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Update

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Summary of President's Pension and Savings Proposal

The President's FY 2004 budget contains a proposal that would dramatically change individual retirement accounts (IRAs) and employer sponsored defined contribution plans. The proposal consists of replacing IRAs with Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs). It also calls for combining 401(k)s, 403(b)s, 457s, and similar plans into Employer Retirement Savings Accounts (ERSAs). The full text of the proposal appears below.

Under an LSA, an individual can save up to \$7,500 each year (tied to inflation in future years). Anyone can contribute, regardless of age or income. The funds can be withdrawn at any time.

As with LSAs, an individual can save up to \$7,500 each year (also indexed) in an RSA. LSAs and RSAs differ in other ways, however. First, an individual cannot contribute to an RSA an amount during a year that is greater than his/her annual wages. Second, an individual may only withdraw funds without penalty from an RSA after age 58 (or at any age if disabled). A tax-free distribution is also made after the individual's death.

Under LSAs and RSAs, individuals make contributions on an after-tax basis. In other words, no tax deduction for contributions exists. Individuals can withdraw the funds and any earnings tax-free (subject to the limitations explained above applicable to RSAs). Thus, the tax treatment of LSAs and RSAs is very similar to that applicable to Roth IRAs.

ERSAs follow the basic existing rules for 401(k) plans, but in a simplified manner. They replace 401(k)s, 403(b)s, 457s, and similar plans. Any employer can sponsor an ERSA. The contribution limits under current law are retained (e.g., in 2003, contributions up to \$12,000 allowed and individuals age 50 and over could defer an additional \$2,000). The right of an eligible individual under current law to contribute to both a 403(b) and a 457 is eliminated. The proposal also ends the special catch-ups for 403(b)s and 457s. The proposal does not apply to defined benefit plans.

The President's proposal effectively freezes in place existing deductible IRAs because no new contributions after 2003 are allowed into them. Likewise, no new contributions after 2003 are allowed into 403(b)s, 401(k)s, 457s, and similar plans.

Bill Sweetnam, Benefits Tax Counsel, Department of the Treasury, reports that the proposal grew out of a general effort to simplify tax and pension rules. He points out that a variety of retirement savings plans exist and all have different rules. The goal of the proposal, he says, is to harmonize the plans.