GRIDLOCK:
Pension Law in Crisis
and
The Road to Simplification

The Association of Private Pension
and Welfare Plans
Washington, DC

September 1989
FOREWORD

Legislative and regulatory assaults launched on pension plans in the last decade have hit plan sponsors with rules and requirements that have them running hard to stay in the same place. Expansion of defined benefit plans has come to a halt in the 1980's and complexity imposed from Washington, no matter what the motivation, is largely to blame.

Unsnarling pension plan gridlock should be a goal of Washington policymakers who have their eyes on America's biological clock. We must aggressively expand pension plan coverage in the waning days of this century to better meet the retirement needs of the baby boom retirees early in the next century.

The driving force behind this prodigious undertaking was Howard Golden, from Kwasha Lipton, who has served as the Chairman of the APPWP Retirement Savings Committee for many years. Without his determination and patience, the contributions and concerns of his committee colleagues, and the scholarship of Birgit Anne Waidmann and Victoria Judson of Steptoe & Johnson, this paper would not have been possible. I also want to add my thanks to Larry Kirby and Booke & Co. for the wonderful artwork and support.

The next steps on the road to simplification belong to all of us. We must take this policy document and use all the resources available to us to achieve the very "doable" recommendations contained herein.

Howard C. Weizmann
Washington, D.C.
September, 1989
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EXECUTIVE SUMMARY

The rules governing private employer-sponsored retirement plans must be simplified. These intricate rules affect all employers, whether large or small, and all of the working people planning for retirement. The rules, which have been altered by layer upon layer of legislative and regulatory change, have become practically unworkable. Rather than promoting retirement security, they are becoming a barrier to it. Unless the rules are simplified, the nation's growing older population will have inadequate resources to meet its retirement needs.

The Association of Private Pension and Welfare Plans (the APPWP), a non-profit organization founded in 1967 to protect and to foster the growth of this country's private employer-sponsored employee benefits system, represents plan sponsors, including large and small employers, and support organizations such as consulting and actuarial firms, investment firms, banks, insurers, and other professionals involved in employee benefits.

In this paper, the APPWP is calling for a complete overhaul and simplification of the rules governing the private retirement system.

The complexity in the law and regulations is due to several factors: the frequency of legislative change, misconceptions which lead to enactment of rules that are difficult to implement, lack of regulatory coordination, and the
nature of retirement plans themselves. As a result of this complexity, plan sponsors either abandon attempts to comply with the law, terminate their plans, or spend ever-increasing amounts of time and resources in an attempt to design and operate their plans. This results in fewer dollars for provision of benefits, significant compliance costs to the IRS and DOL, and a drain on the nation's fiscal resources. Severe burdens are also imposed on plan participants -- the average working people attempting to plan for their own retirement and their family's livelihood in the event of their death.

A more workable structure may be achieved by (1) adopting an overall retirement income policy which encourages the responsible maintenance of fair, secure, and adequate retirement benefits, rather than focusing solely on ways to inhibit the rare abuser of the system; (2) emphasizing development of a simpler regulatory framework; and (3) maintaining communications among those charged with development and implementation of this policy and framework.

While there may be many different views of what constitutes simplification, there should be no dispute concerning the need to simplify the rules. To this end, the APPWP has offered suggestions on how to begin.

In making these suggestions, four principles were applied -- redundancy should be eliminated, outdated provisions should be deleted, provisions with an overly broad impact should
be redirected, and ease of administration should be facilitated. Among the specific recommendations, we have suggested simplifying the determination of the identity of highly compensated employees, modifying the minimum participation rule and the top-heavy rules, simplifying the rules for distribution of benefits, and streamlining and clarifying reporting obligations.

The APPWP looks forward to working with the Congress and the regulatory agencies on these and other changes in an effort to restructure the regulatory requirements so that they are understandable, enforceable, and equitable.
INTRODUCTION

The Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406 ("ERISA") was a landmark piece of legislation. It constituted an important step in achieving the national goal of fostering retirement income security. ERISA was intended to protect participant benefits and strengthen the private pension system by subjecting retirement plans to minimum standards. Unfortunately, subsequent efforts to improve the law through changes to ERISA and the Internal Revenue Code ("the Code") have needlessly overburdened plans to the detriment of sponsors, participants, and government regulators, actually working against their best interests. Furthermore, the statutes are not the sole source of the host of dysfunctional requirements. The agencies responsible for the implementation and administration of the pension laws -- principally the Internal Revenue Service ("IRS") and the Department of Labor ("DOL") -- have added to the burden through the regulatory process.

Key problems have been created both by the frequency of legislative change and the general approach to regulation. Too often, the dominant philosophy has been that it is best to restrict all plans by setting up elaborately structured exceptions and limitations in order to eliminate any possibility of abuse. Little effort is made to advance the beneficial aspects of ERISA and the Code by focusing (through a minimal regulatory framework of qualification, reporting and disclosure requirements) on encouraging plan sponsors to provide fair,
secure and adequate retirement income. In addition, the regulatory pattern has been characterized by constant changes and insensitivity to the enormous compliance costs and burdens such changes impose.

The nature and frequency of change in the laws and regulations governing private retirement plans have resulted in a system that is so complex that it consumes enormous amounts of resources in compliance costs which could be better directed to the provision of benefits. Consequently, overburdened plan sponsors are discouraged from establishing, maintaining, or strengthening the private retirement system. Moreover, vast regulatory resources are expended on efforts to understand and implement the complicated rules rather than developing policies to promote retirement goals or undertaking enforcement efforts. The time has come for a complete overhaul and simplification. Otherwise, we will find a growing older population without adequate resources to meet its retirement needs.

A. REASONS FOR COMPLEXITY

The complexity in the current rules governing private retirement plans is caused by the frequency of legislative change and lack of an overview, misconceptions which lead to enactment of rules that are difficult to implement, and lack of regulatory coordination, as well as by the nature of retirement plans themselves.
1. Frequency of Legislative Change and Lack of an Overview

A major cause of complexity in the private pension system is the constant change imposed by new legislation. ERISA was enacted in 1974. From 1975 through 1980, various revenue acts amended retirement plan provisions of the Code but not Title I of ERISA. Since 1980, an average of one statute per year has been enacted to extensively change the laws governing private pension plans.¹ In fact, since October 1986 four new statutes have been enacted to change the pension laws: the Tax Reform Act of 1986 ("TRA '86"), the Omnibus Budget Reconciliation Act of 1986 ("OBRA '86"), the Omnibus Budget Reconciliation Act of 1987 ("OBRA '87"), and the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA").

This plethora of legislation has lead to a mass of confusion due to the additive effect of new laws, passed at a tremendous pace, and the detail in each set of amendments. The

complexity has snowballed as new laws were enacted before regulations implementing existing laws were promulgated. Confusion has been caused in part as this vehicle for social policy has been used to raise revenues. Further, there has been no concern for simplicity, nor has there been an attempt to create a logical structure of the law. Often, new legislative proposals fail to recognize prior provisions addressing the same issue, resulting in an incoprehensible array of irrational rules. As a result of this failure to consider overall structure, efforts to strengthen the laws have simply led to a patchwork of overlapping, duplicative or inconsistent provisions creating an environment in which compliance is nearly impossible and in which penalties for failure to comply with all of the rules are substantial.

It is as if planners first set up a city on a grid with streets and services laid out in a logical order, but then dealt with all new needs and demands by building additions willy-nilly, on top of roads and on top of each other. The resulting city would have facilities to address different needs, but no one would be able to reach them or use them. Similarly, new laws and regulations have abounded to address often legitimate concerns, but they have been enacted or promulgated without adequate consideration of their effect on each other, or the ability for the over-all private retirement system to function. The result has been chaos rather than improvement. For example, under the rules affecting benefits of individuals working beyond
normal retirement age, it is nearly impossible to reconcile required accruals after normal retirement age with the suspension of benefits rules and minimum distribution requirements. See Recommendations Section B.1.

