[JOINT COMMITTEE PRINT]

DESCRIPTION OF CERTAIN REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2014 BUDGET PROPOSAL

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

December 2013

U.S. Government Printing Office
Washington: 2013

JCS-4-13

C. Require Nonspouse Beneficiaries of Deceased IRA Owners and Retirement Plan Participants to Take Inherited Distributions Over No More Than Five Years

Present Law

In general

Tax-favored treatment applies to employer-sponsored retirement plans that meet certain requirements and to individual retirement arrangements ("IRAs").[325] Minimum distribution rules apply to tax-favored employer-sponsored retirement plans and IRAs.[326] In general, under these rules, during an employee's (or IRA owner's)[327] lifetime, distribution of minimum benefits must begin no later than the required beginning date and a minimum amount must be distributed each year.[328] Minimum distribution rules also apply to benefits payable with respect to an employee who has died. Regulations provide a methodology for calculating the required minimum distribution from an individual account under a defined contribution plan or from an IRA. In the case of annuity payments under a defined benefit plan or an annuity contract, the regulations provide requirements that the annuity stream of payments must satisfy.[329]

Failure to comply with the minimum distribution requirement for a year may result in an excise tax (imposed on the individual who was required to take the distribution) of 50 percent of the portion of the required distribution for the year that was not distributed.[330] In the case of an employer-sponsored plan, failure to comply with the minimum distribution requirement may result in loss of tax-favored status.

Required beginning date

For traditional IRAs, the required beginning date is April 1 following the calendar year in which the IRA owner attains age 70½. For employer-sponsored plans, for an employee other

---

[325] 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 eligible deferred compensation plans of governmental employers under section 457(b).

[326] Secs. 401(a)(9), 403(b)(1), 408(a)(6), 408(b), and 457(d)(2). The minimum distribution rules apply also to eligible deferred compensation plans of nongovernmental tax-exempt employers.

[327] Except where otherwise indicated, references herein to "employee" include IRA owners.

[328] Under section 408A(c)(5), these requirements do not apply to a Roth IRA. For a discussion of traditional and Roth IRAs, see Joint Committee on Taxation, *Report to the House Committee on Ways and Means on Present Law and Suggestions for Reform Submitted to the Tax Reform Working Groups* (JCS-3-13), May 6, 2013, Part II.I.4.

[329] Under section 823 of the Pension Protection Act of 2006, Pub. Law No. 109-280, and Treas. Reg. sec. 1.401(a)(9)-1, A-2(d), a tax-favored employer-sponsored retirement plan that is a governmental plan is treated as having complied with the minimum distribution rules if the plan complies with a reasonable and good faith interpretation of the statutory rules.

[330] Sec. 4974. The excise tax may be waived in certain cases.

than a five-percent owner in the year the employee attains age 70½, the employee's 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 under an employer-sponsored plan who is a five percent owner 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 for individual accounts

While an employee is alive, distributions of the employee's interest are required to be made (in accordance with the regulations) over the life or life expectancy of the employee, or over the joint lives or joint life expectancy of the employee and a designated beneficiary.[331] 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 is alive, is the factor from the uniform lifetime table included in the Treasury regulations.[332] This table is based on the joint life and last survivor expectancy of the employee and a hypothetical beneficiary 10 years younger.

Distributions after death

Payments over a distribution period

The rules for distributions after death vary depending on (1) whether an employee dies on or after the required beginning date or before the required beginning date, and (2) whether there is a designated beneficiary for the benefit. Under the regulations, a designated beneficiary is an individual designated as a beneficiary under the plan.[333] Similar to the lifetime rules, for defined contribution plans and IRAs, the required minimum distribution for each year after the death of the employee is generally determined by dividing the account balance as of the end of the prior year by a distribution period.[334]

---

[331] Sec. 401(a)(9)(A).

[332] Treas. Reg. sec. 1.401(a)(9)-5. 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.

[333] 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. There are special rules for multiple beneficiaries and for trusts named as beneficiary (where the beneficiaries of the trust are individuals). However, if an individual is named as beneficiary through the employee's will or the estate is named as beneficiary, there is no designated beneficiary for purposes of the minimum distribution requirements.

[334] If the employee's surviving spouse is the beneficiary, the surviving spouse generally is permitted to roll his or her interest over on a nontaxable basis to his or her own IRA or a tax-favored employer-sponsored plan in which he or she participates. If the surviving spouse is the sole beneficiary of an IRA, this rollover can be accomplished by simply renaming the IRA as an IRA owned by the surviving spouse. In either case, with respect to the rollover account, the surviving spouse is treated as the employee (rather than as a designated beneficiary) for purposes of the minimum distribution rules.

If an employee dies on or after the required beginning date, the remaining interest must be distributed at least as rapidly as under the minimum distribution method being used as of the date of death.[335] Under the regulations, for individual accounts, if there is no designated beneficiary, the distribution period is equal to the remaining years of the employee's life expectancy, as of the year of death.[336] If there is a designated beneficiary, the distribution period (if longer than the employee's remaining life expectancy) is the beneficiary's life expectancy calculated using the life expectancy table in the regulations, calculated in the year after the year of the death.[337]

If an employee dies before the required beginning date and any portion of the benefit is payable to a designated beneficiary, distributions generally are 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.[338] Under the regulations, for individual accounts, the distribution period is measured by the designated beneficiary's life expectancy, calculated in the same manner as when the employee dies on or after the required beginning date.[339]

In all cases where distribution after death is based on life expectancy (either the remaining life expectancy of the employee or a designated beneficiary), the distribution period generally is fixed at 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.[340]

---

[335] Sec. 401(a)(9)(B)(i).

[336] Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(2).

[337] Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(1).

[338] In the case of a designated beneficiary who is the surviving spouse, special rules apply (in addition to the rule allowing a surviving spouse to roll an inherited interest over to the spouse's own IRA or employer's plan). In that case, distributions are not required to commence until the year in which the employee would have attained age 70½. If the surviving spouse dies before the employee would have attained age 70½, the after-death rules for death before distributions have begun are applied as though the spouse were the employee.

[339] Treas. Reg. sec. 1.401(a)(9)-5, A-5(b).

[340] If the distribution period is based on the surviving spouse's life expectancy (whether the employee'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.

Five-year rule

If an employee dies before the required beginning date and there is no designated beneficiary, then the entire remaining interest of the employee must generally be distributed by the end of the fifth calendar year following the individual's death.[341]

Defined benefit plans and annuity distributions

The regulations provide rules for annuity distributions from a defined benefit plan or an annuity contract purchased from an insurance company (including an annuity contract held in an employee's account under a defined contribution plan) paid over an individual's life or life expectancy.[342] Annuity distributions are generally required to be nonincreasing with certain exceptions, which include, for example, increases to the extent of certain specified cost of living indexes, a constant percentage increase (for a qualified plan, the constant percentage cannot exceed five percent per year), certain accelerations of payments, and 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.[343] 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, the survivor annuitant is limited to a percentage of the life annuity benefit for the employee. 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.[344]

Anti-cutback rules

Tax-favored employer-sponsored retirement plans often offer employees multiple options as to the form in which to receive benefits (for example, as a lump sum, in installments, or as an annuity), referred to as optional forms of benefit. For married participants, certain qualified retirement plans are required to offer a qualified joint and survivor annuity ("QJSA"), which is generally a life annuity for the participant with an annuity of at least 50 percent of the participant's annuity amount payable to the surviving spouse after the participant's death. In addition, a plan that offers annuity benefits may allow an employee to designate a nonspouse beneficiary (only with spousal consent in the case of a married participant).

The requirements for qualified retirement plans include various protections for benefits that employees have already earned, including the "anti-cutback" rules. Under these rules, amendments that eliminate optional forms of benefit with respect to previously earned benefits

[341] In some cases, this rule may apply to a designated beneficiary. See Treas. Reg. sec. 1.401(a)(9)-4, A-4.

