203-204 of ERISA.

⁶⁸ Secs. 411(a)(1) and 401(k)(2)(C). Certain nonelective contributions under a section 401(k) plan and employer matching contributions with respect to elective deferrals must also be nonforfeitable at all times.

⁶⁹ Sec. 411(a)(2)(B). Section 411(a)(3) provides certain permitted forfeitures for accrued benefits that are otherwise 100 percent vested, including, for example, forfeiture upon the participant's death or withdrawal of mandatory employee contributions and suspension of benefits upon reemployment.

schedule, the participant's accrued benefit derived from employer contributions must become 100 percent vested upon completion of no more than three years of service (often referred to as "three year cliff vesting"). Under the second vesting schedule (referred to as "graduated vesting"), the participant's accrued benefit derived from employer contributions must become vested ratably at least over the period from two to six years of service.

Minimum coverage and nondiscrimination requirements

In general

A qualified retirement plan is prohibited from discriminating in favor of highly compensated employees, referred to as the nondiscrimination requirements. These requirements are intended to ensure that a qualified retirement plan provides meaningful benefits to an employer's rank-and-file employees as well as highly compensated employees, so that qualified retirement plans achieve the goal of retirement security for both lower-paid and higher-paid employees. The nondiscrimination requirements consist of a minimum coverage requirement and general nondiscrimination requirements.⁷⁰ For purposes of these requirements, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of \$125,000 (for 2019).⁷¹

The minimum coverage and general nondiscrimination requirements apply annually on the basis of the plan year. In applying these requirements, employees of all members of a controlled group or affiliated service group are treated as employed by a single employer. Employees who have not satisfied minimum age and service conditions under the plan, certain nonresident aliens, and employees covered by a collective bargaining agreement are generally disregarded.⁷² However, a plan that covers employees with less than a year of service or who are under age 21 must generally include those employees in any nondiscrimination test for the year but can test the plan for nondiscrimination in two parts: (1) by separately testing the portion of the plan covering employees who have not completed a year of service or are under age 21 and treating all of the employer's employees with less than a year of service or under age 21 as the only employees of the employer; and (2) then testing the rest of the plan taking into account the rest of the employees of the employer and excluding those employees. If a plan does not satisfy the nondiscrimination requirements on its own, it may in some circumstances be aggregated with another plan, and the two plans tested together as a single plan.

⁷⁰ Sections 401(a)(3) and 410(b) deal with the minimum coverage requirement; section 401(a)(4) deals with the general nondiscrimination requirements, with related rules in section 401(a)(5). Detailed regulations implement the statutory requirements. Governmental plans are generally exempt from these requirements.

⁷¹ Sec. 414(q). At the election of the employer, employees who are highly compensated based on compensation may be limited to the top 20 percent highest paid employees. A nonhighly compensated employee is an employee other than a highly compensated employee.

⁷² A plan or portion of a plan covering collectively bargained employees is generally deemed to satisfy the nondiscrimination requirements.

Minimum coverage requirement

Under the minimum coverage requirement, the plan's coverage of employees must be nondiscriminatory. This is determined by calculating the plan's ratio percentage, that is, the ratio of the percentage of nonhighly compensated employees (of all nonhighly compensated employees in the workforce) covered under the plan over the percentage of highly compensated employees covered. In the case of a section 401(k) plan, the right to make elective deferrals, the right to receive matching contributions, and the allocation of nonelective contributions are each tested separately for nondiscriminatory coverage as though provided under separate plans.

If the plan's ratio percentage is 70 percent or greater, the plan satisfies the minimum coverage requirement. If the plan's ratio percentage is less than 70 percent, a multi-part test applies. First, the plan must cover a group (or "classification") of employees that is reasonable and established under objective business criteria, such as hourly or salaried employees (referred to as a reasonable classification), and the plan's ratio percentage must be at or above a specific level specified in the regulations. In addition, the average benefit percentage test must be satisfied. Under the average benefit percentage test, the average rate of contributions or benefit accruals for all nonhighly compensated employees in the workforce (taking into account all plans of the employer) must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.

General nondiscrimination requirements

Nondiscrimination in the amount of contributions or benefits

There are two general approaches to testing the amount of contributions benefits under a qualified retirement plan:⁷³ (1) design-based safe harbors under which the benefit formula under a defined benefit plan, or the formula for allocating employer nonelective contributions under a defined contribution plan to participants' accounts, satisfies certain uniformity standards; and (2) a mechanical general test under which the distribution of the rates of benefit among highly compensated and nonhighly compensated employees within a plan is tested for nondiscrimination by applying a modified version of the minimum coverage requirement.⁷⁴ The safe harbors and general test may include cross-testing of equivalent accruals or allocations.⁷⁵ A plan is not discriminatory merely because benefit accruals or allocations for highly compensated

⁷³ Treas. Reg. sec. 1.401(a)(4)-1. With respect to the amount of contributions, employee elective deferrals under a section 401(k) plan and employer matching contributions and after-tax employee contributions to a defined contribution plan are subject to special testing rules, rather than being included in applying the general nondiscrimination requirements. In addition, the amount of employer contributions to an ESOP is tested separately from other employer contributions. Rules applicable to benefits, rights and features and the timing of plan amendments are provided in Treas. Reg. secs. 1.401(a)(4)-4 and -5 respectively.

⁷⁴ These approaches are explained in Treas. Reg. secs. 1.401(a)(4)-2 and -3 and -8. Sections 401(a)(5)(C)-(D) and 401(l) and Treas. Reg. secs. 1.401(a)(4)-7 and 1.401(l)-1 through -6 provide rules under which nondiscrimination testing may take into account the employer-paid portion of social security taxes or benefits, referred to as permitted disparity.

⁷⁵ Treas. Reg. sec. 1.401(a)(4)-8

and nonhighly compensated employees are provided as a percentage of compensation (up to \$280,000 for 2019).⁷⁶ Thus, the various testing approaches are generally applied to the amount of contributions or benefits provided as a percentage of compensation (expressed as allocation or accrual rates).

Special nondiscrimination tests for section 401(k) plans

A special annual nondiscrimination test, called the actual deferral percentage test (the “ADP” test) applies to test the amount of elective deferrals under a section 401(k) plan.⁷⁷ The ADP test generally compares the average rate of deferral for highly compensated employees to the average rate of deferral for nonhighly compensated employees. The ADP test allows the average deferral rate for highly compensated employees to exceed that for nonhighly compensated employees within limits: (1) the average deferral rate for highly compensated employees can be up to 125 percent of the average deferral rate for nonhighly compensated employees; or (2) the average deferral rate for highly compensated employees can be two percentage points greater than the average deferral rate for nonhighly compensated employees or, if less, twice the average deferral rate for nonhighly compensated employees. Employer matching contributions and after-tax employee contributions are subject to a similar special nondiscrimination test (the actual contribution percentage test or “ACP test”) which compares the average rate of matching and after-tax contributions to the plan of the two groups.⁷⁸

If the ADP test is not satisfied, a mechanism is provided for the employer to make immediately vested additional contributions for nonhighly compensated employees (and certain other corrections) or to distribute deferrals of highly compensated employees to such employees, so that the ADP test is satisfied. Similar correction mechanisms apply for purposes of satisfying the ACP test.

There are also designed-based safe harbor methods of satisfying the ADP and ACP tests. These safe harbors are based on the premise that, for a 401(k) plan with certain design features with respect to contributions (elective, matching, and nonelective) and enrollment (one of the safe harbors is combined with automatic enrollment), satisfaction of the minimum coverage requirement is a sufficient test of the amount of whether the amount elective deferrals and matching contributions are nondiscriminatory.⁷⁹

⁷⁶ Sec. 401(a)(5)(B).

⁷⁷ Sec. 401(k)(3).

⁷⁸ Sec. 401(m)(2).

⁷⁹ The safe harbors that only require certain matching contributions potentially allow satisfaction of the nondiscrimination requirement with respect to elective and matching contributions under a 401(k) plan for a year even though no contributions are ultimately provided to nonhighly compensated employees under the plan for the year due to a lack of voluntary participation.

Top heavy rules

Top-heavy rules apply to limit the extent to which accumulated benefits or account balances under a qualified retirement plan can be concentrated with key employees.⁸⁰ Whereas the general nondiscrimination requirements are designed to test annual contributions or benefits for highly compensated employees, compared to those of nonhighly compensated employees, the top-heavy rules test the portion of the total plan contributions or benefits that have accumulated for the benefit of key employees as a group. If a plan is top-heavy, minimum contributions or benefits are required for participants who are non-key employees, and, in some cases, faster vesting is required. Non-key employees who have become participants in a defined contribution plan, but who subsequently fail to complete 1,000 hours of service (or the equivalent) for an accrual computation period must receive the top-heavy defined contribution minimum.

For this purpose, a key employee is an officer with annual compensation greater than \$180,000 (for 2019), a five-percent owner, or a one-percent owner with compensation in excess of \$150,000. A defined benefit plan generally is top-heavy if the present value of cumulative accrued benefits for key employees exceeds 60 percent of the cumulative accrued benefits for all employees. A defined contribution plan is top-heavy if the aggregate of accounts for key employees exceeds 60 percent of the aggregate accounts for all employees.

Section 403(b) and governmental 457(b) plans

Tax-deferred annuity plans (referred to as section 403(b) plans) plans are generally similar to qualified defined contribution plans, but may be maintained only by (1) tax-exempt charitable organizations,⁸¹ and (2) educational institutions of State or local governments (that is, public schools, including colleges and universities).⁸² Section 403(b) plans may provide for employees to make elective deferrals (in pretax or designated Roth form), including catch-up contributions, or other after-tax employee contributions, and employers may make nonelective or matching contributions on behalf of employees. Contributions to a section 403(b) plan are generally subject to the same contribution limits applicable to qualified defined contribution plans, including the limits on elective deferrals.

Contributions to a section 403(b) plan must be fully vested. The minimum coverage and general nondiscrimination requirements applicable to a qualified retirement plan generally apply to a section 403(b) plan and to employer matching and nonelective contributions and after-tax

⁸⁰ Secs. 401(a)(10)(B) and 416. The nature of the top-heavy test is such that a plan of a large business with many employees is unlikely to be top-heavy. The top-heavy requirements are therefore viewed as primarily affecting plans of smaller employers in which the owners participate.

⁸¹ These are organizations exempt from tax under section 501(c)(3). Section 403(b) plans of private, tax-exempt employers may be subject to ERISA as well as the requirements of section 403(b).

⁸² Sec. 403(b).

employee contributions to the plan.⁸³ If a section 403(b) plan provides for elective deferrals, the plan is subject to a “universal availability” requirement under which all employees must be given the opportunity to make deferrals of more than \$200. In applying this requirement, nonresident aliens, students, and employees who normally work less than 20 hours per week may be excluded.⁸⁴

An eligible deferred compensation plan of a governmental employer (referred to as a governmental section 457(b) plan) is generally similar to a qualified cash-or deferred arrangement under a section 401(k) plan in that it consists of elective deferrals, that is, contributions (in pretax or designated Roth form) made at the election of an employee, including catch-up contributions. Deferrals under a governmental section 457(b) plan are generally subject to the same limits as elective deferrals under a section 401(k) plan or a section 403(b) plan.

Description of Proposal

The proposal requires a section 401(k) plan to permit an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least three consecutive years and has met the age requirement (age 21) by the end of the three consecutive year period (for this proposal, an employee is referred to as a “long-term part-time employee” after having completed this period of service). Thus, a long-term part-time employee could not be excluded from the plan because the employee has not completed a year of service as defined under the participation requirements described above (a 12-month period with at least 1,000 hours of service). Once a long-term part-time employee meets the age and service requirements, such employee must be able to commence participation no later than the earlier of (1) the first day of the first plan year beginning after the date on which the employee satisfied the age and service requirements or (2) the date 6 months after the date on which the individual satisfied those requirements. Employers may, but are not required to, allow long-term part-time employees to participate in the design based safe harbors (including the automatic enrollment safe harbor). If an employer does permit a long-term part-time employee to participate in such an automatic enrollment 401(k) plan, that employee would have elective deferrals automatically made at the default rate unless the employee affirmatively elects not to make contributions or to make contributions at a different rate.

The proposal does not require a long-term part-time employee to be otherwise eligible to participate in the plan. Thus, the plan can continue to treat a long-term part-time employee as ineligible under the plan for employer nonelective and matching contributions based on not having completed a year of service. However, for a plan that does provide employer contributions for long-term part-time employees, the proposal requires a plan to credit, for each

⁸³ These requirements do not apply to a governmental section 403(b) plan or a section 403(b) plan maintained by a church or a qualified church-controlled organization as defined in section 3121(w).

⁸⁴ For this purpose, nonresident has the meaning in section 410(b)(3)(C), and student has the meaning in section 3121(b)(10). The universal availability requirement does not apply to a section 403(b) plan maintained by a church or a qualified church-controlled organization.

year in which such an employee worked at least 500 hours, a year of service for purposes of vesting in any employer contributions.

With respect to long-term part-time employees, employers would receive nondiscrimination testing relief (similar to the present-law rules for plans covering otherwise excludable employees), including permission to exclude these employees from top-heavy vesting and top-heavy benefit requirements. However, the relief from the nondiscrimination rules ceases to apply to any employee who becomes a full-time employee (as of the first plan year beginning after the plan year in which the employee completes a 12-month period with at least 1,000 hours of service).

This provision does not apply to collectively bargained employees.

Effective Date

The proposal applies to plan years beginning after December 31, 2020, except that for determining whether the three consecutive year period has been met, 12-month periods beginning before January 1, 2021 will not be taken into account.

L. Penalty-Free Withdrawals from Retirement Plans for Individuals in Case of Birth of Child or Adoption

Present Law

Distributions from tax-favored retirement plans

A distribution from a qualified retirement plan, a tax-sheltered annuity plan (a “section 403(b) plan”), an eligible deferred compensation plan of a State or local government employer (a “governmental section 457(b) plan”), or an IRA generally is included in income for the year distributed.⁸⁵ These plans are referred to collectively as “eligible retirement plans.” In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the “early withdrawal tax”) on the amount includible in income.⁸⁶

In general, a distribution from an eligible retirement plan may be rolled over to another eligible retirement plan within 60 days, in which case the amount rolled over generally is not includible in income. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster or other events beyond the reasonable control of the individual.

