REALITY TESTING

FOR PENSION REFORM

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> I'm staring at documents that make no sense to me, no matter how many beers I drink ... Apparently I have until Sept. 30 (in most instances) ... to comply with something (but what?) called "GUST" ... [for my Keogh plan and I] ... must adopt EGTRRA prior to the end of the plan year beginning in 2002. I am, frankly, reluctant to adopt anything called "EGTRRA," which sounds like the name of a giant radioactive chicken that destroys Tokyo ... the federal Tax Code is out of control ... It's gigantic and insanely complex, and it gets worse all the time. Nobody has ever read the whole thing. IRS workers are afraid to go into the same ROOM with it. They keep it locked in the basement, and once a day, they open the door, heave in a live taxpayer - some poor slob who failed to adopt EGTRRA in time to comply with GUST (and various other amendments) - then slam the door shut, before the screams start.[1]

Dave Barry is right. And the private pension system *is* fair game for jokes and ridicule. It is absurdly complicated and incomprehensible. The relevant tax rules and regulations include more than 3,000 pages of small, single-spaced text and weigh more than most laptop computers. The companion labor rules under ERISA are smaller but not by much. There is widespread agreement that the present situation is untenable and something must be done. Every effort to "simplify" the private pension system, however, seems to achieve just the opposite.

But these are interesting times in the pension world. Perhaps for the first time, there are two very different types of proposals for change before Congress. The first is reflected in the Pension Preservation and Savings Expansion Act (PPSEA) introduced in 2003 by Representatives Portman and Cardin. PPSEA is the traditional type of pension reform, an omnibus bill that tinkers with almost every aspect of the private pension system to make incremental changes. The second is reflected in the attempt of the Administration to undertake radical change and simplification. Its 2003 proposal, modified in budget submissions in 2004, contemplates a sweeping consolidation in the number and types of defined contribution plans. This paper evaluates these two approaches to change – the first one for incremental and the second one for radical reform - and then considers an alternative.

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[1] Dave Barry, *"The Taxman Cometh, with Satan in the Van,"* The Miami Herald, April 5, 2003.

Analyses of the private pension system typically focus on such issues as how to improve coverage or encourage saving or prevent tax abuse or generate retirement income more equitably. Those issues are important, but the thesis of this paper is that more attention needs to be paid to the structure in which they are embedded. The paper, therefore, examines the nuts-and-bolts of the private pension system, the plans that comprise it and the rules that govern them. The architecture and machinery of the private pension system have much to teach us about directions for reform.

EGTRRA, Its Origins and Aftermath

As a starting point, it is helpful to take an overview look at the private pension system today. Most people understand that the system is composed of defined benefit and defined contribution plans but few are aware that, legally speaking, there can be as much diversity within these types of plans as between them. Figure 1 illustrates the extraordinary constellation of plans that will be available under current law when EGTTRA is fully phased-in by 2006.

The private pension system evolved over time into its current complicated structure as the result of two primary factors. First, the private pension system is a tax-based system. It provides tax incentives to promote saving for retirement. Second, the private pension system is largely a voluntary employer-based system: employers are encouraged but not required to provide plans for their employees. But different types of employers are subject to different tax rules. For example, for-profit and non-for-profit employers are subject to completely different sections of the federal tax code while governmental employers are largely exempt from such rules. The theory has been that, if pension plans are to be sponsored by different types of employers, those plans should be subject to as many different rules as are necessary and appropriate for those employers.

This focus on the tax attributes of employers largely explains the historical evolution of the private pension system. It began in the 1920s with special tax rules for plans sponsored by corporate employers. Some twenty years later, new types of plans for not-for-profit employers were created. Next special plans for self-employed individuals were developed, and then rules were imposed on plans for governmental employers. With the passage of ERISA in 1974, IRAs were created, almost as an after-thought, to give workers without an employer-sponsored plan a limited opportunity to save for retirement. Finally, special "SIMPLE" plans (of which there are several cousins) have recently been created in hopes of attracting small employers to the private pension system. These are defined contribution plans with safe harbor provisions designed to reduce the regulatory requirements of sponsoring a plan to a minimum.

The post-EGTRRA system still reflects that historical evolution. There continue to be three primary families of plans. The largest group consists of defined benefit and defined contribution plans qualified under IRC § 401(a) and are subject to the full panoply of tax and ERISA rules. Although these plans were originally developed for corporate employers, now, with a few exceptions, any employer can sponsor these types of plans. The second group consists of tax-sheltered annuities that must satisfy IRC § 403(b). These plans continue to be limited to non-profit employers and public educational institutions. As might be expected, these plans are subject to much less regulation than their 401(a) counterparts. The third group consists of IRA-based plans under IRC § 408. Although IRAs were originally intended to be substitute savings plans for individuals without an employer-sponsored plan, simplified plans using IRAs have been created. They are designed to minimize the regulatory burden on employers. Finally, there are still special plans available largely to governmental employers under IRC § 457.

Although each of these families of plans was created with its own rules, there has been some convergence over time. For example, most of the special rules for plans available to the self-employed have been repealed, and IRA-based plans are now available to employers as well as employees. In addition, some of the rigid barriers between plan families have been relaxed. Both non-profit and corporate employers may sponsor 401k plans although governmental employers may not. This convergence, however, has not resulted in much simplification because, in most respects, the plan families retain their historical structures and traditional rules. Instead, special rules and exceptions are created when the traditional rules don't fit a new situation. The result, shown in Table 1, is a vast and complex array of rules that is increasingly difficult to navigate, even by the most experienced legal practitioner. Even if employers or individuals could "easily" adopt one type of plan or another, they often feel compelled to seek out expensive advice to walk them through the maze and try to figure out if any so-called simplified plan is indeed the best plan. The rules illustrated in Table 1 include the EGTRRA changes that have become effective by 2004.

