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IN THIS ISSUE –

Proposed IRA Changes, ***Page 1***

Proposed Qualified Plans, Section 403(b) and Section 457 Changes, Page 4

Proposed New Types of Tax-Preferred Plans—Individual Development Accounts; SAFE Trusts and SAFE Annuities, ***Page 6***

SUMMARY OF PROPOSED IRA AND PENSION LAW CHANGES

Congress has passed The Taxpayer Refund Act of 1999. Congress does not intend to present this proposed tax law change to President Clinton until September. The President has given every indication that he will veto the bill. We devote the entire newsletter to these proposed IRA and other pension law changes because even though they may not become law this time, most of these proposals will become the law in a lesser state when and if the Congress and President Clinton can reach a compromise. It is estimated these tax law changes would mean that taxpayers would pay $792 billion dollars less in federal taxes over the next 10 years than under current law. The principal areas of tax savings would be: (1) IRA and pension changes—$15 billion; (2) education—$11 billion; (3) the lowering of tax rates—$283 billion; (4) reducing the marriage penalty—$119 billion; (5) alternative minimum tax—$103 billion; (6) estate and gift—$66 billion; (7) capital gain—$34 billion; (8) health care—$44 billion and (9) other business—$82 billion. Because Senator Roth is the chairman of the Senate Finance Committee which controls this tax bill in the Senate, one can expect that the IRA proposals will most likely be included in the next bill.

The effective date for most of the law changes will not be until the 2001 tax year or later.

TRA 99 contains the following 14 titles. Most of the IRA and pension changes are found in Title III, but some are to be found in Title IV, Title XIII and Title XIV.

Title I - Broad Based Tax Relief

Title II - Family Tax Relief Provisions

Title III - Retirement Savings Tax Relief

Title IV - Education Tax Relief Provisions

Title V - Health Care Tax Relief Provisions

Title VI - Small Business Tax Relief Provisions

Title VII - Estate and Gift Tax Provisions

Title VIII - Tax Exempt Organizations Provisions

Title IX - International Tax Relief

Title X - Housing and Real Estate Tax Relief Provisions

Title XI - Miscellaneous Provisions

Title XII - Extension of Expired and Expiring Provisions

Title XIII -Revenue Offsets

Title XIV - Technical Corrections

Title XV - Compliance With Congressional Budget Act

THE PROPOSED IRA CHANGES

IRA Law Change # 1 – Traditional and Roth

The contribution limit of $2,000 (and deduction limit for many taxpayers) would be increased over a three-year span to $5,000 and then there would be a COLA adjustment in increments of $100 for years after 2003.

Tax Year	Current Law	Proposed TRA 99	Change
1999	$2,000	NA	NA
2000	$2,000	NA	NA
2001	$2,000	$3,000	+ $1,000
2002	$2,000	$4,000	+ $2,000
2003 and thereafter	$2,000	$5,000	+ $3,000

IRA Law Change # 2 – Traditional and Roth

As with qualified plans, the IRA laws would be changed so that individuals who are age 50 or older would be eligible to make catch-up or larger contributions. These catch-up rules would apply to contributions as of January 1, 2001 (i.e. those contributions made in taxable years beginning after December 31, 2000).

Continued on page 2

Proposed Law Changes,
Continued from page 1

The standard contribution limit of $3,000, $4,000, or $5,000 would be increased by an applicable percentage so that these age 50 or over individuals would be eligible to make a larger contribution. The applicable percentage will increase according to the following table:

For Taxable Years Beginning In Year	Applicable Percentage Age 50 or Over	Standard Contribution Limit as Proposed	Adjusted Contribution Limit Age 50 or Over
2001	110%	$3,000	$3,300
2002	120%	$4,000	$4,800
2003	130%	$5,000	$6,500
2004	140%	$5,000	$7,000
2005 and thereafter	150%	$5,000	$7,500

IRA Law Change #3 – Traditional and Roth

Under current law, the spousal contribution which one spouse may contribute for himself or herself depends upon his or her own compensation plus the compensation of his or her spouse reduced by the amount allowed as a deduction to the spouse and reduced by any contribution which the spouse made to a Roth IRA. The IRS must have thought there was a possible gap in the law which needed to be closed. The current law does not expressly require a reduction if the spouse made a nondeductible contribution. This law change would be retroactively effective as of January 1, 1997.