The terms of a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan generally determine when distributions are permitted. However, in some cases, restrictions may apply to distributions before an employee’s termination of employment, referred to as “in-service” distributions. Despite such restrictions, an in-service distribution may be permitted in the case of financial hardship or an unforeseeable emergency.

Description of Proposal

In general

Under the proposal, an exception to the 10-percent early withdrawal tax applies in the case of a qualified birth or adoption distribution from an applicable eligible retirement plan (as defined). In addition, qualified birth or adoption distributions may be recontributed to an individual’s applicable eligible retirement plans, subject to certain requirements.

⁸⁵ Secs. 401(a), 403(a), 403(b), 457(b) and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

⁸⁶ Sec. 72(t). Under present law, the 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

Distributions from applicable eligible retirement plans

A qualified birth or adoption distribution is a permissible distribution from an applicable eligible retirement plan which, for this purpose, encompasses eligible retirement plans other than defined benefit plans, including qualified retirement plans, section 403(b) plans, governmental section 457(b) plans, and IRAs.⁸⁷

A qualified birth or adoption distribution is a distribution from an applicable eligible retirement plan to an individual if made during the one-year period beginning on the date on which a child of the individual is born or on which the legal adoption by the individual of an eligible adoptee is finalized. An eligible adoptee means any individual (other than a child of the taxpayer's spouse) who has not attained age 18 or is physically or mentally incapable of self-support. The proposal requires the name, age, and taxpayer identification number of the child or eligible adoptee to which any qualified birth or adoption distribution relates to be provided on the tax return of the individual taxpayer for the taxable year.

The maximum aggregate amount which may be treated as qualified birth or adoption distributions by any individual with respect to a birth or adoption is \$5,000. The maximum aggregate amount applies on an individual basis. Therefore, each spouse separately may receive a maximum aggregate amount of \$5,000 of qualified birth or adoption distributions (with respect to a birth or adoption) from applicable eligible retirement plans in which each spouse participates or holds accounts.

An employer plan is not treated as violating any Code requirement merely because it treats a distribution (that would otherwise be a qualified birth or adoption distribution) to an individual as a qualified birth or adoption distribution, provided that the aggregate amount of such distributions to that individual from plans maintained by the employer and members of the employer's controlled group⁸⁸ does not exceed \$5,000. Thus, under such circumstances an employer plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of \$5,000 as a result of distributions from plans of other employers or IRAs.

Recontributions to applicable eligible retirement plans

Generally, any portion of a qualified birth or adoption distribution may, at any time after the date on which the distribution was received, be recontributed to an applicable eligible retirement plan to which a rollover can be made. Such a recontribution is treated as a rollover and thus is not includible in income. If an employer adds the ability for plan participants to receive qualified birth or adoption distributions from a plan, the plan must permit an employee who has received qualified birth or adoption distributions from that plan to recontribute only up to the amount that was distributed from that plan to that employee, provided the employee

⁸⁷ A qualified birth or adoption distribution is subject to income tax withholding unless the recipient elects otherwise. Mandatory 20-percent withholding does not apply.

⁸⁸ The term "controlled group" means any group treated as a single employer under subsection (b), (c), (m), or (o) of section 414.

otherwise is eligible to make contributions (other than recontributions of qualified birth or adoption distributions) to that plan. Any portion of a qualified birth or adoption distribution from an individual's applicable eligible retirement plans (whether employer plans or IRAs) may be recontributed to an IRA held by such an individual which is an applicable eligible retirement plan to which a rollover can be made.

Effective Date

The proposal applies to distributions made after December 31, 2019.

M. Increase in Age for Required Beginning Date for Mandatory Distributions

Present Law

Required minimum distributions

Employer-provided qualified retirement plans, traditional IRAs, and individual retirement annuities are subject to required minimum distribution rules. A qualified retirement plan for this purpose means a tax-qualified plan described in section 401(a) (such as a defined benefit pension plan or a section 401(k) plan), employee retirement annuities described in section 403(a), tax-sheltered annuities described in section 403(b), and a plan described in section 457(b) that is maintained by a governmental employer.⁸⁹ An employer-provided qualified retirement plan that is a defined contribution plan is a plan which provides (1) an individual account for each participant and (2) for benefits based on the amount contributed to the participant's account, and any income, expenses, gains, losses, and forfeitures of accounts of other participants which may be allocated to such participant's account.⁹⁰

Required minimum distributions generally must begin by April 1 of the calendar year following the calendar year in which the individual (employee or IRA owner) reaches age 70½. However, in the case of an employer-provided qualified retirement plan, the required minimum distribution date for an individual who is not a 5-percent owner of the employer maintaining the plan may be delayed to April 1 of the year following the year in which the individual retires if the plan provides for this later distribution date. For all subsequent years, including the year in which the individual was paid the first required minimum distribution by April 1, the individual must take the required minimum distribution by December 31 of the year.

For IRAs and defined contributions plans, the required minimum distribution for each year generally is determined by dividing the account balance as of the end of the prior year by a distribution period,⁹¹ generally a number in the uniform lifetime table.⁹² This table is based on joint life expectancies of the individual and a hypothetical beneficiary 10 years younger than the individual. For an individual with a spouse as designated beneficiary who is more than 10 years younger (and thus the number of years in the couple's joint life expectancy is greater than the uniform life time table), the joint life expectancy of the couple is used. There are special rules in the case of annuity payments from an insurance contract.

If an individual dies on or after the individual's required beginning date, the required minimum distribution is also determined by dividing the account balance as of the end of the

⁸⁹ The required minimum distribution rules also apply to section 457(b) plans maintained by tax-exempt employers other than governmental employers.

⁹⁰ Sec. 414(i).

⁹¹ Treas. Reg. sec. 1.401(a)(9)-5.

⁹² Treas. Reg. sec. 1.401(a)(9)-9.

prior year by a distribution period. The distribution period is equal to the remaining years of the beneficiary's life expectancy or, if there is no designated beneficiary, a distribution period equal to the remaining years of the deceased individual's single life expectancy, using the age of the deceased individual in the year of death.⁹³

In the case of an individual who dies before the individual's required beginning date, there are two methods for satisfying the after death required minimum distribution rules, the life expectancy rule or the five year rule. Under the life expectancy rule, annual required minimum distributions must begin no later than December 31 of the calendar year immediately following the calendar year in which the individual died. This rule is only available if the designated beneficiary is an individual (*e.g.*, not the individual's estate or a charity). If the designated beneficiary is the individual's spouse, commencement of distributions can be delayed until December 31 of the calendar year in which the deceased individual would have attained age 70½. The required minimum distribution for each year is also determined by dividing the account balance as of the end of the prior year by a distribution period, which is determined by reference to the beneficiary's life expectancy.⁹⁴ Under the five-year rule, the individual's entire account must be distributed no later than December 31 of the calendar year containing the fifth anniversary of the individual's death.⁹⁵

A special after-death rule applies for an IRA if the beneficiary of the IRA is the surviving spouse. The surviving spouse is permitted to choose to calculate required minimum distributions while the spouse is alive, and after the spouse's death, as though the spouse is the IRA owner, rather than a beneficiary.

Roth IRAs are not subject to the minimum distribution rules during the IRA owner's lifetime. However, Roth IRAs are subject to the post-death minimum distribution rules that apply to traditional IRAs. For Roth IRAs, the IRA owner is treated as having died before the individual's required beginning date. Thus only the life expectancy rule and the five year rule apply.

Failure to make a required minimum distribution triggers a 50-percent excise tax, payable by the individual or the individual's beneficiary. The tax is imposed during the taxable year that begins with or within the calendar year during which the distribution was required.⁹⁶ The tax may be waived if the distribution did not occur because of reasonable error and reasonable steps are taken to remedy the violation.⁹⁷

⁹³ Treas. Reg. sec. 1.401(a)(9)-5, A-5(a).

⁹⁴ Treas. Reg. sec. 1.401(a)(9)-5, A-5(b).

⁹⁵ Treas. Reg. sec. 1.401(a)(9)-3, Q&As 1, 2.

⁹⁶ Sec. 4974(a).

⁹⁷ Sec. 4974(d).

Eligible rollover distributions

With certain exceptions, distributions from an employer-provided qualified retirement plan are eligible to be rolled over tax free into another employer-provided qualified retirement plan or an IRA. This can be achieved by contributing the amount of the distribution to the other plan or IRA within 60 days of the distribution, or by a direct payment by the plan to the other plan or IRA (referred to as a “direct rollover”). Distributions that are not eligible for rollover include (i) any distribution that is one of a series of periodic payments generally for a period of 10 years or more (or, if a shorter period, certain life expectancies) and (ii) any distribution to the extent that the distribution is a required minimum distribution.⁹⁸

For any distribution that is eligible for rollover, an employer-provided tax-qualified retirement plan must offer the distributee the right to have the distribution made in a direct rollover⁹⁹ and, before making the distribution, the plan administrator must provide the distributee with a written explanation of the direct rollover right and related tax consequences.¹⁰⁰ If a distributee does not choose to have the distribution made in a direct rollover, the distribution is generally subject to mandatory 20-percent income tax withholding.¹⁰¹

Description of Proposal

The proposal changes the age on which the required beginning date for required minimum distributions is based, from the calendar year in which the employee or IRA owner attains 70½ years to the calendar year in which the employee or IRA owner attains 72 years. Under the proposal, present law continues to apply to employees and IRA owners who attain age 70½ prior to January 1, 2020.

In addition, the present law requirement to actuarially adjust an employee’s accrued benefit for an employee who retires in a calendar year after the year the employee attains age 70½, to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan, is not changed.

Effective Date

The proposal is effective for distributions required to be made after December 31, 2019, for employees and IRA owners who attain age 70½ after December 31, 2019.

⁹⁸ Sec. 402(c)(4). Distributions that are not eligible rollover distributions also include distributions made upon hardship of the employee and any qualified disaster relief distribution (within the meaning of section 72(t)(2)(G)).

⁹⁹ Sec. 401(a)(31)

¹⁰⁰ Sec. 402(f).

¹⁰¹ Sec. 3405(c). This mandatory withholding does not apply to a distributee that is a beneficiary other than a surviving spouse of an employee.

N. Election to Apply Alternative Minimum Funding Standards to Certain Single-Employer Community Newspaper Plans

Present Law

The Internal Revenue Code of 1986 (“Code”) and the Employee Retirement Income Security Act of 1974 (“ERISA”) apply minimum funding requirements¹⁰² to defined benefit retirement plans maintained by private-sector employers for their employees (referred to as “single-employer” plans), for purposes of which employers that are members of a controlled group are considered a single employer.

Under these rules, a minimum contribution is required for a plan year if the value of the plan’s assets is less than the plan’s “funding target,” that is, the present value, determined actuarially, of all benefits earned as of the beginning of the year. If the value of plan assets is less than the plan’s funding target, such that the plan has a funding shortfall, the shortfall is generally required to be funded by contributions, with interest, over seven years, taking into account the remaining installments attributable to shortfalls from preceding years. In addition, if participants earn additional benefits for the year,¹⁰³ the required contribution must include the amount of the plan’s “target normal cost,” that is, the present value, determined actuarially, of benefits expected to be earned for the year. In the case of a plan funded below a certain level, referred to as an “at-risk” plan, specified assumptions must be used in determining the plan’s funding target and target normal cost.¹⁰⁴

¹⁰² Special funding rules may apply to certain categories of single-employer plans. For example, special rules apply to certain plans maintained by commercial passenger airlines, under section 402 of the Pension Protection Act of 2006 (“PPA”), Pub. L. No. 109-280. If an election is made by a commercial passenger airline described in section 402(a)(1) of PPA, then in determining the plan’s minimum required contribution under section 430, the airline may use an interest rate of 8.85% to amortize the unfunded liability of the plan in equal installments over the remaining part of the 17-year amortization period. See Treas. Reg. sec. 1.430(a)-1(b)(4)(ii).

¹⁰³ In some cases, a plan may be “frozen” as to service and/or compensation. When a plan is frozen with respect to both service and compensation, participants are entitled to previously earned benefits but do not accrue or earn additional benefits.

¹⁰⁴ For an at-risk plan, the specified assumptions generally are as follows: All employees who are not otherwise assumed to retire as of the valuation date but who will be eligible to elect benefits during the plan year and the next 10 plan years must be assumed to retire at the earliest retirement date under the plan but not before the end of the plan year for which the “at-risk funding target” and “at-risk normal cost” are being determined. Also, all employees must be assumed to elect the retirement benefit available under the plan at the assumed retirement age (determined as above) that would result in the highest present value of benefits. The at-risk funding target is the present value of all benefits accrued or earned under the plan as of the beginning of the plan year using the actuarial assumptions set forth in the Code and regulations for single-employer plans, with the addition of a loading factor which arises when the plan has been in at-risk status for at least two of the four preceding plan years. This loading factor is equal to the sum of (1) \$700 multiplied by the number of participants in the plan and (2) four percent of the funding target (determined without regard to the definition of at-risk funding target). The at-risk normal cost for a plan year generally represents the excess of the sum of (1) the present value of all benefits which are expected to accrue or to be earned under the plan during the plan year using the at-risk assumptions described above plus (2) the amount of plan related expenses expected to be paid from plan assets during the plan year, over (3) the amount of mandatory employee contributions expected to be made during the plan year. In addition, where the plan has been in at-risk status for at least two of the four preceding plan years, a loading factor is added, which is equal to four

The minimum funding rules enacted in the Pension Protection Act of 2006 (“PPA”)¹⁰⁵ specify the interest rates used to determine a plan’s funding target and target normal cost for a year, consisting of three “segment” rates, each of which applies to benefit payments expected to be made from the plan during a certain period.¹⁰⁶ The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the year; the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period. The first, second, and third segment rates are based on the corresponding portion of a corporate bond yield curve with certain adjustments.

Under the Moving Ahead for Progress in the 21st Century Act,¹⁰⁷ for plan years beginning after December 31, 2011, a segment rate determined under the PPA rules is adjusted if it falls outside a specified percentage range of the average segment rates for a preceding period. In particular, if a segment rate determined under the PPA rules is less than the applicable minimum percentage in the specified range, the segment rate is adjusted upward to match the minimum percentage. If a segment rate determined under the PPA rules is more than the applicable maximum percentage in the specified range, the segment rate is adjusted downward to match the maximum percentage.