To be fair, it must be acknowledged that EGTRRA has resulted in some long overdue changes. For example, most employee savings plans – 401(k), 403(b) and 457(b) plans - are now subject to the same limits on contributions, and some anomalies such as the exclusion allowance for 403(b) plans and the coordinated contribution limit for 457(b) plans have been repealed. The limits on employer contributions to defined contribution plans have also largely been rationalized. In addition, there will soon be one less plan type to worry about as the increased deduction limits for profit-sharing plans means the rapid extinction of money purchase plans. But, of course, many of these plans will continue in existence, and even the possibility of adoption adds one more source of confusion to those considering a new plan.

EGTRRA and its predecessors have generally left the private pension system with more rules, not less, more plan types, not fewer, and more choices, even though many are not meaningful or worthwhile if and when understood. Only in a very few cases, such as the repeal of special contribution limits for 403(b)s, did some rules actually disappear. In most cases, however, new rules are just placed on top of old rules. Moreover, the private pension system has not yet felt the full brunt of EGTRRA. Rules permitting IRA contributions to non-IRA plans recently became effective, and in 2006 some plans will be allowed to provide eternal tax forgiveness of future returns as long as no up-front deduction is taken.

Given this background, isn't it a good idea to allow deemed IRA contributions to be made to non-IRA plans (thereby letting employees make these contributions directly to their employer plans rather than having to maintain a separate IRA)? Isn't it at least worthwhile to allow Roth-type contributions to employee savings plans (e.g., Roth 401(k)'s in 2006)? From a legal perspective, the answer to these questions is no and no. Adding deemed IRA contributions means adding an overlay of IRA rules to plans already overwhelmed with their own rules. Adding Roth-type contributions means adding another conflicting tax system on top of the traditional pre-tax and after-tax regimes. Both these new types of contributions mean separate vesting rules, separate distribution rules and separate record keeping and accounting requirements. EGTRRA means more, not less, legal complexity in the private pension system and imposes more, not less, of a compliance burden on employers.

EGTRRA Lays an Egg, PPSEA

According to its sponsors, PPSEA will make "the next generation of improvements to our nation's savings and pension systems" by providing "a number of important new savings tools," strengthening and expanding the employer-sponsored retirement system, offering "new protections to participants" and "assisting retirees in managing and preserving retirement assets and income". It is a massive bill with more than 200 pages and 13 lengthy sections of highly-technical changes to employee benefits law.[2]

The initial thrust of PPSEA is to accelerate and make permanent the changes in EGTRRA, now scheduled to sunset in 2010. Its immediate effect is to increase the amounts individuals could contribute to 401k-type plans and IRAs. PPSEA then winds its way through almost every aspect of the private pension system, changing, adding and deleting rules everywhere it goes. If PPSEA is enacted, the following are just a few of the major rules that will be added or changed:

- rules on vesting in defined benefit and defined contribution plans
- rules on minimum required distributions
- rules on rollovers and transfers between different types of plans
- rules on the 10% early withdrawal tax
- rules on company stock diversification
- rules on plan qualification procedures
- rules on negative contribution elections
- rules to expand non-qualified deferred compensation plans for executives
- rules to promote annuities
- rules for calculating benefits under defined benefit plans
- rules on investment blackout periods
- rules on executive compensation for tax-exempt entities.

In addition to rule changes, there are, as always, changes to plan types. This time, the emphasis is on the special plans intended for small employers that are based on simplified designs and regulations. The proposed changes are:

[2] A 28 page description of PPSEA prepared for the American Benefits Council is available at http://www.americanbenefitscouncil.org.

- the return of salary-reduction-only plans in the form of a SIMPLE plan
- the addition of more flexible matching contributions to SIMPLE 401k plans
- the addition of elective employer contributions to SIMPLE plans
- the creation of a "reverse match salary reduction arrangement simplified employee annuity" for small SEPs
- the elimination of a higher early withdrawal tax on contributions (as opposed to returns on contributions).

None of the changes is particularly evil, and many are in fact improvements in current rules. But perhaps that's not the appropriate standard for evaluating PPSEA. The important question is not whether it does some good for some people but does it help move us toward systematic reform? Why does the private pension system need major reconstructive surgery every year or so? After every extensive legal revision, it usually takes about five years before the necessary regulatory guidance to implement the new rules is available. Too frequent changes leave plans in legal limbo and the system in regulatory gridlock.

What does PPSEA mean for the structure of the private pension system? Not much that's good when it comes to simplification; the vast number of changes represents more "complication." For example, there will be eight ways - 401(k)s, 403(b)s, 457(b)s, SIMPLE 401(k)s, SIMPLE IRAs, IRAs, Roth IRAs, SIMPLEs with salary-reduction-only - for employees to save, depending on what type of employer they have. For employers, distinguishing 401(k)s from 403(b)s from SIMPLE 401(k)s or from SIMPLE IRAs will be difficult because they will outwardly look so much alike. But, as lawyers often say, this can and will be a trap for the unwary.

Depending on the plan, IRA rules will be overlaid on top of 401(a) or 403(b) or SEP or SIMPLE rules or vice versa. Each set of rules must to be satisfied but there will be so many special rules and exceptions and transition rules and historical legal quirks to navigate that compliance will be a nightmare.

Finally, giving employees options to make regular or Roth-type contributions is a nightmare. Not only does it require taxpayers to project future earnings, tax rates, and statutory changes that future Congresses might adopt, but it determines pension and budget policy in part for decades to come. What happens when a taxpayer, even assuming she can make a perfectly rational choice on the alternative offerings by the government, finds that new government rules (e.g., higher rates, lower rates, adoption of a consumption tax) means that the government reneged on what it was offering? And don't kid yourself: when eligibility for future Medicare, Medicaid, and other benefits is determined, "income" from Roth IRAs and 401(k)s should and probably will be counted, meaning that little mini-accounting systems will be required for those returns, especially if they are not listed on income tax forms because they are not taxable under the income tax itself.