[342] Treas. Reg. sec. 1.401(a)(9)-6.

[343] Treas. Reg. sec. 1.401(a)(9)-6, A-14.

[344] Treas. Reg. sec. 1.401(a)(9)-6, A-2(c).

are prohibited unless permitted under regulations.[345] Exceptions to the "anti-cutback" rules apply. For example, optional forms of benefit under a defined contribution plan can generally be eliminated as long as the plan offers lump sums payable at the same times, and the IRS may allow the elimination of an optional form of benefit (or other protected benefit) to the extent required to comply with a statutory change.[346]

Description of Proposal

Under the proposal, after an employee's death, a nonspouse beneficiary, other than an eligible beneficiary, is required to take distributions over no more than five years.[347] For this purpose, an eligible beneficiary is any beneficiary who, as of the date of the employee's death, is (1) disabled, (2) a chronically ill individual, (3) an individual who is not more than 10 years younger than the employee, or (4) a child who has not reached the age of majority.

In the case of an eligible beneficiary, distributions are generally allowed over the life or life expectancy of the beneficiary, beginning in the year following the year of the death of the employee. However, in the case of an eligible beneficiary who is a minor child, the benefit must be fully distributed no later than five years after the child reaches the age of majority.

On the death of any beneficiary, including a surviving spouse or an eligible beneficiary, any remaining balance would be required to be distributed by the end of the calendar year that includes the fifth anniversary of the participant's death.

Effective date.−The proposal is generally effective for distributions with respect to employees who die after December 31, 2013. The requirement that any balance remaining after the death of a beneficiary be distributed by the end of the calendar year that includes the fifth anniversary of the beneficiary's death applies also with respect to employees who die before January 1, 2014, but only if the beneficiary dies after December 31, 2013. The proposal does not apply in the case of an employee whose benefits are determined under a binding annuity contract in effect on the date of enactment.

Analysis

The tax subsidy for retirement savings is intended to provide an incentive for individuals, particularly middle- and lower-income individuals, to save for retirement. Various additional incentives, such as higher contribution limits than those applicable to IRAs, apply with respect to

[345] Sec. 411(d)(6). The "anti-cutback" rules generally prohibit amendments that reduce an employee's accrued benefit (whether or not vested) or eliminate optional forms of benefit or eliminate or reduce early retirement benefits or retirement-type subsidies with respect to the employee's accrued benefit. Most governmental plans and church plans are excepted from these rules.

[346] Treas. Reg. sec. 1.411(d)-4(e) and -4(b)(2)(i).

[347] The proposal does not change the rules for minimum distributions to a surviving spouse during the lifetime of the surviving spouse or the ability of a surviving spouse to roll the inherited benefit over to his or her own retirement plan or IRA.

employer-sponsored plans in order to encourage employers to sponsor plans, thereby increasing the potential for middle- and lower-income employees to save for retirement. At the same time, some aspects of the tax rules are intended to limit the amount that can be saved on a tax-favored basis to an amount reasonably needed for retirement and to maximize the chance that tax-favored savings will in fact be used for retirement. With respect to the latter goal, restrictions on distributions from employer-sponsored retirement plans and additional taxes applicable if distributions are taken before retirement age, death or disability help to preserve savings until retirement.[348] The minimum distribution rules attempt to assure that tax incentives for retirement savings are not instead used as a means of accumulating wealth to pass on after death.

Some view the present-law minimum distribution rules for nonspouse beneficiaries as allowing savings to stay in tax-favored form for longer than is appropriate. In many cases, a designated beneficiary is not dependent on the employee for support, yet is permitted to take distributions over his or her lifetime or life expectancy. Depending on the age of a beneficiary, the required minimum distribution for the beneficiary may be less than the earnings on the account for the year and thus may allow not only continued tax deferral of the amount of the employee's account balance at death but also additional tax-deferred growth of the account.[349] A desire to maximize tax-deferred treatment in some cases leads to the designation of as young a beneficiary as possible.

The proposal addresses these concerns by requiring distributions over five years after the employee's death, except in the case of certain "eligible" nonspouse beneficiaries. Eligible beneficiaries include individuals who are likely to have been supported by the employee (a minor child), or to have a particular income need over the individual's lifetime (a disabled or chronically ill individual), or whose life expectancy is not expected to result in significantly longer tax deferral than the employee's (an individual not more than 10 years younger than the employee). Nonetheless, some may view the definition of eligible beneficiary as too narrow to accommodate the various relationships that may provide a legitimate reason for an employee to want to provide a particular beneficiary with income over the beneficiary's lifetime at the higher level possible with tax-deferred growth. For example, an employee may wish to provide lifetime retirement income for a sibling who has limited financial means and is more than 10 years younger. Others may note that the proposal does not prevent the employee from providing lifetime retirement income for the sibling, but merely limits doing so on a tax-deferred basis.

Under the present-law minimum distribution rules, if the original spouse or nonspouse beneficiary of an employee dies, distributions are required only over the original beneficiary's

---

[348] Restrictions on distributions before termination of employment ("in-service" distributions) and before a certain age apply to defined benefit plans, certain defined contribution plans, section 403(b) plans and section 457(b) plans. In addition, under section 72(t), unless an exception applies, a ten-percent additional tax applies to the portion of a distribution from a tax-favored retirement plan before age 59½ that is includable in income.

[349] Under the single life table in Treas. Reg. sec. 1.401(a)(9)-9, A-1, an adult beneficiary age 60 or younger has a life expectancy of more than 25 years, resulting in an initial required distribution of less than four percent of the account balance. Under the table, the life expectancy of an individual age 33 or younger is more than 50 years, resulting in an initial required minimum distribution of less than two percent of the account balance.

remaining life expectancy as of the time of death. This provides the opportunity for further tax deferral beyond the period of the beneficiary's life. The proposal addresses this by requiring distributions over five years after the death of the original beneficiary, including an eligible beneficiary or a surviving spouse.

The proposal is silent as to whether the five-year rule applies only in the case of a surviving spouse who dies after distributions to the surviving spouse were required to commence, that is, the year in which the employee would have attained age 70½. If, under the proposal, the five-year rule is intended to apply also in the case of a surviving spouse who dies before distributions to the surviving spouse were required to commence, the proposal repeals the present-law rule under which, if a surviving spouse dies before the employee would have attained age 70½, the after-death rules for death before distributions have begun are applied as though the spouse were the employee.[350] This aspect of the proposal should be clarified.

The proposal is effective for distributions with respect to employees who die after December 31, 2013. In the case of an employee who dies before January 1, 2014, if the employee's beneficiary dies after December 31, 2013, the five-year required distribution period after the death of the beneficiary under the proposal will apply.

In some cases this effective date may be viewed as disruptive for older employees (and retirees) and their beneficiaries, who are likely to have made retirement-related financial decisions based on present law. However, providing exceptions for such situations is likely to be complicated and burdensome. In addition, this concern is addressed in part by an exception in the case of an employee whose benefits are determined under a binding annuity contract. This exception reflects a recognition that annuity benefits generally cannot be changed once the terms of the annuity have been set. There are, however, some ambiguities as to the scope of this exception, for example, whether it applies to annuity distributions from a defined benefit plan and how it applies to an employee's beneficiary.

Some transition period may be needed for employers and plan administrators (and, possibly, IRA providers) to assess the changes needed to plan terms and operations to implement the proposal and to make the necessary changes. In addition, a delayed effective date may be appropriate for governmental plans, which sometimes require legislative action to be amended, and for plans maintained pursuant to collective bargaining agreements to accommodate the collective bargaining process.

With respect to qualified retirement plans, some optional forms of benefit currently offered, such as a joint and survivor annuity with the survivor annuity payable to a beneficiary other than a spouse or eligible beneficiary, may be impermissible under the minimum distribution rules as modified by the proposal. In that case, an exception to the anti-cutback rules may be required to allow such optional forms to be eliminated. Rather than relying on the IRS to exercise its authority to provide an exception, an exception could be provided legislatively.