The specified percentage range (that is, the range from the applicable minimum percentage to the applicable maximum percentage of average segment rates), as most recently modified in the Bipartisan Budget Act of 2015,¹⁰⁸ for determining whether a segment rate must

percent of the target normal cost (the excess of the sum of (1) the present value of all benefits which are expected to accrue or to be earned under the plan during the plan year plus (2) the amount of plan-related expenses expected to be paid from plan assets during the plan year, over (3) the amount of mandatory employee contributions expected to be made during the plan year) with respect to the plan for the plan year.

¹⁰⁵ Pub. L. No. 109-280.

¹⁰⁶ Each segment rate is a single interest rate determined monthly by the Secretary of the Treasury, on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The corporate bond yield curve used for this purpose reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. Solely for purposes of determining minimum required contributions, in lieu of the segment rates, an employer may elect to use interest rates on a yield curve based on the yields on investment grade corporate bonds for the month preceding the month in which the plan year begins (that is, without regard to the 24-month averaging described above) (“monthly yield curve”). If an election to use a monthly yield curve is made, it cannot be revoked without Internal Revenue Service approval.

¹⁰⁷ Pub. L. No. 112-141. The Highway Transportation and Funding Act of 2014 (Pub. L. No. 113-159) made changes to the applicable minimum and maximum percentage ranges for determining whether a segment rate must be adjusted upward or downward, as well as the periods for determining such segment rates.

¹⁰⁸ Pub. L. No. 114-74.

be adjusted upward or downward for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012 through 2020,
- 85 percent to 115 percent for 2021,
- 80 percent to 120 percent for 2022,
- 75 percent to 125 percent for 2023, and
- 70 percent to 130 percent for 2024 or later.

For February 2019, the first, second, and third segment rates after adjustment are 3.01 percent, 4.11 percent, and 4.41 percent, respectively.¹⁰⁹

Description of Proposal

Under the proposal, an employer maintaining a “community newspaper plan” (as defined below) under which no participant has had the participant’s accrued benefit increased (whether because of service or compensation) after December 31, 2017, may elect to apply certain alternative funding rules to the plan and any other plan sponsored by any member of the controlled group (determined as of the date of enactment).¹¹⁰ An election under the proposal to apply the alternative funding rules is to be made at such time and in such manner as prescribed by the Secretary of the Treasury, and once made with respect to a plan year, applies to all subsequent years unless revoked with the consent of the Secretary of the Treasury.

Under the alternative funding rules, an interest rate of eight percent is used to determine a plan’s funding target and target normal cost, rather than the first, second, and third segment rates. However, if new benefits are accrued or earned under a plan for a plan year in which the election is in effect, the present value of such benefits must be determined on the basis of the U.S. Treasury obligation yield curve for the day that is the valuation date of such plan for such plan year. In addition, if the value of plan assets is less than the plan’s funding target, such that the plan has a funding shortfall, the shortfall is required to be funded by contributions, with interest, over 30 years, rather than over seven years. The shortfall amortization bases determined¹¹¹ for all plan years preceding the first plan year to which the election applies (and all related shortfall amortization installments) are reduced to zero. Further, the assumptions applicable to an “at-risk” plan do not apply.

Under the proposal, a “community newspaper plan” is a plan to which the new proposal applies, which is maintained by an employer that, as of December 31, 2017,

¹⁰⁹ Notice 2019-21, 2019-14 I.R.B. These rates are determined and published monthly by the Internal Revenue Service by notice and on its website. See <https://www.irs.gov/retirement-plans/minimum-present-value-segment-rates>.

¹¹⁰ For this purpose, the controlled group means all persons treated as a single employer under subsection (b), (c), (m), or (o) of section 414 as of the date of enactment.

¹¹¹ Under section 430(c)(3).

- publishes and distributes daily, either electronically or in printed form, one or more community newspapers (as defined below) in a single State,
- is not a company the stock of which is publicly traded on a stock exchange or in an over-the-counter market, and is not controlled, directly or indirectly, by such a company,
- is controlled, directly or indirectly (a) by one or more persons residing primarily in the State in which the community newspaper is published; (b) for at least 30 years by individuals who are members of the same family; (c) by a trust created or organized in the State in which the community newspaper is published, the sole trustees of which are persons described in (a) or (b); (d) by an entity described in section 501(c)(3) and exempt from tax under code section 501(a) that is organized and operated in the State in which the community newspaper is published, and the primary purpose of which is to benefit communities in the State; or (e) by a combination of persons described in (a), (c), or (d), and
- does not control, directly or indirectly, any newspaper in any other State.

A “community newspaper” means a newspaper that primarily serves a metropolitan statistical area, as determined by the Office of Management and Budget, with a population of not less than 100,000. For purposes of the proposal, a person (the “first” person) is treated as controlled by another person if the other person possesses, directly or indirectly, the power to direct or cause the direction and management of the first person (including the power to elect a majority of the members of the board of directors of the first person) through the ownership of voting securities.

The proposal makes the above-described amendments to both the Code and ERISA.¹¹²

Effective Date

The proposal applies the amendments to plan years ending after December 31, 2017.

¹¹² The proposal adds a new subsection (m) to section 430, and a new subsection (m) to section 303 of ERISA. However, the term community newspaper plan for ERISA purposes includes one that publishes and distributes daily, either electronically or in printed form, either a community newspaper or one or more community newspapers in the same State. Additionally, in the case of a community newspaper plan to which the election has been made, the proposal does not change the basis for calculating underfunding for purposes of Pension Benefit Guaranty Corporation variable rate premiums.

O. Treating Excluded Difficulty of Care Payments as Compensation for Determining Retirement Contribution Limitations

Present Law

Difficulty of care payments

Gross income does not include amounts received by a foster care provider during the taxable year as qualified foster care payments.¹¹³ Qualified foster care payments include any payment made pursuant to a foster care program of a State or political subdivision which is paid by (1) a State or political subdivision thereof or (2) a qualified foster care placement agency, and which is either (1) paid to the foster care provider for caring for a qualified foster individual in the foster care provider's home, or (2) a "difficulty of care" payment.¹¹⁴ A "qualified foster individual" is any individual who is living in a foster family home in which the individual was placed by either an agency of a State (or a political subdivision thereof) or a qualified foster care placement agency.¹¹⁵ A qualified foster care placement agency is any placement agency which is licensed or certified by a State (or political subdivision thereof) or an entity designated by a State (or political subdivision thereof).¹¹⁶

A "difficulty of care" payment is compensation for providing the additional care needed for certain qualified foster individuals. Such payments are provided when a qualified foster individual has a physical, mental or emotional disability for which the State has determined that (1) there is a need for additional compensation to care for the individual, (2) the care is provided in the home of the foster care provider, and (3) the payments are designated by the payor as compensation for such purpose.¹¹⁷ An applicant must request an assessment of need from the State agency administering the program and submit a medical evaluation which is reassessed every year.

In the case of a tax-qualified defined contribution plan, such a plan will not satisfy the tax qualification requirements unless contributions made by a participant to the plan (as well as other additions such as employer contributions and forfeitures) do not exceed the lesser of (1) \$40,000 or (2) 100 percent of the participant's compensation.¹¹⁸ A participant's compensation is defined

¹¹³ Sec. 131(a)

¹¹⁴ Sec. 131(b)(1).

¹¹⁵ Sec. 131(b)(2).

¹¹⁶ Sec. 131(b)(3).

¹¹⁷ Pursuant to section 131(c)(2), in the case of any foster home, difficulty of care payments for any period to which such payments relate are not excludable from gross income to the extent such payments are made for more than 10 qualified foster individuals who have not attained age 19 and five qualified foster individuals who have attained age 19.

¹¹⁸ Sec. 415(c)(1).

generally as the compensation of the participant from the employer for the year.¹¹⁹ A special rule applies for self-employed individuals providing that a participant's compensation is the participant's earned income.¹²⁰ Similar rules apply for contributions made to an individual retirement account.¹²¹

Since "difficulty of care" payments are excluded from gross income, home healthcare workers receiving only such payments are unable to participate in tax-qualified retirement plans or individual retirement accounts because "difficulty of care" payments are not considered compensation or earnings upon which contributions to such plans or accounts may be made.

Description of Proposal

The proposal amends sections 415(c)(3) and 408(o) to increase the contribution limit to qualified retirement plans and individual retirement accounts to include "difficulty of care" payments.

Effective Date

The proposal applies to contributions to individual retirement accounts made after the date of enactment of the Act and to defined contribution plans for plan years beginning after December 31, 2015.

¹¹⁹ Sec. 415(c)(3)(A).

¹²⁰ Sec. 415(c)(3)(B).

¹²¹ See secs. 219, 408 and 408A.

TITLE II – ADMINISTRATIVE IMPROVEMENTS

A. Plan Adopted by Filing Due Date for Year May be Treated as in Effect as of Close of Year

Present Law

In order for a qualified retirement plan to be treated as maintained for a taxable year, the plan must be adopted by the last day of the taxable year.¹²² However, the trust under the plan will not fail to be treated as in existence due to lack of corpus merely because it holds no assets on the last day of the taxable year.¹²³ Contributions made by the due date (plus extensions) of the tax return for the employer maintaining the plan for a taxable year are treated as contributed on account of that taxable year.¹²⁴ Thus a plan can be established on the last day of a taxable year even though the first contribution is not made until the due date of the employer's return of tax for the taxable year. Further, if the terms of a plan adopted during an employer's taxable year fail to satisfy the qualification requirements that apply to the plan for the year, the plan may also be amended retroactively by the due date (including extensions) of the employer's return, provided that the amendment is made retroactively effective.¹²⁵ However, this provision does not allow a plan to be adopted after the end of a taxable year and made retroactively effective, for qualification purposes, for the taxable year prior to the taxable year in which the plan was adopted by the employer.¹²⁶

Description of Proposal

Under the proposal, if an employer adopts a qualified retirement plan after the close of a taxable year but before the time prescribed by law for filing the return of tax of the employer for the taxable year (including extensions thereof), the employer may elect to treat the plan as having been adopted as of the last day of the taxable year.

The proposal does not override rules requiring certain plan provisions to be in effect during a plan year, such as the provision for elective deferrals under a qualified cash or deferral arrangement ("generally referred to as a 401(k) plan").¹²⁷

¹²² Rev. Rul. 76-28, 1976-1 C.B. 106.

¹²³ Rev. Rul. 81-114, 1981-1 C.B. 207.

¹²⁴ Sec. 404(a)(6).

¹²⁵ Sec. 401(b).

¹²⁶ Treas. Reg. sec. 1.401(b)-1(a).

¹²⁷ Treas. Reg. sec. 1.401(k)-1(e)(2)(ii).

Effective Date

The proposal applies to plans adopted for taxable years beginning after December 31, 2019.

B. Combined Annual Report for Group of Plans

Present Law

Under the Code, an employer maintaining a qualified retirement plan generally is required to file an annual return containing information required under regulations with respect to the qualification, financial condition, and operation of the plan.¹²⁸ ERISA requires the plan administrator of certain pension and welfare benefit plans to file annual reports disclosing certain information to the Department of Labor (“DOL”).¹²⁹ These filing requirements are met by filing a completed Form 5500, Annual Return/Report of Employee Benefit Plan. Forms 5500 are filed with DOL, and information from Forms 5500 is shared with the IRS.¹³⁰ A separate Form 5500 is required for each plan.¹³¹

Description of Proposal

The proposal directs the IRS and DOL to work together to modify Form 5500 so that all members of a group of plans described below may file a single consolidated Form 5500. In developing the consolidated Form 5500, IRS and DOL may require it to include all information for each plan in the group as IRS and DOL determine is necessary or appropriate for the enforcement and administration of the Code and ERISA.¹³²

For purposes of the proposal, a group of plans is eligible for a consolidated Form 5500 if all the plans in the group (1) are defined contribution plans, (2) have the same trustee, the same named fiduciary (or named fiduciaries) under ERISA, and the same administrator, (3) use the

¹²⁸ Sec. 6058. In addition, under section 6059, the plan administrator of a defined benefit plan subject to the minimum funding requirements is required to file an annual actuarial report. Under Code section 414(g) and ERISA section 3(16), plan administrator generally means the person specifically so designated by the terms of the plan document. In the absence of a designation, the plan administrator generally is (1) in the case of a plan maintained by a single employer, the employer, (2) in the case of a plan maintained by an employee organization, the employee organization, or (3) 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 that maintain the plan. Under ERISA, the party described in (1), (2) or (3) is referred to as the “plan sponsor.”

¹²⁹ ERISA secs. 103 and 104. Under ERISA section 4065, the plan administrator of certain defined benefit plans must provide information to the PBGC.

¹³⁰ Information is shared also with the PBGC, as applicable. Form 5500 filings are also publicly released in accordance with section 6104(b) and Treas. Reg. sec. 301.6104(b)-1 and ERISA secs. 104(a)(1) and 106(a).

¹³¹ Under section 6011(a) and (e), the IRS is required to provide standards for electronically filed returns, but may not require a person to file a return electronically unless the person is required to file at least 250 returns during the calendar year (“250 return threshold for electronic filing”). Under Treas. Reg. sec. 301.6058-2, Form 5500 for a plan year must be filed electronically if the filer is required to file at least 250 tax returns (including information returns) during the calendar year that includes the first day of the plan year.

¹³² Under the proposal, for purposes of applying the 250 return threshold for electronic filing to Forms 5500 for plan years beginning after December 31, 2019, information regarding each plan for which information is provided on the Form 5500 is treated as a separate return.

same plan year, and (4) provide the same investments or investment options to participants and beneficiaries. A plan not subject to ERISA may be included in the group if the same person that performs each of the previous functions, as applicable, for all the other plans in the group performs each of the functions for the plan not subject to ERISA.

Effective Date

The consolidated Form 5500 is to be implemented not later than January 1, 2022, and shall be effective for returns and reports for plan years beginning after December 31, 2021.

C. Disclosure Regarding Lifetime Income

Present Law

ERISA requires the administrator of a defined contribution plan to provide benefit statements to participants.¹³³ In the case of a participant who has the right to direct the investment of the assets in his or her account, a benefit statement must be provided at least quarterly. Benefit statements must be provided at least annually to other participants.

Among other items, a benefit statement provided with respect to a defined contribution plan generally must include (1) the participant's total benefits accrued, that is, the participant's account balance, (2) the vested portion of the account balance or the earliest date on which the account balance will become vested, and (3) the value of each investment to which assets in the participant's account are allocated. A quarterly benefit statement provided to a participant who has the right to direct investments must provide additional information, including information relating to investment principles.

