

**DESCRIPTION OF THE  
CHAIRMAN'S MODIFICATION OF THE  
"RETIREMENT ENHANCEMENT AND SAVINGS ACT OF 2016"**

Scheduled for Markup  
by the  
SENATE COMMITTEE ON FINANCE  
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## CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
I. MODIFICATION TO THE CHAIRMAN’S MARK.....	2
A. Shrinking Emergency Account Losses .....	2
II. ADDITIONS TO THE CHAIRMAN’S MARK .....	3
A. Multiple-Employer Plans .....	3
B. Clarification of Retirement Income Account Rules.....	15
C. Fiduciary Safe Harbor for Selection of Lifetime Income Provider .....	17
D. Nondiscrimination Flexibility with Respect to Certain Plans.....	20
E. PBGC Premiums for CSEC Plans .....	26
F. IRA Ownership of S Corporation Banks .....	28
G. Benefits for Volunteer Firefighters and Emergency Medical Responders .....	30
H. Treatment of Qualified Equity Grants .....	32
I. Modifications to Required Minimum Distribution Rules.....	40
J. Modification of Hardship Withdrawal Rules.....	49
K. Increased Penalties for Failure to File Retirement Plan Returns .....	50
L. Modification of User Fee Requirements for Installment Agreements.....	53
M. Increase Information Sharing to Administer Excise Taxes .....	55
N. Repeal of Partnership Technical Terminations.....	57

## INTRODUCTION

The Senate Committee on Finance has scheduled a committee markup on September 21, 2016, of an original bill, the Retirement Enhancement and Savings Act of 2016. This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modification of the bill.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification of the Retirement Enhancement and Savings Act of 2016* (JCX-87-16), September 21, 2016. This document can also be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov). All section references herein are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

## **I. MODIFICATION TO THE CHAIRMAN’S MARK**

### **A. Shrinking Emergency Account Losses**

The Chairman’s modification amends the proposal under which tax-favored employer-sponsored plans are prohibited from making loans through credit cards and other arrangements. As modified, the proposal prohibits such loans, except to the extent provided through electronic card systems through which such loans are provided as of September 21, 2016. In addition, any purchase made with such a card must exceed \$1,000 (indexed to inflation starting in 2018), and the card cannot be used to engage in any commercial transaction in a liquor store, casino, gaming establishment, or any retail establishment that provides adult-oriented entertainment.

In addition, the proposal directs the Government Accountability Office (“GAO”) to conduct a study analyzing the impact of such loans on the use of retirement savings for other purposes (referred to as “leakage”). GAO is to report its findings to the Chairman and Ranking Member of the Senate Committee on Finance and the House Committee on Ways and Means, and, if the study shows that such loans, after being subject to the restrictions described above, result in greater leakage than other loans from retirement plans, the report is to include recommendations to reduce leakage.

## II. ADDITIONS TO THE CHAIRMAN'S MARK

### A. Multiple-Employer Plans

#### Present Law

#### Retirement savings under the Code and ERISA

##### Tax-favored arrangements

The Internal Revenue Code (“Code”) provides two general vehicles for tax-favored retirement savings: employer-sponsored plans and individual retirement arrangements (“IRAs”). Code provisions are generally within the jurisdiction of the Secretary of the Treasury (“Secretary”), through his or her delegate, the Internal Revenue Service (“IRS”).

The most common type of tax-favored employer-sponsored retirement plan is a qualified retirement plan,<sup>2</sup> which may be a defined contribution plan or a defined benefit plan. Under a defined contribution plan, separate individual accounts are maintained for participants, to which accumulated contributions, earnings and losses are allocated, and participants’ benefits are based on the value of their accounts.<sup>3</sup> Defined contribution plans commonly allow participants to direct the investment of their accounts, usually by choosing among investment options offered under the plan. Under a defined benefit plan, benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts.<sup>4</sup> Besides qualified retirement plans, certain tax-exempt employers and public schools may maintain tax-deferred annuity plans.<sup>5</sup>

An IRA is generally established by the individual for whom the IRA is maintained.<sup>6</sup> However, in some cases, an employer may establish IRAs on behalf of employees and provide

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<sup>2</sup> Sec. 401(a). A qualified annuity plan under section 403(a) is similar to and subject to requirements similar to those applicable to qualified retirement plans.

<sup>3</sup> Sec. 414(i). Defined contribution plans generally provide for contributions by employers and may include a qualified cash or deferred arrangement under section 401(k) (commonly called a “section 401(k) plan”), under which employees may elect to contribute to the plan.

<sup>4</sup> Sec. 414(j).

<sup>5</sup> Sec. 403(b). Private and governmental employers that are exempt from tax under section 501(c)(3), including tax-exempt private schools, may maintain tax-deferred annuity plans. State and local governmental employers may maintain another type of tax-favored retirement plan, an eligible deferred compensation plan under section 457(b).

<sup>6</sup> Sections 219, 408 and 408A provide rules for IRAs. Under section 408(a)(2) and (n), only certain entities are permitted to be the trustee of an IRA. The trustee of an IRA generally must be a bank, an insured credit union, or a corporation subject to supervision and examination by the Commissioner of Banking or other officer in charge of the administration of the banking laws of the State in which it is incorporated. Alternatively, an IRA trustee may be another person who demonstrates to the satisfaction of the Secretary that the manner in which the person will administer the IRA will be consistent with the IRA requirements.

retirement contributions to the IRAs.<sup>7</sup> In addition, IRA treatment may apply to accounts maintained for employees under a trust created by an employer (or an employee association) for the exclusive benefit of employees or their beneficiaries, provided that the trust complies with the relevant IRA requirements and separate accounting is maintained for the interest of each employee or beneficiary (referred to herein as an “IRA trust”).<sup>8</sup> In that case, the assets of the trust may be held in a common fund for the account of all individuals who have an interest in the trust.

## ERISA

Retirement plans of private employers, including qualified retirement plans and tax-deferred annuity plans, are generally subject to requirements under the Employee Retirement Income Security Act of 1974 (“ERISA”).<sup>9</sup> A plan covering only business owners (or business owners and their spouses) - that is, it covers no other employees - is exempt from ERISA.<sup>10</sup> Thus, a plan covering only self-employed individuals is exempt from ERISA. Tax-deferred annuity plans that provide solely for salary reduction contributions by employees may be exempt from ERISA.<sup>11</sup> IRAs are generally exempt from ERISA.

The provisions of Title I of ERISA are under the jurisdiction of the Secretary of Labor.<sup>12</sup> Many of the requirements under Title I of ERISA parallel Code requirements for qualified retirement plans. Under ERISA, in carrying out provisions relating to the same subject matter, the Secretary (of the Treasury) and the Secretary of Labor are required to consult with each other and develop rules, regulations, practices, and forms which, to the extent appropriate for efficient administration, are designed to reduce duplication of effort, duplication of reporting, conflicting or overlapping requirements, and the burden of compliance by plan administrators, employers, and participants and beneficiaries.<sup>13</sup> In addition, interpretive jurisdiction over parallel Code and

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<sup>7</sup> Simplified employee pension (“SEP”) plans under section 408(k) and SIMPLE IRA plans under section 408(p) are employer-sponsored retirement plans funded using IRAs for employees.

<sup>8</sup> Sec. 408(c).

<sup>9</sup> ERISA applies to employee welfare benefit plans, such as health plans, of private employers, as well as to employer-sponsored retirement (or pension) plans. Employer-sponsored welfare and pension plans are both referred to under ERISA as employee benefit plans. Under ERISA sec. 4(b)(1) and (2), governmental plans and church plans are generally exempt from ERISA.

<sup>10</sup> 29 C.F.R. sec. 2510.3-3(b)-(c).

<sup>11</sup> 29 C.F.R. sec. 2510.3-2(f).

<sup>12</sup> The provisions of Title I of ERISA are codified at 29 U.S.C 1001-734. Under Title IV of ERISA, defined benefit plans of private employers are generally covered by the Pension Benefit Guaranty Corporation’s pension insurance program.

<sup>13</sup> ERISA sec. 3004.

ERISA provisions relating to retirement plans is divided between the two Secretaries by Executive Order, referred to as the Reorganization Plan No. 4 of 1978.<sup>14</sup>

## **Multiple-employer plans under the Code**

### In general

Qualified retirement plans, either defined contribution or defined benefit plans, are categorized as single-employer plans or multiple-employer plans. A single-employer plan is a plan maintained by one employer. For this purpose, businesses and organizations that are members of a controlled group of corporations, a group under common control, or an affiliated service group are treated as one employer (referred to as “aggregation”).<sup>15</sup>

A multiple-employer plan generally is a single plan maintained by two or more unrelated employers (that is, employers that are not treated as a single employer under the aggregation rules).<sup>16</sup> Multiple-employer plans are commonly maintained by employers in the same industry and are used also by professional employer organizations (“PEOs”) to provide qualified retirement plan benefits to employees working for PEO clients.<sup>17</sup>

### Application of Code requirements to multiple-employer plans and EPCRS

Some requirements are applied to a multiple-employer plan on a plan-wide basis.<sup>18</sup> For example, all employees covered by the plan are treated as employees of all employers participating in the plan for purposes of the exclusive benefit rule. Similarly, an employee’s service with all participating employers is taken into account in applying the minimum participation and vesting requirements. In applying the limits on contributions and benefits, compensation, contributions and benefits attributable to all employers are taken into account.<sup>19</sup> Other requirements are applied separately, including the minimum coverage requirements, nondiscrimination requirements (both the general requirements and the special tests for section 401(k) plans) and the top-heavy rules.<sup>20</sup> However, the qualified status of the plan as a whole is

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<sup>14</sup> 43 Fed. Reg. 47713 (October 17, 1978).

<sup>15</sup> Secs. 414(b), (c), (m) and (o).

<sup>16</sup> Sec. 413(c). Multiple-employer status does not apply if the plan is a multiemployer plan, defined under sec. 414(f) as a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s). Multiemployer plans are also known as Taft-Hartley plans.

<sup>17</sup> Rev. Proc. 2003-86, 2003-2 C.B. 1211, and Rev. Proc. 2002-21, 2002-1 C.B. 911, address the application of the multiple-employer plan rules to qualified defined contribution plans maintained by PEOs.

<sup>18</sup> Sec. 413(c).

<sup>19</sup> Treas. Reg. sec. 1.415-1(e).

<sup>20</sup> Treas. Reg. secs. 1.413-2(a)(3)(ii)-(iii) and 1.416-1, G-2.

determined with respect to all employers maintaining the plan, and the failure by one employer (or by the plan itself) to satisfy an applicable qualification requirement may result in disqualification of the plan with respect to all employers.<sup>21</sup>

Because of the complexity of the requirements for qualified retirement plans, errors in plan documents, as well as plan operation and administration, commonly occur. Under a strict application of these requirements, such an error would cause a plan to lose its tax-favored status, which would fall most heavily on plan participants because of the resulting current income inclusion of vested amounts under the plan. As a practical matter, therefore, the IRS rarely disqualifies a plan. Instead, the IRS has established the Employee Plans Compliance Resolution System (“EPCRS”), a formal program under which employers and other plan sponsors can correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.<sup>22</sup>

EPCRS has three components, providing for self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program (“SCP”) generally permits a plan sponsor that has established compliance practices and procedures to correct certain insignificant failures at any time (including during an audit), and certain significant failures generally within a two-year period, without payment of any fee or sanction. The Voluntary Correction Program (“VCP”) permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program (“Audit CAP”) provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

Multiple-employer plans are eligible for EPCRS, and certain special procedures apply.<sup>23</sup> A VCP request with respect to a multiple-employer plan must be submitted to the IRS by the plan administrator, rather than an employer maintaining the plan, and must be made with respect to the entire plan, rather than a portion of the plan affecting any particular employer. In addition, if a failure applies to fewer than all of the employers under the plan, the plan administrator may choose to have a VCP compliance fee or audit CAP sanction calculated separately for each employer based on the participants attributable to that employer, rather than having the compliance fee calculated based on the participants of the entire plan. For example, the plan administrator may choose this option when the failure is attributable to the failure of an employer to provide the plan administrator with full and complete information.

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<sup>21</sup> Treas. Reg. secs. 1.413-2(a)(3)(iv) and 1.416-1, G-2.