[350] As previously noted, however, the proposal does not change the present-law rules under which, if the original beneficiary is a surviving spouse, the spouse may roll the inherited benefit to his or her own retirement plan or IRA. In that case, at his or her death, the rules for surviving spouse and eligible beneficiaries may apply.

Some aspects of the proposal require additional development, such as the definitions of "disabled" and "chronically ill." However, existing Code definitions may be used for this purpose.[351]

[351] See, for example, sections 72(m)(7), defining "disabled," and 7702B(c)(2), defining "chronically ill individual."

D. Limit Accruals Under Tax-Favored Retirement Plans

Present Law

In general

There are several types of tax-favored employer-sponsored retirement plans: qualified retirement plans,[352] tax-deferred annuity plans ("section 403(b)" plans),[353] and eligible deferred compensation plans of State or local governmental employers ("governmental section 457(b)" plans),[354] simplified employee pensions ("SEPs"),[355] and simple retirement plans. These employer-sponsored retirement plans have certain characteristics of tax-favored treatment in common. Even if the arrangement is funded and benefits are vested, most contributions, earnings on contributions, and benefits are not included in gross income until amounts are distributed (or, in the case of Roth arrangements,[356] contributions are after-tax but qualified distributions are not includable in gross income). Additionally, many distributions can be rolled over to another plan for further deferral of income inclusion. The rollover may be achieved by a direct trustee-to-trustee transfer or a distribution and contribution (within 60 days of the distribution) to another tax-favored retirement plan. Contributions and earnings under qualified retirement plans, section 403(b) plans, and governmental section 457(b) plans are held in a tax-exempt trust or custodial account or are funded using annuity contracts. SEPs and certain simple retirement plans ("SIMPLE IRAs")[357] are funded using a traditional individual retirement arrangement ("IRA") for each participating employee. IRAs receive tax-favored treatment similar to employer-sponsored plans, including tax-free rollover.

Tax-favored retirement plans are of two general types: (1) defined benefit plans, under which benefits are determined under a plan formula, and (2) defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings, and losses.

The defined benefit plan formula is generally either a traditional formula under which benefits are expressed as an annuity commencing at a retirement age, usually as a percentage of pay for each year of service, or a hybrid formula under which benefits are expressed as a hypothetical account balance, but with a right to an equivalent annuity. The accrued benefit of a participant as of the end of any plan year during employment is the annuity benefit that would be payable at normal retirement age under the plan if the employee terminated employment on the

---

[352] Secs. 401(a) and 403(a).

[353] Sec. 403(b).

[354] Sec. 457.

[355] Sec. 408(k).

[356] Sec. 402A and 408A.

[357] Sec. 408(p).

last day of the plan year with benefits that were 100 percent vested. Defined benefit plans generally provide for payment in a "normal" form (the form in which the benefits under the plan are expressed under the plan's benefit formula or an actuarially equivalent annuity commencing at the plan's normal retirement age) but also may provide for payment under other optional forms of benefit. The optional forms of benefits must be at least the actuarial equivalent of the normal form of the accrued benefit, but, subject to certain limits, may have a greater actuarial value than the normal form of benefit. For example, the normal form of benefit under a plan might be expressed as a life annuity commencing to the participant at the plan's normal retirement age but an optional form may provide a life annuity commencing at an earlier age or provide a joint and survivor annuity, in either case without a full actuarial reduction in the participant's annuity payments. To the extent an optional form has a greater actuarial value than the normal form of benefit, the difference is generally called a benefit subsidy.

Defined contribution plans generally may provide for nonelective contributions and matching contributions by employers and elective deferrals (either pretax or Roth contributions) or after-tax contributions by employees. Elective deferrals are contributions made pursuant to an election by an employee between cash compensation and a contribution to the plan.

Tax-favored retirement plans are subject to dollar limits on the benefits and contributions provided under the plan.[358] The dollar limits are indexed to reflect cost-of-living increases.[359] The dollar limits generally limit the benefits that may accrue, or contributions that may be made, under a plan even if the benefits under the plan are not yet vested (i.e., are subject to forfeiture).

Qualified retirement plans

Dollar limits on benefits under defined benefit plans

In the case of a qualified defined benefit plan, a dollar limit applies on the amount of benefits payable with respect to a participant. The dollar limit is expressed in terms of a benefit commencing at age 62 in the form of a straight life annuity for the life of the participant.[360] The dollar limit on the annual payments under the annuity is $205,000 a year (for 2013 but increasing

---

[358] The limit on contributions or benefits is generally the lesser of a dollar limit or a percentage of the employee's compensation.

[359] For each limit, there is a rounding rule under which any increase that is not a multiple of a specified dollar amount (such as $500) is rounded down to the next lowest multiple for that dollar amount.

[360] Under Treas. Reg. sec. 1.415(b)-1(b)(1), a straight life annuity is an annuity payable in equal installments for the life of the participant that terminates upon the participant's death.

to $210,000 a year for 2014).[361] The dollar limit applies to the aggregate of all benefits accrued by an employee under all defined benefit plans maintained by the same employer.[362]

If payments under the plan with respect to a participant are made in a form other than a straight life annuity commencing at age 62, the benefits payable under such other form (including any benefit subsidies) generally cannot exceed the defined benefit plan dollar limit when actuarially converted to a straight life annuity commencing at age 62. Thus, the dollar limit is effectively reduced for distributions commencing before age 62 or for a form of benefit more valuable than a straight life annuity. However, if benefits are paid in the form of a qualified joint and survivor annuity (as discussed below) for the life of the participant with the participant's spouse as the survivor, no actuarial reduction is required in applying the dollar limit to reflect the value of the survivor benefit, even if the surviving spouse annuity is 100 percent of the participant's benefit. Thus, an annual benefit of $205,000 (for 2013 but increasing to $210,000 for 2014) commencing at age 62 for the life of the participant and continuing for the life of the participant's surviving spouse satisfies the limit.

For purposes of actuarially adjusting a benefit in a form other than an annuity, such as a lump-sum benefit, the interest rate used generally must be not less than the greatest of: (1) 5.5 percent; (2) the rate that provides a benefit of not more than 105 percent of the benefit that would be provided if the rate (or rates), and mortality assumptions, applicable in determining minimum lump sums were used (as discussed below); or (3) the interest rate specified in the plan.

Minimum lump sum distributions from defined benefit plans

In the case of a distribution from a defined benefit plan of an individual's entire accrued benefit in the form of a single sum (generally referred to as a lump sum), the amount of the single sum must not be less than the actuarial present value of the accrued benefit in the normal form calculated using specified interest rates and a specified mortality table.[363] The specified interest rates (referred to as corporate bond "segment" rates) are determined by the Treasury Department based on a corporate bond yield curve that reflects the monthly yields on investment grade corporate bonds with varying maturities. The segment rates depend on the timing of the expected payments under a participant's annuity benefit, with the first segment rate applicable to payments that would be made in the next five years, the second segment rate applicable to applicable to payments that would be made in the following 15 years, and the third segment rate applicable to payments that would be made thereafter. Thus, the interest rate that applies depends upon how many years in the future a participant's annuity payment will be made. Typically, a higher interest applies for payments to be made further out in the future.

[361] Sec. 415(b)(1)(A). The limit actually is expressed as an annuity commencing at age 65, but there is no actuarial adjustment required for commencement between age 62 and 65.

[362] In applying the limits under both defined benefit plans and defined contributions plans, and the qualification requirement generally to a plan, the members of a control group as determined under section 414(b), (c), (m) , and (o) are treated as a single employer.

[363] These actuarial assumptions are required to determine minimum actuarial equivalent benefits under all forms of benefit other than life annuities.