Similarly, the regulatory structure lacks workable rules with respect to basic concepts that underlie all pension plans. For example, the Code lacks a clear, consistent definition of who is an employer, who is an employee, and what is compensation, all of which are absolutely basic to retirement planning strategy. The determination of who is an employer and who is an employee involves application of a multitude of rules concerning predecessor employers (Code section 414(a)), employees of a controlled group of corporations (Code section 414(b) with regulatory cross-reference to Code section 1563(a)), employees of partnerships under common control (Code section 414(c) with regulatory cross-reference to Treas. Reg. section 1.1563-1(d)), employees of affiliated service groups (Code section 414(m)), leased employees (Code section 414(n)), and Code section 414(o) which permits adoption of additional regulations to treat employees of different organizations as employees of the same employer. Similarly, the Code lacks a uniform definition of compensation. Compensation is defined differently under 414(s), 414(q)(7), and 415(c)(3).

Once the thorny questions of who is an employer, who is an employee, and what is compensation have been decided with respect to a plan, highly compensated employees must be identified for
discrimination purposes. The rules for making such a
determination exemplify the problem created by excessive
regulatory detail. TRA '86 contained a new definition of highly
compensated employees under Code section 414(q), which includes a
myriad of alternative definitions, involving numerous tests,
including some which require treatment of two or more family
members as one employee. The salary levels that must be
considered include $75,000, $50,000, and $45,000, each of which
are indexed annually.

The highly compensated employee definition has so many tests
that it will require expenditure of significant resources to
implement. Furthermore, the requirement that all employees
within an employer's controlled group be tested together adds
significant cost with little benefit. Employers usually do not
aggregate employee salary information in one system, but keep
separate employee records for each company. Moreover, where
companies change hands during the year, it is difficult to
determine the proper universe of employees who must be included
in the calculations. While limiting discrimination is laudable,
this approach imposes a tremendous burden of compliance
requirements and expense on all plans, including those unlikely
to have any discrimination problems.

When statutes and regulations are constantly changing, lack
a clear structure and include excessive detail, sponsors,
participants, and recordkeepers are unable to keep up with the
law.

2. Misconceptions That Impede Enactment of Functional Rules

The complexity in ERISA and the Code may be attributable to two fundamental misconceptions that underlie the current legislative approach. We call these misconceptions "evil plan myopia" and "computer omnipotence".

Evil plan myopia is regulators' tendency to formulate general rules by (1) considering only those few plan sponsors with abusive intent, and (2) failing to consider the effect of the regulation on the vast majority of sponsors, who have no such intent. Plan sponsors and administrators generally will not take advantage of the rules. The view that it is less important to encourage the continuance and growth of responsible pension plans than it is to ensure that the potential for abuse is totally eliminated poses a serious threat to employers' willingness to maintain and institute these programs. Priorities appear to be skewed -- the focus is on the few small plans which may seek to take advantage of the rules, and not on the majority of plans, which generate most of the retirement income security in this country. As a result of evil plan myopia, all sponsors are forced to expend enormous sums
complying with regulations which are aimed at an abuse in which they do not engage.

Computer omnipotence describes the regulators' assumption that all compliance problems can be easily solved by pushing a few buttons on a computer. Regulators' cavalier attitude with respect to the compliance burden may well be due to a good faith but faulty understanding of how businesses are run. Much of such data needed to comply with new rules is not kept in one place for any legitimate business purposes and is not in a form that can be reorganized and aggregated to meet new regulatory requirements.

For example, in many cases salary data for different companies under common control, or even for different divisions, may be kept in different data bases and on different computer systems. Accordingly, such tasks as ranking employees in the top twenty percent based on compensation, as is required for highly compensated employee determinations, can be difficult and expensive.

Also, historic information may not be retained in an easily accessible form because of the high cost of retaining such information on the computer system itself. Each time a regulation requires use of old data or storing a new type of data, the regulation imposes substantial compliance costs and difficulties.

Furthermore, creating the software necessary to do the calculations required by new laws and regulations is a very time consuming process, yet regulations and IRS Forms usually are not
issued in final form until well beyond the effective date of new statutory provisions. For example, the revised 5500 (Annual Report) Forms for 1988 were not released until March 1, 1989. See 54 Fed. Reg. 8631. Compliance is rendered extraordinarily difficult where forms and requirements are not released well in advance of the period for which a report is due.

In summary, because regulators do not have a realistic sense of the way businesses are organized and the barriers to data collection, retention, and aggregation, they impose tremendous compliance costs on all plans, including those of small businesses.

3. Complexity Due to Lack of Regulatory Coordination

The regulatory framework within which the nation's pension system operates has become such a morass that even the regulators cannot keep track of requirements. So many different highly specialized individuals work on these laws and regulations that the drafters are unaware of apparent conflicts they create. For example, in August of 1988, the Treasury issued regulations which permit sponsors to hold elective deferral contributions for up to twelve months after the plan year to which the contribution relates, before transferring them to a trust; however, final regulations issued by the Department of Labor (DOL) in May of 1988 permit employers to hold such contributions only until the earliest date on which the contribution may be segregated from employer assets, but in no event for more than 90 days after they
were received by the employer.\footnote{Compare Treas. Reg. section 1.401(k)-1(b)(6)(i)(B), 53 Fed. Reg. 29658, 29666 (Aug. 8, 1988) with DOL Reg. section 2510.3-102 53 Fed. Reg. 17628, 17630 (May 17, 1988).} While each agency had its own purpose in formulating its rules, any such overlay on particular subject matters should be better coordinated, so that a uniform standard is adopted, or it is clear that different standards apply for different purposes. Individual plan sponsors and participants should not have to try to determine the intention of each of the regulatory agencies or reconcile conflicting regulatory requirements.

In other cases, major delays have resulted from agencies' failure to reach a consensus. For example, while the minimum funding standards were changed in 1987, the PBGC and the IRS have not yet agreed on whether the term "current liability," a concept which is crucial to funding determinations, includes all accrued benefits as defined for purposes of Title IV of ERISA, or something less.

While many other examples of failure to coordinate exist, it is clear that the agencies can work together and make rules that do not overstep their jurisdictions. In promulgating proposed and temporary regulations defining "highly compensated employee" under Code section 414(q), the IRS specifically stated the relationship of section 414(q) to Title I of ERISA, the purposes for which this definition might apply, and the provisions over which the DOL has jurisdiction.
Over the years, many have argued for a single agency which would have jurisdiction over all aspects of employee benefits, to avoid problems with lack of coordination and jurisdictional battles. We believe similar results could be achieved, however, without abandoning DOL and IRS jurisdiction, simply by maintaining open lines of communication between the agencies and committees involved in pension regulation and by clarifying policy goals.

4. Complex Nature of Subject Matter

The complexity of the rules governing private pension plans is not entirely due to the legislative and regulatory process. Funding retirement benefits over the working life of an employee is by its nature a complex task. Moreover, complexity is also inherent in a system which permits diversity and employer discretion with regard to plan design. This diversity is beneficial because it allows creation of plans that better suit the needs of different employees and retirees.

Simplification, then, should not be sought by mandating a uniform retirement plan for all employers and all employees regardless of their situations. Permitting diversity is essential for plans to be tailored to fit the specific needs of the employees and retirees they cover.

It should be possible to achieve a simpler, more workable structure without jeopardizing beneficial flexibility and diversity, by recognizing the misconceptions we have identified,
adopting an overall retirement income policy, maintaining communication among those charged with its management, and emphasizing development of a regulatory framework which encourages the responsible maintenance of fair, secure and adequate retirement benefits.

B. COMPLEXITY IMPEDES GOALS OF RETIREMENT SECURITY

1. Effect of Complexity on Adoption, Maintenance, and Compliance of Plans

As a result of the complexity we have discussed, plan sponsors either (1) abandon attempts to comply with the law, (2) terminate their retirement plans, or (3) spend ever-increasing amounts of time and resources designing and operating these plans, which may result in reductions in the amounts available for benefits.

It is enormously costly to repeatedly amend plans, constantly change software and allocate significant staff time in plan design and administration. These staffing requirements are particularly onerous on the plans with fewer than 100 participants, which comprise a large proportion of existing plans. The additional record-keeping costs may reduce benefits available to all participants. Moreover, the
complexity results in a nation of non-compliers, as sponsors either erroneously believe they are meeting requirements or give up attempts to comply.