<sup>22</sup> Rev. Proc. 2013-12, 2013-04 I.R.B. 313, modified by Rev. Proc. 2015-27, 2015-16 I.R.B. 914, and Rev. Proc. 2015-28, 2015-16 I.R.B. 920.

<sup>23</sup> Section 10.12 of Rev. Proc. 2013-12.



## ERISA

### Fiduciary and bonding requirements

Among other requirements, ERISA requires a plan to be established and maintained pursuant to a written instrument (that is, a plan document) that contains certain terms.<sup>24</sup> The terms of the plan must provide for one or more named fiduciaries that jointly or severally have authority to control and manage the operation and administration of the plan.<sup>25</sup> Among other required plan terms are a procedure for the allocation of responsibilities for the operation and administration of the plan and a procedure for amending the plan and for identifying the persons who have authority to amend the plan. Among other permitted terms, a plan may provide also that any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and administrator) and that a person who is a named fiduciary with respect to the control or management of plan assets may appoint an investment manager or managers to manage plan assets.

In general, a plan fiduciary is responsible for the investment of plan assets. However, ERISA section 404(c) provides a special rule in the case of a defined contribution plan that permits participants to direct the investment of their individual accounts.<sup>26</sup> Under the special rule, if various requirements are met, a participant is not deemed to be a fiduciary by reason of directing the investment of the participant's account and no person who is otherwise a fiduciary is liable for any loss, or by reason of any breach, that results from the participant's investments. Defined contribution plans that provide for participant-directed investments commonly offer a set of investment options among which participants may choose. The selection of investment options to be offered under a plan is subject to ERISA fiduciary requirements.

Under ERISA, any plan fiduciary or person that handles plan assets is required to be bonded, generally for an amount not to exceed \$500,000.<sup>27</sup> In some cases, the maximum bond amount is \$1 million, rather than \$500,000.

### Multiple-employer plan status under ERISA

Like the Code, ERISA contains rules for multiple-employer retirement plans.<sup>28</sup> However, a different concept of multiple-employer plan applies under ERISA.

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<sup>24</sup> ERISA sec. 402.

<sup>25</sup> Fiduciary is defined in ERISA section 3(21), and named fiduciary is defined in ERISA section 402(a)(2).

<sup>26</sup> ERISA sec. 404(c). Under ERISA, a defined contribution plans is also referred to as an individual account plan.

<sup>27</sup> ERISA sec. 412.

<sup>28</sup> ERISA sec. 210(a).

Under ERISA, an employee benefit plan (whether a pension plan or a welfare plan) must be sponsored by an employer, by an employee organization, or by both.<sup>29</sup> The definition of employer is any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan, and includes a group or association of employers acting for an employer in such capacity.<sup>30</sup>

These definitional provisions of ERISA are interpreted as permitting a multiple-employer plan to be established or maintained by a cognizable, bona fide group or association of employers, acting in the interests of its employer members to provide benefits to their employees.<sup>31</sup> This approach is based on the premise that the person or group that maintains the plan is tied to the employers and employees that participate in the plan by some common economic or representational interest or genuine organizational relationship unrelated to the provision of benefits. Based on the facts and circumstances, the employers that participate in the benefit program must, either directly or indirectly, exercise control over that program, both in form and in substance, in order to act as a bona fide employer group or association with respect to the program. However, an employer association does not exist where several unrelated employers merely execute participation agreements or similar documents as a means to fund benefits, in the absence of any genuine organizational relationship between the employers. In that case, each participating employer establishes and maintains a separate employee benefit plan for the benefit of its own employees, rather than a multiple-employer plan.

### **Form 5500 reporting**

Under the Code, an employer maintaining a qualified retirement plan generally is required to file an annual return containing information required under regulations with respect to the qualification, financial condition, and operation of the plan.<sup>32</sup> ERISA requires the plan administrator of certain pension and welfare benefit plans to file annual reports disclosing certain information to the Department of Labor (“DOL”).<sup>33</sup> These filing requirements are met by filing

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<sup>29</sup> ERISA sec. 3(1) and (2).

<sup>30</sup> ERISA sec. 3(5).

<sup>31</sup> See, for example, Department of Labor Advisory Opinions 2012-04A, 2003-17A, 2001-04A, and 1994-07A, and other authorities cited therein.

<sup>32</sup> Sec. 6058. In addition, under section 6059, the plan administrator of a defined benefit plan subject to the minimum funding requirements is required to file an annual actuarial report. Under Code section 414(g) and ERISA section 3(16), plan administrator generally means the person specifically so designated by the terms of the plan document. In the absence of a designation, the plan administrator generally is (1) in the case of a plan maintained by a single employer, the employer, (2) in the case of a plan maintained by an employee organization, the employee organization, or (3) in the case of a plan maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties that maintain the plan. Under ERISA, the party described in (1), (2) or (3) is referred to as the “plan sponsor.”

<sup>33</sup> ERISA secs. 103 and 104. Under ERISA section 4065, the plan administrator of certain defined benefit plans must provide information to the PBGC.

a completed Form 5500, Annual Return/Report of Employee Benefit Plan. Forms 5500 are filed with DOL, and information from Forms 5500 is shared with the IRS.<sup>34</sup> In the case of a multiple-employer plan, the annual report must include a list of participating employers and a good faith estimate of the percentage of total contributions made by the participating employers during the plan year. Certain small plans, that is, plans covering fewer than 100 participants, are eligible for simplified reporting requirements, which are met by filing Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan.<sup>35</sup>

## **Description of Proposal**

### **In general**

The proposal amends the Code rules relating to multiple-employer plans to provide that certain defined contribution plans will not fail to meet the Code requirements applicable for tax-favored treatment merely because one or more employers of employees covered by the plan (“participating employers”) fail to take the actions that are required of employers for the plan to meet such requirements. The proposal applies to a multiple-employer qualified defined contribution plan (“covered multiple-employer plan”) that either (1) is sponsored by employers that both have a common interest other than having adopted the plan and control the plan, or (2) in the case of a plan not described in (1), has a pooled plan provider. The proposal applies also to such a plan that consists of IRAs (an IRA plan), including under an IRA trust.

In addition, under the proposal, a qualified defined contribution plan that is established or maintained for the purpose of providing benefits to the employees of two or more employers and that meets certain requirements (“pooled employer plan”) is treated for purposes of ERISA as a single plan that is a multiple-employer plan.

### **Tax-favored status under the Code**

#### **In general**

The proposal provides relief from disqualification (or other loss of tax-favored status) of the entire plan merely because one or more participating employers fail to take actions required with respect to the plan.

Relief under the proposal does not apply to a plan unless the terms of the plan provide that, in the case of an employer failing to take required actions (“noncompliant employer”)--

- plan assets attributable to employees of the noncompliant employer will be transferred to a plan maintained only by that employer (or its successor), to a tax-

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<sup>34</sup> Information is shared also with the PBGC, as applicable. Form 5500 filings are also publicly released in accordance with section 6104(b) and Treas. Reg. sec. 301.6104(b)-1 and ERISA secs. 104(a)(1) and 106(a).

<sup>35</sup> ERISA sec. 104(b).

favored retirement plan for each individual whose account is transferred,<sup>36</sup> or to any other arrangement that the Secretary determines is appropriate,<sup>37</sup> and

- the noncompliant employer (and not the plan with respect to which the failure occurred or any other participating employer) is, except to the extent provided by the Secretary, liable for any plan liabilities attributable to employees of the noncompliant employer.

In addition, if the pooled plan provider does not perform substantially all the administrative duties required of the provider (as described below) for any plan year, the Secretary, in his or her discretion, may provide that the determination as to whether the plan meets the Code requirements for tax-favored treatment will be made in the same manner as would be made without regard to the relief under the proposal.

#### Pooled plan provider

Under the proposal, “pooled plan provider” with respect to a plan means a person that—

- is designated by the terms of the plan as a named fiduciary under ERISA, as the plan administrator, and as the person responsible to perform all administrative duties (including conducting proper testing with respect to the plan and employees of each participating employer) that are reasonably necessary to ensure that the plan meets the Code requirements for tax-favored treatment and the requirements of ERISA and to ensure that each participating employer takes actions as the Secretary or the pooled plan provider determines necessary for the plan to meet Code and ERISA requirements, including providing to the pooled plan provider any disclosures or other information that the Secretary may require or that the pooled plan provider otherwise determines is necessary to administer the plan or to allow the plan to meet Code and ERISA requirements,
- registers with the Secretary as a pooled plan provider and provides any other information that the Secretary may require, before beginning operations as a pooled plan provider,
- acknowledges in writing its status as a named fiduciary under ERISA and as the plan administrator, and
- is responsible for ensuring that all persons who handle plan assets or are plan fiduciaries are bonded in accordance with ERISA requirements.

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<sup>36</sup> For this purpose, a tax-favored retirement plan means an eligible retirement plan as defined in section 402(c)(8)(B), that is, an IRA, a qualified retirement plan, a tax-deferred annuity plan under section 403(b), or an eligible deferred compensation plan of a State or local government employer under section 457(b).

<sup>37</sup> In appropriate circumstances, the IRS may waive the requirement that plan assets attributable to employees of the noncompliant employer be transferred if the IRS determines it is in the best interests of the employees to retain the assets in the plan.

The proposal specifies that the Secretary may perform audits, examinations, and investigations of pooled plan providers as may be necessary to enforce and carry out the purposes of the proposal.

### Guidance

The proposal directs the Secretary to issue guidance that the Secretary determines appropriate to carry out the proposal, including guidance (1) to identify the administrative duties and other actions required to be performed by a pooled plan provider, (2) that describes the procedures to be taken to terminate a plan that fails to meet the requirements to be a covered multiple-employer plan, including the proper treatment of, and actions needed to be taken by, any participating employer and plan assets and liabilities attributable to employees of that employer, and (3) to identify appropriate cases in which corrective action will apply with respect to noncompliant employers. For purposes of (3), the Secretary is to take into account whether the failure of an employer or pooled plan provider to provide any disclosures or other information, or to take any other action, necessary to administer a plan or to allow a plan to meet the Code requirements for tax-favored treatment has continued over a period of time that clearly demonstrates a lack of commitment to compliance. Any guidance issued by the Secretary under the proposal will not apply to any action or failure occurring before the issuance of the guidance.

The proposal also directs the Secretary, in consultation with the Secretary of Labor when appropriate, to publish model plan language that meets the Code and ERISA requirements under the proposal and that may be adopted to be treated as a pooled provider plan and pooled employer plan under ERISA.

### **Pooled employer plans under ERISA**

#### In general

As described above, under the proposal, a pooled employer plan is treated for purposes of ERISA as a single plan that is a multiple-employer plan. “Pooled employer plan” is defined as a plan (1) that is a defined contribution plan established or maintained for the purpose of providing benefits to the employees of two or more employers, (2) that is a qualified retirement plan or an IRA plan, and (3) the terms of which meet the requirements described below. Pooled employer plan does not include a plan with respect to which the participating employers both share a common interest other than participation in the plan and control the plan.

In order for a plan to be a pooled employer plan, the plan terms must—

- designate a pooled plan provider and provide that the pooled plan provider is a named fiduciary of the plan,
- designate one or more trustees (other than a participating employer)<sup>38</sup> to be responsible for collecting contributions to, and holding the assets of, the plan, and

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<sup>38</sup> Any trustee must meet the requirements under the Code to be an IRA trustee.

- require the trustees to implement written contribution collection procedures that are reasonable, diligent, and systematic,
- provide that each participating employer retains fiduciary responsibility for the selection and monitoring, in accordance with ERISA fiduciary requirements, of the person designated as the pooled plan provider and any other person who is also designated as a named fiduciary of the plan, and, to the extent not otherwise delegated to another fiduciary by the pooled plan provider (and subject to the ERISA rules relating to self-directed investments), the investment and management of the portion of the plan's assets attributable to the employees of that participating employer,
  - provide that a participating employer, or a participant or beneficiary, is not subject to unreasonable restrictions, fees, or penalties with regard to ceasing participation, receipt of distributions, or otherwise transferring assets of the plan in accordance with applicable rules for plan mergers and transfers,
  - require the pooled plan provider to provide to participating employers any disclosures or other information that the Secretary of Labor may require, including any disclosures or other information to facilitate the selection or monitoring of the pooled plan provider by participating employers, and require each participating employer to take any actions that the Secretary of Labor or pooled plan provider determines necessary to administer the plan or to allow for the plan to meet the ERISA and Code requirements applicable to the plan, including providing any disclosures or other information that the Secretary of Labor may require or that the pooled plan provider otherwise determines is necessary to administer the plan or to allow the plan to meet ERISA and Code requirements, and
  - provide that any disclosure or other information required to be provided as described above may be provided in electronic form and will be designed to ensure only reasonable costs are imposed on pooled plan providers and participating employers.