IRA Law Change # 4 – Traditional

There would be an increase in adjusted gross income limits for most active participants. This change would allow more people to be able to deduct their entire $2,000 contribution (or a larger portion of it) or whatever amount the contribution limit is changed to be. This change would be effective for the 2001 tax year and future years.

Set forth below is a comparison of the applicable dollar amounts for a taxpayer who files a joint return:

Tax Year	Current Law	Proposed TRA 99	Change
1999	$51,000	NA	NA
2000	$52,000	NA	NA
2001	$53,000	$53,000	None
2002	$54,000	$54,000	None
2003	$60,000	$60,000	None
2004	$65,000	$65,000	None
2005	$70,000	$70,000	None
2006	$75,000	$75,000	None
2007	$80,000	$80,000	None
2008	$80,000	$84,000	+ $4,000
2009	$80,000	$89,000	+ $9,000
2010 and thereafter	$80,000	$91,000	+ $11,000

Set forth below is a comparison of the applicable dollar amounts for a taxpayer who files a return other than a joint return (other than a married individual filing a separate return):

Tax Year	Current Law	Proposed TRA 99	Change
1999	$31,000	NA	NA
2000	$32,000	NA	NA
2001	$33,000	$33,000	None
2002	$34,000	$34,000	None
2003	$40,000	$40,000	None
2004	$45,000	$45,000	None
2005	$50,000	$50,000	None
2006	$50,000	$50,000	None
2007	$50,000	$50,000	None
2008	$50,000	$52,000	+ $2,000
2009	$50,000	$54,500	+ $4,500
2010 and thereafter	$50,000	$57,000	+ $7,000

Note that the dollar amounts for a married person filing a separate return does not change. There will still be a phaseout range of $0 - $10,000.

IRA Law Change #5 – Roth

Under current law, a distribution from a Roth IRA is presumed, for federal withholding income tax purposes, to be fully taxable and thus is subject to withholding. This makes little sense since most distributions will not be taxable. The proposed law provides that withholding is not required to the extent it is reasonable to believe the distribution is not included in income. Remember that there are ordering rules for distributions from Roth IRAs—annual contributions come out first (nontaxable basis), conversions come out second (generally a return of basis and nontaxable) and earnings come out last. However, it is not all that simple since all Roth IRAs must be aggregated. This law change would be retroactively effective as of January 1,1998.

IRA Law Change #6 – Roth

Under current law, a person may make too much money so that he or she is ineligible or only partially eligible to make a contribution to a Roth IRA. In general, the limits for a single taxpayer are $95,000-$110,000 or more, and for a married person filing a separate return it is $150,000 to $160,000 or more. These income limits would be repealed for the 2003 tax year and all subsequent tax years.

IRA Law Change #7 – Traditional and Roth

Under current law, a person may make too much money so that he or she is ineligible to roll over or convert his or her traditional IRA to a Roth IRA. The current limit is $100,000. This would be increased to $1,000,000. It does not appear the law would be changed to resolve the marriage penalty. For a married person, it appears that his or her adjusted gross income still means the combined adjusted gross income of both spouses. This income limit change would first apply for the 2003 tax year

Continued on page 3

The Pension Digest

Proposed Law Changes, Continued from page 2

and all subsequent tax years. A COLA adjustment has not been authorized for this income limit.

IRA Law Change #8 – Traditional

Current law allows a rollover from an IRA to a qualified plan or 403(b) plan only if the funds are distributed from a conduit IRA which was holding funds rolled over from a previous qualified plan or 403(b) plan.

The proposed law would make radical changes in the rules. Any IRA funds would be able to be rolled into a qualified plan, a 403(b) plan or a section 457 plan. The proposed law contains a restriction which certain taxpayers will find very beneficial. The restriction is—it will not be permissible to roll over the nondeductible portion of any IRA. This rule will give an IRA accountholder who is tired of having to maintain, via a Form 8606, their nondeductible/nontaxable basis within their traditional IRA a way to end this task. Under current law it is not possible for an IRA accountholder who has made nondeductible contributions to withdraw his or her basis first. It must be done pro rata. Under the proposed rule, the accountholder is given a way to take out his or her basis first. The concept would be: Mary Palmer has an IRA with a balance of $38,000 which has a basis of $8,000. She could withdraw the entire $38,000, keep the $8,000 and not pay tax on it, and then roll over the $30,000 to a qualified plan. A short time later she could move the $30,000 back from the qualified plan to her IRA. The effect is—she has taken her nondeductible contributions out of her IRA first.

