U.S. Senate
Republican Policy
Committee

Legislative Notice

Jon Kyl, Chairman

347 Russell Senate Office Building
Washington, DC 20510
202-224-2946
http://rpc.senate.gov

No. 53 August 2, 2006

H.R. 4 – Pension Protection Act of 2006

Calendar No. 561

On July 31, 2006, read the second and placed on the Senate Legislative Calendar under General Orders.

Noteworthy

- The Senate is expected to consider H.R. 4 prior to the August recess.
- H.R. 4 represents the agreed-upon provisions from the conference on H.R. 2830 and S. 1783.
- H.R. 4 provides modifications to pension funding rules including changes to minimum funding amounts, benefit limitations, and lump-sum calculations. In addition, the bill provides tighter rules for multiemployer defined benefit plans and increases Pension Benefit Guaranty Corporation (PBGC) premiums in an effort to strengthen pension security for workers and retirees. H.R. 4 also clarifies the legality of hybrid pension plans and contains a variety of provisions relating to investment advice, and disclosure rules.
- H.R. 4 makes permanent the pension improvements enacted in the Economic Growth Tax Relief Reconciliation Act of 2001, including increased contribution limits for individual retirement accounts (IRAs) and 401(k) plans. In addition, the bill makes permanent the "Savers' Credit" of up to $2,000, which is set to expire at the end of 2006.
- H.R. 4 also contains provisions providing special rules for the airlines.
- On July 28, the House of Representatives approved H.R. 4 by a vote of 279-131.

Background

In 2004, Congress enacted the Pension Funding Equity Act (PFEA), which provided temporary measures to address pension-funding problems and other issues facing businesses sponsoring defined-benefit pension plans.[1] That legislation, however, expired at the end of 2005.

On November 15, 2005, the Pension Benefit Guaranty Corporation (PBGC) reported a $22.8-billion deficit in the assets under the agency's management that are necessary to satisfy all of the potential claims turned over to the PBGC through fiscal year 2005. This deficit is the result of an increased number of pension plans administered by the PBGC, and it has been exacerbated by additional high-profile pension failures, such as those caused by the bankruptcy of U.S. Airways and United Airlines. In addition, estimates by the PBGC indicate that the nation's single-employer pensions are underfunded by more than $450 billion – the highest level on record – in part due to low interest rates and asset values.[2]

The expiration of the PFEA at the end of 2005 creates significant uncertainty for pension sponsors seeking to fund their pension obligations adequately when they are required to make their 2006 payments by April 15, 2007. In addition, the recent pension failures and sizeable PBGC deficit create an urgent need for Congressional action to strengthen and improve the nation's private-pension system.

Responding to those needs, the Administration offered a comprehensive pension-reform package in January 2005. This package proposed reforms to the funding rules to ensure pension promises are kept, improvements are made to disclosure rules for workers, investors and regulators about pension plan status, and adjustments are made to PBGC premiums to better reflect better a pension plan's risk and ensure the pension insurance system's financial solvency.[3]

Last summer, the Senate Finance Committee marked up S. 219, the National Employee Savings and Trust Equity Guarantee Act (NESTEG), which provides new, permanent funding rules, adjusts PBGC insurance premiums, and makes other modifications to strengthen private-pension plans.[4] The Senate HELP Committee marked up similar legislation, the Defined Benefit Security Act of 2005, on September 8, 2005. That bill also addresses the pension funding rules and PBGC premiums, and it includes significant changes to the requirements with respect to the disclosure of information to pension participants and to the rules governing multiemployer

---

[1] Public Law 108-218, H.R. 3108, 108th Congress, 2d Session, April 10, 2004. For a summary of the PFEA's provisions, see the RPC's "Highlights of Conference Report to Accompany H.R. 3108, the Pension Funding Equity Act of 2004," April 6, 2004 – http://rpc.senate.gov/_files/Apr0604CFRPensionsKH.pdf.

[2] Bradley D. Belt, Executive Director, Pension Benefit Guaranty Corporation (PBGC), in testimony before the Senate Committee on Finance, March 1, 2005, p. 8 – http://finance.senate.gov/hearings/testimony/2005test/bbtest030105.pdf

[3] A complete explanation of the Administration's pension-reform proposal is available at: http://www.dol.gov/EBSA/pensionreform.html.