Who really benefits from PPSEA? It certainly means more work for the lawyers, actuaries, consultants and accountants in the plan compliance industry, not that they need it. New regulations will have to be drafted, plans will have to be re-written and re-qualified, and administrative procedures will have to be re-programmed. PPSEA also means more assets of higher-income individuals will need to flow through an extra layer of retirement plan management, thus increasing the fees of financial services, mutual fund, and insurance companies relative to other saving. It means that wealthier Americans can get more tax benefits from savings plans sooner (because of higher limits and liberalized withdrawal rules). And there are lots of special rules and provisions for almost every large group with an interest in pensions.

But it's hard to argue that it does anything much that's constructive for the ordinary pension consumer – the not-so-large employer and the not-so-wealthy employee – from whom the higher costs of management will take a much larger share of any saving made. No one, by the way, has made any estimate that this bill would result in any increase in the percent of low- and middle-income persons who go into retirement with, say, more than $100,000.

Are ERSAs the Answer?

In 2003, the Bush Administration stunned the employee benefits community by proposing a radical pruning of employer-sponsored savings plans. It advocated replacing 401(k)s, SIMPLE 401(k)s, 403(b)s, SEPs and SIMPLE IRAs with a new, standard Employer Retirement Savings Account (ERSAs). New Retirement Savings Accounts (RSAs) modeled on today's Roth IRAs would replace individual IRAs and a new savings arrangement - Lifetime Savings Accounts (LSAs) - would be created for other types of saving. LSAs are also modeled on Roth IRAs but would have fewer rules and restrictions than either ERSAs or RSAs.

The Administration's proposals were widely criticized. Many felt that RSAs and LSAs were too generous to higher-income taxpayers.[3] Others felt that they could destabilize the private pension system because employers, particularly small business owners, would trade in their broad-based plans for personal RSAs and LSAs for themselves and their families. The Profit-Sharing/401k Council of America, for example, expressed the opinion that

> some moderate and lower income employees will make smaller, or no, contributions to LSAs and RSAs than they and their employers would have made to their qualified plans. Many employees will redirect their retirement savings to LSAs and use their accumulations for non-retirement purposes. To the extent that some employers continue to offer 401(k) plans, it may be more difficult for these plans to pass the nondiscrimination tests,

[3] For an analysis of potential LSA opportunities to game the tax system by borrowing to purchase preferred assets, see Gene Steuerle, *"Economic Perspective,"* Tax Notes Magazine, May 5, 2003.

> even as changed in the proposal. Many employees offered a 401(k) will choose instead to save in LSAs, where they will have immediate and unrestricted access to their savings.[4]

The plan compliance industry was distressed that it had not been consulted and the proposals were developed without their knowledge or cooperation. As a result, the proposals failed to find supporters or receive serious consideration.

But, in 2004, ERSAs, RSAs, and LSAs are back and they now include IDAs. This time, the Administration has been actively working with the plan compliance industry, and it shows. The 2004 proposals retain many of the simplification features of the 2003 design (many, in our view, worthy) but there are also some significant differences. Although the details of the 2004 proposals are still in flux, Table 2 illustrates the major design features of each plan as currently proposed and indicates important rule changes from the 2003 proposals.

The Administration has made RSAs and LSAs modestly less attractive by reducing the annual contribution limits by one-third, from \$7,500 to \$5,000 annually. The contribution limit applies to each account. This means that a family of five could contribute \$50,000 annually, by contributing \$5,000 to each family member's RSA and LSA. Otherwise, the accounts are little changed from last year. RSAs and LSAs are essentially Roth-IRAs, funded with after-tax contributions and largely exempt from tax thereafter. In an effort to sell these accounts for the high end of the income scale, the Administration has added something for those at the low end – an expansion of the still-experimental IDAs or individual development accounts. Low-income savers could contribute to an IDA and receive a 100% match of up to \$500 annually. Matching contributions would come indirectly from the government through private financial institutions (not employers) that would receive a 100% tax credit in return for providing the match initially.

[4] ProfitSharing/401(k) Council of America, "President's proposal will reduce the appeal of employer plans," Washington, DC, February 5, 2003, available at: http://www.psca.org/press/p2003/feb5.html.

Account assets would be available to pay for higher education, first-time home purchases and small business capitalization.

ERSAs too have been changed for 2004. If enacted, ERSAs would simplify the architecture of the private pension system. Figure 2 illustrates how ERSAs would reduce the hodgepodge of savings plans - the 401(k)s, the 403(b)s, the 457(b)s, the SIMPLE IRAs, the SARSEPs and the SIMPLE 401(k)s - that now clutter the private pension system to a single, standard plan. All 401(k) plans would become ERSAs. All other plans could become ERSAs; those that did not would be frozen as of 2005. ERSAs could also include RSAs, subject to RSA rules.

In structure, the 2004 ERSA looks much like its 2003 version. But something peculiar has happened to the simplification of major rules promised in 2003. Last year, ERSAs included substantial changes to the general non-discrimination rules. They provided a uniform and simplified definition of compensation and highly-compensated employee as well as a simplified test for coverage. They also dispensed with the top-heavy rules, integration with Social Security and cross-testing. Not this year. The 2004 proposal keeps in place the massive tangle of pseudo-mathematical rules, regulations, testing procedures, and special exceptions that characterize the non-discrimination rules for most qualified plans today.

