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Legislative Bulletin……………………………….……….………July 28, 2006

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H.R. 4—Pension Protection Act

H.R. 4—Pension Protection Act (Boehner, R-OH)

Order of Business: H.R. 4 is scheduled to be considered on Friday, July 28th, subject to a closed rule. Note: this bill contains the same pension language agreed to as part of the conference report for H.R. 2830, which the House cannot consider today because of ongoing House-Senate disagreements, resulting in Senate Finance Committee Chairman Charles Grassley (R-IA) leaving Washington today before a conference committee could be completed.

The House passed its version of H.R. 2830 on December 15, 2005 by a vote of 294-132: http://clerk.house.gov/evs/2005/roll635.xml. The Senate passed its version of the bill on March 3, 2006, by unanimous consent.

Summary by Title: H.R. 4 would amend the Employee Retirement Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 to reform the funding rules for pensions. Highlights of the bill are as follows. This summary is in no way exhaustive, given the short timeframe (a few hours) in which to read the bill.

Title I: Reform of Funding Rules for Single-Employer Defined Benefit Pension Plans

- Repeals ERISA's minimum funding standards that single-employer defined benefit plans must meet and creates new standards.

- Requires that an employer make the minimum contributions to a plan, subject to certain Treasury Department waiver authority in cases of business hardship (when the employer is operating at an economic loss, when there is substantial unemployment or underemployment in the relevant industry, when the sales and profits of the industry are depressed or declining, and when it is reasonable to conclude the plan will be continued only if the waiver is granted).

- Requires that the application for a waiver be submitted to the Treasury Secretary no later than 2-1/2 months after the close of the plan year. The applicant would have to alert each participant, beneficiary, and employee organization about the application for a waiver of minimum contribution requirements.

- Sets the formulas for minimum funding for single-employer defined benefit pension plans and phases in the threshold of what is considered a funding shortfall.

- Sets the funding target of a plan for any year as 100% of the current value of all liabilities attributable to participants and beneficiaries under the plan for that year (current law is 90%--and in some cases 80%). Deficits would have to be made up (i.e. "amortized") over seven years.

- Directs the value of plan assets to be determined on the basis of any "reasonable" actuarial method of valuation that takes into account the fair market value of assets. Asset averaging ("smoothing") could not cover more than two plan years and could not result in a valuation of averaged assets greater than 110% or lower than 90% of the fair market value of the plan's assets.

- In determining the value of liabilities under a plan for a plan year, liabilities attributable to benefits accrued as of the first day of the plan year would be taken into account. Any benefits which are expected to accrue during a plan year would not be taken into account (unless the plan is collectively bargained).

- In determining the value of liabilities under a plan for a plan year, the required interest rate would be that rate which, if used to determine the present value of the plan's liabilities, would result in an amount equal to the funding target of the plan for a plan year. The bill provides formulas for how this interest-rate calculation would be phased in over three years.

- Replaces the 30-year Treasury rate to measure pension liabilities with a three-tiered corporate bond yield curve (as detailed in the bill, phase-in beginning in 2007). The corporate bond yield curve is widely regarded as a more accurate tool.

- Requires that the probability of future benefit payments being made under the plan, including lump sums and other optional forms of benefits, be taken into account and included in the plan's funding target when determining the present value of a plan's liabilities.

- Provides special rules for "at-risk" plans (plans that are grossly underfunded—70% or less using one calculation or 65% phasing up to 80% using another calculation—and in danger of having to terminate)—including accelerated contribution requirements and increased penalties.

- Prohibits underfunded plans (below 80%) from using "credit balances" to replace required contributions.

- Imposes a lien on any plan for failures to make required contributions (in the amount of the unpaid contribution).

- Allows certain plan assets over 100% of a plan's funding target to be transferred to a qualified health benefits plan.

- Prohibits the funding of executive compensation plans when pension plans of rank-and-file workers are significantly underfunded or in bankruptcy.

- Prohibits plans funded at less than 80% on the valuation date (subject to certain exceptions) from increasing the plan's liabilities by increasing benefits, establishing new benefits, changing the rate of benefit accrual, or changing the rate at which benefits become non-forfeitable.