In May 2013, the Department of Labor issued an advance notice of proposed rulemaking providing rules under which a benefit provided to a defined contribution plan participant would include an estimated lifetime income stream of payments based on the participant's account balance.¹³⁴ However, information about lifetime income that might be provided by funds in a defined contribution plan is not currently required to be included in a benefit statement.

Description of Proposal

The proposal requires a benefit statement provided to a defined contribution plan participant to include a lifetime income disclosure as described in the proposal. However, the lifetime income disclosure is required to be included in only one benefit statement during any 12-month period.

A lifetime income disclosure is required to set forth the lifetime income stream equivalent of the participant's total account balance under the plan. The lifetime income stream equivalent to the account balance is the amount of monthly payments the participant would receive if the total account balance were used to provide lifetime income streams, based on assumptions specified in guidance prescribed by the Secretary of Labor (referred to as the "Secretary" in this explanation). The required lifetime income streams are (1) a qualified joint and survivor annuity for the participant and the participant's surviving spouse, based on assumptions specified in guidance, including the assumption that the participant has a spouse of equal age, and (2) a single life annuity. The lifetime income streams may have a term certain or other features to the extent permitted under guidance.

¹³³ ERISA sec. 105. Benefits statements are required also with respect to defined benefit plans. A civil penalty may apply for a failure to provide a required benefit statement.

¹³⁴ 78 Fed. Reg. 26727 (May 8, 2013).

The Secretary is directed to issue, not later than a year after the proposal is enacted, a model lifetime income disclosure, written in a manner to be understood by the average plan participant. The model must include provisions to (1) explain that the lifetime income stream equivalent is only provided as an illustration, (2) explain that the actual payments under the lifetime income stream that may be purchased with the account balance will depend on numerous factors and may vary substantially from the lifetime income stream equivalent in the disclosure, (3) explain the assumptions on which the lifetime income stream equivalent is determined, and (4) provides other similar explanations as the Secretary considers appropriate.

In addition, the Secretary is directed, not later than a year after the proposal is enacted, (1) to prescribe assumptions that defined contribution plan administrators may use in converting account balances into lifetime income stream equivalents, and (2) issue interim final rules under the provision. In prescribing assumptions, the Secretary may prescribe a single set of specific assumptions (in which case the Secretary may issue tables or factors that facilitate conversions of account balances) or ranges of permissible assumptions. To the extent that an account balance is or may be invested in a lifetime income stream, the prescribed assumptions are to allow, to the extent appropriate, plan administrators to use the amounts payable under the lifetime income stream as a lifetime income stream equivalent.

Under the proposal, no plan fiduciary, plan sponsor, or other person has any liability under ERISA solely by reason of the provision of lifetime income stream equivalents that are derived in accordance with the assumptions and guidance under the proposal and that include the explanations contained in model disclosure. This protection applies without regard to whether the lifetime income stream equivalent is required to be provided.

Effective Date

The requirement to provide a lifetime income disclosure applies with respect to benefit statements provided more than 12 months after the latest of the issuance by the Secretary of (1) interim final rules, (2) the model disclosure, or (3) prescribed assumptions.

D. Fiduciary Safe Harbor for Selection of Lifetime Income Provider

Present Law

ERISA imposes certain standards of care with respect to the actions of a plan fiduciary. Specifically, a fiduciary is required to discharge its duties with respect to the plan solely in the interest of the participants and beneficiaries, for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable administration expenses of the plan, with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with relevant matters would use in the conduct of an enterprise of a like character and with like aims (the “prudent man” requirement), by diversifying plan investments so as to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so, and in accordance with plan documents and governing instruments insofar as the documents and instruments are consistent with ERISA.

Department of Labor regulations provide a safe harbor for a fiduciary to satisfy the prudent man requirement in selecting an annuity provider and a contract for benefit distributions from a defined contribution plan.¹³⁵

Description of Proposal

The proposal specifies measures that a plan fiduciary may take with respect to the selection of an insurer and a guaranteed retirement income contract in order to assure that the fiduciary meets the prudent man requirement. The measures under the proposal are an optional means by which a fiduciary will be considered to satisfy the prudent man requirement with respect to the selection of insurers and guaranteed retirement income contracts and do not establish minimum requirements or the exclusive means for satisfying the prudent man requirement.

For purposes of the proposal, an insurer is an insurance company, insurance service or insurance organization qualified to do business in a State and includes affiliates of those entities to the extent the affiliate is licensed to offer guaranteed retirement income contracts. A guaranteed retirement income contract is an annuity contract for a fixed term or a contract (or provision or feature thereof) designed to provide a participant guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or joint lives of the participant and the participant's designated beneficiary as part of a defined contribution plan.

With respect to the selection of an insurer and a guaranteed retirement income contract (as defined below), the prudent man requirement will be deemed met if a fiduciary—

- engages in an objective, thorough and analytical search for the purpose of identifying insurers from which to purchase guaranteed retirement income contracts,
- with respect to each insurer identified through the search, considers the financial capability of the insurer to satisfy its obligations under the guaranteed retirement

¹³⁵ 29 C.F.R. sec. 2550.404a-4.

income contract and considers the cost (including fees and commissions) of the guaranteed retirement income contract offered by the insurer in relation to the benefits and product features of the contract and administrative services to be provided under the contract, and

- on the basis of the foregoing, concludes that, at the time of the selection (as described below), the insurer is financially capable of satisfying its obligations under the guaranteed retirement income contract and that the cost (including fees and commissions) of the selected guaranteed retirement income contract is reasonable in relation to the benefits and product features of the contract and the administrative services to be provided under the contract.

A fiduciary will be deemed to satisfy the requirements above with respect to the financial capability of the insurer if—

- the fiduciary obtains written representations from the insurer that it is licensed to offer guaranteed retirement income contracts; that the insurer, at the time of selection and for each of the immediately preceding seven years operates under a certificate of authority from the Insurance Commissioner of its domiciliary State that has not been revoked or suspended, has filed audited financial statements in accordance with the laws of its domiciliary State under applicable statutory accounting principles, maintains (and has maintained) reserves that satisfy all the statutory requirements of all States where the insurer does business, and is not operating under an order of supervision, rehabilitation, or liquidation; and that the insurer undergoes, at least every five years, a financial examination (within the meaning of the law of its domiciliary State) by the Insurance Commissioner of the domiciliary State (or representative, designee, or other party approved thereby);
- in the case that, following the issuance of the insurer representations described above, there is any change that would preclude the insurer from making the same representations at the time of issuance of the guaranteed retirement income contract, the insurer is required to notify the fiduciary, in advance of the issuance of any guaranteed retirement income contract, that the fiduciary can no longer rely on one or more of the representations; and
- the fiduciary has not received such a notification and has no other facts that would cause it to question the insurer representations.

The proposal specifies that nothing in these requirements is to be construed to require a fiduciary to select the lowest cost contract. Accordingly, a fiduciary may consider the value, including features and benefits of the contract and attributes of the insurer in conjunction with the contract's cost. For this purpose, attributes of the insurer that may be considered include, without limitation, the issuer's financial strength.

For purposes of the proposal, the time of selection may be either the time that the insurer and contract are selected for distribution of benefits to a specific participant or beneficiary or the time that the insurer and contract are selected to provide benefits at future dates to participants or beneficiaries, provided that the selecting fiduciary periodically reviews the continuing

appropriateness of its conclusions with respect to the insurer's financial capability and cost, taking into account the considerations described above.¹³⁶ A fiduciary will be deemed to have conducted a periodic review of the financial capability of the insurer if the fiduciary obtains the written representations described above on an annual basis unless, in the interim, the fiduciary has received notification from the insurer that representations cannot be relied on or the fiduciary otherwise becomes aware of facts that would cause it to question the representations.

A fiduciary that satisfies the requirements of the proposal is not liable following the distribution of any benefit, or the investment by or on behalf of a participant or beneficiary pursuant to the selected guaranteed retirement income contract, for any losses that may result to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of the contract.

Effective Date

The proposal is effective on the date of enactment.

¹³⁶ However, a fiduciary is not required to review the appropriateness of its conclusions following the purchase of any contract or contracts for specific participants or beneficiaries.

E. Modification of Nondiscrimination Rules to Protect Older, Longer Service Participants

Present Law

In general

Qualified retirement plans are subject to nondiscrimination requirements, under which the group of employees covered by a plan (“plan coverage”) and the contributions or benefits provided to employees, including benefits, rights, and features under the plan, must not discriminate in favor of highly compensated employees.¹³⁷ The timing of plan amendments must also not have the effect of discriminating significantly in favor of highly compensated employees. In addition, in the case of a defined benefit plan, the plan must benefit at least the lesser of (1) 50 employees of the employer, or (2) the greater of (a) 40 percent of all employees of the employer or (b) two employees (or one employee if there is only one employee), referred to as the “minimum participation” requirements.¹³⁸ These requirements are designed to help ensure that qualified retirement plans achieve the goal of retirement security for both lower and higher paid employees.

For nondiscrimination purposes, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of \$125,000 (for 2019).¹³⁹ Employees who are not highly compensated are referred to as nonhighly compensated employees.

Nondiscriminatory plan coverage

Whether plan coverage of employees is nondiscriminatory is determined by calculating a plan’s ratio percentage, that is, the ratio of the percentage of nonhighly compensated employees covered under the plan to the percentage of highly compensated employees covered. For this purpose, certain portions of a defined contribution plan are treated as separate plans to which the plan coverage requirements are applied separately, referred to as mandatory disaggregation. Specifically, the following, if provided under a plan, are treated as separate plans: the portion of a plan consisting of employee elective deferrals, the portion consisting of employer matching contributions, the portion consisting of employer nonelective contributions, and the portion

¹³⁷ Secs. 401(a)(3)-(5) and 410(b). Detailed rules are provided in Treas. Reg. secs. 1.401(a)(4)-1 through -13 and secs. 1.410(b)-2 through -10. In applying the nondiscrimination requirements, certain employees, such as those under age 21 or with less than a year of service, generally may be disregarded. In addition, employees of controlled groups and affiliated service groups under the aggregation rules of section 414(b), (c), (m) and (o) are treated as employed by a single employer.

¹³⁸ Sec. 401(a)(26).

¹³⁹ Section 414(q). At the election of the employer, employees who are highly compensated based on the amount of their compensation may be limited to employees who were among the top 20 percent of employees based on compensation.

consisting of an employee stock ownership plan (“ESOP”).¹⁴⁰ Subject to mandatory disaggregation, different qualified retirement plans may otherwise be aggregated and tested together as a single plan, provided that they use the same plan year. The plan determined under these rules for plan coverage purposes generally is also treated as the plan for purposes of applying the other nondiscrimination requirements.

A plan’s coverage is nondiscriminatory if the ratio percentage, as determined above, is 70 percent or greater. If a plan’s ratio percentage is less than 70 percent, a multi-part test applies, referred to as the average benefit test. First, the plan must meet a “nondiscriminatory classification requirement,” that is, it must cover a group of employees that is reasonable and established under objective business criteria and the plan’s ratio percentage must be at or above a level specified in the regulations, which varies depending on the percentage of nonhighly compensated employees in the employer’s workforce. In addition, the average benefit percentage test must be satisfied.

Under the average benefit percentage test, in general, the average rate of employer-provided contributions or benefit accruals for all nonhighly compensated employees under all plans of the employer must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.¹⁴¹ In applying the average benefit percentage test, elective deferrals made by employees, as well as employer matching and nonelective contributions, are taken into account. Generally, all plans maintained by the employer are taken into account, including ESOPs, regardless of whether plans use the same plan year.

Under a transition rule applicable in the case of the acquisition or disposition of a business, or portion of a business, or a similar transaction, a plan that satisfied the plan coverage requirements before the transaction is deemed to continue to satisfy them for a period after the

¹⁴⁰ Elective deferrals are contributions that an employee elects to have made to a defined contribution plan that includes a qualified cash or deferred arrangement (a section 401(k) plan) rather than receive the same amount as current compensation. Employer matching contributions are contributions made by an employer only if an employee makes elective deferrals or after-tax employee contributions. Employer nonelective contributions are contributions made by an employer regardless of whether an employee makes elective deferrals or after-tax employee contributions. Under section 4975(e)(7), an ESOP is a defined contribution plan, or portion of a defined contribution plan, that is designated as an ESOP and is designed to invest primarily in employer stock.

¹⁴¹ Contribution and benefit rates are generally determined under the rules for nondiscriminatory contributions or benefit accruals, described below. These rules are generally based on benefit accruals under a defined benefit plan, other than accruals attributable to after-tax employee contributions, and contributions allocated to participants’ accounts under a defined contribution plan, other than allocations attributable to after-tax employee contributions. (Under these rules, contributions allocated to participants’ accounts are referred to as “allocations,” with the related rates referred to as “allocation rates,” but “contribution rates” is used herein for convenience.) However, as discussed below, benefit accruals can be converted to actuarially equivalent contributions, and contributions can be converted to actuarially equivalent benefit accruals.

transaction,¹⁴² provided coverage under the plan is not significantly changed during that period.¹⁴³

Nondiscriminatory contributions or benefit accruals

In general

There are three general approaches to testing the amount of benefits under qualified retirement plans: (1) design-based safe harbors under which the plan's contribution or benefit accrual formula satisfies certain uniformity standards, (2) a general test, described below, and (3) cross-testing of equivalent contributions or benefit accruals. Employee elective deferrals and employer matching contributions under defined contribution plans are subject to special testing rules and generally are not permitted to be taken into account in determining whether other contributions or benefits are nondiscriminatory.¹⁴⁴

The nondiscrimination rules allow contributions and benefit accruals to be provided to highly compensated and nonhighly compensated employees at the same percentage of compensation.¹⁴⁵ Thus, the various testing approaches described below are generally applied to the amount of contributions or accruals provided as a percentage of compensation, referred to as a contribution rate or accrual rate. In addition, under the "permitted disparity" rules, in calculating an employee's contribution or accrual rate, credit may be given for the employer paid portion of Social Security taxes or benefits.¹⁴⁶ The permitted disparity rules do not apply in testing whether elective deferrals, matching contributions, or ESOP contributions are nondiscriminatory.