The 2004 ERSA model offers simplified rules only for employee savings plans. ERSAs would be available to all types of employers and would permit employees to make the same type of contributions available today - pre-tax and after-tax contributions. Employers could continue to make broad-based contributions as well as matching contributions. The same taxation rules on distributions would apply. For corporate employers, the special testing rules that apply to

401(k) plans would be reduced to a single test. If non-highly compensated employees contribute 6% or less of compensation, highly-compensated employees could contribute no more than twice as much. But if non-highly compensated employees contribute more than 6%, highly-compensated employees could contribute as much as they liked, up to the annual dollar limit. But employers can avoid testing all together if they match employee contributions by 50%, up to 6% of compensation, or its equivalent. Tax-exempt employers would still be exempt from this test if their ERSAs were available to all employees, and governmental employers would continue to be exempt from any tests at all. The ability to make Roth contributions would be accelerated to 2005 (partly because the cash budget treats this as a pick-up in revenues in the short run).

Even though they are now less generous, RSAs and LSAs are likely to remain controversial. RSAs will continue to be criticized for their potential to exacerbate the intractable coverage problem in the private pension system. Even with a lower level of contributions, many employers, particularly small employers, will view RSAs and LSAs, as attractive personal substitutes for a qualified plan. With an RSA and an LSA and a non-qualified plan just for themselves and their most valued employees, they need not undertake the cost and administrative burden of a qualified plan for their employees. IDAs are an interesting addition for an under-served population but have some serious defects. It's not clear that financial institutions would be interested in the small accounts that IDAs would generate, even with the tax credit. These accounts can be expensive and difficult to market and administer so connecting them to the employer plan system in some way might make them more effective. The most important issue is whether money can be kept in the IDAs for any period of time; otherwise, the government ends up making permanent grants for no real saving.

There are merits to ERSAs that have largely been lost in the controversy over RSAs and LSAs but the 2004 model has fewer than last year. ERSAs do help rationalize the private pension system by eliminating archaic plan types. A single plan for employee savings makes sense. But there are drawbacks as well, notably the Roth-style accounts. They represent poor budget policy by pushing all costs into the future, often for decades; they add significant complication for both planning and administration when withdrawals from traditional defined benefit plans receive more traditional tax treatment; they disfavor middle-income employees who are likely to retire and move into lower tax brackets (for whom the traditional tax treatment is better); and, as noted above, other government programs are inevitably going to require income accounting for supposedly-nontaxable Roth-style account income anyway.

A major disappointment in this year's version is the backpedaling on simplifying the non-discrimination rules. These rules retain the devices – permitted disparity and cross-testing – that enable employers to shift more contributions to highly-compensated employees. So changing the rules for employee contributions so that highly-compensated employees can save even more with an ERSA hardly seems fair, even in the name of simplification.

A Compromise Proposal

PPSEA didn't pass in 2003 but it still seems likely to pass sometime soon. Almost every special interest group in the retirement benefit field has its most wanted provision in it, and the muscle of employee benefits and financial service trade associations is behind it. Some of its provisions do simplify. But the bill as a whole is so complicated, as is the subject matter, that it is unlikely to be scrutinized carefully. There will be no real debate over the broader issue of whether this is the proper direction for pension "reform" - a question that should be addressed soon before the cumulative weight of its complexity causes the private pension system to crumble.

Part of the problem is that PPSEA was designed in the unique 1997-2003 budget period, where almost every major tax or expenditure bill began to include give-aways without ever figuring out who would pay. Many of these bills were for good things, but no attention was paid to paying for the changes. Similarly, PPSEA gives away a lot without taking back much of anything. Any simplified rule, for instance, can not be seen as denying any benefit to anyone. If A gets twice what B gets, the compromise is not to give A less and B more, but to try to give B at least as much as A, and perhaps add some sweetener for A. But, unfortunately, when all is said and done, the additional revenue loss was not designed, say, to maximize an increase in coverage but was simply the aggregate of all the patches. (Obviously, we are talking about long-term costs and do not play the game of counting as revenue increases taxpayer exchanges of lower taxes in the future for higher taxes today through Roth-style exchanges.)

This year, the Administration's proposals have been more favorably received. The mutual fund industry is behind it, and the plan compliance industry may come on board too. There's even talk that the proposals, in some form, will be folded into the next version of PPSEA. Perhaps that's the most that can be expected of ERSAs. Maybe the private pension system is only capable of incremental change, and the radical reforms called for by last year's version of ERSAs will never be politically feasible.

But, if real reform were ever possible, ERSAs could be improved. Their design is appealing for its simplicity. Without adding too much complexity, they could have better coverage and discrimination standards to keep low-paid workers from being left behind or left out. Moreover, those standards should apply to all ERSAs. Keeping special rules for tax-exempt and governmental employers is an anachronism. The tax attributes of employers have no relevance for plans designed for employee savings, especially now that employee-funded plans are the primary, and often the only, source of retirement income for millions of Americans. An employee who works for a corporation should have the same opportunity to save as an employee of state government. A high-paid employee of a tax-exempt hospital should have no greater or lesser chance to save than a corporate employee with the same income. If ADP and ACP tests have succeeded in the corporate world in increasing retirement saving by low-paid employees, let's put them to work in tax-exempts and state governments too.

Another crucial reform to the ERSA proposal is to eliminate all opportunities for Roth-like contributions. As noted, they represent substantial complexity in figuring out what type of account to open, they are all back-loaded in costs and represent poor budget policy, and they add to complexity, with only one piece of that complexity related to the potential for conversions over time.

