Federal Update 2005-24

July 27, 2005

TO: NCTR Members

FROM: Cindie Moore, Washington Counsel

RE: Senate Committee Passes Pension Bill with Government Plan Provisions

On July 26, 2005, the Senate Finance Committee approved by voice vote the National Employee Savings and Trust Equity Guarantee (NESTEG) Act of 2005. The bill is a revised version of S. 219, also entitled NESTEG, which was introduced on January 31, 2005. The revisions affect principally private plans; the provisions of interest to NCTR members seem not to have changed. (At this point only a summary of the revisions is available.) The provisions of interest appear below. You will likely recognize them because they were in previous versions of NESTEG.

Committee Chairman, Charles Grassley (R-IA), expects floor action on the bill to be delayed by the Supreme Court confirmation process. The Ranking Democrat, Max Baucus (D-MT), predicts, nevertheless, that the bill will pass this year.

On the House side, the Education and the Workforce Committee approved a pension bill (H.R. 2830) on June 30, 2005. The bill covers private plan issues only. H.R. 2830 could be bundled into a retirement security package being assembled by Ways and Means Committee Chairman, Bill Thomas (R-CA), that could include Social Security reform and various pension changes. Action on the package is not expected until September at the earliest.

Provisions of Interest in NESTEG as Passed by Senate Finance Committee on July 26, 2005

Clarification of Purchase of Service Credit Provisions

These provisions clarify the purchase of service credit provisions in Code Section 415(n). They would make clear that:

- Purchases of service credit (PSC) for periods for which there is no performance of service is allowable.

- PSC may include service credited in order to provide an increased benefit for service credit that the participant is receiving under the plan, i.e., benefit to which the participant is not otherwise entitled.

- A trustee-to-trustee transfer of 403(b) and 457 funds into a governmental defined benefit plan for purchase of PSC is not subject to the limits applicable to non-qualified service, also known as air time. The following limits apply to non-qualified service: not more than 5 years of non-qualified PSC and a participant must have 5 years of participation in the plan.

- Once 403(b)/457 funds are transferred to a governmental defined benefit plan, they take on the distribution rules of such a plan.

- A transfer need not be made between plans maintained by same employer.

After-Tax Contributions to Enhance Portability

NESTEG would also allow defined benefit plans to accept after-tax rollovers, if they so wished, provided that they separately track the after-tax funds from the pre-tax funds. At present, defined contribution plans and IRAs may accept these types of rollovers.

Relief from Minimum Distribution Rules (MDRs) to Ensure Special Features of Governmental Plans Recognized

NESTEG would permit governmental retirement plans to be deemed as having complied with the MDRs of Code Section 401(a)(9) if they follow a reasonable good faith interpretation. The provision would direct the Secretary of Treasury to issue regulations to that effect.

Relief for Public Safety Employees from 10% Early Withdrawal Tax

NESTEG would exempt from the 10% early withdrawal tax any distributions from a governmental defined benefit plan to a qualified public safety employee who separates from service after age 50. Under current law, the age is 55. The provision recognizes that public safety employees often retire earlier than workers in other professions. Thus, they should be permitted to receive distributions from defined benefit pension plans without the imposition of the 10% tax.