This complexity imposes significant costs on the government agencies as well. For example, there are inconsistencies in the plan qualification process and enforcement efforts are haphazard because the current rules are too complicated for IRS agents to understand and apply. This results in inadequate review of determination letter requests, imposing unfair burdens on the agents and leaving sponsors unsure whether the determination letters have any value.

Finally, the complexity also imposes enormous costs on the economy, retirement savings system, and the nation's fiscal resources as an incalculable number of staff hours, computer hours, and other resources are spent on the intricacies of compliance.

All these burdens discourage private employers from adopting new plans or maintaining existing plans, and deprive the public and private economy of needed capital resources.

2. **Effect of Complexity on Participants**

The complexity of the rules and regulations also imposes severe burdens on plan participants who lack the training to adequately assess the options available with respect to plan contributions and distributions. Despite valiant efforts of employers and service providers to disseminate clear information
and assist employees, there remains a significant risk that individuals will err out of ignorance, and thereby will lose important retirement savings through penalties that they cannot understand.

Take, for instance, the ordinary act of electing a distribution from a tax-qualified retirement plan. In this situation, if the participant/taxpayer elects to receive a distribution too early -- generally before age 59-1/2 with numerous exceptions -- there is an additional 10 percent tax on the amount includable in gross income. See Code section 72(t).

On the other hand, if the participant/taxpayer defers the payment of benefits to a date which is too late -- generally, after age 70-1/2 even for individuals who have not yet retired -- there is an excise tax of 50 percent of the amount which should have been distributed. And, even if the participant begins receiving benefits by age 70-1/2, the 50 percent excise tax will be imposed if the amount received in any year is less than a prescribed amount, or is paid out over longer than a prescribed period, determined under regulations that exceed 200 pages with multiple references to lengthy tables. See Code sections 401(a)(9) and 4974.

Finally, even if the participant/taxpayer correctly handles the timing -- that is, the distribution begins neither too early nor too late and is spread over the correct period so each distribution is not too small -- the participant/taxpayer faces an excise tax of 15 percent if the benefit is too large. See
Code section 4980A. This is the case even where the "too large" is attributable solely to good investment returns. Like Goldilocks and her porridge, every participant/taxpayer must find the distribution which is "just right." One can't help but conclude that there is something fundamentally wrong with a regulatory system which requires that a 72-year-old working secretary who inadvertently fails to take a minimum distribution from an IRA will lose an amount equal to 50 percent of the minimum required distribution.

This complex structure of penalty provisions is symptomatic of the real problem, which is the underlying complex series of minimum standards for qualified plans. The complexity exists not only with respect to distributions but with respect to rollovers, lump-sum averaging and basis recovery as well. Average citizens who must struggle to understand these rules are provided with IRS Publication 575, which includes almost 40 pages of single-spaced text and over 60 pages of tables, but still fails to answer numerous questions. The land mines abound for the unwary. The rules are so complex that individuals cannot properly plan for retirement, or determine the best way to take pension distributions.
C. CALL TO SIMPLIFICATION

The time has come to stop adding layer upon layer of special provisions to a private retirement regulatory structure which is already hamstrung by complicated rules. Instead, an effort must be made to simplify the law and regulations. While there will be many different views of what constitutes simplification, there should be no dispute concerning the need to begin the task.

To this end, we offer the following suggestions on how to begin. In producing this list of suggestions, we have targeted the following problems:

1. Redundancy - provisions which duplicate other rules, supersede older provisions, or accomplish the same policy goal as another rule should be eliminated.

2. Obsolescence - outdated provisions should be deleted.

3. Evil plan myopia - provisions with broad impact which were intended to eliminate a narrow abuse should be redirected.

4. Administrative complexity - plan administration and rules affecting participants should be simplified, particularly because in many instances the cost of compliance far outweighs the benefit.
Each of the recommendations made below is proposed in order to solve one or more of these problems. In making our recommendations, we have sought to maintain the diversity and flexibility in the nation's retirement system, rather than mandating adoption of a uniform plan for employers. Our recommendations are set forth by type of provision (thus, for example, suggested changes to rules designed to prohibit discrimination are grouped together), but each suggestion is independent of the rest.

We look forward to working with the Congress and the regulatory agencies on these and other changes in an effort to restructure the regulatory requirements so that they are understandable, enforceable, and equitable.
RECOMMENDATIONS

A. RULES DESIGNED TO PROHIBIT DISCRIMINATION

1. Simplify Definition of Highly Compensated Employee (Code Section 414(q))

In a laudable effort to simplify the law, TRA '86 instituted a new *uniform* definition of "highly compensated employee," and changed many rules to refer to this term in determining the existence or absence of discrimination. Thus eliminated, for example, were the "top 1/3-lower 2/3" distinctions for the nondiscrimination tests under section 401(k), and the notion of the "prohibited group" under Section 401(a)(4). However, the definition of highly compensated employee as enacted and elaborated in Treas. Temporary Reg. section 1.414(q)-1T is far too complicated.

The definition of highly compensated employee should be simplified by replacing the $75,000 rule, the $50,000 top paid group rule, and the officer earning 50 percent of the defined benefit limit rule, with a single rule making any employee earning over some specific amount (between $45,000 and $75,000 (indexed)) a highly compensated employee. Five-percent owners
would continue to be treated as highly compensated employees. The rule should allow the plan administrator to decide which period to use as the determination period (plan year, tax year or calendar year). In addition, the plan administrator should be allowed to choose whether to use prior year compensation or current year compensation (with compensation annualized for employees hired during the year), so long as these choices are consistently applied and may only be changed by filing for approval of the change. This would allow employers the opportunity to use their existing data bases and systems, without sacrificing any compliance goals.

2. Institute Uniform Definition of Compensation
(Code Sections 414(s), 414(q), 415 and 401(a)(17))

The new definition of compensation in Code section 414(s) and the definitions in section 415 and section 414(q)(7) should be amended to institute a uniform definition which should apply for all pension discrimination testing purposes (but not for purposes of the plan benefit formula). Under this uniform definition, compensation would mean W-2 earnings, with elective contributions under Code sections 125, 401(k), 402(h), 403(b), 457 and 501(c)(18) added back at the option of the employer. In addition, clarification is needed concerning the specific Code sections and plan calculations for which the $200,000 limit of Code section 401(a)(17) applies.
3. Eliminate Limitation on Benefits in the Event of Early Termination (Reg. Section 1.401-4(c))

The rules of Treasury Regulation section 1.401-4(c), promulgated in 1956, are obsolete and should be eliminated. ERISA's requirements for the allocation of assets upon termination, the provisions of SEPPAA, the TRA '86 vesting rules, the strengthened funding requirements of the Pension Protection Act (a part of OBRA '87), and the phase-in of the section 415 limitations over years of participation adequately protect participants and make it impossible for the owners of a business to walk away from a plan with all of its assets. Thus, section 1.401-4(c) is unnecessary.

Moreover, the rule creates substantial complexity, both in plan drafting and administration. Treasury Regulation section 1.401-4(c) requires that all defined benefit plans contain language which limits the benefits payable to the 25 highest paid employees of the employer in certain cases. Boiler-plate language which is not understood by most plan administrators must be included in the plan document. Because the language is arcane and its purpose obscure, there is massive noncompliance with these rules. Where a reasonable attempt is made to comply, plan sponsors are required to get private ruling letters in order to pay benefits to some participants -- an inefficient and ineffective method of plan management. There is no reason to
retain such complicated rules when their objectives are accomplished through other provisions.

4. Eliminate or Modify the Minimum Participation Rule (Code Section 401(a)(26))

The minimum participation rule was designed to prohibit discrimination in favor of highly compensated employees and employees with significant ownership interest in the employer. Its original focus was comparatively narrow: it was aimed at the elimination of individual defined benefit plans, plans which covered only the highest paid employee of the employer. However, the provision has grown a life of its own, and now appears so broad that nearly all plans will be affected by it, and so complex that compliance necessitates review of a large number of pages of regulations and expenditure of excessive amounts of time and money.