One compromise suggestion for revising ERSAs is presented in Figure 3. This proposal was originally made five years ago when ERISA turned 25.[5] At that time it didn't seem feasible for another 25 years but, thanks to EGTRRA and the Administration's proposal, it's no longer out of the realm of possibility. Like the Administration's proposal, it calls for a single, simple defined contribution plan for employee savings to replace the many varieties available today. It also calls for uniform contribution and deduction limits and rules on portability that have largely been achieved - thanks to EGTRRA. It goes beyond the Administration proposal and beyond

[5] Pamela Perun and C. Eugene Steuerle, *"ERISA AT 50,"* The Retirement Project, Occasional Paper No. 4, The Urban Institute, March 2000.

PPSEA to propose uniform Social Security treatment for contributions. And, unlike either, it ignores the tax attributes of employers when designing rules to promote employee saving.

It also avoids the issue over which the Administration's proposal has stumbled - overly-generous individual savings vehicles that compete with employer plans - by calling for an individual, coordinated limit on saving between individual and employer-sponsored vehicles. This won't solve the coverage problem; there will still be many smaller employers who will find the current IRA limits an attractive alternative to sponsoring a plan. But, unlike the Administration's RSA proposal, it will keep this plan from becoming the trojan horse of the private pension system.

Finally, it recognizes that more needs to be done than ERSA proposes to make a tax-based system an effective savings tool for low-paid workers. Without improvements in coverage, it's not clear why we want to pretend that major reform has been achieved or why we want to forego any revenues to get there. Our alternative plan suggests government matching contributions for low- and moderate-income workers, following the logic (although not necessarily the design) of the existing Small Savers' Credit. The fiscal realities facing the federal government today are very different from those of five years ago so this proposal appears much less feasible by itself from a revenue standpoint – but not if compared to the existing proposals. Three years ago, however, EGTRRA created Small Savers' Credits for low-income savers that PPSEA now proposes to expand. Instead of expanding the reach of these credits, it makes more sense to make the existing ones refundable and to attempt to figure out ways to keep the government credit in retirement solution Refundability would be fair to the majority of low-income savers who have no tax liability and provide an incentive to save that is similar to matching contributions.

This proposal is just one of many that could be made. It merely takes some good ideas, along with the best elements of EGTRRA, PPSEA and the Administration's proposals, and repackages them. At the same time, it avoids both the mind-numbing complexity of PPSEA and the camouflaged unfairness of the Administration's proposal. Its sensible design is a model for what an effective universal savings plan might look like. The private pension system doesn't need *more* innovative savings tools. It just needs one that works.

Figure 1. Available Plan Types in the Private Pension System (as of 2006)