IRA Law Change #9 – Roth

As discussed in QP Change #l (on page 4), a Roth IRA will be able to receive rollover contributions from a Plus Contribution account. Current law authorizes rollover contributions to a Roth IRA only from a traditional IRA (and then a conversion occurs) or another Roth IRA.

IRA Law Change #10 – Traditional

As discussed in QP Change #8, an IRA will be able to accept rollover contributions of nondeductible employee contributions from a qualified plan.

IRA Law Change #11 – Traditional

The current law governing the rollover from a SIMPLE-IRA to a traditional IRA regarding the two-year requirement is very poorly written, and the proposed law would provide needed clarification. The change would be effective for year 2001.

IRA Law Change #12 - Traditional

The standard withholding rate of 10% which applies to almost all IRA distributions would be increased to 15% for distributions occurring after December 31, 2000.

IRA Law Change #13 - Traditional, Roth & Education

There would be an expansion of the law as of January 1, 2000 (for those with calendar-year tax years) so that more coins will not be treated as a collectible. The new rule would define the following coins as NOT being a collectible and thus would be a permissible investment for IRA funds. Any coin certified by a recognized grading service and traded on a nationally-recognized electronic network, or any coin listed by a recognized wholesale reporting service and (1) which is or was at any time legal tender in the United States or (2) issued under the laws of any state.

Observation. The IRS has written Article III of its Model IRA forms (traditional and Roth) to define what coins are not collectibles. Presumably, if this law change was adopted, the IRS would issue a revised model IRA form(s). The last time the "coins" rules were changed, the IRS did not require the IRA custodian to issue an IRA amendment.

IRA Law Change #14 - Traditional

The general rule is that the recipient of a distribution from a traditional IRA must include this amount in his or her taxable income and pay tax on the distribution. An exception exists under current law for a distribution from an IRA to a nonprofit entity which was an IRA beneficiary because they generally do not have any taxable income. However, this exception only applies after the IRA accountholder had died.

The proposed law provides an exception to the general taxation rule while the accountholder is still alive. If the distribution qualifies as a "qualified charitable distribution," then no amount shall have to be included in the gross income of the recipient. There are special rules which apply to certain charitable remainder trusts, pooled income funds and charitable gift annuities. A qualified charitable distribution means any distribution from a traditional IRA (not a Roth IRA) which is made on or after the date the accountholder attains age 70 1/2 and which is a charitable contribution made directly from the IRA to a section 170(c) organization or a special type of trust, fund or annuity. As a result of such a withdrawal, the taxpayer must adjust the charitable deduction to which he or she is entitled. The amount of the deduction is reduced (but not below zero) by the sum of the qualified charitable distributions excluded from income. Note that there is no limit as to what amount may be excluded from income. This change applies to year 2001.

IRA Law Change #15 - SIMPLE-IRA

There would be an increase in the deferral limit with respect to elective deferral amounts under a SIMPLE-IRA plan.

Tax Year	Current Law	Proposed TRA 99	Change
1999	$6,000	NA	NA
2000	$6,000	NA	NA
2001	$6,000	$7,000	at most $1,000
2002	$6,000	$8,000	at most $2,000
2003	$6,000	$9,000	at most $3,000
2004 and thereafter	$6,000	$10,000	at most $4,000

Continued on page 4

Proposed Law Changes,
Continued from page 3

IRA Law Change #16 - SIMPLE-IRA

Catch-up contributions to a SIMPLE-IRA plan (i.e. increased elective deferrals) would be permitted for individuals age 50 or over. The individual must attain age 50 before the close of the year. There would be a limit as to the amount of these catch-up contributions. They cannot exceed the lesser of: (1) the applicable percentage, or (2) the excess of an individual's compensation over any other elective deferrals he or she would make. This limit appears reasonable—an individual should not be able to defer more than his or her compensation. The applicable percentage would be:

For Taxable Years Beginning In Year	Applicable Percentage Age 50 or Over	Standard Contribution Limit as Proposed	Adjusted Contribution Limit Age 50 or Over
2001	110%	$7,000	$7,700
2002	120%	$8,000	$9,600
2003	130%	$9,000	$11,700
2004	140%	$10,000	$14,000
2005 and thereafter	150%	$10,000	$15,000

IRA Law Change #17 – Education

The definition of who is a family member would be expanded to include the first cousin (and his or her spouse) of the designated beneficiary. This change would be effective for year 2000 and subsequent years.

