

**TECHNICAL EXPLANATION OF THE
“JOB CREATION AND WORKER ASSISTANCE ACT OF 2002”**

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JOINT COMMITTEE ON TAXATION



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Pension-Related Amendments to the Economic Growth and Tax Relief Reconciliation Act of 2001

Individual Retirement Arrangements (“IRAs”).-- Under the Act, a qualified employer plan may provide for voluntary employee contributions to a separate account that is deemed to be an IRA. The provision clarifies that, for purposes of deemed IRAs, the term “qualified employer plan” includes the following types of plans maintained by a governmental employer: a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-sheltered annuity plan under section 403(b), and an eligible deferred compensation plan under section 457(b). The provision also clarifies that the Employee Retirement Income Security Act (“ERISA”) is intended to apply to a deemed IRA in a manner similar to a simplified employee pension (“SEP”).

Increase in benefit and contribution limits.--Under the Act, the benefit and contribution limits that apply to qualified retirement plans are increased. These increases are generally effective for years beginning after December 31, 2001, but the increase in the limit on benefits under a defined benefit plan is effective for years ending after December 31, 2001. In the case of some plans that incorporate the benefit limits by reference and that use a plan year other than the calendar year, the increased benefit limits became effective under the plan automatically, causing unintended benefit increases. The provision permits an employer to amend such a plan by June 30, 2002, to reduce benefits to the level that applied before enactment of the Act without violating the anticutback rules that generally apply to plan amendments.

In connection with the increases in the benefit and contribution limits under the Act, a new base period applies in indexing the 2002 dollar amounts for future cost-of-living adjustments. The same indexing method applies to the dollar amounts used to determine eligibility to participate in a SEP and to determine the proper period for distributions from an employee stock ownership plan (“ESOP”). The provision changes these dollar amounts to the 2002 indexed amounts so that future indexing will operate properly.

Modification of top-heavy rules.--Under the Act, in determining whether a plan is top-heavy, distributions made because of separation from service, death, or disability are taken into account for one year after distribution. Other distributions are taken into account for five years. The Act also permits distributions from a section 401(k) plan, a tax-sheltered annuity plan, or an eligible deferred compensation plan to be made when the participant has a severance from employment (rather than separation from service). The provision clarifies that distributions made after severance from employment (rather than separation from service) are taken into account for only one year in determining top-heavy status.

Elective deferrals not taken into account for deduction limits.--The provision clarifies that elective deferrals to a SEP are not subject to the deduction limits and are not taken into account in applying the limits to other SEP contributions. The provision also clarifies that the combined deduction limit of 25 percent of compensation for qualified defined benefit and defined contribution plans does not apply if the only amounts contributed to the defined contribution plan are elective deferrals.

Deduction limits.--Under present law, contributions to a SEP are included in an employee's income to the extent they exceed the lesser of 15 percent of compensation or \$40,000 (for 2002), subject to a reduction in some cases. Under prior law, the annual limitation on the amount of deductible contributions to a SEP was 15 percent of compensation. Under the Act, the annual limitation on the amount of deductible contributions that can be made to a SEP is increased from 15 percent of compensation to 25 percent of compensation. The provision makes a conforming change to the rule that limits the amount of SEP contributions that may be made for a particular employee. Under the provision, contributions are included in an employee's income to the extent they exceed the lesser of 25 percent of compensation or \$40,000 (for 2002), subject to a reduction in some cases.

Under present law, the Secretary of the Treasury has the authority to require an employer who makes contributions to a SEP to provide simplified reports with respect to such contributions. Consistent with present law and the provision, such reports could appropriately include information as to compliance with the requirements that apply to SEPs, including the contribution limits.

Nonrefundable credit for certain individuals for elective deferrals and IRA contributions.--The provision clarifies that the amount of contributions taken into account in determining the credit for elective deferrals and IRA contributions is reduced by the amount of a distribution from a qualified retirement plan, an eligible deferred compensation plan, or a traditional IRA that is includible in income or that consists of after-tax contributions. The provision retains the rule that distributions that are rolled over to another retirement plan do not affect the credit.

Small business tax credit for new retirement plan expenses.--The provision clarifies that the small business tax credit for new retirement plan expenses applies in the case of a plan first effective after December 31, 2001, even if adopted on or before that date.

Additional salary reduction catch-up contributions.--Under the Act, an individual aged 50 or over may make additional elective deferrals ("catch-up contributions") to certain retirement plans, up to a specified limit. A plan may not permit catch-up deferrals in excess of this limit. The provision clarifies that, for this purpose, the limit applies to all qualified retirement plans, tax-sheltered annuity plans, SEPs and SIMPLE plans maintained by the same employer on an aggregated basis, as if all plans were a single plan. The limit applies also to all eligible deferred compensation plans of a government employer on an aggregated basis.

Under the Act, catch-up contributions up to the specified limit are excluded from an individual's income. The provision also clarifies that the total amount that an individual may exclude from income as catch-up contributions for a year cannot exceed the catch-up contribution limit for that year (and for that type of plan), without regard to whether the individual made catch-up contributions under plans maintained by the more than one employer.