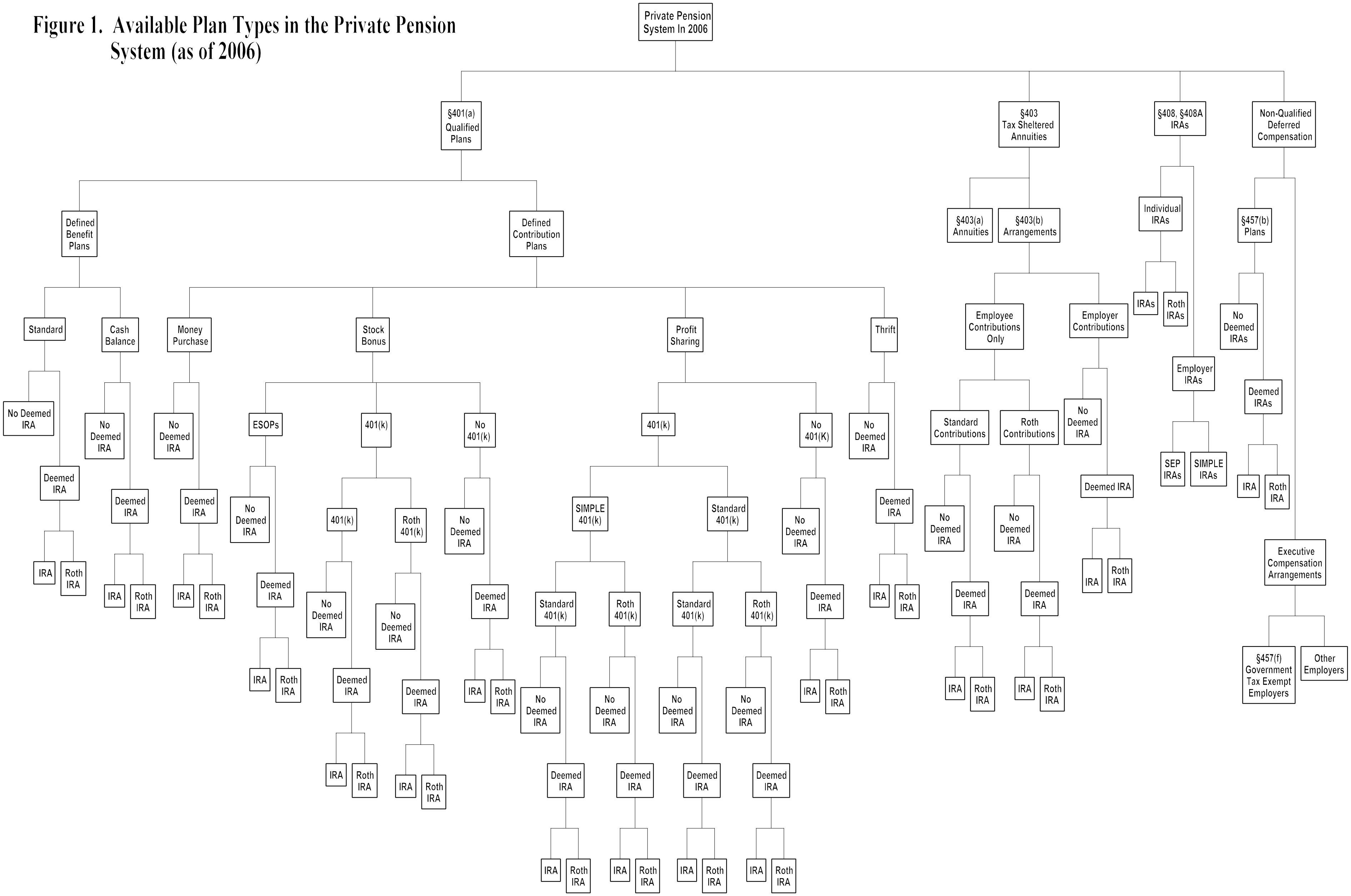

Table 1. Rules of the Private Pension System in 2004

	IRC § 401(a) Plans						IRC § 403 Arrangements
	Defined Benefit	**Money Purchase**	**Profit Sharing or Stock Bonus + Standard 401k**	**Profit Sharing or Stock Bonus + SIMPLE 401k**	**Other Profit Sharing or Stock Bonus without 401k**	**Employee Stock Ownership Plan**	**IRC § 403(b)**
Eligible employer	any employer		any employer except state & local governments	401k eligible employer with <100 employees and no other plan	any employer	corporate employer	IRC § 501(c)(3) organizations and public schools
Overall Limits	annual benefit limit = lesser of $165,000* or 100% x high 3 years' pay	annual contribution limit, per person = lesser of $41,000* or 100% of pay (1)	same as money purchase	annual contribution limit, per person =401k up to $9,000* +match	same as money purchase		same as money purchase
Pay limit	$205,000*						
Required Employer Contributions	amount for funding current + past service costs for each employee over future service OR normal costs of the plan + past service liability amortized over 10 years	amount required by plan formula	none	Match up to 3% of pay OR fixed 2% of pay contribution	none, usually		
Employee Contribution Limits	amount required by plan formula, if any	not permitted	$13,000* + $3,000* catch-up for age 50+	$9,000* + $1,500* catchup for age 50+	not permitted	none, usually	same as standard 401k

<table>
<tr><th></th><th colspan="6">IRC § 401(a) Plans</th><th>IRC § 403 Arrangements</th></tr>
<tr><th></th><th>Defined Benefit</th><th>Money Purchase</th><th>Profit Sharing or Stock Bonus + Standard 401k</th><th>Profit Sharing or Stock Bonus + SIMPLE 401k</th><th>Other Profit Sharing or Stock Bonus without 401k</th><th>Employee Stock Ownership Plan</th><th>IRC § 403(b)</th></tr>
<tr><td>Employer Deduction Limits</td><td>(lesser of (165% of current liability) or accrued liability) - (lesser of value of plan assets or their actuarial value)</td><td>contributions = 25% of aggregate employee pay</td><td>contributions (not 401k) = 25% of aggregate employee pay</td><td>greater of contributions (not 401k) = 25% of aggregate employee pay or required contribution</td><td>same as money purchase</td><td>same as money purchase plus certain dividends+ interest on loan</td><td>not applicable</td></tr>
<tr><td>Exclusion from SS Tax</td><td>yes, contributions and distributions</td><td>yes, contributions and distributions</td><td>no 401k, yes other contributions and distributions</td><td>no 401k, yes other contributions and distributions</td><td>yes</td><td>yes</td><td>no employee deferrals, yes employer contributions and distributions</td></tr>
<tr><td>10% Early Withdrawal Tax</td><td>yes</td><td>yes</td><td>yes</td><td>yes</td><td>yes</td><td>yes</td><td>yes</td></tr>
<tr><td>In-service Withdrawals</td><td colspan="2">not permitted</td><td colspan="2">financial hardship (2), minimum 2 year holding period (employer) , loans</td><td colspan="2">minimum 2 year holding period, loans</td><td>financial hardship, loans</td></tr>
<tr><td>Non-discrimination rules (not governmental plans)</td><td colspan="2">top-heavy, coverage and non-discrimination rules</td><td>ADP, ACP, top-heavy, coverage and non-discrimination rules (3)</td><td>can be exempt from top-heavy rules; no ADP, ACP or non-discrimination rules (3)</td><td colspan="2">top-heavy, coverage and non-discrimination rules</td><td>ACP for match, availability test for deferrals and non-discrimination rules (3)</td></tr>
<tr><td>Integrated with Social Security</td><td>may be</td><td>may be</td><td>may be (not 401k or match)</td><td>no</td><td>may be</td><td>no</td><td>may be</td></tr>
<tr><td>Spousal Protection</td><td colspan="2">survivor annuity, consent and death benefit rights</td><td colspan="5">only death benefit usually (5)</td></tr>
<tr><td>Vesting</td><td colspan="2">deferred</td><td>401k immediate; others deferred</td><td>immediate</td><td colspan="2">deferred</td><td>immediate for deferrals; others deferred</td></tr>
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	IRC § 401(a) Plans						IRC § 403 Arrangements
	Defined Benefit	**Money Purchase**	**Profit Sharing or Stock Bonus + Standard 401k**	**Profit Sharing or Stock Bonus + SIMPLE 401k**	**Other Profit Sharing or Stock Bonus without 401k**	**Employee Stock Ownership Plan**	**IRC § 403(b)**
Special requirements	PBGC guarantee and premium of $19 per participant	minimum funding required in full each year	Special vesting rules for matching contributions		none	forfeitures / interest payments raise annual contribution limit if ≤ 1/3 contributions are for HCEs. 100% employer securities allowed. Diversification optional at 55. Put option/ voting rights.	special catch-up contributions permitted with 15+ years of service

* means the amount is subject to adjustment for inflation or through a scheduled increase

1.The $41,000 overall dollar limit is a cumulative limit for an employee across all defined contribution plans of the same employer.

