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 diametrically opposed proposals for change before Congress. The first is the Pension Preservation and Savings Expansion Act of 2003 recently introduced 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 the Administration's attempt at radical change and simplification. Its proposal contemplates a sweeping consolidation in the number and types of defined contribution plans. This paper evaluates these two approaches - one evolutionary, the other revolutionary - and then considers an alternative.

Analyses of the private pension system typically focus on such issues as how to improve

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

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. It examines the nuts-and-bolts of the private pension system, that is, 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 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 2003.

To be fair, it must be acknowledged that EGTRRA has resulted in some long overdue changes. For example, most employee savings plans - 401k, 403b and 457 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 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 403bs, 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. This year, rules permitting IRA contributions to non-IRA plans become 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. 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 401k'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 in 2004. 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:

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[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 leaves 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 - 401ks, 403bs, 457s, SIMPLE 401ks, 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 401ks from 403bs from SIMPLE 401ks 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 401a or 403b 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 some of pension and budget policy 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?

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. 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.

Are ERSAs the Answer?

Earlier this year, the Bush Administration stunned the employee benefits community by proposing a radical pruning of employer-sponsored savings plans. Under this plan, 401ks, SIMPLE 401ks, 403bs, SEPs and SIMPLE IRAs would be replaced by a new, standard

Employer Retirement Savings Account (ERSAs). Individual IRAs would be replaced with new Retirement Savings Accounts (RSAs) modeled on today's Roth IRAs. In addition, 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.[3]

If enacted, the architecture of the private pension system would be fundamentally changed. Figure 2 suggests how the ERSA pension system might look. In terms of employer-sponsored plans, the system has an appealing simplicity after having been stripped of the hodgepodge of savings plans - the 401ks, the 403bs, the 457s, the SIMPLE IRAs, the SARSEPs and the SIMPLE 401ks - that now clutter it. The structure might be further collapsed if ERSAs could be a component within any of the remaining defined contribution plan types, much as is done today with 401k plans.

The reduction in plan types has also stripped away many plan rules. The Administration's proposal has described some of the rules that would apply to ERSAs which are illustrated in Table 2. ERSAs would be available to all types of employers and would have simplified qualification requirements. ERSAs would permit employees to make the same type of contributions that are available today - pre-tax and after-tax contributions - and the same taxation rules on distribution would apply. For corporate employers, a simplified non-discrimination test for contributions would apply as well as a safe harbor. Tax-exempt employers would retain their availability rule as a non-discrimination test and governmental employers would continue to be exempt from any non-discrimination rules. Matching contributions would be permitted, and the ability to make Roth contributions would be accelerated to 2004. There would be a uniform and

[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.

simplified definition of compensation and highly-compensated employee and a simplified test for coverage. Finally, neither integration with Social Security nor cross-testing would be permitted.

The merits of ERSAs have largely been lost in the controversy over the remainder of the proposal: the creation of RSAs and LSAs. RSAs have been rightly criticized for their potential to exacerbate the intractable coverage problem in the private pension system. Many employers, particularly small employers, will view the expanded contributions and Roth treatment available under RSAs, as well as under the companion 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. We do not deal further with RSAs and LSAs here. They have pretty much been abandoned already. But we would like to retain many of the potential gains from ERSAs – with the major exception of Roth-style accounts that represent poor budget policy by pushing all costs into the future, often for decades.

A Compromise Proposal

Prospects for passage of PPSEA are good, if not this year, then soon. It has the most wanted provision of almost every special interest group in it and the muscle of employee benefits and financial service trade associations behind it. The bill itself is so complicated, as is the subject matter, that it is unlikely to be scrutinized carefully. There will be no real debate about 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.

At the present time, the Administration proposal appears to be dead, although its ERSA component might be resurrected as an alternative to some of PPSEA's complexity. But ERSAs too must be improved. Their design is appealing for its simplicity but, 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 chance to save than a corporate employee. If ADP and ACP tests succeed 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 the potential for conversions over time require an economist and accountant each year to figure out when and if to so act.