The general test is generally satisfied by measuring the rate of contribution or benefit accrual for each highly compensated employee to determine if the group of employees with the same or higher rate (a "rate" group) is a nondiscriminatory group, using the nondiscriminatory plan coverage standards described above. For this purpose, if the ratio percentage of a rate group is less than 70 percent, a simplified standard applies, which includes disregarding the reasonable classification requirement, but requires satisfaction of the average benefit percentage test.

¹⁴² It is for the period beginning on date of the transaction and ending on the last day of the first plan year beginning after the date of the transaction.

¹⁴³ Sec. 410(b)(6)(C).

¹⁴⁴ Secs. 401(k) and (m), the latter of which applies also to after-tax employee contributions under a defined contribution plan.

¹⁴⁵ For this purpose, under section 401(a)(17), annual compensation generally is limited to \$280,000 per year (for 2019).

¹⁴⁶ See sections 401(a)(5)(C) and (D) and 401(l) and Treas. Reg. section 1.401(a)(4)-7 and 1.401(l)-1 through -6 for rules for determining the amount of contributions or benefits that can be attributed to the employer-paid portion of Social Security taxes or benefits.

Cross-testing

Cross-testing involves the conversion of contributions under a defined contribution plan or benefit accruals under a defined benefit plan to actuarially equivalent accruals or contributions, with the resulting equivalencies tested under the general test. However, employee elective deferrals and employer matching contributions under defined contribution plans are not permitted to be taken into account for this purpose, and cross-testing of contributions under a defined contribution plan, or cross-testing of a defined contribution plan aggregated with a defined benefit plan, is permitted only if certain threshold requirements are satisfied.

In order for a defined contribution plan to be tested on an equivalent benefit accrual basis, one of the following three threshold conditions must be met:

- The plan has broadly available allocation rates, that is, each allocation rate under the plan is available to a nondiscriminatory group of employees (disregarding certain permitted additional contributions provided to employees as a replacement for benefits under a frozen defined benefit plan, as discussed below);
- The plan provides allocations that meet prescribed designs under which allocations gradually increase with age or service or are expected to provide a target level of annuity benefit; or
- The plan satisfies a minimum allocation gateway, under which each nonhighly compensated employee has an allocation rate of (a) at least one-third of the highest rate for any highly compensated employee, or (b) if less, at least five percent.

In order for an aggregated defined contribution and defined benefit plan to be tested on an aggregate equivalent benefit accrual basis, one of the following three threshold conditions must be met:

- The plan must be primarily defined benefit in character, that is, for more than fifty percent of the nonhighly compensated employees under the plan, their accrual rate under the defined benefit plan exceeds their equivalent accrual rate under the defined contribution plan;
- The plan consists of broadly available separate defined benefit and defined contribution plans, that is, the defined benefit plan and the defined contribution plan would separately satisfy simplified versions of the minimum coverage and nondiscriminatory amount requirements; or
- The plan satisfies a minimum aggregate allocation gateway, under which each nonhighly compensated employee has an aggregate allocation rate (consisting of allocations under the defined contribution plan and equivalent allocations under the defined benefit plan) of (a) at least one-third of the highest aggregate allocation rate for any nonhighly compensated employee, or (b) if less, at least five percent in the case of a highest nonhighly compensated employee's rate up to 25 percent, increased by one percentage point for each five-percentage-point increment (or portion thereof) above 25 percent, subject to a maximum of 7.5 percent.

Benefits, rights, and features

Each benefit, right, or feature offered under the plan generally must be available to a group of employees that has a ratio percentage that satisfies the minimum coverage requirements, including the reasonable classification requirement if applicable, except that the average benefit percentage test does not have to be met, even if the ratio percentage is less than 70 percent.

Multiple employer and section 403(b) plans

A multiple employer plan generally is a single plan maintained by two or more unrelated employers, that is, employers that are not treated as a single employer under the aggregation rules for related entities.¹⁴⁷ The plan coverage and other nondiscrimination requirements are applied separately to the portions of a multiple employer plan covering employees of different employers.¹⁴⁸

Certain tax-exempt charitable organizations may offer their employees a tax-deferred annuity plan (“section 403(b) plan”).¹⁴⁹ The nondiscrimination requirements, other than the requirements applicable to elective deferrals, generally apply to section 403(b) plans of private tax-exempt organizations. For purposes of applying the nondiscrimination requirements to a section 403(b) plan, subject to mandatory disaggregation, a qualified retirement plan may be combined with the section 403(b) plan and treated as a single plan.¹⁵⁰ However, a section 403(b) plan and qualified retirement plan may not be treated as a single plan for purposes of applying the nondiscrimination requirements to the qualified retirement plan.

Closed and frozen defined benefit plans

A defined benefit plan may be amended to limit participation in the plan to individuals who are employees as of a certain date. That is, employees hired after that date are not eligible to participate in the plan. Such a plan is sometimes referred to as a “closed” defined benefit plan (that is, closed to new entrants). In such a case, it is common for the employer also to maintain a defined contribution plan and to provide employer matching or nonelective contributions only to employees not covered by the defined benefit plan or at a higher rate to such employees.

¹⁴⁷ Sec. 413(c). Multiple employer status does not apply if the plan is a multiemployer plan, defined under sec. 414(f) as a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s). Multiemployer plans are also known as Taft-Hartley plans.

¹⁴⁸ Treas. Reg. sec. 1.413-2(a)(3)(ii)-(iii).

¹⁴⁹ Sec. 403(b). These plans are available to employers that are tax-exempt under section 501(c)(3), as well as to employers that are educational institutions of State or local governments.

¹⁵⁰ Treas. Reg. sec. 1.410(b)-7(f).

Over time, the group of employees continuing to accrue benefits under the defined benefit plan may come to consist more heavily of highly compensated employees, for example, because of greater turnover among nonhighly compensated employees or because increasing compensation causes nonhighly compensated employees to become highly compensated. In that case, the defined benefit plan may have to be combined with the defined contribution plan and tested on a benefit accrual basis. However, under the regulations, if none of the threshold conditions is met, testing on a benefits basis may not be available. Notwithstanding the regulations, recent IRS guidance provides relief for a limited period, allowing certain closed defined benefit plans to be aggregated with a defined contribution plan and tested on an aggregate equivalent benefits basis without meeting any of the threshold conditions.¹⁵¹ When the group of employees continuing to accrue benefits under a closed defined benefit plan consists more heavily of highly compensated employees, the benefits, rights, and features provided under the plan may also fail the tests under the existing nondiscrimination rules.

In some cases, if a defined benefit plan is amended to cease future accruals for all participants, referred to as a “frozen” defined benefit plan, additional contributions to a defined contribution plan may be provided for participants, in particular for older participants, in order to make up in part for the loss of the benefits they expected to earn under the defined benefit plan (“make-whole” contributions). As a practical matter, testing on a benefit accrual basis may be required in that case, but may not be available because the defined contribution plan does not meet any of the threshold conditions.

Description of Proposal

Closed or frozen defined benefit plans

In general

The proposal provides nondiscrimination relief with respect to benefits, rights, and features for a closed class of participants (“closed class”),¹⁵² and with respect to benefit accruals for a closed class, under a defined benefit plan that meets the requirements described below (referred to herein as an “applicable” defined benefit plan). In addition, the proposal treats a closed or frozen applicable defined benefit plan as meeting the minimum participation requirements if the plan met the requirements as of the effective date of the plan amendment by which the plan was closed or frozen.

If a portion of an applicable defined benefit plan eligible for relief under the proposal is spun off to another employer, and if the spun-off plan continues to satisfy any ongoing

¹⁵¹ Notice 2014-5, 2014-2 I.R.B. 276, December 13, 2013 extended by Notice 2015-28, 2015-14 I.R.B. 848, March 19, 2015, Notice 2016-57, 2016-40 I.R.B. 432, September 19, 2016, and most recently by Notice 2017-45, 2017-38 I.R.B. 232, August 31, 2017. Proposed regulations revising the nondiscrimination requirements for closed plans were also issued in 2016, subject to various conditions. 81 Fed. Reg. 4976 (January 29, 2016).

¹⁵² References under the proposal to a closed class of participants and similar references to a closed class include arrangements under which one or more classes of participants are closed, except that one or more classes of participants closed on different dates are not aggregated for purposes of determining the date any such class was closed.

requirements applicable for the relevant relief as described below, the relevant relief for the spun-off plan will continue with respect to the other employer.

Benefits, rights, or features for a closed class

Under the proposal, an applicable defined benefit plan that provides benefits, rights, or features to a closed class does not fail the nondiscrimination requirements by reason of the composition of the closed class, or the benefits, rights, or features provided to the closed class, if (1) for the plan year as of which the class closes and the two succeeding plan years, the benefits, rights, and features satisfy the nondiscrimination requirements without regard to the relief under the proposal, but taking into account the special testing rules described below,¹⁵³ and (2) after the date as of which the class was closed, any plan amendment modifying the closed class or the benefits, rights, and features provided to the closed class does not discriminate significantly in favor of highly compensated employees.

For purposes of requirement (1) above, the following special testing rules apply:

- In applying the plan coverage transition rule for business acquisitions, dispositions, and similar transactions, the closing of the class of participants is not treated as a significant change in coverage;
- Two or more plans do not fail to be eligible to be treated as a single plan solely by reason of having different plan years;¹⁵⁴ and
- Changes in employee population are disregarded to the extent attributable to individuals who become employees or cease to be employees, after the date the class is closed, by reason of a merger, acquisition, divestiture, or similar event.

Benefit accruals for a closed class

Under the proposal, an applicable defined benefit plan that provides benefits to a closed class may be aggregated, that is, treated as a single plan, and tested on a benefit accrual basis with one or more defined contribution plans (without having to satisfy the threshold conditions under present law) if (1) for the plan year as of which the class closes and the two succeeding plan years, the plan satisfies the plan coverage and nondiscrimination requirements without regard to the relief under the proposal, but taking into account the special testing rules described above,¹⁵⁵ and (2) after the date as of which the class was closed, any plan amendment modifying the closed class or the benefits provided to the closed class does not discriminate significantly in favor of highly compensated employees.

¹⁵³ Other testing options available under present law are also available for this purpose.

¹⁵⁴ This rule applies also for purposes of applying the plan coverage and other nondiscrimination requirements to an applicable defined benefit plan and one or more defined contributions that, under the proposal, may be treated as a single plan as described below.

¹⁵⁵ Other testing options available under present law are also available for this purpose.

Under the proposal, defined contribution plans that may be aggregated with an applicable defined benefit plan and treated as a single plan include the portion of one or more defined contribution plans consisting of matching contributions, an ESOP, or matching or nonelective contributions under a section 403(b) plan. If an applicable defined benefit plan is aggregated with the portion of a defined contribution plan consisting of matching contributions, any portion of the defined contribution plan consisting of elective deferrals must also be aggregated. In addition, the matching contributions are treated in the same manner as nonelective contributions, including for purposes of permitted disparity.

Applicable defined benefit plan

An applicable defined benefit plan to which relief under the proposal applies is a defined benefit plan under which the class was closed (or the plan frozen) before April 5, 2017, or that meets the following alternative conditions: (1) taking into account any predecessor plan, the plan has been in effect for at least five years as of the date the class is closed (or the plan is frozen) and (2) under the plan, during the five-year period preceding that date, (a) for purposes of the relief provided with respect to benefits, rights, and features for a closed class, there has not been a substantial increase in the coverage or value of the benefits, rights, or features, or (b) for purposes of the relief provided with respect to benefit accruals for a closed class or the minimum participation requirements, there has not been a substantial increase in the coverage or benefits under the plan.

For purposes of (2)(a) above, a plan is treated as having a substantial increase in coverage or value of benefits, rights, or features only if, during the applicable five-year period, either the number of participants covered by the benefits, rights, or features on the date the period ends is more than 50 percent greater than the number on the first day of the plan year in which the period began, or the benefits, rights, and features have been modified by one or more plan amendments in such a way that, as of the date the class is closed, the value of the benefits, rights, and features to the closed class as a whole is substantially greater than the value as of the first day of the five-year period, solely as a result of the amendments.

For purposes of (2)(b) above, a plan is treated as having had a substantial increase in coverage or benefits only if, during the applicable five-year period, either the number of participants benefiting under the plan on the date the period ends is more than 50 percent greater than the number of participants on the first day of the plan year in which the period began, or the average benefit provided to participants on the date the period ends is more than 50 percent greater than the average benefit provided on the first day of the plan year in which the period began. In applying this requirement, the average benefit provided to participants under the plan is treated as having remained the same between the two relevant dates if the benefit formula applicable to the participants has not changed between the dates and, if the benefit formula has changed, the average benefit under the plan is considered to have increased by more than 50 percent only if the target normal cost for all participants benefiting under the plan for the plan year in which the five-year period ends exceeds the target normal cost for all such participants for that plan year if determined using the benefit formula in effect for the participants for the first

plan year in the five-year period by more than 50 percent.¹⁵⁶ In applying these rules, a multiple employer plan is treated as a single plan, rather than as separate plans separately covering the employees of each participating employer.

In applying these standards, any increase in coverage or value, or in coverage or benefits, whichever is applicable, is generally disregarded if it is attributable to coverage and value, or coverage and benefits, provided to employees who (1) became participants as a result of a merger, acquisition, or similar event that occurred during the 7-year period preceding the date the class was closed, or (2) became participants by reason of a merger of the plan with another plan that had been in effect for at least five years as of the date of the merger and, in the case of benefits, rights, or features for a closed class, under the merger, the benefits, rights, or features under one plan were conformed to the benefits, rights, or features under the other plan prospectively.

Make-whole contributions under a defined contribution plan

Under the proposal, a defined contribution plan is permitted to be tested on an equivalent benefit accrual basis (without having to satisfy the threshold conditions under present law) if the following requirements are met:

- The plan provides make-whole contributions to a closed class of participants whose accruals under a defined benefit plan have been reduced or ended (“make-whole class”);
- For the plan year of the defined contribution plan as of which the make-whole class closes and the two succeeding plan years, the make-whole class satisfies the nondiscriminatory classification requirement under the plan coverage rules, taking into account the special testing rules described above;
- After the date as of which the class was closed, any amendment to the defined contribution plan modifying the make-whole class or the allocations, benefits, rights, and features provided to the make-whole class does not discriminate significantly in favor of highly compensated employees; and
- Either the class was closed before April 5, 2017, or the defined benefit plan is an applicable defined benefit plan under the alternative conditions applicable for purposes of the relief provided with respect to benefit accruals for a closed class.