Subject to certain conditions, a special rule applies in the case of a hybrid plan under which each employee's accrued benefit is calculated as the balance of a hypothetical account. Under the special rule, the plan does not violate the requirements for determining single sums merely because the plan provides that the actuarial present value of the employee's accrued benefit for purposes of determining any single sum distribution of the employee's entire accrued benefit is equal to the employee's hypothetical account balance.[364]

Dollar limits on contributions under defined contribution plans

In general

In the case of a qualified defined contribution plan, a dollar limit applies on the amount of contributions that can be made for each employee for a year under all defined contribution plans of the same employer. The dollar limit is $51,000 (for 2013 but increasing to $52,000 for 2014), and generally applies allocations to a participant's account under the terms of the plan as of any date during the year.[365]

In some cases, contributions are actually made to a plan and allocated to a participant's account after the end of the year, but are considered to be made as of the last day of the year. For example, employer contributions for a year may generally be made up to 8½ months after end of the year. In the case of a discretionary profit-sharing plan, an employer can wait until the date by which contributions must be made to decide how much to contribute to the plan (in total) as long as there is a specific formula under the plan for allocating the amount among participants.[366]

Elective deferrals

Certain qualified defined contribution plans ("section 401(k)" plans) include a feature under which an employee may elect to have contributions (elective deferrals) made to the plan, rather than receive the same amount in cash, subject to a dollar maximum. The dollar limit on maximum elective deferrals allowed for any employee is $17,500 (for 2013 and 2014) and is applied to the amount of deferrals for the employee's taxable year (which is generally the calendar year).[367] Additional elective deferrals ("catch-up contributions") are allowed for employees aged 50 or older, up to a dollar limit of $5,500 (for 2013 and 2014). Elective deferrals up to these limits are either not includable in gross income (but then subsequent distributions attributable to the contributions are includable in gross income) or are designated Roth contributions (in which case the contributions are includable in gross income but then subsequent qualified distributions attributable to the Roth contributions are excludible from gross income).

---

[364] Sec. 411(a)(13). The same rule applies if the accrued benefit is calculated as an accumulated percentage of the employee's final average compensation.

[365] Sec. 415(c)(1)(A). Employee contributions to a defined benefit plan are also taken into account for purposes of this limit.

[366] Treas. Reg. sec. 1.401-1(b)(1)(ii).

[367] Sec. 402(g).

Elective deferrals, other than catch-up contributions, are included in applying the general dollar limit on contributions ($51,000 for 2013 increasing to $52,000 for 2014). Elective deferrals are contributions for the year in which deferred, even if actually contributed to the plan after the end of the year.[368]

Minimum vesting schedules

Under the minimum vesting rules, a participant's right to the employer-provided benefits he or she has earned under a plan (including the participant's account balance under a defined contribution plan) generally must become nonforfeitable (that is, vested) after a specified period of service and at attainment of normal retirement age under the plan.[369]

Under a qualified defined contribution plan, a participant must vest in the account balance attributable to employer contributions no slower than under a three-year cliff vesting schedule (that is, full vesting after three years of service) or a two-to-six-year graduated vesting schedule (that is, a specified percentage is vested after each year of service in this period).

Under a defined benefit plan with only a traditional benefit formula, a participant must vest in his or her employer-provided accrued benefit no slower than under a five-year cliff vesting schedule or a three-to-seven-year graduated vesting schedule. Under a defined benefit plan with a hybrid benefit formula, a participant must vest in his or her employer-provided accrued benefit no slower than under a three-year cliff vesting schedule. However, a defined benefit plan may condition eligibility for optional forms of benefit, including subsidized benefits, on service in addition to the service required under the plan's vesting schedule. For example, a plan with a normal retirement age of 62 might provide an unreduced (that is, subsidized) early retirement benefit at age 55 for an employee who works for the employer until age 55 and has at least 30 years of service at that age.

Nondiscrimination requirements

A qualified retirement plan must also satisfy certain nondiscrimination requirements, under which the coverage and contributions or benefits provided to employees under the plan must not discriminate in favor of highly compensated employees.[370] For purposes of these nondiscrimination requirements, an employee generally is treated as highly compensated if the

---

[368] Under 29 C.F.R. sec 2510.3-102(d)(1)(i), in the case of a plan subject to the Employee Retirement Security Act of 1974 (ERISA), employee contributions (including elective deferrals) must be contributed to the plan as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets. Thus, such amounts must be contributed to a plan within a short period after being deducted from an employee's pay.

[369] Sec. 411. The portion of a participant's account balance under a defined contribution plan, or benefit under a defined benefit plan, that is attributable to the participant's own contribution (including elective deferrals) must at all times be fully vested.

[370] Secs. 401(a)(3) and (4). Under section 403(b)(1)(D) and (b)(12), a section 403(b) plan of a nongovernmental tax-exempt employer (other than a church) is generally also subject to these requirements.

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 $115,000 (for 2013 and 2014).[371] Thus, generally, if a plan covers some highly compensated employees for a year and provides them with benefits or contributions, the plan must cover a nondiscriminatory group (as determined under the Code) and provide nondiscriminatory benefits or contributions for the group of employees covered. Accordingly, an employer that provides benefits or contributions under its plans to any highly compensated employee must provide benefits and contributions to some employees who are not highly compensated at a nondiscriminatory level. However, a qualified retirement plan of a governmental employer is not subject to the nondiscrimination requirements.[372] Further, qualified retirement plans are generally not subject to the nondiscrimination requirements with respect to benefits provided to collectively-bargained employees.

Qualified joint and survivor annuity requirements

Pension plans (defined benefit plans and money purchase pension plans[373]) must provide that the normal form of benefit under the plan is a qualified joint and survivor annuity.[374] For an unmarried participant, a qualified joint and survivor annuity is a life annuity, and, for a married participant, a qualified joint and survivor annuity generally is a life annuity for the employee with at least a 50-percent survivor annuity for the participant's spouse. The accrued benefit must be paid in the form of a qualified joint and survivor annuity unless the participant elects another form of distribution and, in the case of a married participant, the participant's spouse provides notarized consent to the alternative form of distribution.

In the case of a defined benefit plan, the other forms of benefit offered to a married participant under the plan may not be actuarially more valuable than the qualified joint and survivor annuity immediately payable at the time of the distribution. Finally, the qualified joint and survivor annuity requirement only applies if the actuarial present value of the participant's accrued benefit at the time of the distribution (calculated using the same actuarial assumptions that apply in determining minimum lump sums) is more than $5,000.

[371] Sec. 414(q). Further, at the election of the employer, employees who are highly compensated based on the amount of the employee's compensation may be limited to any employee who had compensation for the preceding year in excess of $115,000 (for 2013 and 2014) and was in the top 20 percent of employees by compensation for such year.

[372] Governmental plans are also exempt from certain other qualification requirements, including requirements that have parallels under ERISA, such as the vesting requirements and the qualified joint and survivor requirements.

[373] A money purchase pension plan is a type of defined contribution plan that meets the definition of pension plan under Treas. Reg. sec. 1.401-1(b).

[374] In the case of a profit-sharing plan or stock bonus plan, including a section 401(k) plan, the plan is generally not required to satisfy the qualified joint and survivor requirement unless the participant elects an annuity form of distribution. However, in order for this exception to apply, the spouse must be the beneficiary of the employee's account balance after the employee's death unless the spouse consents in writing to a different beneficiary.

Section 403(b) plans

Section 403(b) plans may be maintained only by (1) tax-exempt charitable organizations,[375] and (2) educational institutions of State or local governments (i.e., 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 or other after-tax contributions.

Contributions to a section 403(b) plan are generally subject to the same contribution limits applicable to qualified defined contribution plans, including the general dollar limit on contributions ($51,000 for 2013 but increasing to $52,000 for 2014) and the special dollar limits for elective deferrals ($17,500 for 2013 and 2014) and catch-up contributions ($5,500 for 2013 and 2014) under a section 401(k) plan. If elective deferral and catch-up contributions are made to both a qualified defined contribution plan and a section 403(b) plan for the same employee, a single limit applies to the elective deferrals under both plans.[376]

Governmental section 457(b) plans

Deferrals under a governmental section 457(b) plan are generally subject to the same dollar limits as elective deferrals ($17,500 for 2013 and 2014) and catch-up contributions ($5,500 for 2013 and 2014) under a section 401(k) plan or a section 403(b) plan. However, the section 457(b) plan limits apply separately from the combined limit applicable to section 401(k) and 403(b) plan contributions, so that an employee covered by a governmental section 457(b) plan and a section 401(k) or 403(b) plan can contribute the full amount to each plan.