[4] A summary of the NESTEG bill prepared by the Joint Committee on Taxation is available at: http://finance.senate.gov/sitepages/leg/072205chmark.pdf

pension plans. Subsequently, the committees combined the two bills into a unified package of pension reforms: S. 1783, the "Pension Security and Transparency Act of 2005," which the Senate approved on November 16, 2005 by a vote of 97 to 2. The House of Representatives passed similar legislation, H.R. 2830, the "Pension Protection Act of 2005," on December 15, 2005 by a vote of 294 to 132.

On March 3, 2006, Senators Enzi, Gregg, DeWine, Isakson, Hatch, Grassley, Lott, Snowe, Santorum, Kennedy, Harkin, Mikulski, Bingaman, Baucus, Rockefeller, and Conrad were appointed Senate conferees, and on March 8, 2006, the House appointed Representatives Boehner, Thomas, Johnson (Sam), McKeon, Tiberi, Kline, Rangel, Miller (George), Andrews, Payne, and Camp as House conferees. After meeting for months, conferees reached a general agreement on the pensions bill, which is embodied in H.R. 4.

Bill Provisions

The following is a brief overview of H.R. 4's provisions.[5]

Title I: Funding Rules For Single-Employer Defined Benefit Pension Plans

Measuring Liabilities

Current Law: A pension plan's ongoing liability consists of the accrued benefits of all its participants. In order to take into account the fact that employees have different life expectancies and retire at different times with varying benefits, a pension's liability is generally stated as the present value of all the participants' accrued benefits. The present value indicates the amount that a plan would need to invest today at a given rate of return in order to have sufficient funds to pay the required benefits as they come due. The key to present-value calculation is the interest rate used to reflect the rate of return.

For healthy plans, liabilities are based on "reasonable assumptions," primarily relating to the participants covered by the plan, and an applicable interest rate. Under special rules for underfunded plans – the Deficit Reduction Contribution (DRC) rules – the plan's current liability is calculated using specified interest rate and mortality assumptions.

The Internal Revenue Code (the Code) and the Employee Retirement Income Security Act of 1974 (ERISA) provide that interest rates shall be based on the yield of 30-year Treasury Bonds. However, the Congress enacted a temporary interest rate applicable to plan years beginning in 2004 and 2005. This temporary rate is based on the yield on high-grade corporate

[5] For additional background information on pension rules addressed in this legislation, see the Congressional Research Service's "Defined Benefit Pension Reform for Single-Employer Plans," RL32991, August 17, 2005 – http://www.congress.gov/erp/rl/pdf/RL32991.pdf.

bonds. For plan years beginning in 2006, if Congress does not act, plans would be required to return to the use of the 30-year Treasury Bond rate.[6]

Mortality assumptions are governed by Treasury regulations. Current law does not permit plan-specific mortality tables to be used for funding.

H.R. 4: The bill provides a new interest rate for the calculation of pension liabilities, based on a modified yield curve approach to provide the applicable interest rate.[7] The yield curve is based on a 24-month average on the yield on the top three grades of corporate bonds. Instead of using the entire yield curve, the bill divides the curve into three segments – in effect, short-term, medium-term, and long-term – and the interest rate will vary according to the due date for each expected payment by the pension plan. The new modified yield curve will be phased in over three years starting in 2008.

The bill requires that in calculating pension liabilities, plans must use a specified mortality table, as determined by Treasury regulations. A pension plan may use a plan-specific mortality table under certain circumstances, unless it is disapproved by the Internal Revenue Service (IRS).

Measuring Assets

Current Law: For funding purposes, plans may measure assets either by using the market value of assets or by using an actuarial-smoothing method that smoothes out fluctuations in asset values over five years, provided that the ultimate asset value is between 80-percent and 120 percent of the assets' market value.

H.R. 4: The bill requires that pensions use either the market value of assets or, pursuant to Treasury guidance, the market value based on an unweighted average over the prior 24 months, but the result is limited to between 90 percent and 110 percent of market value as of the plan's valuation date.

"At Risk" Liability

Current Law: The current rules require accelerated contributions to a pension plan when its current liability falls below certain percentages. This is known as the Deficit Reduction Contribution (DRC). The DRC is not triggered if a plan has higher potential liabilities due to rapid utilization of more expensive forms of benefits such as lump sum distributions or subsidized early retirement benefits.