With respect to one or more defined contribution plans meeting the requirements above, in applying the plan coverage and nondiscrimination requirements, the portion of the plan providing make-whole or other nonelective contributions may also be aggregated and tested on

¹⁵⁶ Under the funding requirements applicable to defined benefit plans, target normal cost for a plan year (defined in section 430(b)(1)(A)(i)) is generally the sum of the present value of the benefits expected to be earned under the plan during the plan year plus the amount of plan-related expenses to be paid from plan assets during the plan year. Under the proposal, in applying this average benefit rule to certain defined benefit plans maintained by cooperative organizations and charities, referred to as CSEC plans (defined in section 414(y)), which are subject to different funding requirements, the CSEC plan’s normal cost under section 433(j)(1)(B) is used instead of target normal cost.

an equivalent benefit accrual basis with the portion of one or more other defined contribution plans consisting of matching contributions, an ESOP, or matching or nonelective contributions under a section 403(b) plan. If the plan is aggregated with the portion of a defined contribution plan consisting of matching contributions, any portion of the defined contribution plan consisting of elective deferrals must also be aggregated. In addition, the matching contributions are treated in the same manner as nonelective contributions, including for purposes of permitted disparity.

Under the proposal, “make-whole contributions” generally means nonelective contributions for each employee in the make-whole class that are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or qualified cash or deferred arrangement under a section 401(k) plan if no change had been made to the defined benefit plan and other plan or arrangement.¹⁵⁷ However, under a special rule, in the case of a defined contribution plan that provides benefits, rights, or features to a closed class of participants whose accruals under a defined benefit plan have been reduced or eliminated, the plan will not fail to satisfy the nondiscrimination requirements solely by reason of the composition of the closed class, or the benefits, rights, or features provided to the closed class, if the defined contribution plan and defined benefit plan otherwise meet the requirements described above but for the fact that the make-whole contributions under the defined contribution plan are made in whole or in part through matching contributions.

If a portion of a defined contribution plan eligible for relief under the proposal is spun off to another employer, and if the spun-off plan continues to satisfy any ongoing requirements applicable for the relevant relief as described above, the relevant relief for the spun-off plan will continue with respect to the other employer.

Effective Date

The proposal is generally effective on the date of enactment, without regard to whether any plan modifications referred to in the proposal are adopted or effective before, on, or after the date of enactment.

However, at the election of a plan sponsor, the proposal will apply to plan years beginning after December 31, 2013. For purposes of the proposal, a closed class of participants under a defined benefit plan is treated as being closed before April 5, 2017, if the plan sponsor’s intention to create the closed class is reflected in formal written documents and communicated to participants before that date. In addition, a plan does not fail to be eligible for the relief under the proposal solely because (1) in the case of benefits, rights, or features for a closed class under a defined benefit plan, the plan was amended before the date of enactment to eliminate one or more benefits, rights, or features and is further amended after the date of enactment to provide the previously eliminated benefits, rights, or features to a closed class of participants, or (2) in the case of benefit accruals for a closed class under a defined benefit plan or application of the minimum benefit requirements to a closed or frozen defined benefit plan, the plan was amended before the date of the enactment to cease all benefit accruals and is further amended after the

¹⁵⁷ For this purpose, consistency is not required with respect to employees who were subject to different benefit formulas under the defined benefit plan.

date of enactment to provide benefit accruals to a closed class of participants. In either case, the relevant relief applies only if the plan otherwise meets the requirements for the relief, and, in applying the relevant relief, the date the class of participants is closed is the effective date of the later amendment.

TITLE III – OTHER BENEFITS

A. Benefits Provided to Volunteer Firefighters and Emergency Medical Responders

Present Law

Benefits for volunteer firefighters and emergency medical responders

In general, a reduction in property tax by persons who volunteer their services as emergency responders under a State law program is includible in gross income.¹⁵⁸ However, for taxable years beginning after December 31, 2007, and before January 1, 2011, an exclusion applied for any qualified State or local tax benefit and any qualified reimbursement payment provided to members of qualified volunteer emergency response organizations.¹⁵⁹

A qualified volunteer emergency response organization is a volunteer organization that is organized and operated to provide firefighting or emergency medical services for persons in a State or a political subdivision and is required (by written agreement) by the State or political subdivision to furnish firefighting or emergency medical services in the State or political subdivision.

A qualified State or local tax benefit is any reduction or rebate of certain taxes provided by a State or local government on account of services performed by individuals as members of a qualified volunteer emergency response organization. These taxes are limited to State or local income taxes, State or local real property taxes, and State or local personal property taxes. A qualified reimbursement payment is a payment provided by a State or political subdivision thereof on account of reimbursement for expenses incurred in connection with the performance of services as a member of a qualified volunteer emergency response organization. The amount of excludible qualified reimbursement payments is limited to \$30 for each month during which a volunteer performs services.

Itemized deductions

Subject to certain limitations, individuals are allowed itemized deductions for (1) State and local income taxes, real property taxes, and personal property taxes, and (2) contributions to charitable organizations, including unreimbursed expenses incurred in performing volunteer services for such an organization.¹⁶⁰

The amount of State or local taxes taken into account in determining the deduction for taxes is reduced by the amount of any excludible qualified State or local tax benefit. Similarly, expenses paid or incurred by an individual in connection with the performance of services as a member of a qualified volunteer emergency response organization are taken into account for

¹⁵⁸ IRS Chief Counsel Advice 200302045 (December 3, 2002).

¹⁵⁹ Sec. 139B. Under section 3121(a)(23), the exclusion applied also for purposes of taxes under the Federal Insurance Contributions Act (“FICA”).

¹⁶⁰ Secs. 164(a) and 170.

purposes of the charitable deduction only to the extent the expenses exceed the amount of any excludible qualified reimbursement payment.

Description of Proposal

The proposal reinstates for one year the exclusions for qualified State or local tax benefits and qualified reimbursement payments provided to members of qualified volunteer emergency response organizations. The proposal also increases the exclusion for qualified reimbursement payments to \$50 for each month during which a volunteer performs services. Under the proposal, the exclusions for qualified State or local tax benefits and qualified reimbursement payments do not apply for taxable years beginning after December 31, 2020.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2019. As described above, the exclusions do not apply for taxable years beginning after December 31, 2020. Thus, the exclusions apply only for taxable years beginning during 2020.

B. Expansion of Section 529 Plans

Present Law

In general

A qualified tuition program (often referred to as a “529 plan”) is a program established and maintained by a State or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a “prepaid tuition program”). Section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.¹⁶¹ In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a “savings account program”). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary’s higher education expenses.

In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary. Decisions with respect to the contract or account are typically made by an individual who is not the designated beneficiary. Qualified tuition accounts or contracts generally require the designation of a person (generally referred to as an “account owner”)¹⁶² whom the program administrator (oftentimes a third-party administrator retained by the State or by the educational institution that established the program) may look to for decisions, recordkeeping, and reporting with respect to the account established for a designated beneficiary. The person or persons who make the contributions to the account need not be the same person who is regarded as the account owner for purposes of administering the account. Under many qualified tuition programs, the account owner generally has control over the account or contract, including the ability to change designated beneficiaries and to withdraw funds at any time and for any purpose. Thus, in practice, qualified tuition accounts or contracts generally involve a contributor, a designated beneficiary, an account owner (who oftentimes is not the contributor or the designated beneficiary), and an administrator of the account or contract.

Qualified higher education expenses

Distributions for the purpose of meeting the designated beneficiary’s higher education expenses are generally not subject to tax. For purposes of receiving a distribution from a

¹⁶¹ For purposes of this description, the term “account” is used interchangeably to refer to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

¹⁶² Section 529 refers to contributors and designated beneficiaries, but does not define or otherwise refer to the term “account owner,” which is a commonly used term among qualified tuition programs.

qualified tuition program that qualifies for this favorable tax treatment, the term qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time. Qualified higher education expenses include the purchase of any computer technology or equipment, or Internet access or related services, if such technology or services are to be used primarily by the beneficiary during any of the years a beneficiary is enrolled at an eligible institution.

For distributions made after December 31, 2017, a designated beneficiary may, on an annual basis, receive up to \$10,000 in aggregate 529 distributions to be used in connection with expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. To the extent such distributions do not exceed \$10,000, they are treated in the same manner as distributions for qualified higher education expenses.

Contributions to qualified tuition programs

Contributions to a qualified tuition program must be made in cash. Section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions generally are treated as a completed gift eligible for the gift tax annual exclusion. Contributions are not tax deductible for Federal income tax purposes, although they may be deductible for State income tax purposes. Amounts in the account accumulate on a tax-free basis (*i.e.*, income on accounts in the plan is not subject to current income tax).

A qualified tuition program may not permit any contributor to, or designated beneficiary under, the program to direct (directly or indirectly) the investment of any contributions (or earnings thereon) more than two times in any calendar year, and must provide separate accounting for each designated beneficiary. A qualified tuition program may not allow any interest in an account or contract (or any portion thereof) to be used as security for a loan.

Deduction for interest on education loans

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit of \$2,500.¹⁶³ For 2019, the deduction is phased out ratably for taxpayers with modified AGI between \$70,000 and \$85,000 (\$140,000 and \$170,000 for married taxpayers filing a joint return). The income phaseout ranges are indexed for inflation.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending on at

¹⁶³ Sec. 221.

least a half-time basis (1) eligible educational institutions, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. The cost of attendance is reduced by any amount excluded from gross income under the exclusions for qualified scholarships and tuition reductions, employer-provided educational assistance, interest earned on education savings bonds, qualified tuition programs, and Coverdell education savings accounts, as well as the amount of certain other scholarships and similar payments.

Description of Proposal

The proposal makes four modifications to section 529 plans.

First, the proposal allows tax-free treatment applicable to distributions for higher education expenses to apply to expenses for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program. The apprenticeship program must be registered and certified with the Secretary of Labor under section 1 of the National Apprenticeship Act.¹⁶⁴

Second, the proposal allows tax-free treatment to apply to distributions made for certain expenses in connection with a homeschool. Under the proposal, distributions for certain homeschool expenses are treated in the same manner as distributions for qualified higher education expenses, and like distributions for elementary and secondary school tuition, are also subject to an annual limit of \$10,000 in aggregate 529 distributions, per beneficiary.¹⁶⁵ For these purposes, qualifying homeschool expenses are those expenses, with respect to a beneficiary, which are incurred in connection with a homeschool and are for: (i) curriculum and curricular materials; (ii) books or other instructional materials; (iii) online educational materials; (iv) tuition for tutoring or educational classes outside of the home if the tutor or instructor is unrelated to the student; (v) dual enrollment in an institution of higher education; and (vi) educational therapies for students with disabilities.

Third, the proposal allows tax-free treatment to apply to distributions of certain amounts used to make payments on principal or interest of a qualified education loan. No individual may receive more than \$10,000 of such distributions, in aggregate, over the course of the individual's lifetime.¹⁶⁶ To the extent that an individual receives in excess of \$10,000 of such distributions, they are subject to the usual tax treatment of 529 distributions (*i.e.*, the earnings are included in income and subject to a 10-percent penalty). The proposal contains a special rule allowing such amounts to be distributed to a sibling of a designated beneficiary (*i.e.*, a brother, sister, stepbrother, or stepsister). This rule allows a 529 account holder to make a student loan distribution to a sibling of the designated beneficiary without changing the designated

¹⁶⁴ 29 U.S.C. 50.

¹⁶⁵ The \$10,000 per beneficiary limit applies to the combined distributions used for either (i) elementary and secondary school tuition or (ii) homeschool expenses.

¹⁶⁶ This limitation applies to such distributions from all 529 accounts. Thus, an individual may not avoid the limitation by receiving separate \$10,000 distributions from multiple 529 accounts.

beneficiary of the account. For purposes of the \$10,000 lifetime limit on student loan distributions, a distribution to a sibling of a designated beneficiary is applied towards the sibling's lifetime limit, and not the designated beneficiary's lifetime limit. The deduction available for interest paid by the taxpayer during the taxable year on any qualified education loan is disallowed to the extent such interest was paid from a tax-free distribution from a 529 plan.

Fourth, the proposal adds additional qualifying expenses for distributions made on behalf of designated beneficiaries attending elementary or secondary school. Under the proposal, in addition to tuition, tax-free treatment would apply to a distribution made for expenses for fees, academic tutoring, special needs services, books, supplies, and other equipment, incurred in connection with enrollment or attendance at such elementary or secondary school. Expenses for the purchase of computer technology or equipment or Internet access and related services are not considered eligible expenses under the proposal.

Effective Date

The proposal applies to distributions made after December 31, 2018.

TITLE IV – REVENUE PROVISIONS

A. Modifications of Required Minimum Distribution Rules for Designated Beneficiaries

Present Law

In general

Minimum distribution rules apply to tax-favored employer-sponsored retirement plans and IRAs.¹⁶⁷ Employer-sponsored retirement plans are of two general types: defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts; and defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses.

In general, under the minimum distribution rules, distribution of minimum benefits must begin to an employee (or IRA owner) no later than a required beginning date and a minimum amount must be distributed each year (sometimes referred to as “lifetime” minimum distribution requirements). These lifetime requirements do not apply to a Roth IRA.¹⁶⁸ Minimum distribution rules also apply to benefits payable with respect to an employee (or IRA owner) who has died (sometimes referred to as “after-death” minimum distribution requirements). The regulations provide a methodology for calculating the required minimum distribution from an individual account under a defined contribution plan or from an IRA.¹⁶⁹ In the case of annuity payments under a defined benefit plan or an annuity contract, the regulations provide requirements that the stream of annuity payments must satisfy.

Failure to comply with the minimum distribution requirement results in an excise tax imposed on the individual who was required to take the distributions equal to 50 percent of the required minimum amount not distributed for the year.¹⁷⁰ The excise tax may be waived in certain cases. For employer-sponsored retirement plans, satisfying the minimum distribution requirement under the plan terms and in operation is also a requirement for tax-favored treatment.

¹⁶⁷ Secs. 401(a)(9), 403(b)(1), 408(a)(6), 408(b)(3), and 457(d)(2). Tax-favored employer-sponsored retirement plans include qualified retirement plans and annuities under sections 401(a) and 403(a), tax-deferred annuity plans under section 403(b), and governmental eligible deferred compensation plans under section 457(b). Minimum distribution requirements also apply to eligible deferred compensation plans under section 457(b) of tax-exempt employers.

