

November 7, 2005

Federal Update 2005-35

TO: NCTR Members
FROM: Cindie Moore, Washington Counsel
RE: Federal Tax Panel Proposal; Re-Opening of 401(k)s to Governments;
Social Security Information

President's Advisory Panel on Federal Tax Reform Releases Report on 11/1

The panel recommended changes to virtually all aspects of the Federal Internal Revenue Code, including the treatment of retirement plans and savings accounts. Proposals of interest to NCTR members include:

- Merging 403(b)s and 457s with 401(k)s;
- Consolidating existing IRAs, Roth IRAs, and non-deductible IRAs into a single retirement account; and
- Combining into one type of account the various tax-favored vehicles for health care and education savings.

The panel also proposed eliminating the deductibility of state and local taxes; changing the taxation of Social Security benefits; curtailing the tax preference for home mortgage interest; and shifting the tax-preferred treatment of health insurance from employers to individuals and limiting it to an amount based on an average annual premium (unlike under current law, where virtually no restrictions on the tax preference exist).

The retirement and savings proposals draw on ideas from the Administration, but with new names as the following chart illustrates.

Current Law	Administration Proposal	Panel Proposal
Various existing plans, e.g., 403(b)s, 457s, and 401(k)s	Employer Retirement Savings Accounts (ERSAs)	Save at Work Accounts
Various IRAs	Retirement Savings Accounts (RSAs)	Save for Retirement Accounts
Various Health and Education Accounts	Lifetime Savings Accounts (LSAs)	Save for Family Accounts

The panel actually proposed two alternate plans: the Simplified Income Tax Plan (SITP) and the Growth and Investment Tax Plan (GITP). They are similar, but not identical. Differences exist in the tax treatment of dividends, capital gains received, and interest received as well as in the treatment of businesses. They also have other variations. The SITP would treat the Save at Work Accounts as pre-tax, so that participants would not be taxed on contributions, but withdrawals. By contrast, the GITP would incorporate the Roth-style feature in which participants make after-tax contributions, but pay no tax on the interest earnings when they withdraw the funds. With respect to the Save for Retirement Accounts and the Save for Family Accounts, both the SITP and the GITP would provide tax treatment similar to that for Roth IRAs.

The Save at Work Accounts have “auto” features to enhance workers’ savings. The features are voluntary – an employer need not provide them. If adopted, the employee would have the chance to opt out of any or all of them. The automatic features are:

- enrollment at hiring;
- increase in contribution over time;
- default investment in balanced, diversified funds; and
- rollover upon leaving a job.

The panel proposed no changes in defined benefit plans. A summary of the panel’s recommendations on retirement plans and savings accounts appears in the following chart.

Type of Plan	Proposed Change
Defined Contribution Plans	Consolidated into Save at Work plans*
Defined Benefit Plans	No change
Retirement Savings Plans	Replaced with Save for Retirement Accounts (\$10,000 annual limit); available to all taxpayers
Education Savings Plans	Replaced with Save for Family Accounts (\$10,000 annual limit); would cover education, medical, new home costs, and retirement saving needs; available to all taxpayers; refundable Saver’s Credit available to low-income taxpayers
Health Savings Plans	See Education Savings Plans

* The annual limits on the Save at Work Accounts would be the same as the current caps on 401(k)s.

The reaction on Capitol Hill has been cautious interest. The Chairmen of the House and Senate tax-writing committees both said they intend to look at the recommendations.

Sen. Thomas Proposes Re-Opening of 401(k)s for State and Local Governments

At the behest of Senator Craig Thomas (R-WY), S. 1783, the Pension Security and Transparency Act, may be amended to incorporate the re-opening of 401(k)s for state and local governments. The Tax Reform Act of 1986 closed the availability of such plans, but any jurisdiction that had authorized a plan before the Act's effective date was grandfathered.

Unlike previous proposals to re-open the plans, Senator Thomas' provision does not require state and local governments to close down existing 403(b)s and 457s as the price for adopting 401(k)s. The provision has, as we understand it, a coordination rule for the annual contribution limits. Under the rule, if a jurisdiction offered all three types of plans, an individual could not make the maximum annual contribution to each plan, but rather would be limited to contributions that did not exceed the limit for a single plan. The provision does not appear to apply to the existing coordination rule, however. The existing rule allows participants in both 403(b)s and 457s to contribute the maximum allowable annual amount to both plans. Thus, if a jurisdiction did not adopt a 401(k), the coordination rule that allows the maximum contribution to both a 403(b) and a 457 would apply. If, however, a jurisdiction adopted a 401(k), the new coordination rule would apply, i.e., that an individual could not exceed the maximum contribution in effect for a single plan.

S. 1783, which includes several provisions for governmental plans, has stalled over private plan funding issues. Congress is concentrating on the reconciliation bill, part of the budget process, and S. 1783 may not come up for some time. By the way, the reconciliation bill contains some pension items, but relating to private plan funding only.

Social Security 2006 Information Available on NCTR's Website

I've posted as Federal Update 2005-34 a fact sheet about next year's Social Security COLA and other information. Click here for the link:
http://www.nctr.org/pdf/fedupd2005_34.pdf