IRA Law Change #18 – Education

The definition of qualified higher education expenses would be changed in two ways. First, the amount spent for books, supplies and equipment could not exceed the allowance for the same included in the cost of attendance as determined by the college or university as of the date TRA 99 would be enacted. Second, it would be clarified that expenses for sports, games or hobbies will not qualify as a qualified higher education expense unless they are part of the student's major (i.e. degree program) or are taken to improve the student's job skills. These changes would be effective for the year 2000 and subsequent years.

PROPOSED QUALIFIED PLANS, SECTION 403(b) AND SECTION 457 CHANGES

QP Change #1

The laws governing qualified plans would be changed to allow a qualified plan to be written to allow a participant to set up his or her IRA within the qualified plan. The qualified plan could accept both annual IRA contributions and rollover IRA contributions from either traditional IRAs or Roth IRAs. This change would be effective for the 2000 tax year/plan year.

This type of provision was also adopted in 1984-1986; the qualified plan administrators at that time did not want to worry about setting up separate accounts for the IRA funds. It appears the large service providers (brokerage companies) now want to see if they again can sell the concept of having just one company handle the investments for a taxpayer if that is what the taxpayer wants.

It is not totally clear what all of the rules would be for this "IRA within a qualified plan."

QP Change #2

The current law does not authorize the rollover of a distribution from a section 457 plan, to either a qualified plan, an IRA or a 403(b) plan and the law does not authorize a rollover to a section 457 plan from a qualified plan, an IRA or a section 403(b) plan. The proposed law would authorize these additional types of rollovers. In addition, direct rollovers would be authorized for distributions from a 457 plan or 403(b) plan only if the receiving plan provides for the separate accounting for such a rollover. The rollover explanation to be furnished by the plan administrator would be required to explain the special tax features associated with these different types of plans. This change would be effective for 2001.

QP Change #3

Effective for 2001 the rules governing 401(k) plans and 403(b) plans would be changed so that a participant would have the option to have his or her elective deferral contribution contributed to a new type of program called a "Plus Contribution Program." The concept would be—for income taxation purposes this Plus Contribution Program would be treated in a manner very similar to how Roth IRA contributions are treated. There would be no immediate tax benefit realized for the elective deferral amount, but all qualified distributions from such a program would be excluded from income.

A qualified plan, or a section 403(b) plan, would have to be written to include this Plus Contribution Program. Of course, there would need to be separate accounting for such contributions and related earnings. An individual would have to indicate what portion of his or her elective deferrals he or she wants to designate as a Plus Contribution. It would be permissible to roll over funds within a Plus Contribution account to another Plus Contribution Program or a Roth IRA if certain rules are met.

As with the Roth IRA, there is a five-year rule for the Plus Contribution Program. A qualified distribution is any distribution which is made after the five taxable year period beginning with the earlier of: (1) the first taxable year for which the individual makes a designated Plus Contribution under the same plan; or (2) if the individual rolled over a designated Plus Contribution from a different and previously established plan, then the first taxable year for which the individual made a designated Plus Contribution. The rule is written to encourage rollovers from one qualified plan to another qualified plan because if there is no rollover, then the individual must satisfy a new five-year require-

Continued on page 5

The Pension Digest

Proposed Law Changes, Continued from page 4

ment with respect to a new employer.

For taxation purposes, Code 72 shall apply separately to distributions from a Plus Account versus other payments from the 401(k) or 403(b) plan.

QP Change #4

There would be an increase in the limit with respect to elective deferral amounts.