One compromise suggestion for revising ERSAs is presented in Figure 3. This proposal was originally made four years ago when ERISA turned 25.[4] 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

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

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 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. The fiscal realities facing the federal government today are very different from those of four years ago so this proposal appears much less feasible. Two years ago, however, EGTRRA enacted a system of tax 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. This 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)

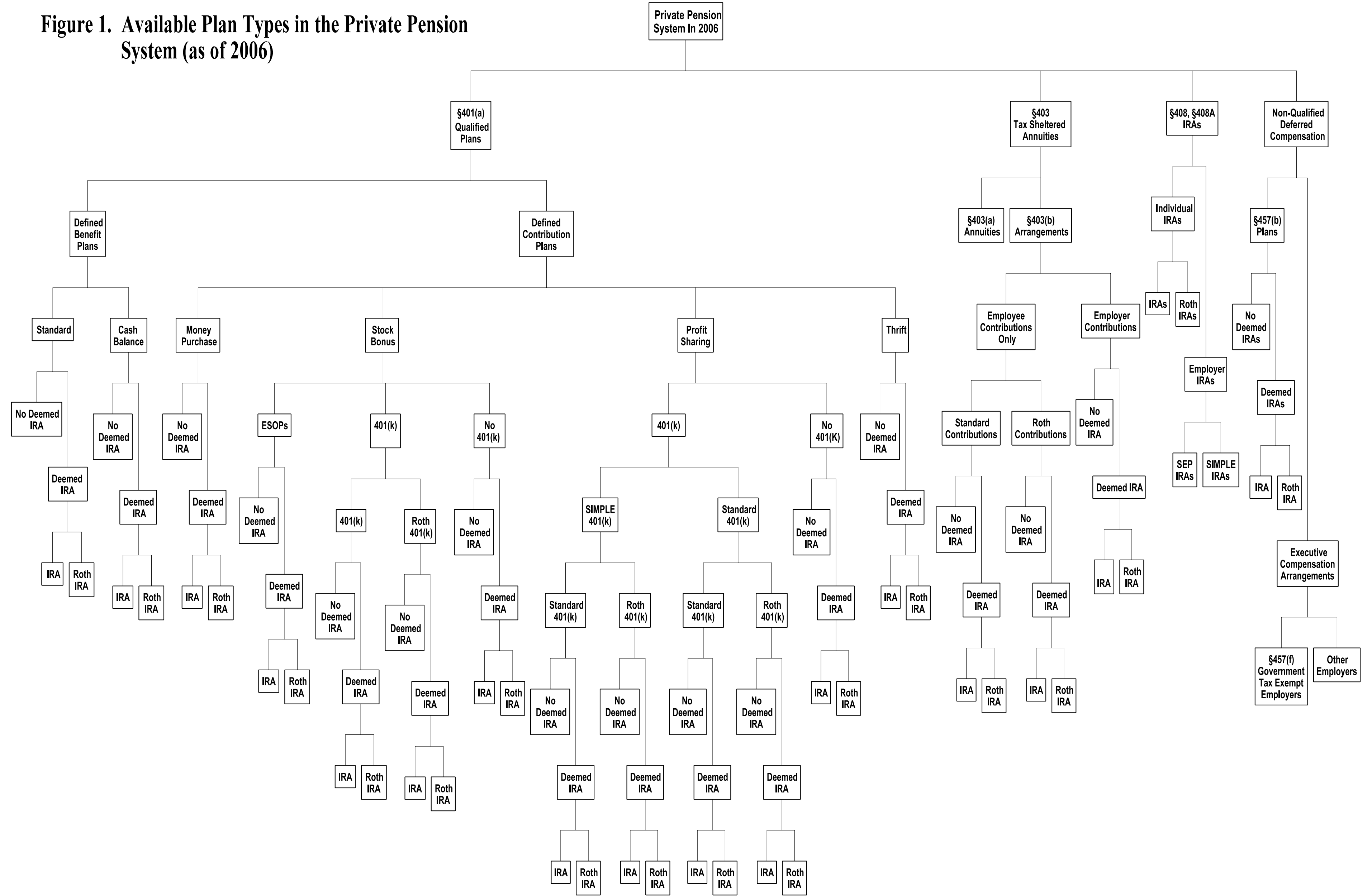

Table 1. Rules of the Private Pension System in 2003

	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 $160,000* or 100% x high 3 years' pay	annual contribution limit, per person = lesser of $40,000* or 100% of pay (1)	same as money purchase	annual contribution limit, per person =401k up to $8,000* +match	same as money purchase		same as money purchase
Pay limit	$200,000*						
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	$12,000* + $2,000* catch-up for age 50+	$8,000* + $1,000* catchup for age 50+	not permitted	none, usually	same as standard 401k
Employer Deduction Limits	(lesser of (165% of current liability) or accrued liability) - (lesser of value of plan assets or their actuarial value)	contributions = 25% of aggregate employee pay	contributions (not 401k) = 25% of aggregate employee pay	greater of contributions (not 401k) = 25% of aggregate employee pay or required contribution	same as money purchase	same as money purchase plus certain dividends+ interest on loan	not applicable