Employer-sponsored retirement plans using IRAs

SIMPLE IRA plan

An employer that employs no more than 100 employees who earned $5,000 or more during the prior calendar year can establish a simple retirement plan, under which an IRA is established for each employee (that is, a SIMPLE IRA). A simple retirement plan allows employees to make elective deferrals, but is subject to a special dollar limit, $12,000 (for 2013 and 2014), and a special catch-up dollar limit for an individual age 50 or over, $2,500 (for 2013 and 2014).

---

[375] Sec. 501(c)(3).

[376] Any elective deferrals under SIMPLE IRAs and SARSEPs are also taken into account for purposes of this single limit.

Simplified employee pension plan

A simplified employee pension ("SEP") is a type of employer-sponsored retirement plan under which an employer may make contributions to a SEP IRA for each eligible employee up to the lesser of 25 percent of the employee's compensation or the dollar limit applicable to contributions to a qualified defined contribution plan ($51,000 for 2013 but increasing to $52,000 for 2014).

Certain SEP plans established before 1997 may include a salary reduction feature ("SARSEP") under which employees can make elective deferrals. Elective deferrals under a SARSEP are subject to the same dollar limit that applies to elective deferrals under a section 401(k) plan ($17,500, plus catch-up contributions up to $5,500 for a participant age 50 or over, for 2013 and 2014).

Correction of excess deferrals

If an individual's total elective deferrals for a taxable year under section 401(k) plans and section 403(b) plans exceed the applicable dollar limit, the excess is includible in income in the year for which it is contributed. If the plan distributes the excess (plus allocable income) by April 15 following the taxable year, the excess amount is not includable in the individual's gross income for the year distributed.[377] If the excess is not distributed by April 15, the excess is not only includable in gross income in the year contributed but the individual receives no basis in the account for the amount included in gross income. Thus, that amount will be taxed again when distributed. In the case of an excess in the form of designated Roth contributions, any distribution attributable to the excess cannot be a qualified distribution.

Dollar limits on individual savings contributions to IRAs

There are two types of IRAs: traditional and Roth. Individuals may make deductible and nondeductible contributions to traditional IRAs; nondeductible contributions result in basis. Distributions from traditional IRAs are includable in gross income except to the extent that a portion of a distribution is a recovery of basis. Contributions to Roth IRAs are nondeductible, but distributions from the Roth IRA may be received tax-free if the applicable conditions are satisfied. The dollar limit for an individual's contributions to all IRAs (traditional and Roth IRAs) is $5,500 (for 2013 and 2014). For individuals over age 50, the dollar limit is increased by a catch-up amount of $1,000 (which is not indexed). Individuals are allowed to make contributions for a taxable year through the due date for filing the individual's income tax return (without extensions) for such taxable year, generally April 15 of the following year.

Reporting to IRS

---

[377] In the case of one or more plans maintained by an employer, the plan or plans generally must enforce the limit. However, an employee who makes elective deferrals during the year to plans of different employers may exceed the limit. Generally, in that case, the employee informs a plan that an excess has occurred and requests that the plan distribute the excess amount.

IRA trustees report the total value of the account balance as of the end of the year, and the amount contributed to the IRA for the year (including rollover contributions), to the individual and to the IRS. Elective deferrals are required to be reported on an employee's Form W-2. Otherwise, the amount of contributions under employer-sponsored retirement plans with respect to individual employees generally are not reported to the IRS.

Description of Proposal

If an individual has accumulated amounts under tax-favored retirement plans sufficient to provide a maximum annuity commencing at age 62, under the proposal, further contributions are prohibited under such plans. The maximum annuity is an annuity with a level annual benefit equal to the present-law dollar limit for defined benefit plans ($205,000 for 2013 but increasing to $210,000 for 2014) and payable in the form of a joint and 100 percent survivor benefit commencing at age 62 and continuing each year for the life of the individual and, if later, the life of the individual's spouse. The maximum annuity is designed to equal the maximum annuity that is permitted to be paid by a qualified defined benefit plan. The Treasury indicates that, using the 2013 defined benefit dollar limit and present law actuarial assumptions, the maximum permitted accumulation for an individual age 62 under this proposal is approximately $3.4 million.[378] For this purpose, tax-favored retirement plans include traditional IRAs (including SEPs and SIMPLE IRAs), Roth IRAs, qualified retirement plans, section 403(b) plans, and governmental section 457(b) plans.

The limitation is determined as of the end of a calendar year and applies to contributions or accruals for the following calendar year. Plan sponsors and IRA trustees are required to report each individual's account balance as of the end of the year as well as the amount of any contribution to that account for the plan year. For an individual who is under age 62, the accumulated account balance is converted to an annuity payable at 62, in the form of a joint and 100 percent survivor benefit using the actuarial assumptions that apply to converting between annuities and lump sums under defined benefit plans. For an individual who is older than age 62, the accumulated account balance is converted to an annuity payable in the same form, where actuarial equivalence is determined by treating the individual as if he or she was still age 62, and the maximum permitted accumulation would continue to be adjusted for cost-of-living increases. Plan sponsors of defined benefit plans would report the amount of the accrued benefit and the accrual for the year, payable in the same form.

If an individual reaches the maximum permitted accumulation as of the end of a calendar year, no further contributions or accruals are generally permitted for subsequent calendar years, and any contributions made (or benefits accrued) for the subsequent calendar year are excess contributions (or accruals). However, an individual's account balances under defined contribution plans and IRAs can continue to grow with investment earnings and gains. In addition, if an individual's investment return for a year is less than the rate of return built into the actuarial equivalence calculation (so that the updated calculation of the individual's equivalent

[378] Department of Treasury, *General Explanation of the Administration's Fiscal year 2014 Revenue Proposals*, April 2013, p. 166

annuity as of the end of the calendar year is less than the maximum annuity permitted under a qualified defined benefit plan), additional contributions are permitted for subsequent calendar years. Furthermore, when the defined benefit dollar limit increases as a result of a cost-of-living adjustment, the maximum permitted accumulation automatically increases as well, potentially allowing a resumption of contributions or accruals for an individual who previously was subject to a suspension of contributions and accruals by reason of the overall limitation.

If there is a contribution made (or an additional benefit accrued) for a year that is an excess accumulation, the tax consequence of the excess accumulation is similar to the consequence of an excess deferral under present law. Thus, the individual must include the amount of the resulting excess accumulation in current income but is allowed a grace period during which the individual can withdraw the excess contribution or excess accrual from the account or plan in order to comply with the limit. If the individual does not withdraw the excess contribution or an amount equal to the actuarial present value of excess accrual, then the excess amounts and attributable earnings are subject to income tax when distributed, without any adjustment for basis (and without regard to whether the distribution is made from a Roth IRA or a designated Roth account within a plan).

Effective date.−The proposal is effective with respect to contributions and accruals for taxable years beginning on or after January 1, 2014.

Analysis

General policy considerations in limiting aggregate tax-favored retirement accumulations

Advocates for this proposal argue that the present-law limitations on retirement plan contributions and benefits do not adequately limit the extent to which an individual can accumulate amounts in tax-favored arrangements through the use of multiple plans. They point out that accumulations through multiple plans can be considerably in excess of amounts needed to fund reasonable levels of consumption in retirement and can be well beyond the level of accumulation that justifies tax-favored treatment of retirement accounts. They argue that the accumulations allowed under the present-law defined benefit dollar limit are sufficient to provide a substantial level of consumption in retirement. Individuals who have exceeded the limit on accumulations under the proposal are not prevented from continuing to increase their retirement savings; they are only prevented from increasing their retirement savings on a tax-favored basis.