¹⁶⁸ Sec. 408A(c)(5).

¹⁶⁹ Reflecting the directive in section 823 of the Pension Protection Act of 2006 (Pub. L. No. 109-280), pursuant to Treas. Reg. sec. 1.401(a)(9)-1, A-2(d), a governmental plan within the meaning of section 414(d) or a governmental eligible deferred compensation plan is treated as having complied with the statutory minimum distribution rules if the plan complies with a reasonable and good faith interpretation of those rules.

¹⁷⁰ Sec. 4974.

Required beginning date

For traditional IRAs, the required beginning date is April 1 following the calendar year in which the employee (or IRA owner) attains age 70½. For employer-sponsored retirement plans, for an employee other than an employee who is a five-percent owner in the year the employee attains age 70½, the required beginning date is April 1 after the later of the calendar year in which the employee attains age 70½ or retires. For an employee who is a five-percent owner under an employer-sponsored tax-favored retirement plan in the year the employee attains age 70½, the required beginning date is the same as for IRAs even if the employee continues to work past age 70½.

Lifetime rules

While an employee (or IRA owner) is alive, distributions of the individual's interest are required to be made (in accordance with regulations) over the life or life expectancy of the employee (or IRA owner), or over the joint lives or joint life expectancy of the employee (or IRA owner) and a designated beneficiary.¹⁷¹ For defined contribution plans and IRAs, the required minimum distribution for each year is determined by dividing the account balance as of the end of the prior year by a distribution period which, while the employee (or IRA owner) is alive, is the factor for the employee (or IRA owner's) age from the uniform lifetime table included in the Treasury regulations.¹⁷² The distribution period for annuity payments under a defined benefit plan or annuity contract (to the extent not limited to the life of the employee (or IRA owner) or the joint lives of the employee (or IRA owner) and a designated beneficiary) is generally subject to the same limitations as apply to individual accounts.

After-death rules

Payments over a distribution period

The after-death minimum distributions rules vary depending on (i) whether an employee (or IRA owner) dies on or after the required beginning date or before the required beginning date, and (ii) whether there is a designated beneficiary for the benefit.¹⁷³ Under the regulations, a

¹⁷¹ Sec. 401(a)(9)(A).

¹⁷² Treas. Reg. sec. 1.401(a)(9)-5. This table is based on the joint life and last survivor expectancy of the individual and a hypothetical beneficiary 10 years younger. For an individual with a spouse as designated beneficiary who is more than 10 years younger (and thus the number of years in the couple's joint life and last survivor expectancy is greater than the uniform lifetime table), the joint life expectancy and last survivor expectancy of the couple (calculated using the table in the regulations) is used. For this purpose and other special rules that apply to the surviving spouse as beneficiary, a former spouse to whom all or a portion of an employee's benefit is payable pursuant to a qualified domestic relations order (within the meaning of section 414(p)) is treated as the spouse (including a surviving spouse) of the employee for purposes of section 401(a)(9).

¹⁷³ In the case of amounts for which the employee or IRA owner's surviving spouse is the beneficiary, the surviving spouse generally is permitted to do a tax-free rollover of such amounts into an IRA (or account of a tax-favored employer-sponsored plan of the spouse's employer) established in the surviving spouse's name as IRA owner or employee. The rules applicable to the rollover account, including the minimum distribution rules, are the same rules that apply to an IRA owner or employee. In the case of an IRA for which the spouse is sole beneficiary,

designated beneficiary is an individual designated as a beneficiary under the plan or IRA.¹⁷⁴ Similar to the lifetime rules, for defined contribution plans and IRAs (“individual accounts”), the required minimum distribution for each year after the death of the employee (or IRA owner) is generally determined by dividing the account balance as of the end of the prior year by a distribution period.

If an employee (or IRA owner) dies on or after the required beginning date, the basic statutory rule is that the remaining interest must be distributed at least as rapidly as under the method of distribution being used before death.¹⁷⁵ Under the regulations, for individual accounts, this rule is also interpreted as requiring the minimum required distribution to be calculated using a distribution period. If there is no designated beneficiary, the distribution period is equal to the remaining years of the employee’s (or IRA owner’s) life, as of the year of death.¹⁷⁶ If there is a designated beneficiary, the distribution period (if longer) is the beneficiary’s life expectancy calculated using the life expectancy table in the regulations, determined in the year after the year of death.¹⁷⁷

If an employee (or IRA owner) dies before the required beginning date and any portion of the benefit is payable to a designated beneficiary, the statutory rule is that distributions are generally required to begin within one year of the employee’s (or IRA owner’s) death (or such later date as prescribed in regulations) and are permitted to be paid (in accordance with regulations) over the life or life expectancy of the designated beneficiary. If the beneficiary of the employee (or IRA owner) is the individual’s surviving spouse, distributions are not required to commence until the year in which the employee (or IRA owner) would have attained age 70½. If the surviving spouse dies before the employee (or IRA owner) would have attained age 70½, the after-death rules apply after the death of the spouse as though the spouse were the employee (or IRA owner). Under the regulations, for individual accounts, the required minimum distribution for each year is determined using a distribution period and the period is measured by the designated beneficiary’s life expectancy, calculated in the same manner as if the individual died on or after the required beginning date.¹⁷⁸

this can be accomplished by simply renaming the IRA as an IRA held by the spouse as IRA owner rather than as a beneficiary.

¹⁷⁴ Treas. Reg. sec. 1.401(a)(9)-4, A-1. The individual need not be named as long as the individual is identifiable under the terms of the plan (or IRA). There are special rules for multiple beneficiaries and for trusts named as beneficiary (where the beneficiaries of the trust are individuals). However, the fact that an interest under a plan or IRA passes to a certain individual under a will or otherwise under State law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan or IRA.

¹⁷⁵ Sec. 401(a)(9)(B)(i).

¹⁷⁶ Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(2).

¹⁷⁷ Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(1).

¹⁷⁸ Treas. Reg. sec. 1.401(a)(9)-5, A-5(b).

In cases where distribution after death is based on life expectancy (either the remaining life expectancy of the employee (or IRA owner) or a designated beneficiary), the distribution period generally is fixed at the employee's (or IRA owner's) death and then reduced by one for each year that elapses after the year in which it is calculated. If the designated beneficiary dies during the distribution period, distributions continue to the subsequent beneficiaries over the remaining years in the distribution period.¹⁷⁹

The distribution period for annuity payments under a defined benefit plan or annuity contract (to the extent not limited to the life of a designated beneficiary) is generally subject to the same limitations as apply to individual accounts.

Five-year rule

If an employee (or IRA owner) dies before the required beginning date and there is no designated beneficiary, then the entire remaining interest of the employee (or IRA owner) must generally be distributed by the end of the fifth calendar year following the individual's death.¹⁸⁰

Defined benefit plans and annuity distributions

The regulations provide rules for the amount of annuity distributions from a defined benefit plan, or from an annuity purchased by the plan from an insurance company, that are paid over life or life expectancy. Annuity distributions are generally required to be nonincreasing with certain exceptions, which include, for example, (i) increases to the extent of certain specified cost-of-living indices, (ii) a constant percentage increase (for a qualified defined benefit plan, the constant percentage cannot exceed five percent per year), (iii) certain accelerations of payments, and (iv) increases to reflect when an annuity is converted to a single life annuity after the death of the beneficiary under a joint and survivor annuity or after termination of the survivor annuity under a qualified domestic relations order.¹⁸¹ If distributions are in the form of a joint and survivor annuity and the survivor annuitant both is not the surviving spouse and is younger than the employee (or IRA owner), the survivor annuity benefit is limited to a percentage of the life annuity benefit for the employee (or IRA owner). The survivor benefit as a percentage of the benefit of the primary annuitant is required to be smaller (but not required to be less than 52 percent) as the difference in the ages of the primary annuitant and the survivor annuitant become greater.

¹⁷⁹ If the distribution period is based on the surviving spouse's life expectancy (whether the employee or IRA owner's death is before or after the required beginning date), the spouse's life expectancy generally is recalculated each year while the spouse is alive and then fixed the year after the spouse's death.

¹⁸⁰ Section 401(a)(9)(B)(ii) provides that the entire interest must be distributed within five years of the employee's death. Treas. Reg. sec. 1.401(a)(9)-3, A-2, provides that this requirement is satisfied if the entire interest is distributed by the end of the fifth calendar year following the employee's death. There are provisions in the regulations allowing a designated beneficiary to take advantage of the five-year rule. See Treas. Reg. secs. 1.401(a)(9)-4, A-4, and 1.4974-2, A-7(b).

¹⁸¹ Treas. Reg. sec. 1.401(a)(9)-6, A-14.

Plan amendment and anti-cut-back requirements

Present law provides a remedial amendment period during which, under certain circumstances, a qualified retirement plan may be amended retroactively in order to comply with the qualification requirements.¹⁸² In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary may extend the time by which plan amendments need to be made.

The Code and ERISA generally prohibit plan amendment that reduce accrued benefits, including amendments that eliminate or reduce optional forms of benefit with respect to benefits already accrued except to the extent prescribed in regulations.¹⁸³ This prohibition on the reduction of accrued benefits is commonly referred to as the "anti-cut-back rule."

Description of Proposal

Change in after-death rules for defined contribution plans

The proposal changes the after-death required minimum distribution rules applicable to defined contribution plans, as defined, with respect to required minimum distributions to designated beneficiaries. A defined contribution plan for this purpose means an eligible retirement plan¹⁸⁴ (qualified retirement plans, section 403(b) plans, governmental section 457(b) plans, and IRAs) other than a defined benefit plan.

Ten-year after-death rule for defined contributions plans

In general

Under the proposal, the five-year rule is expanded to become a 10-year period instead of five years ("10-year rule"), such that the 10-year rule is the general rule for distributions to designated beneficiaries after death (regardless of whether the employee (or IRA owner) dies before, on, or after the required beginning date) unless the designated beneficiary is an eligible beneficiary as defined in the proposal. Thus, in the case of an ineligible beneficiary, distribution of the employee (or IRA owner's) entire benefit is required to be distributed by the end of the tenth calendar year following the year of the employee or IRA owner's death.

Eligible beneficiaries

For eligible beneficiaries, an exception to the 10-year rule (for death before the required beginning date under present law) applies whether or not the employee (or IRA owner) dies before, on, or after the required beginning date. The exception (similar to present law) generally

¹⁸² Sec. 401(b).

¹⁸³ Sec. 411(d)(6) and ERISA sec. 204(g).

¹⁸⁴ Sec. 402(c)(8)(B).

allows distributions over life or life expectancy of an eligible beneficiary beginning in the year following the year of death. Eligible beneficiaries include any beneficiary who, as of the date of death, is the surviving spouse of the employee (or IRA owner),¹⁸⁵ is disabled, is a chronically ill individual, is an individual who is not more than 10 years younger than the employee (or IRA owner), or is a child of the employee (or IRA owner) who has not reached the age of majority. In the case of a child who has not reached the age of majority, calculation of the minimum required distribution under this exception is only allowed through the year that the child reaches the age of majority.

Further, under the proposal, the 10-year rule also applies after the death of an eligible beneficiary or after a child reaches the age of majority. Thus, for example, if a disabled child of an employee (or IRA owner) is an eligible beneficiary of a parent who dies when the child is age 20 and the child dies at age 30, even though 52.1 years remain in measurement period,¹⁸⁶ the disabled child's remaining beneficiary interest must be distributed by the end of the tenth year following the death of the disabled child. If a child is an eligible beneficiary based on having not reached the age of majority before the employee's (or IRA owner's) death, the 10-year rule applies beginning with the earlier of the date of the child's death or the date that the child reaches the age of majority. The child's entire interest must be distributed by the end of the tenth year following that date.

As under present law, if the surviving spouse is the beneficiary, a special rule allows the commencement of distribution to be delayed until end of the year that the employee (or IRA owner) would have attained age 70½. If the spouse dies before distributions were required to begin to the spouse, the surviving spouse is treated as the employee (or IRA owner) in determining the required distributions to beneficiaries of the surviving spouse.

Definitions of disabled and chronically ill individual

Under the proposal, disabled means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to end in death or to be for long-continued and indefinite duration.¹⁸⁷ Further, under the definition, an individual is not considered to be disabled unless proof of the disability is furnished in such form and manner as the Secretary may require. Substantial gainful activity for

¹⁸⁵ As in the case of the present law special rule in section 401(a)(9)(B)(iv) for surviving spouses, spouse is not defined in the proposal. Under Treas. Reg. sec. 1.401(a)(9)-8, A-5, a spouse is the employee's spouse under applicable State law. In the case of a special rule for a surviving spouse, that determination is generally made based on the employee's marital status on the date of death. An exception is provided in Treas. Reg. sec. 1.401(a)(9)-6, A-6, under which a former spouse to whom all or a portion of the employee's benefits is payable pursuant to a qualified domestic relations order as defined in section 414(p) is treated as the employee's spouse (including a surviving spouse). In the case of a qualified joint and survivor annuity under section 401(a)(11) and 417, the spouse is generally determined as of the annuity starting date.

¹⁸⁶ The measurement period is the life expectancy of the child calculated for the child's age in the year after the employee's (or IRA owner's) death (age 21 (20 plus 1)).

¹⁸⁷ The definition of disabled in section 72(m)(7) is incorporated by reference.

this purpose is the activity, or a comparable activity, in which the individual customarily engaged prior to the arising of the disability (or prior to retirement if the individual was retired at the time the disability arose).¹⁸⁸

Under the proposal, the definition of a chronically ill individual for purposes of qualified long-term care insurance¹⁸⁹ is incorporated by reference with a modification. Under this definition, a chronically ill individual is any individual who (1) is unable to perform (without substantial assistance from another individual) at least two activities of daily living for an indefinite period (expected to be lengthy in nature)¹⁹⁰ due to a loss of functional capacity, (2) has a level of disability similar (as determined under regulations prescribed by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability described above requiring assistance with daily living based on loss of functional capacity, or (3) requires substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment. The activities of daily living for which assistance is needed for purposes of determining loss of functional capacity are eating, toileting, transferring, bathing, dressing, and continence.

Annuity payments under commercial annuities

The proposal applies to after-death required minimum distributions under defined contribution plans and IRAs, including annuity contracts purchased from insurance companies under defined contribution plans or IRAs.