---

[6] For more information on the effect of interest rates on pension liabilities, see the RPC's policy paper: "Retirement-Income Security: Strengthening the Private-Pension System," April 7, 2005 – http://rpc.senate.gov/_files/Apr0705RetIncomeSecMW.pdf.

[7] For more information on the yield-curve concept and its application to the measurement of pension liabilities, see the RPC's policy paper: "Retirement-Income Security: Strengthening the Private-Pension System," April 7, 2005 – http://rpc.senate.gov/_files/Apr0705RetIncomeSecMW.pdf.

H.R. 4: The bill uses the funding target attainment percentage as the determinant of the plan's financial health. A plan is in "at-risk" status if its funding target attainment percentage is both less than 80 percent on an ongoing basis (without regard to at-risk liabilities) and less than 70-percent counting at-risk liabilities. The 80-percent test is phased in over four years, and the 70-percent test is phased in over five years. The rules require that plans calculate at-risk liabilities based on the assumption that workers who might retire in the following 10 years will do so. For purposes of determining these percentages, credit balances are deducted from assets. The 70-percent test applies starting in 2008, but the 80-percent ongoing liability test is phased in over four years (65 percent in 2008, 70 percent in 2009, 75 percent in 2010, and 80 percent thereafter). Once at-risk liability is triggered, plans must phase in the higher funding target over five years.

If a plan is "at-risk" for the current year and two out of the previous four years, the at-risk liability is increased by 4 percent of liability plus $700 per participant. Plans with 500 or fewer participants are excluded from the at-risk rules.

Funding Target

Current Law: The funding target for healthy pensions is 90 percent of the plan's current liability. For plans subject to the DRC, the funding target moves up to 100 percent of current liability.

H.R. 4: The bill increases the funding target from 90 percent to 100 percent of the plan's ongoing liability. For plans subject to the at-risk rules, the bill also sets the target at 100 percent, but that percentage applies to a larger liability target since the at-risk rules require pensions to calculate their liabilities based on assumptions that generally will increase the overall ongoing liability.

Valuation Date

Current Law: The valuation date is the day of the year on which all liability measurements are made. Most plans use the first day of the plan year as the "as of" valuation date, but plans may select a different date. Date changes are subject to approval by the IRS.

H.R. 4: Under the bill, plans with more than 100 participants must use the first day of the plan year as the "as of" valuation date. Plans with 100 or fewer participants may use any day of the plan year, but changes are subject to approval by the IRS.

Minimum Contributions

Current Law: Generally, an employer must contribute to the pension plan an amount sufficient to cover the benefits that participants accrue during the year plus an amount to amortize any underfunding from past years. Charges and credits to the plan are amortized over varying periods (e.g., 5 to 30 years) depending on the cause of the charge or credit. In addition, unless the plan is more than 90-percent funded on a current-liability basis, the employer is generally subject to the DRC and must make an additional annual contribution. Under the DRC rules, underfunded amounts are generally amortized over 4 to 7 years.

H.R. 4: Under the bill, an employer must contribute to the plan an amount sufficient to cover the year's normal cost (i.e., the amount of benefits accrued during that year). In addition, the employer must amortize the shortfall between the plan's assets and its target liability over a 7-year period. For the first year under this proposal, the funding shortfall is the target liability minus assets. Each year the employer will be required to recalculate the amount of underfunding based on that year's assets and liabilities (including experience gains and losses). The employer continues to make payments due on previous unfunded liabilities plus amortizing any new underfunding over a new 7-year period. In any year in which a plan's assets exceed its liability target, an amortization contribution will not be required.

For the purposes of setting up amortization bases, the funding target is phased in over four years (92 percent in 2008, 94 percent in 2009, 96 percent in 2010, and 100 percent thereafter). Plans funded at the phase-in percentage for the year are considered "fully funded" and are not required to make shortfall payments for that year.