Under the proposal, however, a pooled employer plan does not include a plan established before January 1, 2016, unless the plan administrator elects that the plan will be treated as a pooled employer plan and the plan meets the requirements of ERISA applicable to a pooled employer plan established on or after such date.<sup>39</sup>

In the case of a fiduciary of a pooled employer plan or a person handling assets of a pooled employer plan, the maximum bond amount under ERISA is \$1 million.

#### Pooled plan provider

The definition of pooled plan provider for ERISA purposes is generally similar to the definition under the Code portion of the proposal, described above.<sup>40</sup> The ERISA definition

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<sup>39</sup> A pooled employer plan also does not include a multiemployer plan.

<sup>40</sup> In determining whether a person meets the requirements to be a pooled plan provider with respect to a plan, all persons that are members of the same controlled group or group under common control and that perform services for the plan are treated as one person.

requires a person to register as a pooled plan provider with the Secretary of Labor and provide any other information that the Secretary of Labor may require, before beginning operations as a pooled plan provider.

The proposal specifies that the Secretary of Labor may perform audits, examinations, and investigations of pooled plan providers as may be necessary to enforce and carry out the purposes of the proposal.

### Guidance

The proposal directs the Secretary of Labor to issue guidance that such Secretary determines appropriate to carry out the proposal, including guidance (1) to identify the administrative duties and other actions required to be performed by a pooled plan provider, and (2) that requires, in appropriate cases of a noncompliant employer, plan assets attributable to employees of the noncompliant employer to be transferred to a plan maintained only by that employer (or its successor), to a tax-favored retirement plan for each individual whose account is transferred, or to any other arrangement that the Secretary of Labor determines in the guidance is appropriate,<sup>41</sup> and the noncompliant employer (and not the plan with respect to which the failure occurred or any other participating employer) to be liable for any plan liabilities attributable to employees of the noncompliant employer, except to the extent provided in the guidance. For purposes of (2), the Secretary of Labor is to take into account whether the failure of an employer or pooled plan provider to provide any disclosures or other information, or to take any other action, necessary to administer a plan or to allow a plan to meet the requirements of ERISA and the Code requirements for tax-favored treatment, has continued over a period of time that clearly demonstrates a lack of commitment to compliance.

### **Form 5500 reporting**

Under the proposal, the Form 5500 of a pooled employer plan must include the identifying information for the person designated under the terms of the plan as the pooled plan provider. In addition, with respect to annual reports required under ERISA, the Secretary of Labor may by regulation prescribe simplified reporting for a multiple-employer plan that covers fewer than 1,000 participants, but only if no single participating employer has more than 100 participants covered by the plan.

### **Effective Date**

The proposal applies to years beginning after December 31, 2019, and to Forms 5500 for plan years beginning after December 31, 2019.

Nothing in the Code amendments made by the proposal is to be construed as limiting the authority of the Secretary of the Treasury (or the Secretary's delegate) to provide for the proper

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<sup>41</sup> The Secretary of Labor may waive the requirement to transfer assets to another plan or arrangement in appropriate circumstances if the Secretary of Labor determines it is in the best interests of the employees of the noncompliant employer to retain the assets in the pooled employer plan.

treatment of a failure to meet any Code requirement with respect to any employer (and its employees) in a multiple-employer plan.



## **B. Clarification of Retirement Income Account Rules**

### **Present Law**

Assets of a tax-sheltered annuity plan (“section 403(b)” plan), generally must be invested in annuity contracts or mutual funds.<sup>42</sup> However, the restrictions on investments do not apply to a retirement income account, which is a defined contribution program established or maintained by a church, or a convention or association of churches, to provide benefits under the plan to employees of a religious, charitable or similar tax-exempt organization.<sup>43</sup>

Certain rules prohibiting discrimination in favor of highly compensated employees, which apply to section 403(b) plans generally, do not apply to a plan maintained by a church or qualified church-controlled organization.<sup>44</sup> For this purpose, church means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches, and includes a qualified church-controlled organization. A qualified church-controlled organization is any church-controlled tax-exempt organization other than an organization that (1) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities that are sold at a nominal charge substantially less than the cost of providing the goods, services, or facilities, and (2) normally receives more than 25 percent of its support from either governmental sources, or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities that are not unrelated trades or businesses, or from both. Church-controlled organizations that are not qualified church-controlled organizations are generally referred to as “nonqualified church-controlled organizations.”

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

### **Description of Proposal**

The proposal clarifies that employees of nonqualified church-controlled organizations, in addition to employees of churches and qualified church-controlled organizations, may be covered under a section 403(b) plan that consists of a retirement income account.

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<sup>42</sup> Sec. 403(b)(1)(A) and (7).

<sup>43</sup> Sec. 403(b)(9)(B), referring to organizations exempt from tax under section 501(c)(3). For this purpose, a church or a convention or association of churches includes an organization described in section 414(e)(3)(A), that is, an organization, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, provided that the organization is controlled by or associated with a church or a convention or association of churches.

<sup>44</sup> Sec. 403(b)(1)(D) and (12).

**Effective Date**

The proposal is effective on the date of enactment.

## **C. Fiduciary Safe Harbor for Selection of Lifetime Income Provider**

### **Present Law**

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

Department of Labor regulations provide a safe harbor for a fiduciary to satisfy the prudent man requirement in selecting an annuity provider and a contract for benefit distributions from a defined contribution plan.<sup>45</sup>

### **Description of Proposal**

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

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

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

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

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<sup>45</sup> 29 C.F.R. sec. 2550.404a-4.

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

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

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

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

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

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

appropriateness of its conclusions with respect to the insurer's financial capability and cost, taking into account the considerations described above.<sup>46</sup> A fiduciary will be deemed to have conducted a periodic review of the financial capability of the insurer if the fiduciary obtains the written representations described above on an annual basis unless, in the interim, the fiduciary has received notification from the insurer that representations cannot be relied on or the fiduciary otherwise becomes aware of facts that would cause it to question the representations.

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

### **Effective Date**

The proposal is effective on the date of enactment.

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<sup>46</sup> However, a fiduciary is not required to review the appropriateness of its conclusions following the purchase of any contract or contracts for specific participants or beneficiaries.

## **D. Nondiscrimination Flexibility with Respect to Certain Plans**

### **Present Law**

#### **In general**

Qualified retirement plans are subject to nondiscrimination requirements, under which the group of employees covered by a plan and the contributions or benefits provided to employees, including benefits, rights, and features under the plan, must not discriminate in favor of highly compensated employees.<sup>47</sup> In addition, in the case of a defined benefit plan, the plan must benefit at least the lesser of (1) 50 employees and (2) the greater of 40 percent of all employees and two employees (or one employee if the employer has only one employee), referred to as the “minimum participation” requirements.<sup>48</sup> These nondiscrimination requirements are designed to help ensure that qualified retirement plans achieve the goal of retirement security for both lower and higher paid employees.

For nondiscrimination purposes, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of \$120,000 (for 2016).<sup>49</sup> Employees who are not highly compensated are referred to as nonhighly compensated employees.

#### **Nondiscriminatory plan coverage**

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

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<sup>47</sup> Secs. 401(a)(3)-(5) and 401(b). The timing of plan amendments must also not have the effect of discriminating significantly in favor of highly compensated employees. Detailed rules are provided in Treas. Reg. secs. 1.401(a)(4)-1 through -13 and secs. 1.410(b)-2 through -10. In applying the nondiscrimination requirements, certain employees, such as those under age 21 or with less than a year of service, generally may be disregarded. In addition, employees of controlled groups and affiliated service groups under section 414(b), (c), (m) and (o) are treated as employed by a single employer. In addition, if a plan does not satisfy the nondiscrimination requirements on its own, it may in some circumstances be aggregated with another plan, and the two plans tested together as a single plan.

<sup>48</sup> Sec. 401(a)(26).

<sup>49</sup> Section 414(q). At the election of the employer, employees who are highly compensated based on the amount of their compensation may be limited to employees who were among the top 20 percent of employees based on compensation.

satisfied. Under the average benefit percentage test, the average rate of contributions or benefit accruals for all nonhighly compensated employees under all plans of the employer must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.<sup>50</sup>

### **Nondiscriminatory contributions or benefit accruals**

#### **In general**

There are three general approaches to testing the amount of benefits under qualified retirement plans: (1) design-based safe harbors under which the plan's contribution or benefit accrual formula satisfies certain uniformity standards, (2) a general test, described below, and (3) cross-testing of equivalent contributions or benefit accruals. Employee elective deferrals and employer matching contributions under defined contribution plans are subject to special testing rules.<sup>51</sup>

The nondiscrimination rules allow contributions and benefit accruals to be provided to highly compensated and nonhighly compensated employees at the same percentage of compensation.<sup>52</sup> Thus, the various testing approaches described below are generally applied to the amount of contributions or accruals provided as a percentage of compensation, referred to as a contribution rate or accrual rate. In addition, in calculating an employee's contribution or accrual rate, credit may be given for the employer paid portion of Social Security taxes or benefits.<sup>53</sup>

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

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<sup>50</sup> The tests under the regulations are generally based on benefit accruals under a defined benefit plan and contributions allocated to participants' accounts under a defined contribution plan, which are referred to as "allocations," with the related rates referred to as "allocation rates." However, as discussed below, benefit accruals can be converted to actuarially equivalent contributions, and contributions can be converted to actuarially equivalent benefit accruals.

<sup>51</sup> Secs. 401(k) and (m), the latter of which applies also to after-tax employee contributions under a defined contribution plan.

<sup>52</sup> For this purpose, under section 401(a)(17), compensation generally is limited to \$265,000 per year (for 2016).

<sup>53</sup> See sections 401(a)(5)(C) and (D) and 401 (l) and Treas. Reg. section 1.401(a)(4)-7 and 1.401(l)-1 through -6 for rules for determining the amount of contributions or benefits that can be attributed to the employer-paid portion of Social Security taxes or benefits. This attribution is referred to as permitted disparity.

## Cross-testing

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

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

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

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

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



## Benefits, rights, and features

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

### **Closed and frozen defined benefit plans**

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

Over time, the group of employees continuing to accrue benefits under the defined benefit plan may come to consist more heavily of highly compensated employees, for example, because of greater turnover among nonhighly compensated employees or because increasing compensation causes nonhighly compensated employees to become highly compensated. In that case, the defined benefit plan may have to be combined with the defined contribution plan and tested on a benefit accrual basis. However, under the regulations, if none of the threshold conditions is met, testing on a benefits basis may not be available. Notwithstanding the regulations, recent IRS guidance provides relief for a limited period, allowing certain closed defined benefit plans to be aggregated with a defined contribution plan and tested on an aggregate equivalent benefits basis without meeting any of the threshold conditions.<sup>54</sup> When the group of employees continuing to accrue benefits under a closed defined benefit plan consists more heavily of highly compensated employees, the benefits, rights, and features provided under the plan may also fail the tests under the existing nondiscrimination rules.

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

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<sup>54</sup> Notice 2014-5, 2014-2 I.R.B. 276, extended by Notice 2016-57 (released September 19, 2016). Proposed regulations revising the nondiscrimination requirements for closed plans were also issued earlier this year, subject to various conditions. 81 Fed. Reg. 4976 (January 29, 2016).

## **Description of Proposal**

### **Closed defined benefit plans**

The proposal provides nondiscrimination relief with respect to benefit accruals and benefits, rights, and features for a closed class of participants under a defined benefit plan (“closed class”). Under the proposal, the defined benefit plan may be aggregated with one or more defined contribution plans and tested on a benefit accruals basis, without having to satisfy the threshold conditions, and benefits, rights, and features under the plan do not fail the nondiscrimination requirements for a year if the following conditions are met:<sup>55</sup>

- For the year the class closed and the two preceding years the plan satisfied the nondiscrimination requirements,
- Either the class was closed before September 21, 2016, or the plan (or predecessor plan) has been in effect for at least five years before the class is closed and, during that five-year period, there has not been a substantial increase (as defined under the proposal) in the coverage or the benefits or other rights or features under the plan, other than in connection with certain transactions, and
- After the class was closed, either no discriminatory amendment is adopted to modify the class or the benefit accruals or benefits, rights, and features for the closed class, or the nondiscrimination requirements are otherwise met.