Effective Date

General effective date

In determining required minimum distributions after the death of an employee (or IRA owner), the proposal is generally effective for required minimum distributions with respect to employees (or IRA owners) with a date of death after December 31, 2019.

Delayed effective date for governmental and collectively bargained plans

In the case of a governmental plan (as defined in section 414(d)), in determining required minimum distributions after the death of an employee, the proposal applies to distributions with respect to employees who die after December 31, 2021.

¹⁸⁸ Treas. Reg. sec. 1.72-17(f). Under the regulations, in determining whether an individual is disabled, primary consideration is given to the nature and severity of the individual's impairment. However, consideration is also given to other factors such as the individual's education, training, and work experience. Whether an impairment in a particular case constitutes a disability is determined with reference to all the facts in the case.

¹⁸⁹ Sec. 7702B(c)(2).

¹⁹⁰ Section 7702B(c) only requires this period to be at least 90 days.

In the case of a collectively bargained plan,¹⁹¹ in determining required minimum distributions after the death of an employee, the proposal applies to distributions with respect to employees who die in calendar years beginning after the earlier of two dates. The first date is the later of (1) the date on which the last collective bargaining agreement ratified before date of enactment of the proposal terminates,¹⁹² or (2) December 31, 2019. The second date is December 31, 2021.

10-year rule after the death of a beneficiary

In the case of an employee (or IRA owner) who dies before the effective date (as described below) for the plan (or IRA), if the designated beneficiary of the employee (or IRA owner) dies on or after the effective date, the proposal applies to any beneficiary of the designated beneficiary as though the designated beneficiary were an eligible beneficiary. Thus, the entire interest must be distributed by the end of the tenth calendar year after the death of the designated beneficiary. For this purpose, the effective date is the date of death of the employee (or IRA owner) used to determine when the proposal applies to the plan (or IRA), for example, before January 1, 2020, under the general effective date.

Certain annuities grandfathered

The modification to the after-death minimum distribution rules does not apply to a qualified annuity that is a binding annuity contract in effect on the date of enactment of the proposal and at all times thereafter. A qualified annuity with respect to an individual is a commercial annuity,¹⁹³ under which the annuity payments are made over the lives of the individual and a designated beneficiary (or over a period not extending beyond the life expectancy of the individual or the life expectancy of the individual and a designated beneficiary) in accordance with the required minimum distribution regulations for annuity payments as in effect before enactment of this proposal. In addition to these requirements, annuity payments to the individual must begin before the date of enactment, and the individual must have made an irrevocable election before that date as to the method and amount of the annuity payments to the individual or any designated beneficiaries. Alternatively, if an annuity is not a qualified annuity solely based on annuity payments not having begun irrevocably before the date of enactment, an annuity can be a qualified annuity if the individual has made an irrevocable election before the date of enactment as to the method and amount of the annuity payments to the individual or any designated beneficiaries.

¹⁹¹ A collectively bargained plan is a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers.

¹⁹² The date that the last agreement terminates is determined without regard to any extension thereof agreed to on or after the date of enactment of the proposal. Further, any plan amendment made pursuant to a collective bargaining agreement relating to the plan that amends the plan solely to conform to any requirement added by the proposal shall not be treated as a termination of the collective bargaining agreement.

¹⁹³ For this purpose, commercial annuity is defined in section 3405(e)(6).

Plan amendments made pursuant to the proposal

A plan amendment made pursuant to the enacted provision (or regulations issued thereunder) may be retroactively effective and (except as provided by the Secretary) will not violate the anti-cut-back rule, if, in addition to meeting the other applicable requirements described below, the amendment is made on or before the last day of the first plan year beginning after December 31, 2021 (or in the case of a governmental or collectively bargained plan, December 31, 2023), or a later date prescribed by the Secretary. In addition, the plan will be treated as operated in accordance with plan terms during the period beginning with the date that the provision or regulations take effect (or the date specified by the plan if the amendment is not required by the provision or regulations) and ending on the last permissible date for the amendment (or, if earlier, the date the amendment is adopted).

A plan amendment will not be considered to be pursuant to the provision (or applicable regulations) if it has an effective date before the effective date of the provision (or regulations) to which it relates. Similarly, the proposal does not provide relief from the anti-cut-back rule for periods prior to the effective date of the relevant portion of the provision (or regulations) or the plan amendment. In order for an amendment to be retroactively effective and not violate the anti-cut-back rule, the plan amendment must apply retroactively for the period described in the preceding paragraph, and the plan must be operated in accordance with the amendment during that period.

B. Increase in Penalty for Failure to File

Present Law

The Federal tax system is one of “self-assessment,” *i.e.*, taxpayers are required to declare their income, expenses, and ultimate tax due, while the IRS has the ability to propose subsequent changes. This voluntary system requires that taxpayers comply with deadlines and adhere to the filing requirements. While taxpayers may obtain extensions of time in which to file their returns, the Federal tax system consists of specific due dates of returns. In order to foster compliance in meeting these deadlines, Congress has enacted a penalty for the failure to timely file tax returns.¹⁹⁴

A taxpayer who fails to file a tax return on or before its due date is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 25 percent of the net amount.¹⁹⁵ If the failure to file a return is fraudulent, the taxpayer is subject to a penalty equal to 15 percent of the net amount of tax due for each month the return is not filed, up to a maximum of 75 percent of the net amount.¹⁹⁶ The net amount of tax due is the amount of tax required to be shown on the return reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credits against tax which may be claimed on the return.¹⁹⁷ The penalty will not apply if it is shown that the failure to file was due to reasonable cause and not willful neglect.¹⁹⁸

If a return is filed more than 60 days after its due date, and unless it is shown that such failure is due to reasonable cause, then the failure to file penalty may not be less than the lesser of \$205 or 100 percent of the amount required to be shown as tax on the return. If a penalty for failure to file and a penalty for failure to pay tax shown on a return both apply for the same month, the amount of the penalty for failure to file for such month is reduced by the amount of the penalty for failure to pay tax shown on a return.¹⁹⁹ If a return is filed more than 60 days after its due date, then the penalty for failure to pay tax shown on a return may not reduce the penalty for failure to file below the lesser of \$205 or 100 percent of the amount required to be shown on the return.²⁰⁰

¹⁹⁴ See *United States v. Boyle*, 469 U.S. 241, 245 (1985).

¹⁹⁵ Sec. 6651(a)(1).

¹⁹⁶ Sec. 6651(f).

¹⁹⁷ Sec. 6651(b)(1).

¹⁹⁸ Sec. 6651(a)(1).

¹⁹⁹ Sec. 6651(c)(1).

²⁰⁰ *Ibid.*

The failure to file penalty applies to all returns required to be filed under subchapter A of Chapter 61 (relating to income tax returns of an individual, fiduciary of an estate or trust, or corporation; self-employment tax returns, and estate and gift tax returns), subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), and subchapter A of chapter 53 (relating to machine guns and certain other firearms).²⁰¹ The failure to file penalty is adjusted annually to account for inflation. The failure to file penalty does not apply to any failure to pay estimated tax required to be paid by sections 6654 or 6655.²⁰²

Description of Proposal

Under the proposal, if a return is filed more than 60 days after its due date, then the failure to file penalty may not be less than the lesser of \$400 or 100 percent of the amount required to be shown as tax on the return.

Effective Date

The proposal applies to returns with filing due dates (including extensions) after December 31, 2019.

²⁰¹ Sec. 6651(a)(1).

²⁰² Sec. 6651(e).

C. Increased Penalties for Failure to File Retirement Plan Returns

Present Law

Form 5500

An employer that maintains a pension, annuity, stock bonus, profit-sharing or other funded deferred compensation plan (or the plan administrator of the plan) is required to file an annual return containing information required under regulations with respect to the qualification, financial condition, and operation of the plan.²⁰³ The plan administrator of a defined benefit plan subject to the minimum funding requirements²⁰⁴ is required to file an annual actuarial report.²⁰⁵ These filing requirements are met by filing an Annual Return/Report of Employee Benefit Plan, Form 5500 series, and providing the information as required on the form and related instructions.²⁰⁶ A failure to file Form 5500 generally results in a civil penalty of \$25 for each day during which the failure continues, subject to a maximum penalty of \$15,000.²⁰⁷ This penalty may be waived if it is shown that the failure is due to reasonable cause.

Annual registration statement and notification of changes

In the case of a plan subject to the vesting requirements under the Employee Retirement Income Security Act of 1974 (“ERISA”), the plan administrator is required to file a registration statement with the IRS with respect to any plan participant who (1) separated from service during the year and (2) has a vested benefit under the plan, but who was not paid the benefit during the year (a “deferred vested” benefit).²⁰⁸ The registration statement must include the name of the plan, the name and address of the plan administrator, the name and taxpayer identification number of the separated participant, and the nature, amount, and form of the participant’s deferred vested benefit. A failure to file a registration statement as required generally results in a civil penalty of \$1 for each participant with respect to whom the failure applies, multiplied by the number of days during which the failure continues, subject to a maximum penalty of \$5,000 for a

²⁰³ Sec. 6058.

²⁰⁴ Sec. 412. Most governmental plans (defined in section 414(d)) and church plans (defined in section 414(e)) are exempt from the minimum funding requirements.

²⁰⁵ Sec. 6059.

²⁰⁶ Treas. Reg. secs. 301.6058-1(a) and 301.6059-1.

²⁰⁷ Sec. 6652(e). The failure to file penalties in section 6652 generally apply to certain information returns, including retirement plan returns. The failure to file penalties in section 6651(a)(1), discussed above in section 502 of the bill, generally apply to income, estate, gift, employment and self-employment, and certain excise tax returns.

²⁰⁸ Code sec. 6057(a). Under Code section 6057(e) and ERISA section 105(c), similar information must be provided to the separated participant.

failure with respect to any plan year.²⁰⁹ This penalty may be waived if it is shown that the failure is due to reasonable cause.

A plan administrator is also required to notify the IRS if certain information in a registration changes, specifically, any change in the name of the plan or in the name or address of the plan administrator, the termination of the plan, or the merger or consolidation of the plan with any other plan or its division into two or more plans. A failure to file a required notification of change generally results in a penalty of \$1 for each day during which the failure continues, subject to a maximum penalty of \$1,000 for any failure.²¹⁰ This penalty may be waived if it is shown that the failure is due to reasonable cause.

Withholding notices

Withholding requirements apply to distributions from tax-favored employer-sponsored retirement plans and IRAs, but, except in the case of certain distributions, payees may generally elect not to have withholding apply.²¹¹ A plan administrator or IRA custodian is required to provide payees with notices of the right to elect no withholding. A failure to provide a required notice generally results in a civil penalty of \$10 for each failure, subject to a maximum penalty of \$5,000 for all failures during any calendar year.²¹² This penalty may be waived if it is shown that the failure is due to reasonable cause and not to willful neglect.

Description of Proposal

Form 5500

Under the proposal, a failure to file Form 5500 generally results in a penalty of \$105 for each day during which the failure continues, subject to a maximum but the total amount imposed under this subsection on any person for failure to file any return shall not exceed \$50,000.

Annual registration statement and notification of changes

Under the proposal, a failure to file a registration statement as required generally results in a penalty of \$2 for each participant with respect to whom the failure applies, multiplied by the number of days during which the failure continues, subject to a maximum penalty of \$10,000 for a failure with respect to any plan year. A failure to file a required notification of change

²⁰⁹ Sec. 6652(d)(1).

²¹⁰ Sec. 6652(d)(2).

²¹¹ Sec. 3405.

²¹² Sec. 6652(h).

generally results in a penalty of \$2 for each day during which the failure continues, subject to a maximum penalty of \$5,000 for any failure.

Withholding notices

Under the proposal, a failure to provide a required withholding notice generally results in a penalty of \$100 for each failure, subject to a maximum penalty of \$50,000 for all failures during any calendar year.

Effective Date

The proposal is effective for returns, statements and notifications required to be filed, and withholding notices required to be provided, after December 31, 2019.

D. Increase Information Sharing to Administer Excise Taxes

Present Law

Generally, tax returns and return information (“tax information”) are confidential and may not be disclosed unless authorized in the Code.²¹³ Return information includes data received, collected or prepared by the Secretary with respect to the determination of the existence or possible existence of liability of any person under the Code for any tax, penalty, interest, fine, forfeiture, or other imposition or offense. Criminal penalties apply for the unauthorized inspection or disclosure of tax information. Willful unauthorized disclosure is a felony under section 7213 and the willful unauthorized inspection of tax information is a misdemeanor under section 7213A. Taxpayers may also pursue a civil cause of action for disclosures and inspections not authorized by section 6103.²¹⁴

Section 6103 provides exceptions to the general rule of confidentiality, detailing permissible disclosures. Under section 6103(h)(1), tax information is open to inspection by or disclosure to Treasury officers and employees whose official duties require the inspection or disclosure for tax administration purposes.

The heavy vehicle use tax, an annual highway use tax, is imposed on the use of any highway motor vehicle that has a gross weight of 55,000 pounds or more.²¹⁵ Proof of payment of the heavy vehicle use tax must be presented to customs officials upon entry into the United States of any highway motor vehicle subject to the tax and that has a base in a contiguous foreign country.²¹⁶ If the operator of the vehicle is unable to present proof of payment of the tax with respect to the vehicle, entry into the United States may be denied.²¹⁷

Prior to 2003, customs officials who had responsibility for enforcing and/or collecting excise taxes were employees of the U.S. Department of the Treasury (“Treasury”). Thus, prior to 2003, section 6103(h)(1) allowed disclosure of tax information by the IRS to these customs officials in the performance of their duties. In 2003, U.S. Customs and Border Protection became an official agency of the U.S. Department of Homeland Security.²¹⁸ At that time, customs officials were transferred from Treasury to the Department of Homeland Security.

²¹³ Sec. 6103(a).

²¹⁴ Sec. 7431.

²¹⁵ Sec. 4481(a).

²¹⁶ Treas. Reg. 41.6001-3(a).

²¹⁷ Treas. Reg. 41.6001-3(b).

²¹⁸ The Homeland Security Act of 2002, Pub. L. No. 107-296 (“Homeland Security Act”), enacted November 25, 2002 established the U.S. Department of Homeland Security. Several agencies were combined under this new department.

Description of Proposal

The proposal allows the IRS to share returns and return information with employees of U.S. Customs and Border Protection whose official duties require such inspection or disclosure for purposes of administering and collecting the heavy vehicle use tax.

Effective Date

The proposal is effective on date of enactment.