Credit Balances

Current Law: In some cases, employers make contributions in excess of the minimum amount required for a year. These excesses are referred to as a "credit balance" and can be used in future years to offset required contributions. Under current law, plans may increase the value of their credit balances based on an assumed rate of return, regardless of the actual performance of the plan's assets. For example, during the economic decline that started in 2000, plans could, and did, assume that their credit balances grew by 8 or 9 percent, when the assets in the plan (including the funds that made up the credit balance) actually declined with the markets.

H.R. 4: The bill requires that credit balances must be adjusted annually to reflect their market value (i.e., marked to market) rather than varying by the assumed rate of return. For plans that are less than 80-percent funded, credit balances may not be used to satisfy minimum contributions requirements.

Special Rules for Multiple-Employer Pension Plans

Current Law: Multiple-employer pension plans, such as those maintained by certain rural cooperatives, are considered single-employer plans under the Code and ERISA, but they operate on a collective basis, usually sharing administrative functions and liability. Under current law, the funding rules for multiple-employer plans are the same as those applicable to single-employer plans.

H.R. 4: The bill delays the effective date of the new funding rules for 9 years (until 2017) for eligible multiple-employer pension plans, including those operated by rural electric cooperatives, rural telephone cooperative associations, and certain agricultural cooperatives. In addition, the bill delays new rules for defense contractors (until 2011) and plans of employers that took over sponsorship of the plan so that the PBGC did not have to terminate the plan (until 2014).

Benefit Limitations

Current Law: ERISA and the Internal Revenue Code contain two limitations on benefit increases. First, an employer in bankruptcy cannot amend its plans to increase benefits. Second, if the funded current-liability percentage of a plan, calculated using only post-1987 liabilities, is less than 60 percent, the employer may not increase benefits unless the employer immediately funds or secures the liability resulting from the benefit increase.

In certain cases involving the closure of a segment of an employer's business, a pension plan may provide participants with special "shutdown benefits." Ordinarily, benefit increases provided to participants within five years of a plan termination are not fully covered by the PBGC guarantee; the full guarantee is phased in over the 5-year period. Shutdown benefits are guaranteed by the PBGC, and the guarantee on shutdown benefits is phased in, beginning on the date that the benefit is added to the pension plan, not from the time the shutdown occurs.

H.R. 4:

Benefit Limitations: If a plan is less than 60-percent funded, the proposal prohibits the plan from triggering shutdown benefits, prohibits accelerated payments (lump-sum distributions) during the year, and freezes benefit accruals. If a plan is less than 80-percent funded, the plan may not have benefit increases. Between 60 percent and 80 percent, lump sum payments are allowed with certain restrictions. These restrictions do not apply if the plan is fully funded. Special rules apply to new plans and to plans of employers in bankruptcy.

Generally, the funded percentages are determined by deducting any credit balances from assets. There is an exception, however, if the plan is fully funded (without deducting credit balances). Special rules apply to new plans and to plans of employees in bankruptcy.

PBGC and Bankruptcy: The bill treats the bankruptcy filing date as the plan-termination date for certain PBGC purposes if the plan terminates before the company emerges from bankruptcy. Unless the plan is 100-percent funded, no benefit increases are allowed and lump-sum distributions are limited. Bankruptcy also triggers a temporary freeze on the PBGC guarantee limits (e.g., the maximum limit and the counting of years for the phase-in of guarantees) and certain asset allocation priorities. The temporary freeze takes effect if the plan terminates before the company comes out of bankruptcy.

The bill also provides that the PBGC guarantee of shutdown benefits is phased in over five years from the time that the shutdown occurs.

Lump-Sum Calculations

Current Law: The value of lump-sum payments to participants is determined by using the yield on 30-year Treasury Bonds as of the relevant date of the distribution.

H.R. 4: The bill provides that the value of lump-sum distributions shall be determined according to the three-segment yield curve based on a monthly interest rate. This change will be phased in over five years, starting in 2008.

Maximum Deductible Contribution

Current Law: Employers are currently limited in the amount of deductible contributions they can make to their pension plans. An employer may contribute and deduct up to the plan's unfunded current liability in any year. Contributions in excess of the deductible limit may be made, but they are subject to a 10-percent excise tax. In addition, for employers maintaining both a defined-benefit and defined-contribution plan, current law provides a combined limit on deductible contributions to the plans.