In addition, under the proposal a closed defined benefit plan, or a frozen defined benefit plan, that meets similar requirements is deemed to satisfy the minimum participation requirements.

### **Make-up contributions under a defined contribution plan**

Under the proposal, a defined contribution is permitted to be tested on an equivalent benefit accruals basis, without having to satisfy the threshold conditions, if the following conditions are met:<sup>56</sup>

- The plan provides make-up contributions to a class of participants whose benefits under a defined benefit plan were reduced or frozen (“frozen class”),
- Either the class was frozen before September 21, 2016, or the plan (or predecessor plan) has been in effect for at least five years before the class is frozen and, during that five-year period, there has not been a substantial increase (as defined under the proposal) in the coverage or the benefits or other rights or features under the plan, other than in connection with certain transactions, and

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<sup>55</sup> The proposal also provides additional testing rules, such as allowing matching contributions to be taken into account.

<sup>56</sup> The proposal also provides additional testing rules, such as allowing matching contributions to be taken into account.

- After the class was frozen, either no discriminatory amendment is adopted to modify the class or the contributions or benefit accruals or benefits, rights, and features for the frozen class, or the nondiscrimination requirements are otherwise met.

### **Effective Date**

The proposal is generally effective on the date of enactment of the proposal, without regard to whether any plan modifications referred to in the proposal are adopted or effective before, on, or after the date of enactment, except that an employer may elect to apply the proposal to plan years beginning after December 31, 2013.

## **E. PBGC Premiums for CSEC Plans**

### **Present Law**

Qualified retirement plans, including defined benefit plans, are categorized as single-employer plans or multiple-employer plans. A single-employer plan is a plan maintained by one employer.<sup>57</sup> A multiple-employer plan generally is a single plan maintained by two or more unrelated employers (that is, employers that are not treated as a single employer under the aggregation rules).<sup>58</sup>

Defined benefit plans maintained by private employers are generally subject to minimum funding requirements.<sup>59</sup> Although single-employer and multiple-employer plans are generally subject to the same funding requirements, multiple-employer plans that are CSEC (cooperative and small employer charity) plans are subject to different rules.<sup>60</sup>

Private defined benefit plans are also covered by the Pension Benefit Guaranty Corporation (“PBGC”) insurance program and are required to pay annual premiums to the PBGC.<sup>61</sup> Single-employer and multiple-employer plans, including CSEC plans, are subject to the same PBGC premium requirements, consisting of flat-rate, per participant premiums and variable rate premiums, based on the unfunded vested benefits under the plan. For 2016, flat-rate premiums are \$64 per participant, and variable rate premiums are \$30 for each \$1,000 of unfunded vested benefits, subject to a limit of \$500 multiplied by the number of plan participants.<sup>62</sup>

### **Description of Proposal**

Under the proposal, for CSEC plans, flat-rate premiums are \$19 per participant, and variable rate premiums are \$9 for each \$1,000 of unfunded vested benefits.<sup>63</sup>

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<sup>57</sup> For this purpose, businesses and organizations that are members of a controlled group of corporations, a group under common control, or an affiliated service group are treated as one employer (referred to as “aggregation”). Secs. 414(b), (c), (m) and (o).

<sup>58</sup> Sec. 413(c). Multiple-employer status does not apply if the plan is a multiemployer plan, defined under sec. 414(f) as a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s). Multiemployer plans are also known as Taft-Hartley plans.

<sup>59</sup> Secs. 412 and 430-433 and ERISA secs. 301-306. Unless a funding waiver is obtained, an employer may be subject to a two-tier excise tax under section 4971 if the funding requirements are not met.

<sup>60</sup> Funding rules for CSEC plans were enacted by the Cooperative and Small Employer Charity Pension Flexibility Act, Pub. L. No. 113-197. CSEC plan is defined in section 414(y) and ERISA section 210(f).

<sup>61</sup> Title IV of ERISA.

<sup>62</sup> These premiums rates have been increased several times by legislation since 2005.

<sup>63</sup> These are the premium rates that applied to single-employer and multiple-employer plans in 2005.

**Effective Date**

The proposal applies to plan years beginning after December 31, 2015.

## **F. IRA Ownership of S Corporation Banks**

### **Present Law**

#### **IRAs**

An individual retirement account (“IRA”) is a tax-exempt trust or account established for the exclusive benefit of an individual and his or her beneficiaries.<sup>64</sup> There are two general types of IRAs: traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs, contributions to which are not deductible. In general, amounts held in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income; distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings. A qualified distribution is a distribution that is made (1) after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) after attainment of age 59½, on account of death or disability, or for first-time homebuyer expenses of up to \$10,000.

#### **S corporations and permissible shareholders**

In general, an S corporation is not subject to corporate-level income tax on its items of income and loss.<sup>65</sup> Instead, an S corporation passes through its items of income and loss to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns.

Only certain tax-exempt organizations are permitted to be shareholders of an S corporation, including qualified retirement plans. Under present law, an IRA, including a Roth IRA, is permitted to be a shareholder of an S corporation only if the S corporation is a bank and only to the extent of bank stock held by the IRA on October 22, 2004.<sup>66</sup> In the case of a tax-exempt S corporation shareholder, including an IRA, the shareholder’s interest in the S corporation is treated as an unrelated trade or business and its share of S corporation items of income and loss (and gain or loss on disposition of the S corporation stock) is taken into account in determining its unrelated business taxable income.<sup>67</sup>

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<sup>64</sup> Secs. 408 and 408A.

<sup>65</sup> The rules for S corporations are in Subchapter S of the Code, sections 1361-1379.

<sup>66</sup> This is the date of enactment of the American Jobs Creation Act, Pub. L. No. 108-357, which allowed an IRA to be a shareholder of an S corporation that is a bank. A related exemption under section 4975(d)(16) of the prohibited transaction rules allowed stock held by an IRA at the time a bank elected to become an S corporation to be sold to the IRA owner.

<sup>67</sup> Sec. 512(e). This rule does not apply to employee stock ownership plans.

### **Description of Proposal**

Under the proposal, an IRA, including a Roth IRA, is permitted to be a shareholder of an S corporation that is a bank without regard to whether the IRA held the bank stock on October 22, 2004. Thus, any IRA is permitted to be a shareholder of any S corporation that is a bank.<sup>68</sup> As under present law, an IRA's interest in an S corporation is treated as an unrelated trade or business and its share of S corporation items of income and loss (and gain or loss on disposition of the S corporation stock) is taken into account in determining its unrelated business taxable income.

### **Effective Date**

The proposal applies to taxable years beginning after December 31, 2015.

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<sup>68</sup> The proposal also amends the exemption under section 4975(d)(16) of the prohibited transaction rules to allow stock held by an IRA at the time a bank elects to become an S corporation to be sold to the IRA owner.

## **G. Benefits for Volunteer Firefighters and Emergency Medical Responders**

### **Present Law**

#### **Benefits for volunteer firefighters and emergency medical responders**

In general, a reduction in property tax by persons who volunteer their services as emergency responders under a State law program is includible in gross income.<sup>69</sup> However, for taxable years beginning after December 31, 2007, and before January 1, 2011, an exclusion applied for any qualified State or local tax benefit and any qualified reimbursement payment provided to members of qualified volunteer emergency response organizations.<sup>70</sup>

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

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

#### **Itemized deductions**

Individuals are allowed itemized deductions for (1) State and local income taxes, real property taxes, and personal property taxes, and (2) subject to certain limitations, contributions to charitable organizations, including unreimbursed expenses incurred in performing volunteer services for such an organization.<sup>71</sup>

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

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<sup>69</sup> IRS Chief Counsel Advice 200302045 (December 3, 2002).

<sup>70</sup> Sec. 139B. Under section 3121(a)(23), the exclusion applied also for purposes of taxes under the Federal Insurance Contributions Act (“FICA”).

<sup>71</sup> Secs. 164(a) and 170.



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

### **Description of Proposal**

The proposal reinstates for one year the exclusions for qualified State or local tax benefits and qualified reimbursement payments provided to members of qualified volunteer emergency response organizations. The proposal also increases the exclusion for qualified reimbursement payments to \$50 for each month during which a volunteer performs services. Under the proposal, the exclusions for qualified State or local tax benefits and qualified reimbursement payments do not apply for taxable years beginning after December 31, 2017.

### **Effective Date**

The proposal is effective for taxable years beginning after December 31, 2016. As described above, the exclusions do not apply for taxable years beginning after December 31, 2017. Thus, the exclusions apply only for taxable years beginning during 2017.

## H. Treatment of Qualified Equity Grants

### Present Law

#### Income tax treatment of employer stock transferred to an employee

Specific rules apply to property, including employer stock, transferred to an employee in connection with the performance of services.<sup>72</sup> These rules govern the amount and timing of income inclusion by the employee and the amount and timing of the employer's compensation deduction.

Under these rules, an employee generally must recognize income for the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture (referred to herein as "substantially vested"). Thus, if the employee's right to the stock is substantially vested when the employee receives the stock, income is recognized for the taxable year in which received. If the employee's right to the stock is not substantially vested at the time of receipt, in general, income is recognized for the taxable year in which the employee's right becomes substantially vested.<sup>73</sup> The amount includible in the employee's income is the excess of the fair market value of the stock (at the time of receipt if substantially vested at that time or, if not, at the time of substantial vesting) over the amount, if any, paid by the employee for the stock.

In general, an employee's right to stock or other property is subject to a substantial risk of forfeiture if the employee's right to full enjoyment of the property is subject to a condition, such as the future performance of substantial services.<sup>74</sup> An employee's right to stock or other property is transferable if the employee can transfer an interest in the property to any person other than the transferor of the property.<sup>75</sup> Thus, generally, employer stock transferred to an employee by an employer is not transferable merely because the employee can sell it back to the employer.

In the case of stock transferred to an employee, the employer is allowed a deduction (to the extent a deduction for a business expense is otherwise allowable) equal to the amount

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<sup>72</sup> Sec. 83. Section 83 applies generally to transfers of any property, not just employer stock, in connection with the performance of services by any service provider, not just an employee. However, the proposal described herein applies only with respect to certain employer stock transferred to employees.

<sup>73</sup> Under section 83(b), if an employee's right to the stock is not substantially vested at the time of receipt (nonvested stock), the employee may nevertheless elect within 30 days of receipt to recognize income for the taxable year of receipt, referred to as a "section 83(b)" election. Under Treas. Reg. sec. 1.83-2, the employee makes an election by filing with the Internal Revenue Service a written statement that includes the fair market value of the property at the time of receipt and the amount (if any) paid for the property. The employee must also provide a copy of the statement to the employer.

<sup>74</sup> See section 83(c)(1) and Treas. Reg. sec. 1.83-3(c) for the definition of substantial risk of forfeiture.

<sup>75</sup> Treas. Reg. sec. 1.83-3(d). In addition, under section 83(c)(2), the right to stock is transferable only if any transferee's right to the stock would not be subject to a substantial risk of forfeiture.

included in the employee's income as a result of receipt of the stock.<sup>76</sup> The deduction is allowed for the employer's taxable year in which or with which ends the taxable year for which the amount is included in the employee's income.

These rules do not apply to the grant to an employee of a nonqualified option on employer stock unless the option has a readily ascertainable fair market value.<sup>77</sup> Instead, these rules apply to the receipt of employer stock by the employee on exercise of the option. That is, if the right to the stock is substantially vested on receipt, income recognition applies for the taxable year of receipt. If the right to the stock is not substantially vested on receipt, the timing of income inclusion is determined under the rules applicable to the receipt of nonvested stock. In either case, the amount includible in income by the employee is the excess of the fair market value of the stock as of the time of income inclusion, less the exercise price paid by the employee and the amount, if any, paid by the employee for the option. The employer's deduction is also determined under these rules.