- Prohibits lump sum distributions or any other accelerated form of benefits when a plan is funded at less than 60% on the valuation date (subject to certain exceptions, including partial payments when a plan is funded between 60% and 80%).

- Prohibits all future benefit accruals for plans that are funded at less than 60% (after a plan's first five years).

- Requires that plan administrators provide written notice to plan participants and beneficiaries within 30 days after the plan has become subject to any of the above restrictions, subject to civil penalties.

- Inserts the above changes to ERISA into the tax code as well.

- Allows the payment of plant-shutdown benefits from single-employer pension plan assets—as long as the benefits are funded up front for plans funded above 60%. Treats them like benefit improvements for the purpose of PBGC's maximum guarantee.

- Sets a special premium rate for certain terminated single-employer plans (excluding those terminated in bankruptcy reorganization—which must pay a $1,250 premium per participant for three years once they emerge from bankruptcy).

Title II: Funding Rules for Multi-Employer Defined Benefit Plans

- Establishes minimum funding standards for multi-employer pension plans.

- Directs every multi-employer plan to establish and maintain a funding standard account into which employer contributions can go and from which payments can be made.

- Provides procedures for the amortization of unfunded liabilities of plans using the account just described (reduces schedule from 30 years to 15 years).

- Instructs plan actuaries to certify to the Secretary of the Treasury, within 90 days of the start of each plan year, whether a plan is in endangered or critical status for a plan

year. A plan would be considered endangered if the plan has a funded liability percentage of less than 80% (and greater than 65%) or there is an equivalent projected deficiency in the any of the next seven plan years. A plan's status would be considered critical if the plan has a funded liability percentage of less than 65% or meets certain other tests (as detailed in the bill).

- If a certification of endangerment is filed, the plan sponsor has 30 days to alert participants, contributing employers, unions, the Secretary of Labor, and the Secretary of the Treasury. In addition, a funding improvement plan (as approved by all bargaining parties) would have to be filed within 240 days of the certification and would have to remove the plan from endangered status within ten years. While a funding improvement plan is being negotiated, no benefits could be increased in the plan. If no certification is filed, a plan will be assumed to be endangered.

- If a critical status certification is filed, the plan sponsor has 30 days to alert participants, contributing employers, unions, the Secretary of Labor, and the Secretary of the Treasury. In addition, a rehabilitation plan (as approved by all bargaining parties) would have to be filed within 240 days of the certification and would have to remove the plan from critical status (into endangered status or higher) within ten years. While a rehabilitation plan is being negotiated, no benefits could be increased in the plan. The bill limits the reductions in rates of future accruals that rehabilitation plans could implement. If no certification is filed, a plan will be assumed to be in critical condition.

- Levies a 5% surcharge (of the contribution otherwise required under the collective bargaining agreement) on each contributing employer for the first plan year in which a multi-employer plan is in critical status (10% for each subsequent year).

- Prohibits the trustees of a plan in critical status from reducing adjustable benefits of any participant or beneficiary in pay status at least one year before the first day of the first plan year in which the plan enters into critical status.

- Allows a plan sponsor to treat the failure of any contributing employer to make the required contributions under a rehabilitation plan as a partial or complete withdrawal by that contributing employer from the plan.

- Directs that—if a plan sponsor makes a determination that the plan will be insolvent in any of the next five plan years—the plan sponsor make an annual assessment of the current rehabilitation plan and take any allowable steps to ensure that the plan will not be insolvent in any of the subsequent five plan years.

- Repeals several provisions in ERISA regarding withdrawal liability (what companies owe multi-employer plans as the cost of withdrawing from the plan), including the provision limiting withdrawal liability payments to twenty years and the provision providing a special exemption from withdrawal liability for the long- and short-haul trucking industry.

- Provides that an employer who switches to contractor employees to do the same work that former employees (for who contributions to the plan used to be made) were doing incur partial or complete withdrawal liability from the plan.