H.R. 4: The bill increases the deductible limit for single-employer plans to the year's normal cost plus the amount necessary to fully fund the funding target. In addition employers can contribute and deduct a cushion of 50 percent of the funding target plus additional amounts reflecting projections for salary increases. Under the bill's provisions regarding multiemployer plans, such plans may deduct up to140 percent of their unfunded current liability, less the value of the assets held by the plan.

The bill eliminates the combined deductible limit for employers that maintain defined-benefit and defined-contribution plans (both single-employer and multiemployer) beginning in 2006. For other employers (mainly those that provide professional services and maintain plans for fewer than 25 participants), the combined limit does not apply unless the employer's contributions to the defined-contribution plan exceed 6 percent of compensation. This limited rule also applies to PBGC-covered plans for 2006.

Title II: Funding Rules for Multiemployer Defined Benefit Plans

Current Law: Multiemployer pension plans provide retirement benefits to employees of multiple employers, subject to collective-bargaining agreements. These plans generally are subject to the same funding rules as single-employer plans, although the DRC rules do not apply to multiemployer plans. The only limitations on funding assumptions are that the plan actuary must certify that the assumptions are reasonable. Multiemployer plans also have a longer period to amortize unfunded liabilities than single-employer plans. Like single-employer plans, multiemployer plans experiencing financial hardships can petition the Treasury Department for an amortization-period extension.

Additionally, special rules apply to multiemployer plans that have to be reorganized or become insolvent, although such events are rare. Generally, multiemployer plans do not terminate or enter reorganization. If they become insolvent, the PBGC lends them funds to pay a reduced benefit (well below single-employer guaranteed benefits). The PBGC has made such loans to fewer than thirty plans since 1974. If an employer withdraws from a multiemployer plan and the plan is underfunded, the employer must pay withdrawal liability to the plan based on one of several formulas. Generally, the amount of withdrawal liability depends on the proportion of the employer's contributions over time to the other active employers' contributions.

H.R. 4: The bill includes detailed new rules for multiemployer plans, which require plans failing to meet certain funding and other tests to adopt funding improvement plans or rehabilitation plans. Plans that are funded below 80 percent, but are not projected to have an accumulated funding deficiency within 7 years, are considered to be in "endangered status." Plans that are less than 65-percent funded and are facing an accumulated funding deficiency in a shorter period of time are deemed to be in "critical status." The financial improvement (for endangered) and rehabilitation (for critical) plans specify what actions the plans and the bargaining parties will take to get out of their status within ten to fifteen years, as applicable under the provision. Plans in critical status may only reduce or eliminate "adjustable" benefits such as early retirement subsidies for current workers.

The bill requires the plan actuary to certify not only that the funding percentage is accurate, but also that the financial improvement or rehabilitation plan is on track to accomplish its goal within 10 years. The actuary must also certify each year that the plan is still on target or that the funding improvement or rehabilitation plan has been changed as necessary to accomplish the target.

The bill requires plans to determine whether they will be insolvent within 5 years, compared with the current 3-year period.

The bill allows multiemployer plans projected to experience an accumulated funding deficiency within 10 years to obtain an automatic 5-year amortization period extension as long as the plan satisfies certain requirements to ensure adequate funding. A second 5-year amortization extension may be sought from Treasury. Plans may also adopt the shortfall funding method as an accounting technique during periods between collective bargaining agreements.

The bill also changes the amortization schedule for any plan benefit amendments from 30 years to 15 years and increases the maximum deductible limit to 140 percent of the current liability.

The provisions affecting multiemployer plans are sunset after 8 years though funding improvement and rehabilitation plans may continue.

Title IV: PBGC Guarantee and Related Provisions

Variable-Rate Premiums

Current Law: In addition to the flat-rate premium, certain single-employer plans also must pay a variable rate premium (VRP) of $9 per $1,000 of unfunded, vested current liability. Plans that satisfy the current "full funding limit" (i.e., 90 percent) are exempt from the VRP, even though they may actually be underfunded.

H.R. 4: The bill eliminates the full-funding exemption, meaning that all underfunded plans would be required to pay the VRP premiums.

Special Rules for Airlines

Current Law: Airlines must follow the same funding rules under current law as other plan sponsors. Special relief was provided for the airlines in 2004 and 2005, which allowed them to defer paying part of their additional contribution due under the DRC rules.