In some cases, the transfer of employer stock to an employee may be in settlement of restricted stock units. Restricted stock unit ("RSU") is a term used for an arrangement under which an employee has the right to receive at a specified time in the future an amount determined by reference to the value of one or more shares of employer stock. An employee's right to receive the future amount may be subject to a condition, such as continued employment for a certain period or the attainment of certain performance goals. The payment to the employee of the amount due under the arrangement is referred to as settlement of the RSU. The arrangement may provide for the settlement amount to be paid in cash or in employer stock (or either). The receipt of employer stock in settlement of an RSU is subject to the same rules as other receipts of employer stock with respect to the timing and amount of income inclusion by the employee and the employer's deduction.

### **Employment taxes and reporting**

Employment taxes generally consist of taxes under the Federal Insurance Contributions Act ("FICA"), tax under the Federal Unemployment Tax Act ("FUTA"), and income taxes required to be withheld by employers from wages paid to employees ("income tax withholding").<sup>78</sup> Unless an exception applies under the applicable rules, compensation provided to an employee constitutes wages subject to these taxes.

FICA imposes tax on employers and employees, generally based on the amount of wages paid to an employee during the year. The tax imposed on the employer and on the employee is

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<sup>76</sup> Sec. 83(h).

<sup>77</sup> See section 83(e)(3) and Treas. Reg. sec. 1.83-7. A nonqualified option is an option on employer stock that is not a statutory option, discussed below.

<sup>78</sup> Secs. 3101-3128 (FICA), 3301-3311 (FUTA), and 3401-3404 (income tax withholding). Instead of FICA taxes, railroad employers and employees are subject, under the Railroad Retirement Tax Act ("RRTA"), sections 3201-3241, to taxes equivalent to FICA taxes with respect to compensation as defined for RRRA purposes. Sections 3501-3510 provide additional rules relating to all these taxes.

each composed of two parts: (1) the Social Security or old age, survivors, and disability insurance (“OASDI”) tax equal to 6.2 percent of covered wages up to the OASDI wage base (\$118,500 for 2016); and (2) the Medicare or hospital insurance (“HI”) tax equal to 1.45 percent of all covered wages.<sup>79</sup> The employee portion of FICA tax generally must be withheld and remitted to the Federal government by the employer. FICA tax withholding applies regardless of whether compensation is provided in the form of cash or a noncash form, such as a transfer of property (including employer stock) or in-kind benefits.<sup>80</sup>

FUTA imposes a tax on employers of six percent of wages up to the FUTA wage base of \$7,000.

Income tax withholding generally applies when wages are paid by an employer to an employee, based on graduated withholding rates set out in tables published by the Internal Revenue Service (“IRS”).<sup>81</sup> Like FICA tax withholding, income tax withholding applies regardless of whether compensation is provided in the form of cash or a noncash form, such as a transfer of property (including employer stock) or in-kind benefits.

An employer is required to furnish each employee with a statement of compensation information for a calendar year, including taxable compensation, FICA wages, and withheld income and FICA taxes.<sup>82</sup> In addition, information relating to certain nontaxable items must be reported, such as certain retirement and health plan contributions. The statement, made on Form W-2, Wage and Tax Statement, must be provided to each employee by January 31 of the succeeding year.<sup>83</sup>

### **Statutory options**

Two types of statutory options apply with respect to employer stock: incentive stock options (“ISOs”) and options provided under an employee stock purchase plan (“ESPP”).<sup>84</sup>

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<sup>79</sup> The employee portion of the HI tax under FICA (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount is \$250,000 in the case of a joint return, \$125,000 in the case of a married individual filing a separate return, and \$200,000 in any other case.

<sup>80</sup> Under section 3501(b), employment taxes with respect to noncash fringe benefits are to be collected (or paid) by the employer at the time and in the manner prescribed by the Secretary of the Treasury (“Treasury”). Announcement 85-113, 1985-31 I.R.B. 31, provides guidance on the application of employment taxes with respect to noncash fringe benefits.

<sup>81</sup> Sec. 3402. Specific withholding rates apply in the case of supplemental wages.

<sup>82</sup> Secs. 6041 and 6051.

<sup>83</sup> Employers send Form W-2 information to the Social Security Administration, which records information relating to Social Security and Medicare and forwards the Form W-2 information to the IRS. Employees include a copy of Form W-2 with their income tax returns.

<sup>84</sup> Sections 421-424 govern statutory options.

Stock received pursuant to a statutory option is subject to special rules, rather than the rules for nonqualified options, discussed above. No amount is includible in an employee's income on the grant or exercise of a statutory option.<sup>85</sup> In addition, no deduction is allowed to the employer with respect to the option or the stock transferred to an employee on exercise.

If a holding requirement is met with respect to the stock received on exercise of a statutory option and the employee later disposes of the stock, the employee's gain generally is treated as capital gain rather than ordinary income. Under the holding requirement, the employee must not dispose of the stock within two years after the date the option is granted or one year after the date the option is exercised. If a disposition occurs before the end of the required holding periods (a "disqualifying disposition"), statutory option treatment no longer applies. Instead, the income realized on the disqualifying disposition, up to the amount of income that would have applied if the option had been a nonqualified option, is includible in income by the employee as compensation received in the taxable year in which the disposition occurs and a corresponding deduction is allowable to the employer for the taxable year in which the disposition occurs.

Employment taxes do not apply with respect to the grant of a statutory option, the receipt of stock pursuant to the option, or a disqualifying disposition of the stock.<sup>86</sup>

### **Nonqualified deferred compensation**

Compensation is generally includible in an employee's income when paid to the employee. However, in the case of a nonqualified deferred compensation plan,<sup>87</sup> unless the arrangement meets certain requirements, the amount of deferred compensation is includible in income for the taxable year when earned (or, if later, when not subject to a substantial risk of forfeiture) even if payment will not occur until a later year.<sup>88</sup> In general, under these requirements, the time when nonqualified deferred compensation will be paid must be specified at the time of deferral with limits on further deferral after the time for payment.

Nonqualified options on employer stock may be structured so as not to be considered nonqualified deferred compensation and thus not subject to these rules.<sup>89</sup> An arrangement

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<sup>85</sup> Under section 56(b)(3), this income tax treatment with respect to stock received on exercise of an ISO does not apply for purposes of the alternative minimum tax under section 55.

<sup>86</sup> Secs. 3121(a)(22), 3306(b)(19), and the last sentence of section 421(b).

<sup>87</sup> Compensation earned by an employee is generally paid to the employee shortly after being earned. However, in some cases, payment is deferred to a later period, referred to as "deferred compensation." Deferred compensation may be provided through a plan that receives tax-favored treatment, such as a qualified retirement plan under section 401(a). Deferred compensation provided through a plan that is not eligible for tax-favored treatment is referred to as "nonqualified" deferred compensation.

<sup>88</sup> Section 409A and the regulations thereunder provide rules for nonqualified deferred compensation.

<sup>89</sup> Treas. Reg. sec. 1.409A-1(b)(5). In addition, statutory option arrangements are not nonqualified deferred compensation arrangements.

providing RSUs is considered a nonqualified deferred compensation plan and is subject to these rules, including the limits

## **Description of Proposal**

### **In general**

The proposal allows a qualified employee to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer.<sup>90</sup> An election to defer income inclusion (“inclusion deferral election”) with respect to qualified stock must be made no later than 30 days after the first time the employee’s right to the stock is substantially vested.<sup>91</sup> Absent an inclusion deferral election under the proposal, the income is includable for the taxable year in which the qualified employee’s right to the qualified stock is substantially vested under present law.

If an employee elects to defer income inclusion, the income must be included in the employee’s income for the taxable year that includes the earliest of (1) the first date the qualified stock becomes transferable, including transferable to the employer;<sup>92</sup> (2) the date the employee first becomes an excluded employee (as described below); (3) the first date on which any stock of the employer becomes readily tradable on an established securities market;<sup>93</sup> (4) the date five years after the date the employee’s right to the stock becomes substantially vested; and (5) the date on which the employee revokes his or her inclusion deferral election.<sup>94</sup>

An employee may not make an inclusion deferral election for a year with respect to qualified stock if, in the preceding calendar year, the corporation purchased any of its outstanding stock unless at least 25 percent of the total dollar amount of the stock so purchased is stock with respect to which an inclusion deferral election is in effect (“deferral stock”) and the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.<sup>95</sup> For purposes of this requirement, stock purchased from an individual is not treated as deferral stock (and the purchase is not treated as a purchase of deferral stock) if,

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<sup>90</sup> The proposal does not apply to income with respect to nonvested stock that is includible as a result of a section 83(b) election.

<sup>91</sup> An inclusion deferral election is made in a manner similar to the manner in which a section 83(b) election is made. Thus, as in the case of a section 83(b) election under present law, the employee must provide a copy of the inclusion deferral election to the employer.

<sup>92</sup> Thus, for this purpose, the qualified stock is considered transferable if the employee has the ability to sell the stock to the employer (or any other person).

<sup>93</sup> An established securities market is determined for this purpose by the Secretary, but does not include any market unless the market is recognized as an established securities market for purposes of another Code provision.

<sup>94</sup> An inclusion deferral election is revoked at the time and in the manner as the Secretary provides.

<sup>95</sup> This requirement is met if the stock purchased by the corporation includes all the corporation’s outstanding deferral stock.

immediately after the purchase, the individual holds any deferral stock with respect to which an inclusion deferral election has been in effect for a longer period than the election with respect to the purchased stock. Thus, in general, in applying the purchase requirement, an individual's deferral stock with respect to which an inclusion deferral election has been in effect for the longest periods must be purchased first. A corporation that has deferral stock outstanding as of the beginning of any calendar year and that purchases any of its outstanding stock during the calendar year must report on its income tax return for the taxable year in which, or with which, the calendar year ends the total dollar amount of the outstanding stock purchased during the calendar year and such other information as the Secretary may require for purposes of administering this requirement.

A qualified employee may make an inclusion deferral election with respect to qualified stock attributable to a statutory option. In that case, the option is not treated as a statutory option and the rules relating to statutory options and related stock do not apply. In addition, an arrangement under which an employee may receive qualified stock is not treated as a nonqualified deferred compensation plan solely because of an employee's ability to make an inclusion deferral election.

Deferred income inclusion applies also for purposes of the employer's deduction of the amount of income attributable to the qualified stock. That is, if an employee makes an inclusion deferral election, the employer's deduction is deferred until the employer's taxable year in which or with which ends the taxable year of the employee for which the amount is included in the employee's income as described in (1)-(5) above.

### **Qualified employee and qualified stock**

Under the proposal, a qualified employee means an individual who is not an excluded employee and who agrees, in the inclusion deferral election, to meet the requirements necessary (as determined by the Secretary) to ensure the income tax withholding requirements of the employer corporation with respect to the qualified stock (as described below) are met. For this purpose, an excluded employee with respect to a corporation is any individual (1) who is, or has been at any time during the 10 preceding calendar years, a one-percent owner of the corporation,<sup>96</sup> (2) who is, or has been at any prior time, the chief executive officer or chief financial officer of the corporation or an individual acting in either capacity, (3) who is a family member of an individual described in (1) or (2),<sup>97</sup> or (4) who is, or has been for any of the 10 preceding taxable years, one of the four highest compensated officers of the corporation.<sup>98</sup>

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<sup>96</sup> One-percent owner status is determined under the top-heavy rules for qualified retirement plans, that is, section 416(i)(1)(B)(ii).

<sup>97</sup> In the case of one-percent owners, this results from application of the attribution rules of section 318 under section 416(i)(1)(B)(i)(II). Family members are determined under section 318(a)(1) and generally include an individual's spouse, children, grandchildren and parents.

<sup>98</sup> Highest paid employee status is determined at the close of the corporation's taxable year.

Qualified stock is any stock of a corporation if--

- an employee receives the stock in connection with the exercise of an option or in settlement of an RSU, and
- the option or RSU was provided by the corporation to the employee in connection with the performance of services and in a year in which the corporation was an eligible corporation (as described below).

However, qualified stock does not include any stock if, at the time the employee's right to the stock becomes substantially vested, the employee may sell the stock to, or otherwise receive cash in lieu of stock from, the corporation.