Tax Year	Current Law	Proposed TRA 99	Change
1999	$10,000	NA	NA
2000	$10,000	NA	NA
2001	$10,000	$11,000	at most $1,000
2002	$10,000	$12,000	at most $2,000
2003	$10,000	$13,000	at most $3,000
2004	$10,000	$14,000	at most $4,000
2005 and thereafter	$10,000	$15,000	at most $5,000

QP Change #5

Catch-up contributions to a 401(k) plan (i.e. increased elective deferrals) would be permitted for individuals age 50 or over. The individual must attain age 50 before the close of the plan year. The plan would need to be written to allow such catch-up contributions. There would be a limit as to the amount of these catch-up contributions. They cannot exceed the lesser of: (1) the applicable percentage, or (2) the excess of an individual's compensation over any other elective deferrals he or she would make. This limit appears reasonable—an individual should not be able to defer more than his or her compensation. The applicable percentage would be:

For Taxable Years Beginning In Year	Applicable Percentage Age 50 or Over	Standard Contribution Limit as Proposed	Adjusted Contribution Limit Age 50 or Over
2001	110%	$11,000	$12,100
2002	120%	$12,000	$14,400
2003	130%	$13,000	$16,900
2004	140%	$14,000	$19,600
2005 and thereafter	150%	$15,000	$22,500

QP Change #6

An employer, in general, under current law is permitted to deduct 15% of the participants' aggregate compensation for such year. Under current law, elective deferrals are applied in the first step of determining the permissible deduction by the employer. Elective deferrals have the effect of reducing the amount which the employer can deduct. For example, ABC Corporation has a payroll expense of $500,000 before considering elective deferrals of $40,000. If not for the elective deferrals, the employer could contribute and deduct $75,000 ($500,000 x 15%).

Because of the elective deferrals of $40,000 however, the employer can deduct, by contributing an additional $19,000, a maximum of only $69,000 (($500,000-40,000) x 15%). Under the proposed law, elective deferrals would not be taken into account in determining the employer's deduction limit. Thus, the employer could deduct $75,000 in the above situation. This change would not occur until 2001 and subsequent years.

QP Change #7

Current law places both a percentage limit and annual amount limit on the contribution which an employer can make for any participant. The limit is the lesser of $30,000 or 25% of compensation. The law would be changed by replacing the 25% with 100%. That is, there would be no percentage limit. The concept is—a person earning $8,000 could defer the entire $8,000 into a 401(k) plan if they could otherwise afford to do so. This change would be effective for the 2001 tax year.

QP Change #8

The current law allows a surviving spouse to roll over his or her deceased spouse's account balance in a qualified plan only to his or her own IRA. The proposed law would allow the surviving spouse to roll over funds to a qualified plan in which he or she was a participant. This change would be effective for 2001.

QP Change #9

The current law does not permit the rollover of nondeductible employee contributions within a qualified plan to another qualified plan or an IRA. The proposed law would permit such rollovers effective for the year 2001. A qualified plan which will accept such rollovers must provide for separate accounting.

QP Change #10

The current law mandates a certain rate of vesting for the employer's contributions. An employer can choose between a vesting schedule which complies with the 3/7-year rule or the five-year cliff rule. The proposed law change would require a plan which uses the cliff rule to have a three-year cliff rather than the five-year cliff rule for the employer's matching contributions. The change is effective for 2001.

QP Change #11

Current law requires a participant who takes a hardship distribution from a 401(k) plan to be ineligible to make additional elective deferrals for 12 months. Under the proposed law, the time limit would be reduced to six months. The change would be effective for the 2001 year.

QP Change #12

Under current law, in some top heavy plan situations, an employer is required to make a minimum contribution for non-highly compensated employees. Under current law, an employer is not permitted to use matching contributions which it makes to satisfy this minimum contribution requirement. The top-heavy rules would be changed so the employer could use its matching contributions to satisfy the minimum contribution requirement.

The top-heavy rules would also be changed by eliminating family attribution. Certain 401(k) plans, by definition, would be

Continued on page 6

Proposed Law Changes, Continued from page 5

defined to be a non-top-heavy plan.

QP Change #13

Current law provides that prohibited transactions will occur if a plan lends, pays any compensation for personal services or buys or sells any plan property to an owner-employee, a family member of an owner-employee or certain corporations in which the owner-employee has an ownership interest. The current law allows one exception—the sale of employer stock to an ESOP plan. In addition to the standard definition, an owner-employee for this purpose is also defined to be: (1) a participant or beneficiary of an IRA; (2) an employer or an association of employees which establishes an IRA under section 408(c); or (3) a shareholder-employee (i.e. an employee or officer of an S Corporation who owns or is considered as owning more than 5% on any day during the tax year). The law would be changed to allow loans to shareholder-employees. This change would be effective for loans made after December 31, 2000.