The regulations will prohibit small employers from using a variety of comparable plans to tailor their benefit packages to individual groups of employees -- an option which will continue to be available to larger employers (those who can assure that at least 50 employees participate in each plan). However, all employers, both large and small, will be required to divide their benefit programs into "separate benefit structures," treating every variation in terms or benefits as a separate plan subject to these rules. The complications are enormous, and the goals have been obscured. This epitomizes evil plan myopia, as it is apparently based on the assumption that any business which
employs fewer than 125 employees (the rule requires coverage of at least 50 employees or 40 percent of all employees, and 40 percent of 125 is 50) or provides any variety in benefits or options is seeking to take advantage of the rules to the detriment of its rank and file employees.

The rules set forth in the proposed regulations add significant compliance costs and produce very little benefit. In lieu of these rules, a simple rule designed to prohibit clearly abusive behavior should be crafted. For example, such a rule generally could apply only to plans covering a nominal number of employees (e.g., 5 or fewer) and would exempt arrangements such as frozen plans, plans for retirees only, wasting trusts, plans maintained for an employer's former employees upon the sale of a division, and plans maintained for employees of an acquired business, because other provisions will ensure that such arrangements are non-discriminatory. Because the abuse at which section 401(a)(26) was directed involved only defined benefit plans, the law could exempt defined contribution plans, or at least treat each such plan as a single benefit structure.

Furthermore, the law should operate in accordance with reasonable rules for determining comparability of plans and benefits -- rules which the Treasury has been directed to promulgate to replace those of Rev. Rul. 81-202, 1981-2 C.B. 93. When such rules have been designed, there will be no need for the complexities of section 401(a)(26) as it is now interpreted.
5. **Eliminate the ADP Tests of Section 401(k)**

The average deferral percentage ("ADP") tests of Code section 401(k) are too complex, and are unnecessary, as well as unfair to those at the low end of the group of highly compensated employees. Accordingly, these tests should be eliminated.

The ADP tests are designed to assure participation by the low paid and to limit deferrals by the high paid. The rules for calculating, returning and taxing deferrals in excess of the ADP limits are extremely complicated. In addition, the ADP tests include a multiple use test, rules for treating amounts which were elective deferrals as contributions subject to the tests of Code section 401(m), or vice versa, rules on lineal descendants, separate testing for ESOP portions of the plan, and an "adjusted balance" provision for determining income on excess amounts, all of which are examples of unnecessary complexity that far outweigh any possible utility.

The tests were found unnecessary for the Federal Employees Thrift Plan and, therefore, they should not be required for private sector plans. The federal government successfully lobbied Congress to exempt the Federal Employees Thrift Plan from the ADP requirements, because the $7,000 limit on elective deferrals of Code section 402(g) adequately limits participation by the highly compensated. In section 401(k) plans, elective deferrals are available to all participants, up to the section 402(g) limit, in the same way that IRA or SEP contributions are
available to employed individuals. However, the participant in
the section 401(k) arrangement has the advantage of being in an
employer-sponsored plan which must meet the coverage requirements
and offers economies of scale and possibly employer contributions
as well.

Not only are the ADP tests unnecessary, but they also
interact with the Code section 402(g) limitation in such a way as
to penalize the lower end of the highly-compensated group. In a
typical situation, if a store manager earning $50,000
contributes $7,000, her deferral percentage will be 14 percent.
If the firm president contributes $7,000 and earns $200,000, his
deferral percentage is 3.50 percent. If the ADP tests are not
met, the store manager's deferral must be reduced first, because
of her higher deferral ratio, even though her contribution was
the same as the president's. Moreover, in order to assure
compliance with the ADP tests, many plan sponsors enact rules
limiting the amount that the highly-compensated can defer,
unfairly penalizing the lower end of the highly-compensated group
to the advantage of the most highly paid employees. For example,
if a company places a 3.5 percent ceiling on contributions by the
highly compensated, a president earning $200,000 could defer
$7,000, but a store manager earning $50,000 could defer only
$1,750. Another store manager earning $48,000 could defer the
full $7,000 simply because he or she is not deemed to be "highly
compensated."
We suggest that the section 401(k) rules be simplified by eliminating the ADP test and adopting the requirements governing elective deferrals under section 403(b) annuities. Section 403(b) does not impose an average deferral percentage test, but, instead, requires that all non-excludable employees be eligible to make a salary deferral of at least $200, but not more than an annual maximum amount of $9,500. If all employees are eligible for salary reduction contributions, no further testing is necessary.

6. Simplify Rules for Aggregation of Employers and Employees (Code Sections 414(b), (c), (m), (n) and (o))

As discussed in Section A.1 of the Introduction, the rules for determining who is an employer and who is an employee involve complicated tests and cross-references and should be totally re-examined and simplified.

The leased employee rules are so complex that they are impossible to apply and so broad that they defy logic. The perils involved in these requirements, as interpreted in voluminous proposed regulations (Prop. Reg. sections 1.414(m)-5, 1.414(m)-6, 1.414(n)-1 through 1.414(n)-4 and 1.414(o)-1), have been well documented. Under these regulations, even a professional service provider, such as a lawyer or accountant, who spends a substantial amount of time working on one client's matters could be deemed to be an employee of the client. Moreover, contract employees, such as those employed by a food
service organization, may be deemed to be employees of the business which hired the food service organization to run its cafeteria. Office cleaning personnel and security personnel and even construction employees fall into this category.

These rules go far beyond curing any conceivable abuse and should be simplified. We recommend that the Code define employees to include individuals who (1) would be considered employees under common law standards, or (2) are considered employees under the Federal Insurance Contributions Act (FICA), see Code section 3121(d).

We have not offered a specific recommendation on how the rules for aggregating employers and businesses should be changed because the rules and policy objectives behind them are particularly complex and merit further study. Yet, we are convinced that these rules can be improved. We look forward to working with Congress and the regulatory agencies in efforts to formulate simpler methods for identifying the "employer" for the purpose of applying the laws and regulations governing retirement plans.

7. Eliminate or Simplify Top-Heavy Rules (Code Section 416)

    Code section 416 sets forth complicated testing and definitional rules for determining whether or not a plan is top-heavy. Top-heavy plans are required to satisfy a special vesting schedule and make minimum contributions or accruals for "non-key employees." Plans which are "super top-heavy" must make
additional minimum contributions or accruals and are subject to a lowered aggregate limitation under Code section 415.

The law requires that top-heavy provisions be included in all plans, even those which can never conceivably become top-heavy. Eliminating this requirement alone would be a major step forward for simplicity. Even wiser would be the elimination of the top-heavy rules altogether. Because of the changes enacted as part of TRA '86, including the new coverage and participation rules, new vesting standards, strengthened integration requirements, and new limits under sections 401(a)(17), 402(g), and 415, the top-heavy rules are unnecessary and redundant. The TRA '86 rules will ensure that the objectives which led to imposition of the top-heavy rules are met; that is, benefits are limited for the highly compensated, and rank and file employees receive minimum benefits with early vesting. Therefore, these rules should be eliminated, or, at a minimum, simplified. For example, the rules might be simplified by eliminating the five-year look-back for key employee determinations, by deleting the special top-heavy vesting schedule and by keeping only the "super top heavy" test, instead of having two sets of tests and rules.
B. BENEFIT LIMITATIONS

1. Simplify Rules on Minimum Distribution of Benefits (Code Section 401(a)(9))

In general, distributions from all qualified plans, IRAs, tax-qualified annuities, and custodial accounts must begin by April 1 of the calendar year following the calendar year in which the employee attains age 70 and 1/2 ("the required beginning date") regardless of when the employee retires. The distributions must be made over the life of the employee or over the lives of the employee and designated beneficiary, or over a period not extending beyond the life expectancy of the employee or the life expectancy of the employee and designated beneficiary. The "incidental death benefit requirement" of Treas. Reg. section 1.401-1(b) imposes additional restrictions on the distribution unless the employee's designated beneficiary is a spouse or no more than ten years younger than the employee.