A corporation is an eligible corporation with respect to a calendar year if (1) no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year,<sup>99</sup> and (2) the corporation has a written plan under which, in the calendar year, not less than 80 percent of all employees who provide services to the corporation in the United States (or any U.S. possession) are granted stock options, or restricted stock units ("RSUs"), with the same rights and privileges to receive qualified stock ("80-percent requirement").<sup>100</sup> For this purpose, in general, the determination of rights and privileges with respect to stock is determined in a similar manner as provided under the present-law ESPP rules.<sup>101</sup> However, employees will not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, provided that the number of shares available to each employee is more than a de minimis amount. In addition, rights and privileges with respect to the exercise of a stock option are not treated for this purpose as the same as rights and privileges with respect to the settlement of an RSU.<sup>102</sup>

For purposes of the proposal, corporations that are members of the same controlled group are treated as one corporation.

### **Notice, withholding and reporting requirements**

Under the proposal, a corporation that transfers qualified stock to a qualified employee must provide a notice to the qualified employee at the time (or a reasonable period before) the

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<sup>99</sup> This requirement continues to apply up to the time an inclusion deferral election is made. That is, under the proposal, no inclusion deferral election may be made with respect to qualified stock if any stock of the corporation is readily tradable on an established securities market at any time before the election is made.

<sup>100</sup> In applying the requirement that 80 percent of employees receive stock options or RSUs, excluded employees and part-time employees are not taken into account. For this purpose, part-time employee is defined as under section 4980E(d)(4), that is, an employee customarily employed for fewer than 30 hours per week.

<sup>101</sup> Sec. 423(b)(5).

<sup>102</sup> Under a transition rule, in the case of a calendar year beginning before January 1, 2017, the 80-percent requirement is applied without regard to whether the rights and privileges with respect to the qualified stock are the same.



employee's right to the qualified stock is substantially vested (and income attributable to the stock would be includible absent an inclusion deferral election). The notice must (1) certify to the employee that the stock is qualified stock, and (2) notify the employee (a) that the employee may elect to defer income inclusion with respect to the stock and (b) that, if the employee makes an inclusion deferral election, the amount of income required to be included at the end of the deferral period will be based on the value of the stock at the time the employee's right to the stock is substantially vested, notwithstanding whether the value of the stock has declined during the deferral period, and the amount of income to be included at the end of the deferral period will be subject to withholding as provided under the proposal, as well as of the employee's responsibilities with respect to required withholding. Failure to provide the notice may result in the imposition of a penalty of \$100 for each failure, subject to a maximum penalty of \$50,000 for all failures during any calendar year.

An inclusion deferral election applies only for income tax purposes. The application of FICA and FUTA are not affected. The proposal includes specific income tax withholding and reporting requirements with respect to income subject to an inclusion deferral election.

For the taxable year for which income subject to an inclusion deferral election is required to be included in income by the employee (as described above), the amount required to be included in income is treated as wages with respect to which the employer is required to withhold income tax at a rate not less than the highest income tax rate applicable to individual taxpayers.<sup>103</sup> The employer must report on Form W-2 the amount of income covered by an inclusion deferral election (1) for the year of deferral and (2) for the year the income is required to be included in income by the employee. In addition, for any calendar year, the employer must report on Form W-2 the aggregate amount of income covered by inclusion deferral elections, determined as of the close of the calendar year.

### **Effective Date**

The proposal generally applies with respect to stock attributable to options exercised or RSUs settled after December 31, 2016. Under a transition rule, until the Secretary (or the Secretary's delegate) issues regulations or other guidance implementing the 80-percent and employer notice requirements under the proposal, a corporation will be treated as complying with those requirements (respectively) if it complies with a reasonable good faith interpretation of the requirements. The penalty for a failure to provide the notice required under the proposal applies to failures after December 31, 2016.

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<sup>103</sup> That is, the maximum rate of tax in effect for the year under section 1. The proposal specifies that qualified stock is treated as a noncash fringe benefit for income tax withholding purposes.

## I. Modifications to Required Minimum Distribution Rules

### Present Law

Minimum distribution rules apply to tax-favored employer-sponsored retirement plans and IRAs.<sup>104</sup> Employer-sponsored retirement plans are of two general types: defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts; and defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses.

In general, under the minimum distribution rules, distribution of minimum benefits must begin to an employee (or IRA owner) no later than a required beginning date and a minimum amount must be distributed each year (sometimes referred to as “lifetime” minimum distribution requirements). These lifetime requirements do not apply to a Roth IRA.<sup>105</sup> Minimum distribution rules also apply to benefits payable with respect to an employee (or IRA owner) who has died (sometimes referred to as “after-death” minimum distribution requirements). The regulations provide a methodology for calculating the required minimum distribution from an individual account under a defined contribution plan or from an IRA.<sup>106</sup> In the case of annuity payments under a defined benefit plan or an annuity contract, the regulations provide requirements that the stream of annuity payments must satisfy.

Failure to comply with the minimum distribution requirement results in an excise tax imposed on the individual who was required to take the distributions equal to 50 percent of the required minimum amount not distributed for the year.<sup>107</sup> The excise tax may be waived in certain cases. For qualified retirement plans, satisfying the minimum distribution requirement under the plan terms and in operation is also a qualification requirement for the trust of the plan to remain tax-exempt.

### Required beginning date

For traditional IRAs, the required beginning date is April 1 following the calendar year in which the employee (or IRA owner) attains age 70½. For employer-sponsored retirement plans,

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<sup>104</sup> Sections 401(a)(9), 403(b)(1), 408(a)(6), 408(b)(3), and 457(d)(2). Tax-favored employer-sponsored retirement plans include qualified retirement plans and annuities under sections 401(a) and 403(a), tax-deferred annuity plans under section 403(b), and governmental eligible deferred compensation plans under section 457(b). Minimum distribution requirements also apply to eligible deferred compensation plans under section 457(b) of tax-exempt employers.

<sup>105</sup> Sec. 408A(c)(5).

<sup>106</sup> Reflecting the directive in section 823 of the Pension Protection Act of 2006 (Pub. L. No. 109-280), pursuant to Treas. Reg. sec. 1.401(a)(9)-1, A-2(d), a governmental plan within the meaning of section 414(d) or a governmental eligible deferred compensation plan is treated as having complied with the statutory minimum distribution rules if the plan complies with a reasonable and good faith interpretation of those rules.

<sup>107</sup> Section 4974.

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

### **Lifetime rules**

While an employee (or IRA owner) is alive, distributions of the individual's interest are required to be made (in accordance with regulations) over the life or life expectancy of the employee (or IRA owner), or over the joint lives or joint life expectancy of the employee (or IRA owner) and a designated beneficiary.<sup>108</sup> For defined contribution plans and IRAs, the required minimum distribution for each year is determined by dividing the account balance as of the end of the prior year by a distribution period which, while the employee (or IRA owner) is alive, is the factor for the employee (or IRA owner's) age from the uniform lifetime table included in the Treasury regulations.<sup>109</sup> The distribution period for annuity payments under a defined benefit plan or annuity contract (to the extent not limited to the life of the employee (or IRA owner) or the joint lives of the employee (or IRA owner) and a designated beneficiary) is generally subject to the same limitations as apply to individual accounts.

### **After-death rules**

#### **Payments over a distribution period**

The after-death minimum distributions rules vary depending on (i) whether an employee (or IRA owner) dies on or after the required beginning date or before the required beginning date, and (ii) whether there is a designated beneficiary for the benefit.<sup>110</sup> Under the regulations, a

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<sup>108</sup> Section 401(a)(9)(A).

<sup>109</sup> Treas. Reg. sec. 1.401(a)(9)-5. This table is based on the joint life and last survivor expectancy of the individual and a hypothetical beneficiary 10 years younger. For an individual with a spouse as designated beneficiary who is more than 10 years younger (and thus the number of years in the couple's joint life and last survivor expectancy is greater than the uniform lifetime table), the joint life expectancy and last survivor expectancy of the couple (calculated using the table in the regulations) is used. For this purpose and other special rules that apply to the surviving spouse as beneficiary, a former spouse to whom all or a portion of an employee's benefit is payable pursuant to a qualified domestic relations order (within the meaning of section 414(p)) is treated as the spouse (including a surviving spouse) of the employee for purposes of section 401(a)(9).

<sup>110</sup> In the case of amounts for which the employee or IRA owner's surviving spouse is the beneficiary, the surviving spouse generally is permitted to do a tax-free rollover of such amounts into an IRA (or account of a tax-favored employer-sponsored plan of the spouse's employer) established in the surviving spouse's name as IRA owner or employee. The rules applicable to the rollover account, including the minimum distribution rules, are the same rules that apply to an IRA owner or employee. In the case of an IRA for which the spouse is sole beneficiary, this can be accomplished by simply renaming the IRA as an IRA held by the spouse as IRA owner rather than as a beneficiary.

designated beneficiary is an individual designated as a beneficiary under the plan or IRA.<sup>111</sup> Similar to the lifetime rules, for defined contribution plans and IRAs (“individual accounts”), the required minimum distribution for each year after the death of the employee (or IRA owner) is generally determined by dividing the account balance as of the end of the prior year by a distribution period.

If an employee (or IRA owner) dies on or after the required beginning date, the basic statutory rule is that the remaining interest must be distributed at least as rapidly as under the method of distribution being used before death.<sup>112</sup> Under the regulations, for individual accounts, this rule is also interpreted as requiring the minimum required distribution to be calculated using a distribution period. If there is no designated beneficiary, the distribution period is equal to the remaining years of the employee’s (or IRA owner’s) life, as of the year of death.<sup>113</sup> If there is a designated beneficiary, the distribution period (if longer) is the beneficiary’s life expectancy calculated using the life expectancy table in the regulations, determined in the year after the year of death.<sup>114</sup>

If an employee (or IRA owner) dies before the required beginning date and any portion of the benefit is payable to a designated beneficiary, the statutory rule is that distributions are generally required to begin within one year of the employee’s (or IRA owner’s) death (or such later date as prescribed in regulations) and are permitted to be paid (in accordance with regulations) over the life or life expectancy of the designated beneficiary. If the beneficiary of the employee (or IRA owner) is the individual’s surviving spouse, distributions are not required to commence until the year in which the employee (or IRA owner) would have attained age 70½. If the surviving spouse dies before the employee (or IRA owner) would have attained age 70½, the after-death rules apply after the death of the spouse as though the spouse were the employee (or IRA owner). Under the regulations, for individual accounts, the required minimum distribution for each year is determined using a distribution period and the period is measured by the designated beneficiary’s life expectancy, calculated in the same manner as if the individual died on or after the required beginning date.<sup>115</sup>

In cases where distribution after death is based on life expectancy (either the remaining life expectancy of the employee (or IRA owner) or a designated beneficiary), the distribution period generally is fixed at the employee’s (or IRA owner’s) death and then reduced by one for

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<sup>111</sup> Treas. Reg. sec. 1.401(a)(9)-4, A-1. The individual need not be named as long as the individual is identifiable under the terms of the plan (or IRA). There are special rules for multiple beneficiaries and for trusts named as beneficiary (where the beneficiaries of the trust are individuals). However, the fact that an interest under a plan or IRA passes to a certain individual under a will or otherwise under State law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan or IRA.

<sup>112</sup> Section 401(a)(9)(B)(i).

<sup>113</sup> Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(2).

<sup>114</sup> Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(1).

<sup>115</sup> Treas. Reg. sec. 1.401(a)(9)-5, A-5(b).

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.<sup>116</sup>

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

#### Five-year rule

If an employee (or IRA owner) dies before the required beginning date and there is no designated beneficiary, then the entire remaining interest of the employee (or IRA owner) must generally be distributed by the end of the fifth calendar year following the individual's death.<sup>117</sup>

#### **Defined benefit plans and annuity distributions**

The regulations provide rules for the amount of annuity distributions from a defined benefit plan, or from an annuity purchased by the plan from an insurance company, that are paid over life or life expectancy. Annuity distributions are generally required to be nonincreasing with certain exceptions, which include, for example, (i) increases to the extent of certain specified cost-of-living indices, (ii) a constant percentage increase (for a qualified defined benefit plan, the constant percentage cannot exceed five percent per year), (iii) certain accelerations of payments, and (iv) increases to reflect when an annuity is converted to a single life annuity after the death of the beneficiary under a joint and survivor annuity or after termination of the survivor annuity under a qualified domestic relations order.<sup>118</sup> If distributions are in the form of a joint and survivor annuity and the survivor annuitant both is not the surviving spouse and is younger than the employee (or IRA owner), the survivor annuity benefit is limited to a percentage of the life annuity benefit for the employee (or IRA owner). The survivor benefit as a percentage of the benefit of the primary annuitant is required to be smaller (but not required to be less than 52 percent) as the difference in the ages of the primary annuitant and the survivor annuitant become greater.