	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)**
Exclusion from SS Tax	yes, contributions and distributions	yes, contributions and distributions	no 401k, yes other contributions and distributions	no 401k, yes other contributions and distributions	yes	yes	no employee deferrals, yes employer contributions and distributions
10% Early Withdrawal Tax	yes	yes	yes	yes	yes	yes	yes
In-service Withdrawals	not permitted		financial hardship (2), minimum 2 year holding period (employer) , loans		minimum 2 year holding period, loans		financial hardship, loans
Non-discrimination rules (not governmental plans)	top-heavy, coverage and non-discrimination rules		ADP, ACP, top-heavy, coverage and non-discrimination rules (3)	can be exempt from top-heavy rules; no ADP, ACP or non-discrimination rules (3)	top-heavy, coverage and non-discrimination rules		ACP for match, availability test for deferrals and non-discrimination rules (3)
Integrated with Social Security	may be	may be	may be (not 401k or match)	no	may be	no	may be
Spousal Protection	survivor annuity, consent and death benefit rights		only death benefit usually				
Vesting	deferred		401k immediate; others deferred	immediate	deferred		immediate for deferrals; others deferred
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 raise contribution limit if ≤ 1/3 are for HCEs, 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 $40,000 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.

3. 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 $40,000 for individuals and $60,000 for couples (2)	$3,000* for all IRAs + $500* catchup	lesser of $40,000* or 25% of pay (3)	amount of employee and employer contributions	$12,000* + $2,000* catchup	none
Maximum % of Pay	100%	100%	25%	not applicable	100%	none
Employer Contribution Limits	not applicable	not applicable	lesser of $40,000 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	$8,000* + $1,000* catchup	lesser of $12,000* + $2,000* 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	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		$200,000	$200,000 for 2% of pay contribution	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.

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 2003: $40,000-$50,000 for individuals and $50,000-$70,000 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 $40,000 overall dollar limit is a cumulative limit for each employee from the same employer.