H.R. 4: The bill provides special rules that permit commercial airlines to amortize their funding deficiencies over a number of years depending upon the status of their defined benefit plans. Airlines adopting a "hard freeze"[8] on benefits are given 10 additional years to meet funding obligations and a specific interest rate of 8.85 percent to calculate pension contributions in order to avoid turning over pension obligations to the PBGC. For plans electing this relief, the PBGC guarantee on worker benefits is frozen for the first ten years and a company must pay double the termination premium ($2500/participant) if it terminates a pension plan during the first five years of taking relief. There is an exception to the premium requirement in the case of terrorist attack or other similar event. Airlines that have not frozen their defined benefit plans on benefits are given an additional three years to meet funding obligations, but must follow the other statutory funding rules.

Title V: Disclosure

Current Law: Plan administrators must file an annual report (Form 5500) each year providing details on the plan's operations. For plans using the calendar year (rather than a fiscal year), this report can be filed as late as October 15th of the year following the year covered by the report, subject to extensions. Sixty days after the annual report is filed, the plan administrator must distribute to each participant a summary annual report (SAR), which provides certain summary financial data from the Form 5500. At the same time, administrators of plans that pay the PBGC variable rate premium and owe the Deficit Reduction Contribution must provide participants with a notice (the "4011 notice") of the plan's current liability funding percentage and a description of the PBGC guarantee rules. Sponsors of plans with $50 million

[8] A "hard freeze" means that the accrual of future benefits is stopped and no additional benefit accrual is made for current plan participants regardless of salary increase or tenure.

or more in underfunding, on an aggregate basis, must file actuarial and financial information with the PBGC ("section 4010 filings"). The PBGC is required to keep information in section 4010 filings confidential. Plans are not required to give benefit statements on a regular basis to participants.

H.R. 4: The bill creates a new notice for plan participants, which would be due 120 days after the beginning of the plan year. This notice includes funding and other information and must be provided by single and multiemployer plans, although the requirements are slightly different. The notice must include detailed information on plan funding and a multiemployer must provide additional information including whether the plan is in endangered or critical status and information on how to get a copy of the funding improvement or rehabilitation plan. The bill eliminates the notice on the SAR for defined benefit plans.

The bill also changes the criteria for filing the section 4010 reports. The bill eliminates the $50 million in aggregate filing requirement and substitutes a requirement that all plans less than 80 percent funded must provide additional funding information, including termination liabilities, to the PBGC.

The bill requires most retirement-savings plans to provide periodic benefit statements. Defined benefit plans must provide notices every 3 years. Defined contribution plans must provide benefit notices every year.

Title VI: Investment Advice[9]

Current Law: ERISA prohibits financial service providers from providing investment recommendations to participants in 401(k) plans or IRAs, which include investment options affiliated with their own institutions. Transactions between a pension plan and a party-in-interest are prohibited unless there is a statutory class or individual exemption.

H.R. 4: The bill creates a transaction exemption allowing qualified fiduciary advisers to offer personal investment advice to employer-sponsored financial plans for defined contribution plans and IRAs through computer models. The computer models for IRAs would be certified by the Departments of Labor and Treasury.

The bill also makes changes to prohibited transaction rules. With respect to amending the prohibited transaction provisions of ERISA, the bill allows for the following: for block trading, where the trade involves more that 10,000 shares with a market value of at least $200,000; for the use of electronic communication networks and similar electronic trading systems subject to regulation and oversight; for service providers who are not fiduciaries with respect to the involved plan assets to provide ancillary services; for fiduciaries to conduct foreign exchange transactions where the broker-dealer does not offer transaction advice; and for

[9] For additional information, see CRS report "Employer Stock in Pension Plans: Economic and Tax Issues," RL31551, September 4, 2002 - http://www.congress.gov/erp/rl/pdf/RL31551.pdf.

the ability to permit cross-trading involving plans with over $100 million in assets. The bill calls on the Secretary of Labor, in consultation with the SEC, to release policies and required procedures within 180 days of the Act's enactment which deal with the new exemptions.