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<sup>116</sup> If the distribution period is based on the surviving spouse's life expectancy (whether the employee or IRA owner's death is before or after the required beginning date), the spouse's life expectancy generally is recalculated each year while the spouse is alive and then fixed the year after the spouse's death.

<sup>117</sup> Section 401(a)(9)(B)(ii) provides that the entire interest must be distributed within five years of the employee's death. Treas. Reg. sec. 1.401(a)(9)-3, A-2, provides that this requirement is satisfied if the entire interest is distributed by the end of the fifth calendar year following the employee's death. There are provisions in the regulations allowing a designated beneficiary to take advantage of the five-year rule. See Treas. Reg. secs. 1.401(a)(9)-4, A-4, and 1.4974-2, A-7(b).

<sup>118</sup> Treas. Reg. sec. 1.401(a)(9)-6, A-14.

## **Plan amendment and anti-cut-back requirements**

Present law provides a remedial amendment period during which, under certain circumstances, a qualified retirement plan may be amended retroactively in order to comply with the qualification requirements.<sup>119</sup> In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary may extend the time by which plan amendments need to be made.

The Code and ERISA generally prohibit plan amendment that reduce accrued benefits, including amendments that eliminate or reduce optional forms of benefit with respect to benefits already accrued except to the extent prescribed in regulations.<sup>120</sup> This prohibition on the reduction of accrued benefits is commonly referred to as the "anti-cut-back rule."

### **Description of Proposal**

#### **Change in after-death rules for defined contribution plans and IRAs**

The proposal changes the after-death required minimum distribution rules applicable to defined contribution plans and IRAs, as described below. However, the proposal only applies to the extent that the amount of an individual's aggregate account balances under all IRAs and defined contributions plans, determined as of the date of death, exceeds \$450,000 (indexed for inflation). Thus for example if an individual dies with aggregate account balances of \$600,000, as of the date of death, present law continues to apply to \$450,000, and the proposal applies to the remaining \$150,000.

If the individual has more than one beneficiary, the portion of the amount above \$450,000 that is subject to the proposal with respect to each beneficiary is the amount that is the same proportion of the excess as the portion of the total to which the individual is entitled. The result is the same whether or not the beneficiary is an eligible beneficiary (as described below). Thus, under the example above, if the individual has two beneficiaries, one who is an eligible designated beneficiary, as discussed below, and one who is not an eligible designated beneficiary, each with a right to 50 percent of the aggregate amount, then present law applies for determining required minimum distributions for each beneficiary with respect to \$225,000 and the proposal applies to \$75,000.

The proposal does not apply for determining after-death required minimum distributions from defined benefit plans.

#### **Expansion of five-year after-death rule for defined contributions plans**

Under the proposal, the five-year rule is the general rule for all distributions after death (regardless of whether the employee (or IRA owner) dies before, on, or after the required

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<sup>119</sup> Section 401(b).

<sup>120</sup> Section 411(d)(6) and ERISA section 204(g).

beginning date) unless the designated beneficiary is an eligible beneficiary as defined in the proposal. Thus, in the case of an ineligible beneficiary, distribution of the employee (or IRA owner's) entire benefit is required to be distributed by the end of the fifth calendar year following the year of the employee or IRA owner's death.

### **Eligible beneficiaries**

For eligible beneficiaries, an exception to the five-year rule (for death before the required beginning date under present law) applies whether or not the employee (or IRA owner) dies before, on, or after the required beginning date. The exception (similar to present law) generally allows distributions over life or life expectancy of an eligible beneficiary beginning in the year following the year of death. Eligible beneficiaries includes any beneficiary who, as of the date of death, is the surviving spouse of the employee (or IRA owner),<sup>121</sup> is disabled, is a chronically ill individual, is an individual who is not more than 10 years younger than the employee (or IRA owner), or is a child of the employee (or IRA owner) who has not reached the age of majority. In the case of a child who has not reached the age of majority, calculation of the minimum required distribution under this exception is only allowed through the year that the child reaches the age of majority.

Further, under the proposal, the five-year rule also applies after the death of an eligible beneficiary or after a child reaches the age of majority. Thus, for example, if a disabled child of an employee (or IRA owner) is an eligible beneficiary of a parent who dies when the child is age 20 and the child dies at age 30, even though 52.1 years remain in measurement period,<sup>122</sup> the disabled child's remaining beneficiary interest must be distributed by the end of the fifth year following the death of the disabled child. If a child is an eligible beneficiary based on having not reached the age of majority before the employee's (or IRA owner's) death, the five-year rule applies beginning with the earlier of the date of the child's death or the date that the child reaches the age of majority. The child's entire interest must be distributed by the end of the fifth year following that date.

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

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<sup>121</sup> As in the case of the present law special rule in section 401(a)(9)(B)(iv) for surviving spouses, spouse is not defined in the proposal. Under Treas. Reg. sec. 1.401(a)(9)-8, A-5, a spouse is the employee's spouse under applicable State law. In the case of a special rule for a surviving spouse, that determination is generally made based on the employee's marital status on the date of death. An exception is provided in Treas. Reg. sec. 1.401(a)(9)-6, A-6, under which a former spouse to whom all or a portion of the employee's benefits is payable pursuant to a qualified domestic relations order as defined in section 414(p) is treated as the employee's spouse (including a surviving spouse). In the case of a qualified joint and survivor annuity under section 401(a)(11) and 417, the spouse is generally determined as of the annuity starting date.

<sup>122</sup> The measurement period is the life expectancy of the child calculated for the child's age in the year after the employee's (or IRA owner's) death (age 21 (20 plus 1)).

begin to the spouse, the surviving spouse is treated as the employee (or IRA owner) in determining the required distributions to beneficiaries of the surviving spouse.

### **Definitions of disabled and chronically ill individual**

Under the proposal, disabled means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to end in death or to be for long-continued and indefinite duration.<sup>123</sup> Further, under the definition, an individual is not considered to be disabled unless proof of the disability is furnished in such form and manner as the Secretary may require. Substantial gainful activity for this purpose is the activity, or a comparable activity, in which the individual customarily engaged prior to the arising of the disability (or prior to retirement if the individual was retired at the time the disability arose).<sup>124</sup>

Under the proposal, the definition of a chronically ill individual for purposes of qualified long-term care insurance<sup>125</sup> is incorporated by reference with a modification. Under this definition, a chronically ill individual is any individual who (1) is unable to perform (without substantial assistance from another individual) at least two activities of daily living for an indefinite period (expected to be lengthy in nature)<sup>126</sup> due to a loss of functional capacity, (2) has a level of disability similar (as determined under regulations prescribed by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability described above requiring assistance with daily living based on loss of functional capacity, or (3) requires substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment. The activities of daily living for which assistance is needed for purposes of determining loss of functional capacity are eating, toileting, transferring, bathing, dressing, and continence.

### **Annuity payments under commercial annuities**

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

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<sup>123</sup> The definition of disabled in section 72(m)(7) is incorporated by reference.

<sup>124</sup> Treas. Reg. sec. 1.72-17(f). Under the regulations, in determining whether an individual is disabled, primary consideration is given to the nature and severity of the individual's impairment. However, consideration is also given to other factors such as the individual's education, training, and work experience. Whether an impairment in a particular case constitutes a disability is determined with reference to all the facts in the case.

<sup>125</sup> Section 7702B(c)(2).

<sup>126</sup> Section 7702B(c) only requires this period to be at least 90 days.



## **Effective Date**

### **General effective date**

In determining required minimum distributions after the death of an employee (or IRA owner), the proposal is generally effective for required minimum distributions with respect to employees (or IRA owners) with a date of death after December 31, 2016.

### **Delayed effective date for governmental and collectively bargained plans**

In the case of a governmental plan (as defined in section 414(d)), in determining required minimum distributions after the death of an employee, the proposal applies to distributions with respect to employees who die after December 31, 2018.

In the case of a collectively bargained plan,<sup>127</sup> in determining required minimum distributions after the death of an employee, the proposal applies to distributions with respect to employees who die in calendar years beginning after the earlier of two dates. The first date is the later of (1) the date on which the last collective bargaining agreement ratified before date of enactment of the proposal terminates,<sup>128</sup> or (2) December 31, 2016. The second date is December 31, 2018.

### **Five-year rule after the death of a beneficiary**

In the case of an employee (or IRA owner) who dies before the effective date (as described below) for the plan (or IRA), if the designated beneficiary of the employee (or IRA owner) dies on or after the effective date, the proposal applies to any beneficiary of the designated beneficiary as though the designated beneficiary were an eligible beneficiary. Thus, the entire interest must be distributed by the end of the fifth calendar year after the death of the designated beneficiary. For this purpose, the effective date is the date of death of the employee (or IRA owner) used to determine when the proposal applies to the plan (or IRA), for example, before January 1, 2017 under the general effective date.

### **Certain annuities grandfathered**

The modification to the after-death minimum distribution rules does not apply to a commercial annuity<sup>129</sup> which is a binding annuity contract in effect on the date of enactment of this proposal and at all times thereafter.

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<sup>127</sup> A collectively bargained plan is a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers.

<sup>128</sup> The date that the last agreement terminates is determined without regard to any extension thereof agreed to on or after the date of enactment of this proposal. Further, any plan amendment made pursuant to a collective bargaining agreement relating to the plan that amends the plan solely to conform to any requirement added by this proposal shall not be treated as a termination of the collective bargaining agreement.

<sup>129</sup> See section 3405(e)(6) for the definition of commercial annuity.

### **Plan amendments made pursuant to the proposal**

A plan amendment made pursuant to the proposal (or regulations issued thereunder) may be retroactively effective and (except as provided by the Secretary) will not violate the anti-cut-back rule, if, in addition to meeting the other applicable requirements described below, the amendment is made on or before the last day of the first plan year beginning after December 31, 2018 (or in the case of a governmental or collectively bargained plan, December 31, 2020), or a later date prescribed by the Secretary. In addition, the plan will be treated as operated in accordance with plan terms during the period beginning with the date of the proposal or regulations take effect (or the date specified by the plan if the amendment is not required by the proposal or regulations) and ending on the last permissible date for the amendment (or, if earlier, the date the amendment is adopted).

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

## **J. Modification of Hardship Withdrawal Rules**

### **Present Law**

Subject to limits, a qualified defined contribution plan may allow employees to elect to have contributions made to the plan (referred to as “elective deferrals”) rather than receive the same amount as current compensation (referred to as a “section 401(k) plan”).<sup>130</sup> Amounts attributable to elective deferrals generally are subject to distribution restrictions. Such amounts cannot be distributed before the earliest of the employee's severance from employment, death, disability or attainment of age 59½ or termination of the plan. However, subject to certain conditions, elective deferrals, but not associated earnings, can also be distributed on account of hardship.<sup>131</sup>

An employer may also make nonelective and matching contributions for employees under a section 401(k) plan. Elective deferrals, and matching contributions and after-tax employee contributions, are subject to special tests (“nondiscrimination tests”) to prevent discrimination in favor of highly compensated employees. Nonelective contributions and matching contributions that satisfy certain requirements (“qualified nonelective contributions and qualified matching contributions”) may be used to enable the plan to satisfy these nondiscrimination tests. One of the requirements is that these contributions be subject to the same distribution restrictions as elective deferrals except that these contributions (and attributable earnings) are not permitted to be distributed on account of hardship.

Under present law, a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the need. Generally, the determination of whether these two requirements are met is based on the relevant facts and circumstances. However, a safe harbor applies under which a distribution may be deemed to be on account of hardship. One requirement of this safe harbor is that the employee represent that the need cannot be satisfied through currently available plan loans.

### **Description of Proposal**

The proposal allows earnings on elective deferrals under a section 401(k) plan, as well as qualified nonelective contributions and qualified matching contributions (and attributable earnings), to be distributed on account of hardship. Further, a distribution is not treated as failing to be on account of hardship solely because the employee does not take any available plan loan.

### **Effective Date**

The proposal is effective for plan years beginning after December 31, 2016.

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<sup>130</sup> Sec. 401(k).

<sup>131</sup> Distributions on account of hardship may be subject to an additional 10-percent early distribution tax under section 72(t).