As we discussed in Section B.2 of the Introduction, to apply the minimum distribution rules, it is necessary to refer to voluminous proposed regulations and make computations using various IRS actuarial tables. See Prop. Treas. Reg. sections 1.401(a)(9)-1 and 2. In one large employer's case, a significant amount of time and energy was spent on understanding and implementing these proposed rules, but only two out of approximately 64,000 employees were affected when the first payment was finally required, in April 1989. Moreover, these two employees were not high-paid executives attempting to build up
their estates or extend indefinitely the tax deferral advantage of their pension funds, but rank-and-file employees who continued to work past age 70 in order to continue receiving a paycheck.

The minimum distribution rules are detailed and fairly rigid. Generally, no credit is provided with respect to distributions made prior to the required beginning date. Therefore, an individual who takes a large distribution at age 70 to purchase a retirement home could not forego distributions from age 71 through 75 to save plan resources for other needs, such as anticipated medical expenses.

Not only are the minimum distribution rules themselves complex and rigid, but also, these rules add substantial complexity when combined with the suspension of benefit rules and the rules prohibiting cessation of accruals for employees working beyond normal retirement age. For years, ERISA and DOL regulations have permitted certain suspensions of plan benefits when an employee works beyond normal retirement age. Generally, such an employee is not entitled to receive pension distributions (which are derived from employer contributions) until after actual retirement.3/ When TRA '86 amended Code section 401(a)(9), no exception to the minimum distribution requirement

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3/ ERISA indicates that a suspension occurs if benefits are suspended after their payment has commenced, i.e., with respect to retirees who are re-employed. See ERISA section 203(a)(3)(B). The DOL, however, has taken the position that a suspension can occur even with respect to an employee who has never begun receiving benefits but works beyond his or her normal retirement date. See DOL Reg. section 2530.203-3.
was provided for benefits that are suspended. Furthermore, after enactment of TRA '86, OBRA '86 amended the Code to prohibit cessation of benefit accruals because an employee attains a specified age, thereby mandating that pension accruals continue past normal retirement age. See Code section 411(b)(1)(H) and (b)(2). Accordingly, employees must continue accruing benefits even if distribution of benefits may be suspended, and even if minimum benefits must be paid. Proposed regulations provide some guidance on the interrelationship between the accrual and suspension rules, including permissible offsets. Yet, the rules are complicated to apply and administer. See Prop. Treas. Reg. section 1.411(b)-2, 53 Fed. Reg. 11876, 11879 (April 11, 1988).

Imposing the minimum distribution requirements on top of this structure of suspensions and accruals adds complexity which far outweighs any conceivable benefit, and is likely to become a trap for the unwary.

The distribution rules are not only overly complex but also unnecessary. The minimum distribution rules were initially included in order to prevent the wealthy from using qualified plans as an estate planning device. However, this risk generally was removed when the estate tax exclusion for distributions from qualified plans was repealed. See former Code section 2039(c) (repealed by the Deficit Reduction Act of 1984, P.L. 98-369, section 525 and TRA '86, section 1852(e)).

The minimum distribution rules should be reviewed and changed to limit the administrative burden they impose. These
rules are unnecessary for the majority of plan participants, because these participants will use their benefits for retirement purposes regardless of whether or not minimum distributions are required by law. Options for simplifying the minimum distribution rules include their:

(a) repeal;

(b) modification to apply only on a participant -- rather than a plan -- basis, and to apply only with respect to individuals who have total account balances over a specified amount, such as $750,000 (representing a benefit of $50,000 per year for 15 years);

(c) modification to apply only on a participant -- rather than a plan -- basis, and to apply only with respect to five-percent owners; or

(d) modification to return to a rule similar to the one in effect prior to TRA '86: requiring that distributions begin by the April 1 of the year following the later of (i) the year in which the employee attains age 71 or (ii) the year in which the employee retires, except that distributions of five-percent owners must begin by the April 1 following the year in which the participant attains age 71; but simplifying rules with respect to calculating the minimum amount of the distribution (e.g., requiring that the full amount be distributed in 25 years, which is the expected return multiple for an ordinary joint and last survivor annuity for a 71 and 61 year-old individual).
2. Eliminate Excise Tax on Excess Distributions and Modify Limitations on Contributions and Benefits (Code Sections 4980A and 415)

A 15 percent excise tax is imposed on individuals to the extent that annual aggregate distributions from tax-favored arrangements exceed the greater of $150,000 or $112,500, indexed. Where an individual elects five-year income averaging with respect to a lump sum distribution, the excise tax will be imposed on the amount of the distribution that exceeds $750,000 or five times $112,500, as indexed. Individuals could have elected to exclude benefits accrued as of August 1, 1986 from the tax, if these accrued benefits exceeded $562,500 and an election was made with, or prior to, the 1988 income tax return filing. However, those who made such a grandfather election are subject to the threshold of $112,500, indexed, not the $150,000 (or $750,000 for lump sum) threshold, when determining the amount of excess distributions after the grandfathered amount is recovered.

This excise tax originally was intended to replace the complex combined plans limitations of section 415(e) with a simpler and more equitable scheme for limiting retirement income. However, as finally enacted, the excise tax does not replace the combined plans limitations but is applied in addition to them, and it is neither simple nor equitable. Therefore, this excise tax should be eliminated.

While one of the purposes of the excise tax was to prohibit the accumulation of multiple maximum benefits from several
employers as well as individual savings in an IRA, no additional tax is needed to accomplish that goal. There is no need to encompass IRA benefits in an overall limitation because IRA deductions are eliminated for employees earning over a threshold amount who participate in employer plans. Similarly, contributions to section 403(b) annuities are coordinated with other elective deferrals and with the section 415 limits. Thus, the only conceivable gap in this system of limitations involves the high-paid individual employed by several completely unrelated employers, who earns maximum benefits under plans of each employer. This situation is so rare that the imposition of the excise tax only to cover it is completely unwarranted.

Furthermore, even where a high-paid individual works for multiple employers, his ability to defer income in qualified plans is not unfettered because: (1) section 415(c) limits contributions to defined contribution plans each year, (2) the defined benefit limit is now phased in over 10 years of participation rather than service, and (3) compensation taken into account under plans is limited to $200,000. There is, therefore, very little policy reason to justify this excise tax.

Also, because the excise tax is imposed on the dollar value of retirement distributions, it acts as a penalty on investment success. Such a penalty, even if it were necessary, contravenes so much other valid policy that it bears close re-examination. While we believe the excise tax itself is unnecessary, if it proves impossible to eliminate altogether, it should be applied
only to excess distributions from qualified defined benefit plans so as not to penalize capital investments. Moreover, this tax serves as a disincentive for owners to continue to contribute to plans on behalf of their rank-and-file employers once their own benefits have reached the section 4980A threshold.

Not only is the excise tax redundant and contrary to other policies, the structure of the tax is so complex that compliance is extremely difficult. There are major unanswered questions concerning the application of both the tax on retirement income and the estate tax, so that even tax professionals and IRS personnel may misconstrue the rules, and the excise tax poses severe difficulties for any individual potentially subject to it.

For all the reasons given above, this tax should be eliminated. If, however, the tax is preserved in anything resembling its present form, the combined plans limitation of section 415(e) should be deleted. The recordkeeping requirements of this test are enormous, and if the excise tax is retained, the section 415(e) limitation is redundant.

A final change which should be made in section 415 is to eliminate the 25 percent of compensation limit on annual additions. See Code section 415(c). This limitation simply harms the lower-paid and is unnecessary in view of the dollar limitation and the deduction limits under Code section 404.
3. **Simplify Basis Recovery Rules (Code Section 72)**

TRA '86 repealed the three-year basis recovery rule of section 72, under which an employee's investment in the contract was deemed to be recovered before any taxable amounts, if the full amount of the basis could be recovered within the first three years of annuity payments. The new rule requires pro-rata recovery of basis, involving calculation of an exclusion ratio which is applied to each payment until the entire basis is recovered. This rule should be repealed, and the three-year rule reinstated, because any potential benefit of pro-rata recovery of basis is outweighed by the administrative cost of compliance.