2. Financial hardship is an immediate and heavy financial need, even if foreseeable or voluntarily incurred, not satisfiable by other resources.

4. Both the Actual Deferral Percentage (ADP) test for 401k contributions and the Average Contribution Percentage (ACP) test for matching and after-tax contributions are designed to limit contributions for HCEs based on the average contributions for NHCEs.

4. The surviving spouse receives the account balance as a death benefit unless he/she has consented to another beneficiary being named.

	IRC §408, 408A IRAs				Non-qualified Deferred Compensation Plans	
	Traditional IRA	Roth IRA	SEP-IRA	SIMPLE IRA	Eligible 457(b) plans	Executive Arrangements
Eligibility	anyone	earnings less than $110,000 for individuals and $160,000 for couples (1)	any employer	employees of employers with no other plan and <100 employees	employees of state and local government and tax-exempt organizations	select group of officers or highly-compensated employees
Dollar Limit	$3,000* for all IRAs,+ $500* catchup fully deductible if no employer plan or income less than $45,000 for individuals and $65,000 for couples (2)	$3,000* for all IRAs + $500* catchup	lesser of $41,000* or 25% of pay (3)	amount of employee and employer contributions	$13,000* + $3,000* catchup	none
Maximum % of Pay	100%	100%	25%	not applicable	100%	none
Employer Contribution Limits	not applicable	not applicable	lesser of $41,000 or 25% of pay	match of up to 3% of pay or fixed 2% of pay	none	none
Employee Contribution Limits	$3,000* + $500* catchup	$3,000* + $500* catchup	not applicable	$9,000* + $1,500* catchup	lesser of $13,000* + $3,000* catchup or 100% of pay	none
Employer Deduction Limits	not applicable	not applicable	25% of aggregate pay	amount of contributions	not applicable	none
Exclusion from SS Tax	no on contribution; yes on distribution		yes on contribution and distribution	no on employee; yes on employer contribution and distribution	no on employee contribution; yes on distribution	no (except after vesting)
10% Early Withdrawal Tax	yes	usually not	yes	yes, increased to 25% in 1st 2 years	not applicable	no (unless annuity purchased)

	IRC §408, 408A IRAs				Non-qualified Deferred Compensation Plans	
	Traditional IRA	Roth IRA	SEP-IRA	SIMPLE IRA	Eligible 457(b) plans	Executive Arrangements
Early Withdrawal Tax Exceptions	medical, 1st home purchase and higher education expenses, health insurance payments for unemployed	age 59 ½ death disability 1st home purchase	same as traditional IRA	same as traditional IRA	not applicable	none (unless annuity purchased)
Withdrawals	yes, may be subject to excise tax	5-year waiting period	yes	yes	unforeseeable emergency only while employed	yes
Loans Available	no				unclear	yes
Non-discrimination rules	none	none	uniform percent of pay contribution; top-heavy rules	required employer contribution only	none	none
Pay Limit	see above		$205,000	$205,000 for 2% of pay contribution	$205,000	not applicable
Integrated with Social Security	no		may be	no	not applicable	
Spousal Protection	none under federal law, may be available under state law					
Vesting	immediate				immediate	usually deferred
Special Restrictions and Benefits	none	after-tax contributions; no tax on distributions	employer does not have to contribute every year	employees generally responsible for investments	special double contributions catch-up available during 3 years before retirement. Unfunded plan but trust requirement for public sector plans.	Taxed when paid or made available (or when vested for tax-exempts) May be DC or DB.

* means the amount is subject to adjustment for inflation or through a scheduled increase

1. The phase-out schedule for Roth IRAs is $95,000-110,000 for individuals and $150,000-160,000 for married couples filing jointly.
2. IRA phase-out schedule in 2004: $45,000-$55,000 for individuals and $65,000-$75,000 for married couples filing together. These phase-outs are scheduled to increase to $50,000-$60,000 for individuals and $80,000-$100,000 for joint filers by 2007. There are also special limits for non-working spouses.
3. The $41,000 overall dollar limit is a cumulative limit for each employee from the same employer.

Table 2. Rules for ERSAs, RSAs, LSAs and IDAs, 2003 and 2004

	EMPLOYER PLAN	EMPLOYER OR INDIVIDUAL PLAN	INDIVIDUAL PLANS	
	Employer Retirement Savings Accounts (ERSAs)	**Retirement Savings Accounts (RSAs)**	**Lifetime Savings Accounts (LSAs)**	**Individual Development Accounts (IDAs)**
Sponsor/Contributor	any employer	na	na	na
Eligibility	na	**2004:** no income limits no age limits	**2004:** no income limits no age limits	single: <$20,000 income married:<$40,000 income
Annual funding	optional: pre- and post-tax employee contributions; pre-tax employer contributions (broad-based and match)	optional - post-tax only	optional - post-tax only	individual contributions plus 100% match up to $500
Contribution Limits	employee: $13,000 + $3,000 catch-up maximum: $41,000 or 100% pay	**2003**: $7,500* or pay **2004**: $5,000 or pay	**2003:** $7,500or pay* **2004:** $5,000 or pay	?
Exclusion from SS Tax	no, employee contribution; yes, other contributions and distributions	na	na	?
Early Withdrawal Tax	probably, same as today	**2003:** non-qualified withdrawals subject to income+ penalty tax **2004:** non-qualified withdrawals in excess of contributions subject to income + penalty tax **2004:** 5 year holding period for conversions from ERSAs or traditional IRAs to avoid 10% penalty	no	?
In-service / qualified withdrawals	probably, same as today	after age 58, death, disability	any amount, any time	higher education, 1st time home purchase, small business capitalization