## **K. Increased Penalties for Failure to File Retirement Plan Returns**

### **Present Law**

#### **Form 5500**

An employer that maintains a pension, annuity, stock bonus, profit-sharing or other funded deferred compensation plan (or the plan administrator of the plan) is required to file an annual return containing information required under regulations with respect to the qualification, financial condition, and operation of the plan.<sup>132</sup> The plan administrator of a defined benefit plan subject to the minimum funding requirements<sup>133</sup> is required to file an annual actuarial report.<sup>134</sup> These filing requirements are met by filing an Annual Return/Report of Employee Benefit Plan, Form 5500 series, and providing the information as required on the form and related instructions.<sup>135</sup> A failure to file Form 5500 generally results in a penalty of \$25 for each day during which the failure continues, subject to a maximum penalty of \$15,000.<sup>136</sup>

#### **Annual registration statement and notification of changes**

In the case of a plan subject to the vesting requirements under the Employee Retirement Income Security Act of 1974 (“ERISA”), the plan administrator is required to file a registration statement with the IRS with respect to any plan participant who (1) separated from service during the year and (2) has a vested benefit under the plan, but who was not paid the benefit during the year (a “deferred vested” benefit).<sup>137</sup> The registration statement must include the name of the plan, the name and address of the plan administrator, the name and taxpayer identification number of the separated participant, and the nature, amount, and form of the participant’s deferred vested benefit. A failure to file a registration statement as required generally results in a penalty of \$1 for each participant with respect to whom the failure applies, multiplied by the number of days during which the failure continues, subject to a maximum penalty of \$5,000 for a failure with respect to any plan year.<sup>138</sup>

A plan administrator is also required to notify the IRS if certain information in a registration changes, specifically, any change in the name of the plan or in the name or address

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<sup>132</sup> Sec. 6058.

<sup>133</sup> Sec. 412. Most governmental plans (defined in section 414(d)) and church plans (defined in section 414(e)) are exempt from the minimum funding requirements.

<sup>134</sup> Sec. 6059.

<sup>135</sup> Treas. Reg. secs. 301.6058-1(a) and 301.6059-1.

<sup>136</sup> Sec. 6652(e).

<sup>137</sup> Code sec. 6057(a). Under Code section 6057(e) and ERISA section 105(c), similar information must be provided to the separated participant.

<sup>138</sup> Sec. 6652(d)(1).

of the plan administrator, the termination of the plan, or the merger or consolidation of the plan with any other plan or its division into two or more plans. A failure to file a required notification of change generally results in a penalty of \$1 for each day during which the failure continues, subject to a maximum penalty of \$1,000 for any failure.<sup>139</sup>

### **Withholding notices**

Withholding requirements apply to distributions from tax-favored employer-sponsored retirement plans and IRAs, but, except in the case of certain distributions, payees may generally elect not to have withholding apply.<sup>140</sup> A plan administrator or IRA custodian is required to provide payees with notices of the right to elect no withholding. A failure to provide a required notice generally results in a penalty of \$10 for each failure, subject to a maximum penalty of \$5,000 for all failures during any calendar year.<sup>141</sup>

## **Description of Proposal**

### **Form 5500**

Under the proposal, a failure to file Form 5500 generally results in a penalty of \$100 for each day during which the failure continues, subject to a maximum but the total amount imposed under this subsection on any person for failure to file any return shall not exceed \$50,000.

### **Annual registration statement and notification of changes**

Under the proposal, a failure to file a registration statement as required generally results in a penalty of \$2 for each participant with respect to whom the failure applies, multiplied by the number of days during which the failure continues, subject to a maximum penalty of \$10,000 for a failure with respect to any plan year. A failure to file a required notification of change generally results in a penalty of \$2 for each day during which the failure continues, subject to a maximum penalty of \$5,000 for any failure.

### **Withholding notices**

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

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<sup>139</sup> Sec. 6652(d)(2).

<sup>140</sup> Sec. 3405.

<sup>141</sup> Sec. 6652(h).

### **Effective Date**

The proposal is effective for returns, statements and notifications required to be filed, and withholding notices required to be provided, in calendar years beginning after December 31, 2016.

## L. Modification of User Fee Requirements for Installment Agreements

### Present Law

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer agrees to pay taxes owed, as well as interest and penalties, in installments over an agreed schedule, if the IRS determines that doing so will facilitate collection of the amounts owed.<sup>142</sup> This agreement provides for a period during which IRS enforcement actions are held in abeyance while payments are made.<sup>143</sup> An installment agreement generally does not reduce the amount of taxes, interest, or penalties owed. However, the IRS is authorized to enter into installment agreements with taxpayers which do not provide for full payment of the taxpayer's liability over the life of the agreement. The IRS is required to review such partial payment installment agreements at least every two years to determine whether the financial condition of the taxpayer has significantly changed so as to warrant an increase in the value of the payments being made.

Taxpayers can request an installment agreement by filing Form 9465, Installment Agreement Request.<sup>144</sup> If the request for an installment agreement is approved by the IRS, the IRS charges a user fee.<sup>145</sup> Under sections 300.1 and 300.2 of the Treasury Regulations, the IRS currently charges \$120 for entering into an installment agreement.<sup>146</sup> If the application is for a direct debit installment agreement, whereby the taxpayer authorizes the IRS to request the monthly electronic transfer of funds from the taxpayer's bank account to the IRS, the fee is reduced to \$52. In addition, regardless of the method of payment, the fee is \$43 for low-income taxpayers. For this purpose, low-income is defined as a person who falls below 250 percent of the Federal poverty guidelines published annually. Finally, there is no user fee if the agreement is for a term of 120 days or less (*i.e.*, a short-term agreement).

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<sup>142</sup> Sec. 6159.

<sup>143</sup> Sec. 6331(k).

<sup>144</sup> The IRS accepts applications for installment agreements online, from individuals and businesses, if the total tax, penalties and interest is below \$50,000 for the former, and \$25,000 for the latter.

<sup>145</sup> 31 U.S.C. sec. 9701; Treas. Reg. sec. 300.1. The Independent Offices Appropriations Act of 1952 (IOAA), 65 Stat. B70, (June 27, 1951). A discussion of the IRS practice regarding user fees and a list of actions for which fees are charged is included in the Internal Revenue Manual. See "User Fees," paragraph 1.32.19 IRM, available at [https://www.irs.gov/irm/part1/irm\\_01-032-019.html](https://www.irs.gov/irm/part1/irm_01-032-019.html).

<sup>146</sup> On August 22, 2016, Treasury issued proposed changes to the schedule of user fees for installment agreements, effective January 2017, based on a biennial review of the costs of administering the program. <https://www.irs.gov/uac/irs-proposes-revised-fees-for-installment-agreements>. A public hearing on the proposed regulations is scheduled for October 19, 2016. If finalized, the revised schedule imposes user fees in the following amounts: \$225 for a regular installment agreement; \$107 for a regular direct debit installment agreement; \$149 for online payment agreement; \$31 for a direct debit online payment agreement; \$89 for a restructured or reinstated agreement; and \$43 for an agreement with a low-income taxpayer.

### **Description of Proposal**

The proposal generally prohibits increases in the amount of user fees charged by the IRS for installment agreements. For low-income taxpayers (those whose adjusted gross income, as determined for the most recent year for which such information is available, does not exceed 250 percent of the applicable poverty level as determined by the Secretary), it alleviates the user fee requirement in two ways. First, it waives the user fee if the low-income taxpayer enters into an installment agreement under which the taxpayer agrees to make automated installment payments through a debit account. Second, it provides that low-income taxpayers who are unable to make payments electronically remain subject to the required user fee, but the fee is reimbursed upon completion of the installment agreement.

### **Effective Date**

The proposal applies to agreements entered into on or after the date that is 60 days after the date of enactment.



## M. Increase Information Sharing to Administer Excise Taxes

### Present Law

Generally, tax returns and return information (“tax information”) are confidential and may not be disclosed unless authorized in the Code.<sup>147</sup> Return information includes data received, collected or prepared by the Secretary with respect to the determination of the existence or possible existence of liability of any person under the Code for any tax, penalty, interest, fine, forfeiture, or other imposition or offense. Criminal penalties apply for the unauthorized inspection or disclosure of tax information. Willful unauthorized disclosure is a felony under section 7213 and the willful unauthorized inspection of tax information is a misdemeanor under section 7213A. Taxpayers may also pursue a civil cause of action for disclosures and inspections not authorized by section 6103.<sup>148</sup>

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

Under section 6103(o), tax information with respect to taxes on alcohol, tobacco and firearms is open to inspection by or disclosure to officers and employees of a Federal agency whose official duties require such inspection or disclosure. The Alcohol and Tobacco Tax and Trade Bureau (“TTB”) is a bureau under the Treasury. The TTB collects Federal excise taxes on alcohol, tobacco, firearms, and ammunition and ensures compliance with Federal tobacco and alcohol permitting, labeling, and marketing.

Prior to 2003, customs officials who had responsibilities for enforcing and/or collecting excise taxes on imports were employees of the Treasury Department. Thus, prior to 2003, section 6103(h)(1) allowed disclosure of tax information by the IRS and TTB to these customs officials in the performance of their duties. In 2003, U.S. Customs and Border Protection became an official agency of the U.S. Department of Homeland Security.<sup>149</sup> At that time, Customs and Border Protection employees (“customs officials”) were transferred from Treasury to the Department of Homeland Security. While the U.S. Customs Service moved from Treasury to the Department of Homeland Security, the authority to collect excise taxes remains with Treasury.<sup>150</sup>

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<sup>147</sup> Sec. 6103(a).

<sup>148</sup> Sec. 7431.

<sup>149</sup> The Homeland Security Act of 2002, Pub. L. 107-296 (“Homeland Security Act”), enacted November 25, 2002 established the U.S. Department of Homeland Security. Several agencies were combined under this new department.

<sup>150</sup> Sec. 412 of the Homeland Security Act.

The heavy vehicle use tax, an annual highway use tax, is imposed on the use of any highway motor vehicle that has a gross weight of 55,000 pounds or more.<sup>151</sup> Proof of payment of the heavy vehicle use tax must be presented to customs officials upon entry into the United States of any highway motor vehicle subject to the tax and that has a base in a contiguous foreign country.<sup>152</sup> If the operator of the vehicle is unable to present proof of payment of the tax with respect to the vehicle, entry into the United States may be denied.<sup>153</sup>

### **Description of Proposal**

The proposal would allow employees of the U.S. Customs and Border Protection to have access to returns and return information related to the heavy vehicle use tax.

### **Effective Date**

The proposal is effective for disclosures made on or after the date of enactment.

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<sup>151</sup> Sec. 4481(a).

<sup>152</sup> Treas. Reg. 41.6001-3(a).

<sup>153</sup> Treas. Reg. 41.6001-3(b).

## **N. Repeal of Partnership Technical Terminations**

### **Present Law**

Present law provides that a partnership is terminated under specified circumstances.<sup>154</sup> Rules are also provided for the merger, consolidation, or division of a partnership.<sup>155</sup>

A partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.<sup>156</sup>

A partnership is treated as terminated if within any 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.<sup>157</sup> This is sometimes referred to as a technical termination. Under regulations, the technical termination gives rise to a deemed contribution of all the partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners.<sup>158</sup>

The effect of a technical termination is not necessarily the end of the partnership's existence, but rather, the termination of some tax attributes. Upon a technical termination, the partnership's taxable year closes, potentially resulting in short taxable years.<sup>159</sup> Partnership-level elections generally cease to apply following a technical termination. A technical termination generally results in the restart of partnership depreciation recovery periods.

### **Description of Proposal**

The proposal repeals the section 708(b)(1)(B) rule providing for technical terminations of partnerships. The proposal does not change the present-law rule of section 708(b)(1)(A) that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

### **Effective Date**

The proposal applies to transfers after December 31, 2016.

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<sup>154</sup> Sec. 708(b)(1).

<sup>155</sup> Sec. 708(b)(2). Mergers, consolidations, and divisions of partnerships take either an assets-over form or an assets-up form pursuant to Treas. Reg. sec. 1.708-1(c).

<sup>156</sup> Sec. 708(b)(1)(A).

<sup>157</sup> Sec. 708(b)(1)(B).

<sup>158</sup> Treas. Reg. sec. 1.708-1(b)(4).

<sup>159</sup> Sec. 706(c)(1); Treas. Reg. sec. 1.708-1(b)(3).