4. **Permit Rollovers of Employee Contributions and Partial Rollovers of Any Amount (Code Section 402(a)(5))**

Under current law, an employee may not roll over employee contributions. The prohibition on rollovers of employee contributions should be removed since employees may now make non-deductible contributions to IRAs and may exclude from tax that portion of an IRA distribution that constitutes a return of properly reported non-deductible contributions. Thus, IRAs must now account for after-tax contributions, and there is no reason not to allow them to accept such contributions through rollovers as well as annual contributions.

A participant should be permitted to rollover any amount into an IRA, including partial distributions of less than 50
percent of the balance to the credit of the employee (but excluding any minimum required distribution). The current restrictions on partial rollovers and rollovers of employee contributions add complexity and limit portability. In fact, these restrictions create an incentive for participants to spend distributions rather than saving them for retirement, contrary to the explicit recommendation of the President's Commission on Pension Policy, and the provisions of proposals on portability being considered in Congress.4/

5. Eliminate Hardship Rules of Section 401(k)

Code section 401(k)(2)(B) restricts distributions of amounts attributable to employee elective deferrals. These amounts may be distributed only upon separation from service, death, disability, termination of the plan, attainment of age 59 and 1/2, or hardship. Treasury regulations concerning the hardship standards under section 401(k) appear to be more stringent than the standards which generally apply to profit-sharing plans. While profit-sharing plans may permit hardship distributions only in accordance with objective criteria set forth in the plan, sponsors are not required to make inquiries with respect to the participant's other resources available to meet a heavy and immediate financial need. In contrast, the

401(k) regulations require that plan sponsors determine whether (1) an employee has an immediate and heavy financial need and (2) the distribution is necessary to satisfy such a need. The determination of whether a distribution is necessary to satisfy a financial need may be satisfied by using a safe harbor that imposes significant restrictions or through "reasonable reliance" on a detailed employee representation. Compare Treas. Reg. section 1.401(k)-1(d)(2) with Treas. Reg. section 1.411(d)-4, Q&A 4(b) and 6 and Rev. Rul. 71-224.

The requirement that administrators determine whether a participant has other resources available to meet a financial need is administratively burdensome, intrusive on employee privacy, and unnecessary. The Code section 72(t) ten percent penalty on early withdrawals adequately assures that an employee will seek to satisfy financial needs from other sources before taking withdrawals from retirement plans.

Moreover, imposing rules with respect to elective deferrals and earnings as of December 31, 1988 (but not earnings after such date, and not amounts treated as elective contributions) which differ from the rules imposed with respect to withdrawals of employer contributions and earnings adds unnecessary recordkeeping complexity. See Prop. Treas. Reg. section 1.401(k)-1(d)(1)(iii). Under current law, a profit-sharing plan may permit distributions after a fixed number of years, the attainment of a stated age, or the prior occurrence of some event such as separation from service, illness, disability, retirement,
death, or hardship. See Treas. Reg. section 1.401(b)(1)(ii); Rev. Rul. 74-224. There is little reason why the rules governing certain distributions from section 401(k) plans should be any different than the general rules governing distributions from profit-sharing plans. For all these reasons, we recommend that Code section 401(k)(2)(B) be deleted.

C. REPORTING AND DISCLOSURE REQUIREMENTS

ERISA and the Code require that so many forms be prepared, distributed to participants and filed with the government that the resulting costs and burdens imposed upon plans and plan sponsors have been enormous. This paperwork burden is not, as some suggest, an unqualified benefit to participants. Not only are the costs of the reporting and disclosure requirements borne in part by current plan participants; they also discourage small employers from establishing new plans for employees not now covered.

Despite the negative impact on plans, new reporting obligations have been added, often without adequate consideration of their usefulness or practical application. (See, e.g., the discussion of ERISA section 204(h) below). The time has come to carefully weigh, in light of nearly fifteen years' experience under ERISA and parallel Code provisions, the costs and benefits of applicable reporting and disclosure requirements, and improve or eliminate those requirements that have not proven cost-effective.
It should be pointed out, however, that it is essential that changes not be made in any required report, form, or document unless those changes are substantial and made at one time, after adequate public notice and participation, rather than seriatim. Typically, it costs more to reprogram computers, retrain employees, and set up new filing systems than is saved by small changes.

1. Simplify Annual Report

ERISA section 103 requires each plan to prepare and file with the Secretary of Labor an Annual Report (currently the Form 5500 series). Much of the information required in the Annual Report is of minimal use to participants or the government: e.g., the detailed listing of plan investments and all 5 percent transactions.\(^5\) Submission of this data is enormously burdensome and costly; yet it is inappropriate for plans funded through bank trust funds or pooled insurance accounts, provides little useful information to participants generally, and is rarely, if ever, scrutinized by the DOL absent other problems which would suggest a more thorough investigation of plan asset investment.

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\(^5\)/ Recently, the DOL did change the reportable transaction threshold from 3 percent to 5 percent and eliminated the requirement of reporting the dates of reportable transactions. See DOL Reg. section 2520.103-6 as amended in 54 Fed. Reg. 8624 (Mar. 1, 1989). While this constitutes an improvement, it does not go far enough in eliminating unnecessary detail from required reports.
ERISA section 103 should be amended to reduce the amount and detail of data required in the Annual Report. The Annual Report should contain only information useful to participants and necessary to the agencies in identifying problem areas. Despite efforts to streamline these Forms, they still require much information that cannot possibly be truly useful. Therefore, the government should pare down the Forms to include only items it actually uses in a meaningful way, and eliminate all others. In the alternative, the simplified Forms 5500C and 5500R should be used for all plans. If problems are indicated, the agencies may then require more specific information.

2. Eliminate Summary Annual Report and Plan Description

The summary annual report (SAR) requirement of ERISA section 104(b)(3) should be eliminated. The SAR is widely regarded as a document with more form than substance. It tells a participant virtually nothing of value, and serves only as a reminder that there is a plan, the details of which must be found elsewhere. At the same time, it is expensive to prepare and mail, and because of its brevity, it may often be misleading or raise questions which would be far more efficiently answered by reference to actual plan documents, the summary plan description, or the annual report itself. Therefore it should be eliminated, or the requirement should be limited to posting a notice in a prominent site in the work place.
Moreover, the requirement of ERISA section 102(a)(2) and (b) that a "plan description" be filed with the Labor Department should be eliminated, with appropriate changes to DOL regulations.

3. Simplify and Clarify Reporting Obligations With Respect to Distributions

Currently, confusion abounds regarding the reporting obligations of plan administrators, payors, and participants. First, the reporting rules generally are not contained in regulations, but only on Forms and Instructions, so it is often difficult for recordkeepers to determine their obligations. Second, the same information is often required from different sources (such as the plan recordkeeper and the participant), resulting in additional costs and unnecessary duplication. Third, guidance on reporting items affected by changes in the law is often insufficient, unclear, or provided too late. A thorough revision of reporting requirements to eliminate duplication and clarify obligations is needed.

An example of the confusion regarding reporting requirements is the situation which led to publication of Notice 89-32, 1989-12 I.R.B. 76, retroactively correcting the positions taken in IRS Notice 87-77, 1987-2 C.B. 385 and Notice 88-33, 1988-13 I.R.B. 23. These Notices all concern the proper reporting of corrective distributions of excess deferrals, excess contributions and excess aggregate contributions. Congress retroactively changed the treatment of these amounts in TAMRA, generating considerable
confusion. The rules add complexity by distinguishing between various excess amounts, splitting the excess and its earnings into two separate years and treating refunds of less than $100 differently from refunds in excess of $100. There should be one simple rule -- all refunds of excess amounts and income thereon should be treated as income in either the year of contribution or the year of receipt. Regardless of the action taken on the underlying provision, however, when the government position regarding the reporting and treatment of distributions shifts in a manner such as we have described, the government should provide sample language which may be used by payors to notify participants of their reporting options and regulatory requirements.

With respect to a more general problem, it is very difficult for payors to properly report distributions, not only because of constant changes in the law and IRS guidance, but also because of the use of multiple forms by the IRS and because of lack of clear regulatory guidance on reporting. The IRS should combine the Form W-2P (which is required for reporting of retirement distributions other than total distributions) with the Form 1099R (which is required for reporting of total distributions). There is no statutory basis for requiring use of the two different forms. Prior to adopting a new combined form, however, the IRS should provide time for comment by payors. Furthermore, the IRS should recognize that significant time will be needed to reprogram computer reporting systems to comply with a new format.
Accordingly, the final version of the new form should be released well in advance of its adoption.