QP Change #14

There would be reduced PBGC premiums for new plans of small employers. This change would apply to 2001 and subsequent years.

QP Change #15

Current law provides that an employer may unilaterally distribute to a terminated participant his or her account balance as long as it is $5,000 or less. The proposed law change would be that the employer would be able to exclude from consideration any rollover balance. For example, Max Murphy has an account balance of $20,000, $16,000 of which came from a rollover and $4,000 from his current employer's contributions. In this case, the $16,000 would not need to be considered, and since the $4,000 attributable to this employer is less than the $5,000 limit, the employer could pay out the entire $20,000 without the consent of the participant.

QP Change #16

The current law and IRS procedures require that many small business owners with a qualified plan or Keogh file a Form 5500-EZ each year. The general rule is that this form must be filed annually if the plan has ever had more than $100,000 in plan assets or if the plan has terminated. The proposed law change would be—any one-participant plan (including the owner and spouse) would not be required to file a return for a given year if the plan had assets of $500,000 or less as of the close of the plan year.

In addition, if the plan has less than 25 participants as of the first day of the plan year and certain other conditions are met, then this plan will be able to file a simplified Form 5500 which is to be substantially similar to the Form 5500 required to be filed by a one-participant plan.

QP Change #17

There would be an elimination of any user fee for requests to the IRS regarding new pension plans by an eligible employer. There cannot have been any contributions made or benefits accrued to a plan sponsored by the employer (or a predecessor) in the three most recent tax years ending prior to the year the request is made to the IRS. This change would be effective for 2001 and subsequent years.

QP Change #18

In general, the deadline for amendments would be—on or before the last day the first plan year beginning on or after January 1, 2003.

PROPOSED NEW TYPES OF TAX-PREFERRED PLANS

Individual Development Account

The law would create a new type of tax-preferred savings account—an Individual Development Account (IDA). Contributions to an IDA would be authorized only for the years 2001 to 2005 unless another law would extend the right to make contributions. Code section 530A would be the authority for the IDA. Section 530 is the authority for the Education IRA. The IDA would be available to certain individuals with relatively lower incomes and net worths. These individuals would make contributions within defined limits. A financial institution (not an employer) would have the right to make a matching contribution. The individual is able to exclude from his or her gross income the amount of any matching contribution plus the related earnings. The individual will forfeit an amount in the matching account established for himself or herself to the extent he or she takes a distribution from an IDA which is not a qualified expense distribution and which is not recontributed as a qualified rollover. The financial institution will use any forfeited funds to make eligible matching contributions for other IDA contributions made by other eligible individuals.

The reason that a financial institution would have an interest in making matching contributions is that the financial institution would be allowed a credit on its corporate income tax return. The credit would be an amount equal to 85% of that year's eligible matching contributions. The credit cannot exceed the excess of the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55 over the sum of certain other credits.

An IDA is a custodial account established pursuant to a written governing instrument for the exclusive benefit of an individual or such individual's beneficiaries. The written governing instrument must contain the following six provisions:

1. The custodian of the account must be a qualified financial institution—this means any entity or person authorized to be a trustee of any IRA as defined in section 408(a)(2).

2. The contribution must be in cash except in the case of a qualified rollover.

3. Contributions will not be accepted for any tax year if they exceed the lesser of: $350 or an amount equal to the compensation includible in the eligible individual's gross income for such tax year. Presumably, then, the standard annual contribution will

Continued on page 7

The Pension Digest

Proposed Law Changes,
Continued from page 6

be $350 since most individuals would have compensation in excess of $350.

4. The interest of the accountholder in this IDA (determined without regard to any matching contributions or related earnings) must be nonforfeitable.

5. The investments of the IDA cannot be commingled with other property or investments except in a common trust fund or common investment fund.

6. There can be distributions from the IDA only if they qualify as a qualified expense distribution unless certain rules are met. A qualified expense distribution is one which meets the following three requirements:

a. It must be paid by the financial institution serving as the custodian of the IDA directly to the person to whom an amount is owed or to another IDA.

b. Before payment by the institution, the accountholder must have completed an economic literary course offered by the financial institution, a nonprofit organization or a government entity.

c. It is used exclusively to pay the qualified expenses of the accountholder, or the accountholder's spouse, or their dependents. A qualified expense is any of the following:

(1) A qualified higher education expense. This term has the same meaning it has for IRA purposes except postsecondary vocational educational schools are treated as eligible educational institutions. There is coordination with other tax code provisions providing credit exclusions from income so there will be no double benefit.