Title VII: Hybrid-Pension Plans

Current Law: The legality of hybrid-pension plans – commonly referred to as "cash balance" plans – has been the subject of considerable litigation in recent years. The legal uncertainty pertains to both the design of such plans and whether conversions from traditional defined-benefit plans to cash-balance plans comply with the age-discrimination rules of the Internal Revenue Code, ERISA, and the Age Discrimination in Employment Act of 1967 (29 U.S.C. § 623(i)).

Many employers have either established new cash-balance plans or converted existing defined-benefit plans to cash-balance plans. Participants have challenged both the basic design and the "wearaway" of benefits during a conversion. While the litigation is ongoing in many cases, there are also situations in which there has been no litigation. The fact pattern of each plan design or conversion is somewhat different, and the effects on workers differ in each situation.[10]

H.R. 4: The bill validates the basic design of hybrid-pension plans and provides that conversions are valid as long as certain rules are followed. The bill's hybrid-pension provisions are prospective only – the bill states that there is no inference as to the legality of the basic design or the manner in which plans were converted prior to the date of enactment (i.e., no implication is intended for any plan currently involved in litigation). The bill also provides rules for addressing the "whipsaw" issue[11] as well as the treatment of variable indices when a plan terminates. The bill establishes an age-discrimination standard for all defined-benefit plans that clarifies current law with respect to age-discrimination requirements under ERISA on a prospective basis.

Title VIII: Revenue Provisions

EGTRRA Permanence: The provision makes permanent the individual retirement account (IRA) and pension provisions enacted under 2001 tax cut legislation. The 2001 law increased annual contribution limits for IRAs and qualified pension plans, created additional "catch-up" contributions for individuals age 50 and older, and created incentives for small employers to offer pension plans. These reforms – initially enacted in 2001 – are scheduled to expire after 2010.

---

[10] For more information on hybrid-pension plans, see the RPC's policy paper: "Retirement-Income Security: The Status of Hybrid-Pension Plans," April 25, 2005 – http://rpc.senate.gov/_files/Apr2505RetIncomeSecMW.pdf.
[11] For additional information on the whipsaw issue, see the Congressional Research Service's "Pension Issues: Cash-Balance Plans," RL30196, January 24, 2005 – http://www.congress.gov/erp/rl/pdf/RL30196.pdf.

Extend permanently and modify the enhanced savings provisions under § 529: The bill makes permanent the 2001 change to allow tax-free withdrawals from 529 accounts provided they are used for education. The bill also provides authority for the Treasury to promulgate regulations with respect to 529 plans and prevent abuses.

Automatic Enrollment: The provision creates a safe harbor to encourage employers to offer automatic enrollment in employer-sponsored defined contribution pension plans.

Saver's Credit: The provision makes permanent the "Savers' Credit" of up to $2,000, which will not be available after 2006. This credit allows eligible individuals who make contributions to an IRA or qualified pension plan to receive a federal "match" in the form of an income tax credit for the first $2,000 of annual contributions.

Split Tax Refunds: The provision allows taxpayers to choose whether they want to deposit a portion of their federal tax refund directly into an IRA.

No 10-Percent Penalty: The provision waives a 10-percent early IRA distribution penalty for military reservists and national guardsmen who are called to active duty for at least 180 days. Withdrawn amounts may be repaid to the IRA or pension plan within 2 years of the distribution without regard to the annual contribution limits; also waives the 10-percent early distribution penalty for public safety employees over age 50 who participate in governmental pension plans with a Deferred Retirement Option Plan (DROP) benefit feature.

Tax-Free Rollovers: The provision allows tax-free rollovers from the IRA or pension of a deceased individual to an IRA or pension of a designated beneficiary. Under current law, such transfers are tax-free only if made to the account of a spouse.

Charitable Provisions

CHARITABLE GIVING INCENTIVES (extend through 2007 unless otherwise noted)

***Tax-Free Distributions From IRAs for Charitable Purposes*:** The provision provides an exclusion from gross income for certain distributions of up to $100,000 from a traditional individual retirement account (IRA) or a Roth IRA, which would otherwise be included in income. To qualify, the charitable distribution must be made to a tax-exempt organization to which deductible contributions can be made.

Basis Adjustment to Stock of S Corporation Contributing Property: The provision provides that the amount of a shareholder's basis reduction in the stock of an S corporation, by reason of a charitable contribution made by the corporation, will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property.