Others argue that a cap on aggregate tax-favored retirement savings would limit the present-law consumption-tax treatment for retirement savings accumulated in IRAs and employer-sponsored tax-favored retirement plans. Limiting the aggregate value in retirement plan accumulations eliminates this consumption tax treatment for additional saving. Further, present-law tax deferral for retirement savings allows a form of "income averaging" across one's lifetime, which some argue provides a fairer distribution of lifetime tax burdens. A cap on aggregate retirement saving cuts back on this feature of present law. Advocates for the proposal respond that, while these elements of present-law taxation of retirement saving are desirable to a degree, it is not unreasonable to impose limits on tax-favored treatment once the objective of a financially secure retirement has been achieved.

Finally, some point out that one reason employers provide for contributions (or benefit accruals) for rank-and file-workers under their tax-favored retirement plans is to allow contributions to be made (or benefits to accrue) under the plan for business owners and other highly compensated employees without violating plan nondiscrimination requirements. Thus, if the retirement plan accumulations of a business owner or favored highly compensated employees reach the aggregate limit, the employer may have less incentive to provide contributions (or benefit accruals) at the same level for rank-and-file. Some argue that small business owners in that situation are likely to terminate the plan. Others argue that employers maintain retirement plans to recruit employees and not simply to allow tax-favored retirement savings for business owners and highly compensated employees.

Administrative complexities and burdens with respect to the limit

In general

Although the basic concept of limiting an individual's aggregate retirement benefits from all tax-favored plans may be appropriate and the amount needed to provide a joint and survivor annuity with annual payments equal to the defined benefit plan limit ($205,000 for 2013 but increasing to $210,000 for 2014) may be a reasonable limit, the actual application of this limit annually to aggregate retirement accumulations of all individuals presents complexities, uncertainties, and potential burdens for both plan sponsors and individuals. As a practical matter, these complexities and burdens are likely to result in higher administrative costs, which can have a negative impact on net retirement savings for individuals generally, not just those at or near the limit. Also, as discussed below, the basic description of the proposal leaves some questions unanswered.

Further, some point out that the proposal does not prevent excessive tax-favored retirement accumulations due to unusually favorable investment returns on contributions under defined contribution plans and IRAs made before reaching the limit.

Expressing the limit as an annuity commencing at age 62 rather than a single-sum value

In order to apply an aggregate limit to an individual's accumulated retirement savings (both in the form of individual accounts and benefits under a defined benefit plans), the limit and the relevant savings amounts must be expressed in a common form. Under the proposal, the limit is expressed as a level joint and 100-percent survivor annuity with an apparent uniform assumption that the individual is married to a spouse that is the same age.[379] One option is to convert the limit to a single sum and compare it to the sum of an individual's annuity benefits under any defined benefit plan (if any) converted to an equivalent single sum and any account-based savings of the individual. The other is to convert any account-based savings of an

[379] The Treasury estimate that, using present law actuarial assumptions and the 2013 defined benefit dollar limit, the maximum permitted accumulation for an individual age 62 under this proposal is approximately $3.4 million is consistent with this uniform assumption.

individual to an equivalent level joint and 100 percent survivor annuity, which is then added to any benefits of the individual under defined benefit plans, expressed in the same form.

The proposal takes the latter approach, that is the sum of an individual's accumulated account balances under defined contribution plans and IRAs is converted to an annuity payable at 62, in the form of a level joint and 100-percent survivor benefit, using the actuarial assumptions that apply to converting between annuities and lump sums under defined benefit plans. The amount of this equivalent annuity is then combined with the individual's accumulated accrued benefits under defined benefit plans.

In theory, a similar computation is not needed for an individual's accumulated accrued benefits under defined benefit plans. However, accrued benefits under defined benefit plans are not expressed as joint and 100-percent survivor annuities commencing at age 62, with a spouse that is the same age (without regard to whether the employee is unmarried or has a spouse that is a different age). Most defined benefit plans do not even express the accrued benefit as a level joint and survivor annuity commencing at age 62. In particular, defined benefit plans commonly express the accrued benefit as a single life annuity commencing at a normal retirement age of 65, and hybrid plans generally express each individual's accrued benefit as a hypothetical account balance. Thus, the benefits under a defined benefit plan must also be actuarially converted to a level joint and 100-percent survivor annuity commencing at age 62, with a spouse that is the same age in order to compare the benefit to the limit as expressed under the proposal.

Some therefore argue that expressing the limit as a single-sum dollar amount equivalent to the defined benefit dollar limit payable as a joint and 100-percent survivor annuity commencing at age 62 with a same-age spouse would make the limit easier to understand and apply. Treasury could then calculate and publish annually the dollar limit for individuals at each age. Under this approach, accumulated accrued benefits under defined benefit plans would generally be converted to a single-sum value using the assumptions that apply in determining minimum lump sums under defined benefit plans. No conversion would be required for accumulations under defined contribution plans, IRAs, or hybrid plans under which the lump-sum benefit is the hypothetical account balance.

<u>Variation in the aggregate limit when expressed as a present value</u>

Because the limit is expressed as an actuarially equivalent annuity commencing at age 62, the limit (when expressed as an actuarial present value) for an individual for a taxable year is reduced for each year the individual is younger than age 62. Some argue that any aggregate limit applied to account balances under defined contribution plans and IRAs should the same for all individuals, regardless of an individual's age. Under the proposal, the annual change in the limit potentially causes individuals to be over the limit or under the limit to the extent the rate of return produced by their actual earnings experience is higher or lower than the assumed rate of return. Further, the variation in the corporate bond segment rates causes the limit to change from year to year even for individuals who are the same age. If corporate bond rates rise for some period, the limit (expressed as a present value) is reduced. Individuals who, before the interest rate rise, could have continued to make retirement plan contributions may be prevented from making additional contributions and taking advantage of the higher interest rates during the accumulation period for those contributions. Further, some suggest that, if interest rates rise, the percentage of individuals subject to the limit may rise.[380] If interest rates subsequently go down, the individual may not be in a position to make further retirement plan contributions. For example, the individual may no longer be employed. Further, the effect of corporate bond interest rate changes adds complexity and causes the limit to be unpredictable, potentially making it difficult for individuals to make long range retirement savings decisions. Finally, being forced to assume a future rate of return (whether fixed or variable) fails to allow individuals to protect themselves against the potential for significant losses due to an economic down turn, such as in 2008, potentially causing a loss of principal (original contributions) as well as earnings.[381]

Others argue that any limit that applies to the aggregate amount of defined benefit and defined contribution plan retirement savings must be based on a future value because accruals under defined benefit plans are generally expressed as an annuity commencing at normal retirement age. Others also argue that, even if the limit only applied to defined contribution plan and IRA aggregate accumulations, it would be appropriate to take into account the time value of money in determining the limit, and thus, in the case of defined contribution plan account balances, to assume future earnings during years of accumulation until age 62. They further argue that the corporate bond segment rates are appropriate interest rates for assumptions as to such future earnings. The market forces that set corporate bond rates take into account expected future economic events, including the potential for economic downturns and upturns during the period of the bond. If an individual's average earnings on account balances over the period of prior accumulation are less than the assumed rate at any point in time, additional contributions can be made with respect to the individual (to the extent permitted under the annual contribution limits). Further, when interest rates are higher, individuals need a smaller aggregate accumulation to provide an annuity at age 62 equal to the defined benefit plan limit. If interest rates are lower, individuals can expect a lower future rate of return so the limit should be higher. If interest rates change, contributions for most individuals can be adjusted accordingly.

Some argue that, if an individual's aggregate defined contribution plan and IRA accumulations exceed the limit, and, accordingly, contributions for an individual are not allowed for a period, but then later the individual's aggregate account balances fall below the limit, the individual should be able to make up the prior missed contributions. Others respond that providing such a catch-up provision adds further complexity and increases the compliance burden on defined contribution plan administrators (and IRA trustees) as well as the IRS.