Also, in order to reduce the unnecessary paperwork burden imposed on plan payors and administrators, the procedures for electing out of withholding could be simplified. The IRS should explicitly permit participants to elect out of withholding on their benefit applications, and should provide a short sample notice of election rights which could be provided to participants at the time they complete their benefit applications.

4. **Simplify REA Consent Requirements**

The requirements for consent to receive a distribution are far too complicated. If the rules themselves were simplified, the required notices to employees could be simplified. Specific situations where the rules could be simplified include the following:

a. Section 1.411(a)-11(c) of the regulations requires that plans give participants a general description of the material features, and an explanation of the relative values, of the optional forms of benefit available under the plan at least 30 days prior to the annuity starting date. The term "annuity starting date" is defined to mean the first day on which a benefit is payable. This requirement appears to preclude a plan from paying benefits any earlier than 30 days after a special notice is given, even if, for example, under the plan, the benefit is payable in any form
and a surviving spouse requests an immediate distribution to pay funeral expenses. At minimum, the rules should be modified to allow payment to begin when it is requested.

b. The rules for consent to receipt of benefits prior to normal retirement age (or 62, if later) require that consent be given if the benefit is "immediately distributable" and provide that a benefit which is distributable immediately upon the attainment of normal retirement age or age 62, if later, is not immediately distributable, so no consent is required. While the policy behind this convoluted language may be appropriate, the regulations are so complicated that plan administrators cannot understand them. These regulations should be amended to clearly state that consent is not required for distributions made after the later of the plan's normal retirement age or age 62.

c. The age 35 threshold for waiver of the QPSA should be eliminated, in favor of a rule allowing waivers to be made upon commencement of participation, and withdrawn and remade at any time thereafter. Notices and explanatory material should be required upon commencement of participation, and when requested thereafter (but not more frequently than once a year). The current complicated rules add significant administrative expense and reflect an erroneous attitude that anyone under age 35 is simply too young to know what he is doing.
5. Limit Scope of Requirement of Notice of Reduction in Future Accruals (ERISA Section 204(h))

ERISA section 204(h) added a requirement prohibiting any significant reductions in future accruals under plans subject to the minimum funding standards unless written notice of the amendment is provided to all plan participants, certain beneficiaries, and certain employee organizations, at least 15 days prior to the effective date of the amendment.

The intent of this requirement was to provide prior notice to employees when an employer, on its own initiative, seeks to significantly cut back on plan benefit formulas. However, the provision, as written, imposes the same notice requirement where an employer must change accruals to comply with federally mandated changes in the law.

Recently, sponsors were in a quandary whether to provide cut-back notices in face of the tardy release of integration regulations which will require significant changes in plan design. Plan amendments effecting these changes are not required, generally, until the due date, with extensions, for filing the employer's tax return for the 1989 plan year. In Notice 88-131, 1988-52 I.R.B. 15, the IRS provided some relief from the ERISA notice requirement, but this relief was not provided until the day before sponsors would otherwise have been required to notify all employees of unknown changes in accruals.
In order to prevent such situations in the future, ERISA section 204(h) should be amended to exclude from the notice requirement any future accrual changes made to comply with changes in the federal law governing qualified plans, or to require such notice not earlier than a reasonable time after the amendment is actually adopted.

6. Eliminate Requirement of Notice to Interested Parties

The IRS requires the notification of all "interested parties" prior to the filing with the IRS of a request for a determination letter. See Treas Reg. section 601.201(o)(3)(xvi), Rev. Proc. 80-30, 1980-1 C.B. 685, as modified. Determination letters are routinely sought by plan sponsors when a plan is adopted, materially amended or terminated. The notification requirement is unduly burdensome and expensive, serves no useful purpose, and is generally ignored or misunderstood by participants. Therefore, the notice to interested parties should be eliminated.

7. Delete Requirement of Submission of Annual Statement of Collective Trust or Insurance Carrier Account (ERISA Sections 103(b)(3)(G) and 103(b)(4))

The statutory provision requiring the submission with the plan's annual report of an additional report for plans held in common or collective trust funds or separate accounts of insurance carriers should be deleted.
ERISA section 103(b)(3)(G) provides that if some or all of a plan's assets are held in a bank common or collective trust fund, or separate bank trust, or insurance carrier separate account, the plan's annual report must include the most recent annual statement of the trust or account. ERISA section 103(b)(4) and DOL Regs. section 2520.103-9 permits direct filing with the DOL by the common or commingled trust of the account involved.

This requirement of filing the statement of the underlying collective fund should be deleted. For reporting purposes, a plan's investment in a bank's collective trust fund should not be treated differently from its investment in mutual funds or in an insured separate account, which do not require reports of the underlying investment medium. As a result, no filing of such information should be required, although it could be made available to the Department of Labor upon request.

D. FUNDING LIMITATIONS

1. Amend the Full Funding Limitation

(Code Section 412(c)(7))

Code section 412(c)(7) was amended by OBRA '87 to redefine the full funding limitation as 150 percent of termination liability. Contributions in excess of this limitation are not deductible and are subject to a 10 percent excise tax. The calculation of this limitation requires a separate actuarial valuation each year, which adds to the cost and complexity of maintaining a defined benefit plan. This, alone, may be
sufficient justification for calling for a return to the
limitation as it existed prior to OBRA '87. Moreover, there are
policy issues surrounding this limitation which overwhelm the
simplification argument for its removal. While the limit may
appear reasonable -- why should a plan need assets in excess of
100 percent of "termination" liability -- it is very misleading.
"Termination liability" is often less than the actual liability
required to close out a plan at termination, and the limit is
applied to ongoing plans which are not terminating. The effect
of the current full funding limitation is that a plan's actual
funding will always lag behind in the funding needed for "real"
benefits at retirement where such benefits are based on final
average pay, and level funding over the life of a plan is
impossible.

In effect, current law inappropriately mortages benefit
promises by prohibiting the level funding that is the reasonable
way for plan sponsors to fulfill their benefit obligations and,
instead, requires plans to be funded with payments which escalate
in later years. This results in tremendous cost in terms of plan
benefit security. Ironically, this is the type of funding which
Code section 412 was designed to eliminate, not require.
Therefore, the full funding limitation should be based on ongoing
(projected) liabilities, not on termination liability.
2. Eliminate Tax on Nondeductible Contributions (Code Section 4972)

A 10 percent excise tax is imposed on employers making nondeductible contributions to qualified plans. The purported abuse at which this penalty is directed -- placing large amounts of funds into plans in order to obtain the advantage of tax deferral on the income generated -- is simply not a common occurrence.

There are numerous reasons why employers do not, as a general rule, make unnecessary contributions to plans. First, Code section 412(c)(3) requires that actuarial assumptions must be reasonable, and an excise tax is imposed for the overstatement of pension liabilities. See Code section 6659A. Second, it is impossible to recoup excess amounts contributed to a plan without terminating the plan (unless a mistake of fact can be established). Third, amounts recovered at plan termination are themselves subject to a 15 percent excise tax. Fourth, contributions in excess of those needed to fund the plan may not be deducted. Fifth, businesses cannot tie up funds indefinitely, but have other uses for their money.

Not only is the tax not needed to accomplish its intended purpose, but also it may result in imposition of inappropriate penalties. After the recently enacted funding rule changes, many employers will be subjected to this excise tax, not because they have any abusive intent, but because they made reasonable and, in some cases, legally required contributions which are no longer
deductible. For example, the change in the full funding limitation, which eliminates the deduction for contributions in excess of those needed to provide 150 percent of termination liability, will cause significant year-to-year variations in the deductible amount. An employer who makes level contributions for budgetary reasons may incur the excess tax periodically, because of swings in termination liability due to variations in interest rates and the composition of its work force. Furthermore, the new funding provisions require quarterly payment of estimated contributions. If the estimate exceeds the full funding limitation, the excise tax will be incurred despite the fact that the contributions were required to be made before valuation results were available, and once made cannot generally be withdrawn. Finally, where an employer is required by the terms of a collective bargaining agreement to make certain contributions to a multiemployer plan which is or becomes overfunded, the employer may incur the excise tax although it cannot reduce its level of contributions and has no control over the terms of the plan. For all these reasons, this excise tax should be eliminated.