(2) Qualified first-time home buyer costs. These costs are qualified acquisition costs as defined for IRA purposes except the $10,000 limit does not apply.

(3) Qualified business capitalization costs. This means certain expenditures (capital, plant, equipment, working capital and inventory) for the capitalization of a qualified business pursuant to a qualified business plan. The Secretary of Housing and Urban Development shall specify when a business plan will be a qualified business plan.

(4) Qualified rollovers. This is a distribution from an IDA which is paid to the same IDA or another IDA within 120 days of the payment. The law provides that rules similar to the IRA rollover rules shall apply. This means that one rollover per twelve-month period should be permissible.

Who Is Eligible for an IDA?

Only certain individuals are eligible. An eligible individual is an individual who: (1) is 18 years old or older; (2) is a citizen or legal resident of the United States; and (3) is a member of one of three types of households. A household means all individuals who share the use of a dwelling unit as primary quarters for living and eating separate from other individuals. The first type of household is one which is eligible for the earned income tax credit under section 32. The second type of household is one which is eligible for assistance under a State program funded under Part A of title IV of the Social Security Act. The third type of household is one which has gross income which does not exceed 60% of the area median income (as determined by the Department of Housing and Urban Affairs) and which has a net worth not exceeding $10,000. The net worth of a household is defined to be aggregate fair market value of all assets that are owned in whole or in part by any member of a household less the obligations or debts of any member of the household. However, there is a calculation rule which lessens greatly the practical impact of the $10,000 net worth requirement. For purposes of determining the net worth of a household, a household's assets shall be determined by excluding the primary dwelling unit and one motor vehicle.

Special Administrative and Tax Requirements

The financial institution shall report to those individuals for whom it has made a matching contribution, the amount of such contribution on not less frequently than a quarterly basis.

At the time an individual establishes his or her IDA account and at least annually thereafter, the individual must furnish the financial institution with a copy of his or her Form W-2 and such other forms as the IRS may require to prove his or her status as an eligible individual.

All IDAs Shall be Treated as One Account

The IDA custodian will be required to prepare reporting forms as the IRS shall require for the accountholder and the IRS. The deadline for furnishing the report to the individual shall be January 31 of the following year.

SAFE Trusts and SAFE Annuities

Another new type of employer-sponsored retirement plan would be created. This new type of plan is a simplified defined-benefit plan with rules very similar to those which apply to a SIMPLE-IRA plan. This plan would first be available for the year 2001 and subsequent years. There would be two versions of this plan—a SAFE TRUST plan or a SAFE ANNUITY plan.

As with the SIMPLE-IRA plan, a business entity may establish and maintain a SAFE plan for any year only if, on any day of the preceding year, it employed 100 or fewer employees who earned at least $5,000 and the business entity does not maintain another retirement plan other than a SIMPLE-IRA plan or a plan similar to a SIMPLE-IRA plan.

A SAFE ANNUITY means, in general, an IRA annuity, but there is no $2,000 limit and only the employer may make contributions.

This plan must cover all employees who received at least $5,000 in compensation from the employer during any two consecutive preceding years, and received at least $5,000 in compensation during the current year. The plan is permitted to exclude certain union employees and nonresident aliens.

As mentioned above, this SAFE annuity plan is a simplified defined-benefit plan. The form of the benefit is—a single life

Continued on page 8

Proposed Law Changes,
Continued from page 7

annuity with monthly payments (with no ancillary benefits) beginning at age 65. However, the participant may elect any other form of benefit (a joint life annuity) which is the actuarial equivalent of the single life annuity. In addition, the joint and survivor and preretirement survivor annuity rules apply.

Each year the employer must fund the plan to provide the benefit due each participant. The employer is required to contribute to each participant's annuity each year the amount necessary to purchase the SAFE ANNUITY in the amount of the benefit accrued for such year. The employer has until its tax filing deadline for such year (including extensions) to make the contribution. The 10% tax and the 100% tax imposed under Code section 4971 will apply if the employer fails to make the required contributions.