[380] See discussion of effect of variable interest rates on the cap and the percentage of plan participants with benefits limited by the cap in Jack VanDerhei, "The Impact of Retirement Savings Account Cap," *Employee Benefit Research Institute Issue Brief No. 389*, August 2013.

[381] Generally, for a defined benefit plan, the risk of investment loss under the trust falls on the employer. However, for an employer that becomes insolvent, the plan may be forced into a distress termination and benefits ultimately provided are subject to the plan's funding level and the benefit guaranteed by Pension Benefit Guaranty Corporation.

Determining the account balance subject to the limit under defined contribution plans and IRAs

In the case of a defined contribution plan, an individual's accrued benefit is the individual's account balance under the plan. The proposal makes no apparent distinction between vested and forfeitable benefits. Thus, forfeitable amounts may cause an individual's savings to be at the limit, cutting off the individual's ability to make or receive additional contributions and accruals, and yet the individual may later forfeit some of those amounts on termination of employment. Some argue that individuals who have accumulated sufficient retirement benefits to be over this limit are unlikely to have nonvested benefits. In the unlikely scenario that a forfeiture does occur upon termination of employment with an employer, the individual may resume retirement plan accumulations with the next employer. Others respond that the very events that cause a job loss and benefit forfeiture may also seriously diminish the individual's ability or opportunity to make up the loss through further contributions or accruals.

Under the proposal, whether an individual's tax-favored retirement accumulations have reached the limit is determined "as of" the end of a calendar year. Thus, an individual's account balances under any defined contribution plans or IRA as of the end of the calendar year are taken into account. Some argue that the limit should simply be applied using the value on the last day of the calendar year, disregarding any contributions actually made after that day.

Others argue that the words "as of" should be interpreted in the same manner as for the annual defined contribution plan and IRA limits. Otherwise, plan contributions for an individual could be timed to delay the application of the limit for an individual for an additional year.[382] Under this approach, any elective deferrals relating to compensation that otherwise would have been received during the calendar year and thus are taken into account in applying the limits on elective deferrals are included in the account balance "as of" the end of the calendar year.[383] In addition, under this approach, any other contributions that are allocated to an individual's account under a plan as of a date during a calendar year for purposes of the annual defined contribution plan limit are taken into account in applying the aggregate retirement accumulation limit under the proposal even if the contribution is not actually made until after the end of the calendar year. Similarly, under this approach, the IRA contributions for a calendar year that are not actually contributed to the IRA until after the end of calendar year would be taken into account. Some point out, however, that, in at least some cases, under this approach, individual account balances "as of" the end of a calendar year cannot be determined until near the end of the immediately following calendar year.

Finally, regardless of the approach taken with respect to contributions made for a year but not actually made until after the end of the year, to prevent avoidance of the limit, account

[382] For example, contributions for a calendar year that would result in the individual reaching the limit for a year could be made after the end of that calendar year and then contributions for the immediately following calendar year could be made during such immediately following year.

[383] Elective deferrals deducted from compensation paid for the last pay period ending in a calendar year may not be actually be contributed until the beginning of the following calendar year.

balances "as of" the end of the calendar year need to be interpreted to take into account any 60-day rollover amounts that are not actually in any account on the last day of the calendar year.[384]

Determining the accrued benefits under defined benefit plans subject to the limit

By specifying that the plan annually reports the amount of each individual's accrued benefit, the proposal indicates that the aggregate limit only takes into account the individual's accrued benefit and not subsidies provided through optional forms of payment. Some point out that, because, under present law, benefit subsidies are taken into account in applying the defined benefit plan limit, there is an apparent inconsistency in basing the limit on the defined benefit dollar limit but not taking into account potential benefit subsidies to which an individual may be entitled.[385] They further point out that, if benefits subsidies to which an individual is potentially entitled are not taken into account, the individual's aggregate tax-favored retirement accumulations may be below the limit, allowing additional contributions or accruals for the individual, but then the individual may actually receive a much more valuable form of benefit under the defined benefit plan which, if taken into account, would have prevented both additional accruals and contributions.

Others respond that it would be inappropriate to take into account potential benefit subsidies in applying an aggregate limit. They argue that the risk that an individual will never receive a benefit subsidy is far greater than any risk of forfeiture of the accrued benefit. In many cases, it is not possible to know whether the individual will ever meet the conditions for the subsidy until very near the time of commencement of benefits. If the subsidy is taken into account in applying the accumulated benefit cap, then an individual may be treated as having accrued a benefit that the individual never receives, either because the individual never fulfills the conditions for entitlement to payment in that form or does not elect that form of payment. In the meantime, contributions for the individual to defined contribution plans or IRAs may not be allowed. In addition, taking all possible subsidized benefits into account in determining the individual's aggregate retirement benefits subject to the limit makes the proposal even more complicated.

Ability to stop future accruals or contributions

A basic premise of the proposal is that when the aggregate retirement plan accumulations and accruals reach the limit, no further contributions will be made (and no further benefits will accrue) with respect to that individual. However, some point out that participation in a defined benefit plan is generally not a choice by an employee. Once an employee is a participant, accruals under a defined benefit plan happen automatically. An employee accrues rights to plan

---

[384] Unless these rollover contributions are taken into account, the limit on accumulations could be avoided by annually withdrawing all amounts in IRAs before the end of a calendar year and recontributing the amount (within 60 days) in the following calendar year.

[385] In the case of an individual who actually receives a joint and 100 percent survivor annuity under a defined benefit plan with an annual benefit of $210,000 (for 2014), the survivor benefit is by definition a benefit subsidy. The accrued benefit payable in any other form is limited to the actuarial equivalent of a straight single life annuity with an annual benefit of $210,000 (for 2014).

benefits by virtue of being a member of the defined coverage group under the plan and fulfilling the requirements for entitlement to accrual of benefits under the plan's benefit formula. Similarly, nonelective contributions under a defined contribution plan are based on a plan formula and defined coverage group, and are not permitted to be subject to an employee's election. Generally, under a defined contribution plan, only elective deferrals and, in some cases, after-tax employee contributions are elective on the part of the employee.

Some argue that an employer can design its retirement plans so that accruals and allocations of employees do not exceed the limit. An employee's right to an allocation or accrual can be conditioned on aggregate benefits under all plans of the employer not exceeding the aggregate limit. Further, under most plans, after termination of employment, an individual has an opportunity to elect to receive a distribution of benefits. The amount of such distribution can be retained (and included in gross income) or rolled over to an IRA or another tax-favored retirement plan. Thus, to the extent that an individual's accumulated tax-favored retirement savings include amounts held in IRAs or under the retirement plans of another employer, the individual can correct for any excess defined benefit plan accrual or defined contribution plan allocation under the plan of the individual's current employer by withdrawing amounts from IRAs or plans of prior employers.[386]

Reporting defined contribution plan and IRA account balances and contributions, and corrections for excess contributions

The proposal requires that defined contribution plans report to the individual and the IRS each individual's account balance as of the end of the year as well as the amount of any contribution to the individual's account for the plan year.[387] If contributions made after the last day of the calendar year that are allocated retroactively as of a date during the calendar year are taken into account in determining if the limit is exceeded for such previous year or in determining the amount of excess contributions made for such previous year (if such year follows a year in which the limit is exceeded), as discussed above, some defined contribution plans may not be able to report the account balance subject to the limit, or contributions for the year, until near the end of the following calendar year. As a result, under the proposal, an individual may not receive the information needed to take a corrective distribution of excess amounts until after the date by which the corrective distribution must be made (generally April 15 following the calendar year for which the contribution was made). Thus, some argue that individuals should have additional time to withdraw amounts needed to correct any excess.