Figure 2. The Private Pension System with ERSAs, RSAs and LSAs

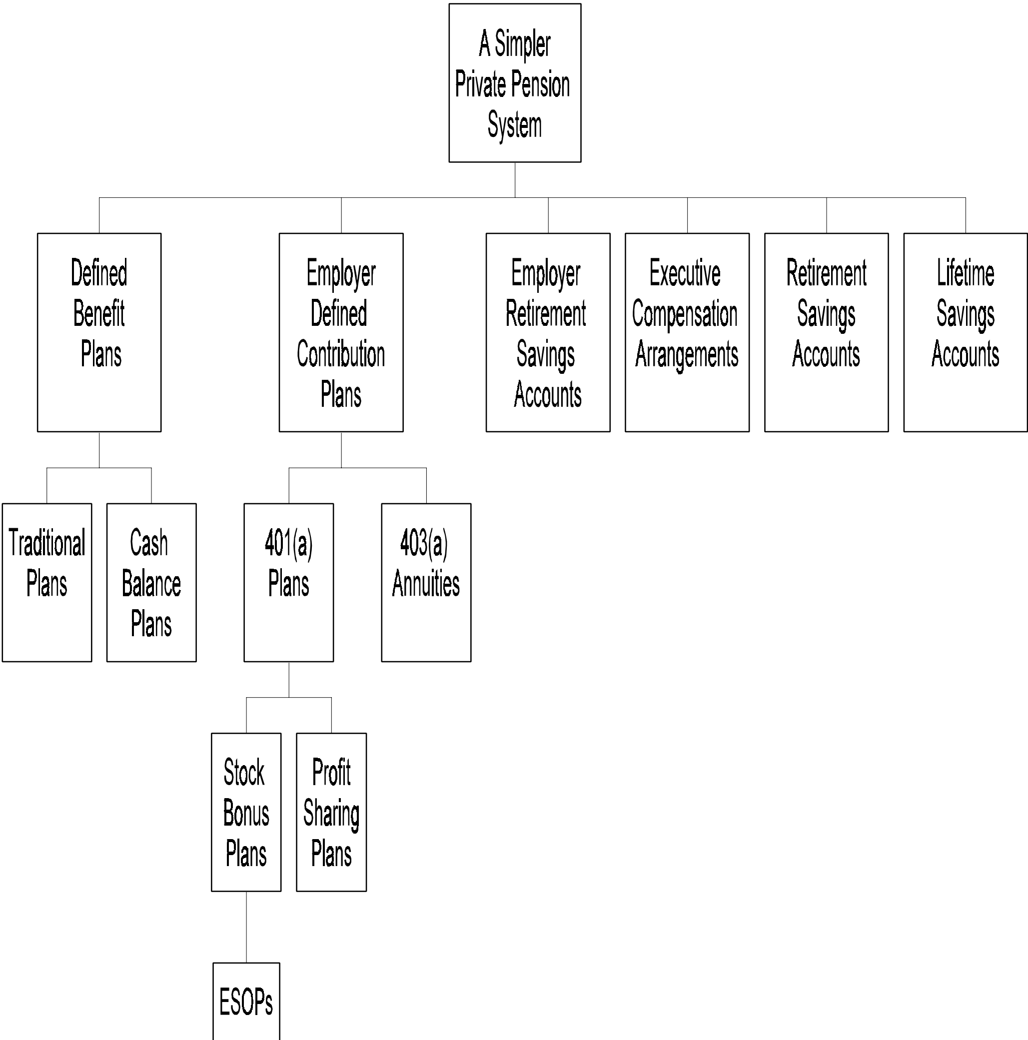

Table 2. Rules of the Private Pension System with ERSAs, RSAs and LSAs

	EMPLOYER PLANS				INDIVIDUAL PLANS	
	Defined Benefit	**Profit-Sharing or Stock Bonus**	**ESOPs**	**Employer Retirement Savings Accounts (ERSAs)**	**Retirement Savings Accounts (RSAs)**	**Lifetime Savings Accounts (LSAs)**
Eligible Employer	any employer	any employer	corporate employer	any employer	na	na
Overall Limits	annual benefit limit = lesser of $160,000* or 100% x high 3 years' pay	annual contribution limit = lesser of $40,000* or 100% of pay	annual contribution limit = lesser of $40,000* or 100% of pay	annual contribution limit = lesser of $40,000* or 100% of pay	<$7,500 or pay	$7,500*[1]
Pay limit	$200,000*			?	see above	none
Annual funding	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	discretionary	discretionary unless leverage	optional: permits pre- and post-tax contributions	optional	optional
Individual Limits	na	same as overall limits		$12,000* + $2,000* catch-up	<$7,500* or pay	$7,500*
Deduction Limits	based on funding requirement	25% of aggregate pay	25% of aggregate	25% of aggregate pay ?	after-tax contributions only	after-tax contributions only
Exclusion from SS Tax	yes, contributions and distributions			no on employee contribution, yes other contributions and distributions	na	na
Early Withdrawal Tax	yes				non-qualified withdrawals subject to income tax on earnings + extra tax	no

[1]Anyone can contribute to another person's LSA up to the individual $7,500 limit. The $7,500 limit also applies to the contributions to any one account in a given year.

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

	EMPLOYER PLANS				INDIVIDUAL PLANS	
	Defined Benefit	**Profit-Sharing or Stock Bonus**	**ESOPs**	**Employer Retirement Savings Accounts (ERSAs)**	**Retirement Savings Accounts (RSAs)**	**Lifetime Savings Accounts (LSAs)**
In-service / qualified withdrawals	not allowed	financial hardship, minimum 2 year holding period, loans	minimum 2 year holding period, loans	?	after age 58, death, disability	any amount, any time
Non-discrimination rules (not governmental plans)	top-heavy, coverage and non-discrimination rules			no top-heavy rules, must have 70% coverage of NHCEs in plan, no cross-testing, 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. Special rules for government and non-for-profit employers.	na	na
Integrated with Social Security	may be		no	no	na	na
Spousal Protection	survival annuity, consent and death benefit rights	death benefit rights		?	?	?
Vesting	deferred			immediate for employee contributions, deferred for others?	na	na
Special features	PBGC guarantee and premium of $19 per participant			Uniform definition of compensation: W-2 compensation + elective deferrals. HCE = pay > taxable wage base. 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) and taxes paid over 4 years. Roth treatment for contributions and distributions	Roth treatment for contributions and distributions

Figure 3: A Compromise Proposal