The accrued benefit for each participant for the current year when expressed as a single life annuity cannot be less than 3% of the participant's compensation for such year. The employer will have the option to use a percentage of 0%, 1%, or 2% for a given year if the employer notifies its employees of the percentage within a reasonable period before the beginning of such year. Compensation is capped at the $160,000 (or the COLA adjusted amount) level. The rules requiring continued benefit accrual beyond age 65 also apply. A participant's accrued benefit is always 100% vested. **Observation.** The law as proposed would seem to allow an employer to set the applicable percentage at larger than 3%.

If certain special nondiscrimination rules are met, the employer may grant credit and make contributions for service before the plan was adopted. It will be permissible for a participant to transfer or roll over other funds into this SAFE ANNUITY plan.

A participant will only be able to withdraw funds from his or her SAFE ANNUITY if he or she has attained age 65 or if he or she separates from service, dies or becomes disabled. A participant will be able to roll over funds from one SAFE ANNUITY to another SAFE ANNUITY. If a participant receives a distribution prior to age 59 1/2, then he or she will owe a 20% additional tax and not the 10% tax.

A group annuity policy providing for individual accounting will be able to qualify as a SAFE ANNUITY.

There would be some type of simplified annual return required to be filed with the IRS and there would be a requirement to furnish a summary description setting forth: (1) the name and address of the employer and the issuer; (2) the eligibility requirements; (3) the benefits provided by the plan; and (4) the procedures for, and effects of, withdrawals (including rollover) from the plan.

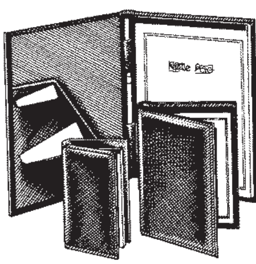
SAFE Trust Plan

A SAFE TRUST plan means a trust forming part of a defined-benefit plan which meets, in general, all of the same rules which the SAFE ANNUITY must meet. The employer will be required to make annual contributions to fund the promised accrued benefit. However, there are the following differences.

First, the SAFE TRUST must meet the requirements of code sections 401(a) as modified by 401(d).

Second, each participant's benefit under the plan is based on his or her balance which is maintained in a separate account.

Third, although the plan may accumulate funds for a participant and then purchase a SAFE annuity, it will also have the option of permitting, as an optional form of benefit, the distribution of the entire balance to the credit of the participant. If the participant is under age 65, such distribution must be in the form of a transfer to a SAFE ANNUITY, another SAFE TRUST, a SAFE ROLLOVER plan (if the amount is more than $5,000) or a traditional IRA if the amount is less than $5,000. A SAFE ROLLOVER plan is an IRA which accepts only rollover contributions from a SAFE ANNUITY or SAFE TRUST.



Fourth, because this is a trust arrangement, separate accounts must be maintained. For actuarial purposes, the assumed interest rate shall be not less than 3% and not more than 5% per year. If an "unfunded" liability arises because of investment losses, then the employer will have to make additional contributions.

Fifth, a SAFE TRUST must prohibit the trust from holding directly or indirectly securities which are not readily tradable on an established securities market or otherwise.

Sixth, a SAFE TRUST would be able to designate a designated financial institution as can be done with a SIMPLE-IRA plan.

SPECIAL RULES APPLYING TO BOTH SAFE PLANS

The following special rules apply to both SAFE TRUST plans and SAFE ANNUITY plans.

First, for purposes of Code section 401(a) a SAFE ANNUITY or SAFE TRUST is deemed to comply with the nondiscrimination rules, minimum participation rules, coverage rules, benefit accrual rules, minimum funding rules, limits on benefits and contribution rules and the top heavy rules.

Second, contributions to a SAFE ANNUITY or SAFE TRUST do not count against the limits set forth in Code section 404. If the benefit can be greater than 3% of compensation (e.g. 90% of compensation) this seems to be too good of a deal and one would expect future legislation would create some limits.

Summary. Defined-benefit plans have played a much lesser role in the pension system since the rules became so complex. The proposed creation of the SAFE ANNUITY and SAFE TRUST are an attempt to increase the popularity of defined-benefit plans. Such plans will certainly become more popular if the proposed law with its "very few limits" approach would become law. The purpose of this article has been to summarize the main features of these plans. President Clinton has been a proponent of such plans. ◆