Others argue that the limit could be applied on the basis of the actual account balance on the last day of the year, without regard to later contributions made for the year, and contributions would only be reported for the calendar year during which the contributions were actually made, This approach would be simpler for plans to administer and would not require additional time for correction, but, as discussed above, would potentially allow contributions to be timed to allow

[386] Some point out that plans are not required to allow withdrawals before the plan's normal retirement age by individuals who have terminated employment.

[387] Under present law, section 408(i) requires annual reporting for IRAs.

contributions for an additional year after the limit would have been reached (under the other interpretation of "as of" the end of the calendar year).

Reporting of accumulated benefits and annual accruals under defined benefit plans.

The proposal requires defined benefit plans to report the amount of the accrued benefit and the accrual for the year, payable in the same form. Some argue that this annual reporting of accrued benefits and annual accruals for individuals (whether expressed as an annuity or an actuarial present value) presents a much more significant burden than reporting by defined contribution plans and may not be possible for some defined benefit plans. Most plans do not make a precise calculation of each participant's accrued benefit each year. Instead, a calculation is generally made when a participant actually applies for benefits. Generally, a participant's benefits are calculated under a formula that takes into account the individual's age, years of service, and compensation, but may also take into account other factors. Most plans obtain this information when the individual applies for benefits and selects a particular form of payment. For many plans, this information is not readily available for an annual calculation, particularly in the timeframe needed to comply with the reporting requirement under the proposal.[388]

Moreover, as discussed above, plans do not express the accrued benefits in terms of a level joint and 100 percent survivor annuity commencing at age 62, using a uniform assumption that an individual has a spouse that is the same age. Except in the case of certain hybrid plans, plans do not express accrued benefits as a lump sum dollar amount. Thus, the plan would need to annually convert each accrued benefit and annual accrual into either an actuarially equivalent level joint and 100 percent survivor annuity commencing at age 62 or a current lump sum.

Application of limit only to highly compensated employees

Some suggest that the complexities and burdens of the proposal could be reduced by only applying the limit with respect to aggregate accumulations of individuals who are current or former highly compensated employees of an employer. With this change, employer-sponsored plans would only be required to provide annual reports of account balances and contributions (or accrued benefits and accruals) for highly compensated current or former highly compensated employees. However, IRA trustees do not generally maintain records of the plan that was the original source of funds in the IRA, and the trustee would not have a record of whether the source of the funds was a plan under which the IRA owner had been a highly compensated employee. In addition, not all employers have a reason to identify highly compensated employees for their plans, for example, governmental plans which are not subject to the nondiscrimination requirements.

[388] Plans need a certain amount of data to calculate minimum funding obligations but this information is generally based on a reasonable estimates of participants' benefits rather than individualized benefit determinations. Section 105 of ERISA requires that, every three years, defined benefit plans provide a benefit statement to each active participant who has a vested accrued benefit. These benefits are also permitted to be based on reasonable estimates. However, a benefit statement must be provided to a participant who requests one and the information is not permitted to be based on reasonable estimates.

Conclusion

Some argue that the complexities of applying a combined limit that takes into account both defined benefit accruals and defined contribution plans and IRA account balances outweigh the conceptual arguments in favor of this approach. They argue that a simpler, more administrable approach might be to provide a fixed dollar limit on aggregate defined contribution and IRA accumulations that does not take into account accrued benefits under defined benefit plans.[389] They argue that not only would this approach be easier for individuals to understand and for plans to administer, it would also be easier for the IRS to monitor compliance. The IRS would only need to match reported account balances to a fixed limit. If there is a concern that aggregate accumulations of younger individuals could reach this limit and then continue to grow, a provision requiring withdrawal of a portion of amounts in excess of the limit could be included.

Others argue that fairness concerns compel taking into account accruals under defined benefit plans despite the administrative complexities.[390] Otherwise, individuals who participate in defined benefit plans in addition to defined contribution plans are able to accumulate greater retirement savings than individuals who only have the opportunity to participant in defined contribution plans.[391]

Some suggest that a return to approaches similar to those under prior law could be considered. As under prior law, a combined limit could be imposed on annual contributions and accruals under the defined contribution and defined benefit plans of an employer.[392] Alternatively, as under prior law, an additional tax could be imposed on annual distributions in excess of a specified amount supplemented by a tax on excess accumulations remaining at the

---

[389] This approach is suggested in John A. Turner, David D. McCarthy, and Norman P. Stein, Closing a Tax Loophole: Defined Contribution Plans with Very Large Individual Account Balances, available upon request from John A Turner, jaturner49@aol.com

[390] In the case of certain hybrid plan designs that express the benefit as an accumulated account balance, some argue that the accumulation under such a plan is nearly identical to an accumulation under a defined contribution plan, and should be subject to any aggregate limit on defined contribution plan accumulations. Not taking into account defined benefit plans accumulations under any aggregate limit produces anomalous results in certain situations. For example, if an individual whose aggregate accumulations under defined contributions plans are less than the limit receives a lump sum from a defined benefit plan and rolls it over to an IRA, the value of the accruals under the defined benefit plan are included in applying the limit with respect to further contributions to defined contribution plans and IRAs. If, instead, the individual does not commence distributions or commences distributions in an annuity form, the accumulations in the defined benefit plan are disregarded.

[391] For example, if defined contribution plan and IRA accumulations of a self-employed individual without employees reaches the limit, the individual can establish a defined benefit plan and continue accumulating retirement savings.

[392] Prior to 2000, there was a combined limit under section 415 that took into account the contributions and accruals for a participant under both defined contribution plans and defined benefit plans of an employer. The combined limit generally limited aggregate contributions and accruals to a total of 125 percent of the separate defined benefit and defined contributions limits. This combined limit was repealed by section 1452 of the Small Business Job Protection Act of 1996 (Pub. L. No. 104-188), effective for limitation years beginning after December 31, 1999.

individual's death.[393] Similar to the reasons for the proposal for an aggregate limit on tax-favored retirement accumulations, the reason cited for imposing additional taxes on excess distributions and excess accumulations under prior law was that "Congress believed that there was no need to permit a participant to accumulate excessive retirement savings, regardless of whether such excess was attributable to the receipt of multiple maximum benefits from several employers, very large appreciation in defined contribution plans, or the use of IRAs by individuals receiving significant employer-provided benefits."[394]

[393] Prior to 1997, under then section 4980A, there was also a 15-percent excise tax on aggregate distributions from tax-favored retirement plans to the extent they exceeded $155,000 (for 1996) with an increase in the estate tax at death equal to 15 percent of the remaining retirement plan accumulations to the extent they exceeded the present value of an immediate life annuity of the same annual dollar amount, using the individual's age at the time of death. Section 4980A was repealed by section 1073(a) of the Taxpayer Relief Act of 1997 (Pub. L. No. 105-34), effective for distributions received after December 31, 1996, and, for the increase in the estate tax, for decedents dying after that same date.

[394] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Pub. L. No. 99-514)* (JCS-10-87), May 1987, p.755. Similarly, the combined limit on contributions and accruals was included in ERISA to prevent an employer from establishing multiple plans (either multiple plans of the same type (defined contribution or defined benefit) or different types of plans) as a way of avoiding the limits. The limits were intended to "operate as an overall ceiling on the maximum benefits the employee can obtain under all plans." H.R. Report No. 93-779, 93rd Cong, 2nd Sess. p. 120. The reason for repealing the taxes on excess distributions and excess accumulations, as reflected in Joint Committee on Taxation, *General Explanation of the Tax Legislation Enacted in 1997* (JCS-23-97), December 1997, p. 263, was that Congress believed that the limits on contributions and benefits applicable to each type of vehicle are sufficient limits on tax-deferred savings. There was also a concern that additional penalties would deter savings and penalize favorable investment returns. As reflected in Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 104th Congress* (JCS-12-96), December 1996, p. 171, one of the reasons cited for repealing the combined limit under section 415 was that Congress believed that the combined limit may have had the effect of discouraging employers from providing adequate retirement benefits to their employees.