The provision clarifies that an individual who will attain age 50 by the end of the taxable year is an eligible participant as of the beginning of the taxable year rather than only at the attainment of age 50. The provision also clarifies that a participant in an eligible deferred compensation plan of a government employer may make catch-up contributions in an amount

equal to the greater of the amount permitted under the new catch-up rule and the amount permitted under the special catch-up rule for eligible deferred compensation plans.

The provision revises the lists of requirements that do not apply to catch-up contributions to reflect other statutory amendments made by the Act and to reflect the fact that catch-up contributions can be made only to a qualified defined contribution plan, not to a qualified defined benefit plan. The provision also clarifies that the special nondiscrimination rule for mergers and acquisitions applies for purposes of the nondiscrimination requirement applicable to catch-up contributions.

Equitable treatment for contributions of employees to defined contribution plans.--

Under prior law, the limits on contributions to a tax-sheltered annuity plan applied at the time contributions became vested. Under the Act, tax-sheltered annuity plans are generally subject to the same contribution limits as qualified defined contribution plans, but certain special rules were retained.

The provision clarifies that the limits apply to contributions to a tax-sheltered annuity plan in the year the contributions are made without regard to when the contributions become vested. The provision also clarifies that contributions may be made for an employee for up to five years after retirement, based on includible compensation for the last year of service before retirement. The provision also restores special rules for ministers and lay employees of churches and for foreign missionaries that were inadvertently eliminated.

Under the Act, amounts deferred under an eligible deferred compensation plan are generally subject to the same contribution limits as qualified defined contribution plans. The provision conforms the definition of compensation used in applying the limits to an eligible deferred compensation plan to the definition used for defined contribution plans.

Rollovers of retirement plan and IRA distributions.-- Under prior law and under the Act, a qualified retirement plan must provide for the rollover of certain distributions directly to a qualified defined contribution plan, a qualified annuity plan, a tax-sheltered annuity plan, a governmental eligible deferred compensation plan, or a traditional IRA, if the participant elects a direct rollover. The provision clarifies that a qualified retirement plan must provide for the direct rollover of after-tax contributions only to a qualified defined contribution plan or a traditional IRA. The provision also clarifies that, if a distribution includes both pretax and after-tax amounts, the portion of the distribution that is rolled over is treated as consisting first of pretax amounts.

Employers may disregard rollovers for purposes of cash-out amounts.-- Under prior and present law, if a participant in a qualified retirement plan ceases to be employed with the employer maintaining the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed \$5,000. Under the Act, a plan may provide that the present value of the benefit is determined without regard to the portion of the benefit that is attributable to rollover contributions (and any earnings allocable thereto) for purposes of determining whether the participant must consent to the cash-out of the benefit. The provision

clarifies that rollover amounts may be disregarded also in determining whether a spouse must consent to the cash-out of the benefit.

Notice of significant reduction in plan benefit accruals.-- Under the Act, notice must be provided to participants if a defined benefit plan is amended to provide for a significant reduction in the future rate of benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy. The provision clarifies that the notice requirement applies to a defined benefit plan only if the plan is qualified. The provision further clarifies that, in the case of an amendment that eliminates an early retirement benefit or retirement-type subsidy, notice is required only if the early retirement benefit or retirement-type subsidy is significant. The provision also eliminates inconsistencies in the statutory language.

Modification of timing of plan valuations.-- Under the Act, a plan valuation may be made as of any date in the immediately preceding plan year if, as of such date, plan assets are not less than 100 percent of the plan's current liability. Under the Act, a change in funding method to use a valuation date in the prior year generally may not be made unless, as of such date, plan assets are not less than 125 percent of the plan's current liability. The provision conforms the statutory language to Congressional intent as reflected in the Statement of Managers.

ESOP dividends may be reinvested without loss of dividend deduction.-- Under prior and present law, a deduction is permitted for a dividend paid with respect to employer stock held in an ESOP if the dividend is (1) paid in cash directly to participants or (2) paid to the plan and subsequently distributed to the participants in cash no later than 90 days after the close of the plan year in which the dividend is paid to the plan. The deduction is allowable for the taxable year of the corporation in which the dividend is paid or distributed to the participants.

Under the Act, in addition to the deductions permitted under present law, a deduction is permitted for a dividend paid with respect to employer stock that, at the election of the participants, is payable in cash directly to participants or paid to the plan and subsequently distributed to the participants in cash no later than 90 days after the close of the plan year in which the dividend is paid to the plan, or paid to the plan and reinvested in qualifying employer securities. Under the provision, the deduction for dividends that are reinvested in qualifying employer securities at the election of participants is allowable for the taxable year in which the later of the reinvestment or the election occurs. The provision also clarifies that a dividend that is reinvested in qualifying employer securities at the participant's election must be nonforfeitable.

Amendments to the Community Renewal Tax Relief Act of 2000

Phaseout of \$25,000 amount for certain rental real estate under passive loss rules.-- Present law provides for a phaseout of the \$25,000 amount allowed in the case of certain deductions and certain credits with respect to rental real estate activities, for taxpayers with adjusted gross income exceeding \$100,000. The phaseout rule does not apply, or applies separately, in the case of the rehabilitation credit, the low-income housing credit, and the commercial revitalization deduction. The provision clarifies the operation of the ordering rules to reflect the exceptions and separate phaseout rules for these items.