	EMPLOYER PLAN	EMPLOYER OR INDIVIDUAL PLAN	INDIVIDUAL PLANS	
	Employer Retirement Savings Accounts (ERSAs)	**Retirement Savings Accounts (RSAs)**	**Lifetime Savings Accounts (LSAs)**	**Individual Development Accounts (IDAs)**
Non-discrimination rules	**2003:** no top-heavy rules, must have 70% coverage of NHCEs in plan, no integration or cross-testing. **2004:** current minimum coverage, top-heavy, integration, cross-testing rules still apply. No ACP or ADP. If NHCEs' contributions (employer and employee) average <6% of pay, HCE contributions limited to 200% of NCHE contribution, otherwise no limit. Design safe harbors if NHCEs get vested contributions of 3% of pay. **2004:** If 50% vested match up to 6% of pay, no testing. Special rules for government and non-profit employers.	na	na	na
Integrated with Social Security	**2003:** no **2004:** yes	na	na	na
Spousal Protection	?	?	?	?
Vesting	immediate for employee contributions; deferred for others?	na	na	na
Special features	Consolidates 401(k), SIMPLE 401(k), 403(b), governmental 457(b)s, SARSEPs, SIMPLE IRAs. **2003:** uniform definition of HCE and compensation : HCE = pay > taxable wage base; compensation = W-2 pay + elective deferrals. **2004:** no uniform definition of HCE or compensation. Roth treatment for after-tax contributions and distributions; current rules for employee and employer contributions	Existing IRAs frozen but taxable IRAs could be converted (no income limits). Roth treatment for contributions and distributions. **2004:** some withdrawal exceptions to be eliminated. No minimum distribution rules.	Roth treatment for contributions and distributions No minimum distribution rules. Can convert Coverdell accounts and 529 plans but not health savings accounts or medical savings accounts.	Sponsoring financial institutions get 100% tax credit for match plus $50 per account credit for administrative expenses.

Figure 2. Savings Plans in 2005?

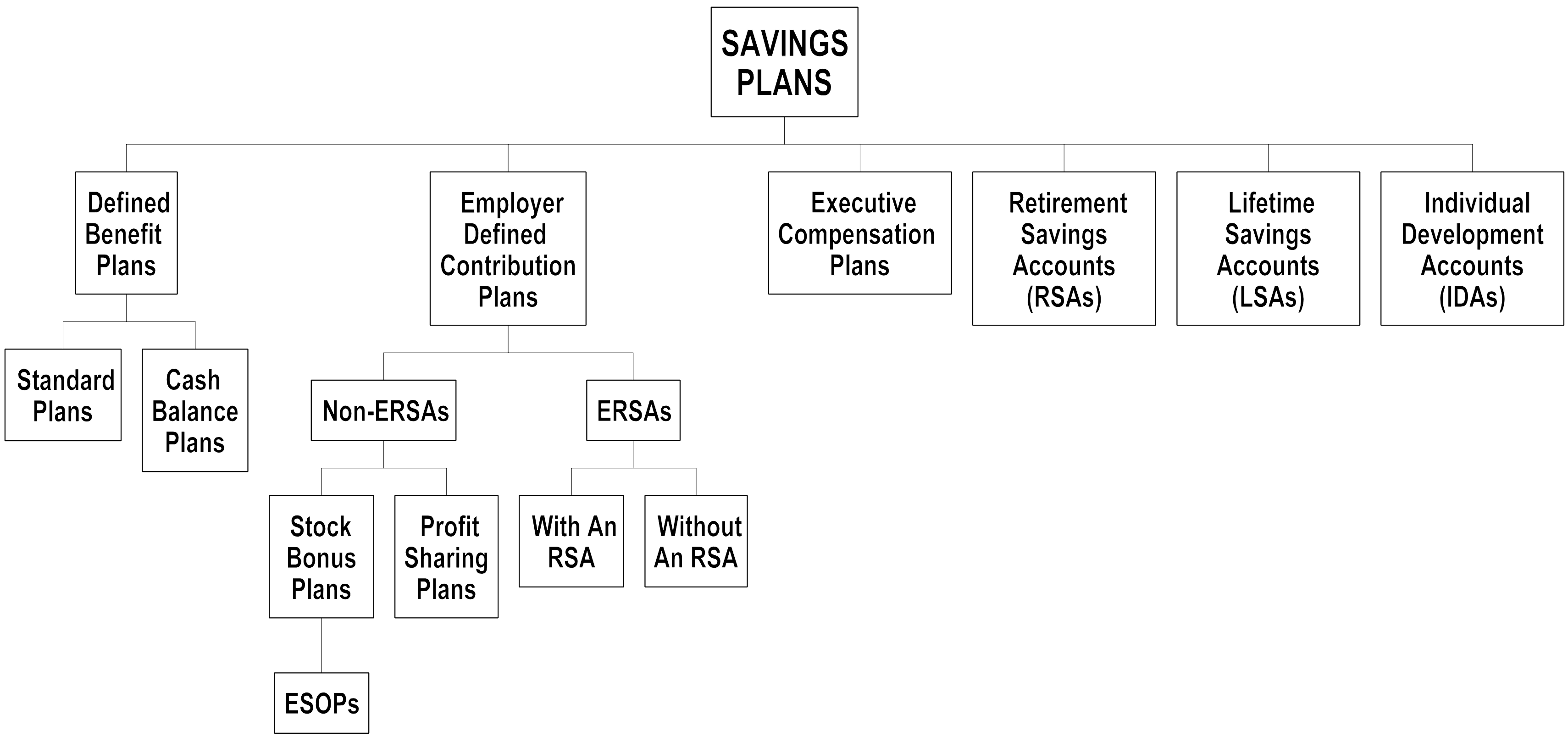

Figure 3: A Compromise Proposal