Charitable Deduction for Contributions of Book Inventory: The provision extends the current-law provision that adds public schools to the list of eligible donees for the enhanced deduction for contributions of qualified book inventory by C corporations.

The Tax Treatment of Certain Payments to Controlling Exempt Organizations: The provision provides that payments received or accrued by certain exempt parents from taxable controlled subsidiaries will not be treated as unrelated business taxable income. Exempt organizations are required to report certain amounts received from controlled organizations.

CHARITABLE REFORM

Treasury Report on Certain Life Insurance Contracts: Charitable organizations must report to the Secretary certain acquisitions of interests in certain insurance contracts for 2 years beginning on the date of enactment. The Secretary is required to issue a report within 30 months after the date of enactment examining if acquisitions of applicable insurance contracts are consistent with the tax-exempt purposes of those charitable organizations that acquire such contracts.

Fines and Penalties Applicable to Charitable Organizations: The provision doubles the amount of excise taxes applicable to certain activities by charities, social welfare organizations, private foundations and exempt organization managers.

Clothing and Household Items: The provision specifies that no deduction is allowed for charitable contributions of clothing and household items if such items are not in good used condition or better. In addition, the Secretary may deny a deduction for any item with minimal monetary value.

Private Foundation Net Investment Income Excise Tax: The provision amends the definition of gross investment income to include capital gains, national principal contracts, annuities, and other substantially similar investment income.

Titles IX through XIV: Other Provisions

Diversification: Like the NESTEG legislation, H.R. 4 requires that publicly held companies must allow workers to divest themselves of company stock attributable to employer contributions once the worker has completed three years of service. Workers would be permitted to diversify accounts attributable to employee contributions immediately. Freestanding Employee Stock Ownership Plans and single-participant plans are exempt from these requirements.

Spousal Pension Protection**:** The bill clarifies that domestic-relations orders issued subsequent to a divorce can be Qualified Domestic Relations Orders directing assignment of unpaid benefits to an alternate payee (i.e., usually a former spouse).

Special Catch-up Contributions**:** H.R. 4 helps individuals adversely affected by the ENRON bankruptcy, or a similar situation, to make additional contributions to an Individual Retirement Account (IRA) for a period of five years. To qualify for the additional contribution, the individual must have participated in a plan that had a matching contribution made in employer stock. The employer must be bankrupt and an officer must be under indictment or subject to conviction for acts related to the bankruptcy. The additional contributions are limited to $3,000 per year for tax years 2006 through 2009.

Portability enhancements: The bill provides a number of changes to improve the portability of retirement savings from one pension arrangement to another. Specifically, the bill does the following:

- Allows rollovers by non-spouse beneficiaries of certain retirement plan distributions;
- Provides faster vesting of employer non-elective contributions (i.e., 6-year-graded or 3-year-cliff vesting);
- Allows direct rollovers from retirement plans to Roth IRAs;
- Eliminates the special penalties on SIMPLE IRAs and permits rollovers between SIMPLE plans and other tax-favored retirement arrangements within the first 2 years of participation; and
- Clarifies the rules regarding the purchase of service credit from a so-called 403(b) annuity or a section 457 plan to a governmental defined-benefit plan.

Company-Owned Life Insurance: H.R. 4 limits the availability of tax-free proceeds on company-owned life insurance, and provides disclosure and reporting requirements.

Tariff Provisions: The bill amends the Harmonized Tariff Schedule of the United States to provide for temporary duty suspensions, increases, or reductions through December 31, 2009 in numerous product lines.

Cost

The Congressional Budge Office (CBO) estimates that H.R. 4 will reduce direct spending by $1.8 billion over the period of 2007 to 2011, and would reduce direct spending by $6.5 billion over the period of 2007 to 2016. Included in the CBO estimate is scoring of various tax provisions by the Joint Committee on Taxation (JCT). CBO and JCT estimate the revenue provisions of H.R will reduce direct spending by $7.71 billion over the period of 2007 to 2011, and would reduce direct spending by $73.2 billion over the period of 2007 to 2016. A copy of the revenue estimate is available at: http://www.house.gov/jct/x-36-06.pdf.

Administration Position

At press time, no Statement of Administration Policy was available.

Staff contacts: Derek Kan, Sarah Novascone, and Michael Stransky, 224-2946