E. FIDUCIARY RULES

1. Modify Prohibited Transaction Exemption Procedure (Code Section 4975 and ERISA Section 408)

The current procedures for receiving an exemption from the prohibited transaction rules of ERISA section 408 and Code
section 4975 take much too long to complete. Many investment options which would benefit participants and plans are foreclosed because of the delays created by these procedures, particularly the requirement that the notice of a proposed exemption -- and the decision to grant an exemption -- must be published in the Federal Register. See DOL Prop. Reg. section 2570.30 et. seq., 53 Fed. Reg. 24422 (June 28, 1988).

The prohibited transaction exemption procedures should be modified to provide the Department of Labor with a specified time, such as 20 days, in which to deny an application. If no denial is issued within that period, the application for exemption should be deemed to be granted. This suggested procedure is similar to the procedure used with respect to securities registration statements under section 8 of the Securities Act of 1933, as amended, 15 U.S.C. section 77(h).

2. Revise and Consolidate the Excise Taxes on Prohibited Transactions (Code Section 4975(a) and (b) and ERISA Section 502(i))

Under current law, Code section 4975 imposes a 5 percent excise tax on disqualified persons engaging in prohibited transactions with respect to tax-qualified plans, and ERISA section 502(i) permits imposition of a 5 percent civil penalty with respect to other plans. Both the Code section 4975(a) tax and the ERISA section 502(i) penalty are imposed on the amount involved in any prohibited transaction, but the Code excise tax is automatic, and applies regardless of knowledge or intent.
Because of the automatic nature of this tax, it reaches too broadly, and applies to innocent errors where no losses occurred. In contrast, under ERISA section 502(i), the DOL has the right to impose a 5 percent penalty for the commission of a prohibited transaction, but is not required to do so.

Under Code section 4975(b), an excise tax of 100 percent is imposed where a prohibited transaction is not corrected. See Code section 4975(b) and ERISA section 3003(a) (permitting waiver of tax in appropriate cases). Similarly, under ERISA section 502(i), the DOL may assess a civil penalty of 100 percent for uncorrected transactions.

Under Reorganization Plan No. 4 of 1978, the general authority to issue regulations, rulings, opinions, and exemptions for prohibited transactions under Code section 4975 was transferred to the Department of Labor. See Executive Order No. 12108, 44 Fed. Reg. 1065 (December 28, 1978). The provisions relating to taxes on disqualified persons under Code section 4975(a) and (b), however, and exemptions on certain limited transactions, were not included in this transfer of authority. In order to minimize administrative complexity, and prevent the anomaly of having one agency determine whether a transaction constitutes a violation of the prohibited transaction rules while another agency enforces penalties for such a violation, the power to impose penalties should be shifted to the Department of Labor. Accordingly, the prohibited transaction excise taxes of Code section 4975(a) and (b) should be repealed and the DOL
should be given authority to impose civil penalties for prohibited transactions with respect to all plans under ERISA section 502(i). In addition, the DOL should retain flexibility not to impose the 5 percent penalty in appropriate cases.

F. MISCELLANEOUS

1. Eliminate Half-Years in Code Provisions (Code Sections 72, 219, 401(a)(9), 402(e), 403(b))

Several provisions in the Code relate to the age of the employee at a certain time. Using half-year ages for these determinations is confusing and adds complexity for no apparent reason. For example, if an individual turns age 70 on July 1, 1989, he or she must pour through voluminous regulations to determine if he or she is 70-1/2 in 1989 or in 1990. In contrast, everyone knows his or her birth date, and this date is already included in plan and employer records. Basing rules on half birthdays requires additional records and adds confusion. All half-years should be eliminated.

2. Delete Extension of Amortization Period (Code Section 412(e))

Code section 412(e) should be deleted. The Secretary's authority to extend the amortization period has rarely, if ever, been used. The minimum funding waiver procedure of section 412(d) is sufficient for the intended purpose.
3. Replace Five-Year Phase-In of Benefit Guarantee With Three-Year Cliff Guarantee (ERISA Section 4022(b)(7))

ERISA section 4022(b)(7) provides that benefits are guaranteed only to the extent of the greater of 20 percent of the amount which, but for the fact that the plan or amendment has not been in effect for 60 months or more, would be guaranteed, or $20 per month, multiplied by the number of years (up to five) the plan or amendment has been in effect. This rule unnecessarily complicates the determination of guaranteed benefits, and should be replaced with a rule guaranteeing all benefits (up to the general limit on guaranteed benefits) which have been in effect for three years or more.

The purpose of ERISA section 4022(b)(7) has been largely accomplished with the changes enacted in SEPPAA. It is no longer possible for a solvent employer to enact large benefit increases and dump the liabilities on the PBGC. A three-year waiting period for coverage would assure that an employer in distress could not dump new liability on the PBGC, and would be much easier to implement.

4. Narrow the Definition of Participant (ERISA Section 3(7))

The definition of "participant" in ERISA section 3(7) should be narrowed to exclude any non-employee who is not receiving benefits and who does not have a vested right to an accrued benefit. Such individuals have no current or future
right to any benefits under the plan, unless they are subsequently rehired. The elimination of this category from the definition of participant would simplify reporting obligations and payment of PBGC insurance premiums. The PBGC premium, of a minimum of $16 per "participant," should not be assessed on behalf of individuals who are in fact no longer participants.

This change would also clarify entitlements upon the termination of a plan. Under current law it is unclear whether non-vested terminated employees regain a right to the amounts they previously forfeited if the plan is terminated within a certain period of time (up to 5 years, according to some interpretations), after the employee's termination. The suggested change in the definition of participant would help clarify that non-vested terminated employees are not entitled to receive such amounts.

5. **Eliminate Remnants of H.R. 10 Plans**

Since 1982, when TEFRA was passed, Congress has attempted to create parity between the income tax treatment of self-employed individuals and common-law employees. A few changes are still necessary in the retirement plan rules in order to fully achieve this goal. The fact that a number of separate rules and limitations still exist is confusing, adds additional complexity, and impedes the professed objective of attaining parity. The most troublesome of these remaining rules are as follows:
a) The employer aggregation rules of Code section 401(d)(1) and (2) differ from those in Code sections 414(c)d, (m), and (n), and impose more restrictions on owner-employees. The additional complexity is not justified by the minimal opportunity for abuse in this area.

b) Code sections 401(c)(2) and 404(a)(8)(C) limit contributions on behalf of the self-employed to their "earned income." No such limit exists for corporate employees. Furthermore, contributions to retirement plans should be subtracted from earned income before determining the deduction limits or the section 415 limits, as such contributions are not included as compensation for corporate employees.

c) Plan loans to self-employed participants are prohibited transactions, unless the plan obtains an administrative exemption under ERISA section 408(a). Qualified loans to other participants are not prohibited transactions.

d) Lump sum treatment of distributions (Code section 402(e)) is not available to the self-employed upon separation from service, though common law employees may receive lump sum treatment upon separation from service. Conversely, self-employed individuals may be eligible for lump sum treatment upon becoming disabled, but common law employees are not.
These separate rules for self-employed employees should be eliminated.

6. Clarify Standards for Retroactive
Revocation of a Plan

A plan which satisfies all the requirements of Code section 401(a) is considered a "qualified plan" and consequently receives a special status for tax purposes. In the event the plan fails to satisfy any requirement for a qualified plan in any year, the IRS may retroactively disqualify the plan.

Under Code sections 401(b) and 7805(b), the IRS may provide relief from retroactive disqualification. These Code sections should be clarified to make clear that (1) such relief is available when sponsors have made good faith efforts to comply with statutory requirements and (2) participants who had no control over plan design are exempted from adverse tax consequences of disqualification.