- Allows certain plans covering employees in the building and construction industry to elect to adopt a rule under which an employer who withdraws from the plan in a complete or partial termination is not liable to the plan if the employer was a contributing employer for less than five years. *[The Education and the Workforce Committee reports that this rule is applicable to plans in other industries under current law.]*

- Inserts the above changes to ERISA into the tax code as well.

Title III: Interest Rate Assumptions

- Provides for interest rate calculations regarding lump-sum distributions.

Title IV: PBGC Guarantee and Related Provisions

- Gives airlines that opt for a "hard freeze" of their pension plans an additional 10 years to meet their funding obligations and avoid defaulting on their plans and turning these obligations over to the PBGC. An employer-paid termination premium of $2,500 per plan participant also must be paid by these airlines if they terminate their employee pension plan upon entering bankruptcy. The plan sponsor would pay the premium after a company emerges from bankruptcy.

- Gives airlines that opt for a "soft freeze" of their pension plans an additional three years to meet their funding obligations and avoid defaulting on their plans and turning these obligations over to the PBGC. An employer-paid termination premium of $2,500 per plan participant also must be paid by these airlines if they terminate their employee pension plan upon entering bankruptcy. The plan sponsor would pay the premium after a company emerges from bankruptcy. For these airlines, the bill also extends the deficit reduction contribution relief – that was included in the 2004 *Pension Funding Equity Act* – through 2007.

Title V: Disclosure

- Increases the disclosure requirements (to plan participants and the federal government) for defined benefit plan funding notices, including:
  --accelerating the due date;
  --requiring a statement of the ratio of inactive participants to active participants in the plan;
  --requiring an estimate of the value of plans assets and projected liabilities, as well as the plan's funded ratio;
  --requiring a summary of any funding improvement plan or rehabilitation;

--making available copies of all actuary reports and financial reports received by the plan for a plan year; and
--giving contributing employers (in multi-employer plans) the right to a notice of the amount of their withdrawal liability.

Title VI: Investment Advice, Prohibited Transactions, and Fiduciary Rules

- Exempts from ERISA's and the tax code's prohibited transaction rules:
  --the provision of investment advice to a plan, its participants, or its beneficiaries;
  --the sale, acquisition, or holding of securities or other property pursuant to such investment advice; and
  --the direct or indirect receipt of fees or other compensation in connection with providing the advice.
- Allows pension plan administrators to provide voluntary investment advice to employees, as long as any potential conflicts of interest are disclosed. Fiduciary advisors—not employers—would be liable for any advice given.
- Adds the investment advice provisions to the tax code as well.
- Provides fiduciary protection to plans that "map" a participant's investments into similar funds when a plan changes administrators or when funds are replaced—but only when the participant has given no investment direction to the contrary.

Title VII: Benefit Accrual Standards

- Clarifies the rules relating to the reduction in accrued benefits under ERISA, thereby creating a uniform age discrimination standard for all defined benefit plans. Specifically, a plan would not be treated as failing to meet ERISA requirements if a participant's entire accrued benefit would be equal to or greater than that of any similarly situated, younger individual (an individual identical in every respect, including period of service, compensation, position, date of hire, work history, and any other respect, except for age). Further, lump sum distributions would not be age discriminatory if such payment equals the worker's account balance or an accumulated percentage of the employee's final average compensation.
- Shields certain other practices regarding the accounting and adjustment of accrued benefits from being ERISA violations.

Title VIII: Pension Related Revenue Provisions

- Makes permanent the retirement savings provisions of the Bush tax cut of 2001 (including the increased contribution limits for traditional IRAs and Roth IRAs). See Title IX of Public Law 107-16.

- Makes permanent the saver's tax credit (for certain retirement savings accounts set to expire at the end of 2006), which taxpayers could choose to have the IRS deposit directly to a savings account, IRA, or pension plan.

- Allows active-duty servicemembers to make penalty-free early withdrawals from their retirement plans, as long as they've been activated for at least 180 days. This provision would apply only to distributions after September 11, 2001.

- Allows public safety employees in government plans to make certain penalty-free early withdrawals from their retirement plans.

- Allows combat zone compensation to be counted as gross income when determining the limitations on and deductibility of contributions to individual retirement plans. *[This would expand IRA eligibility for servicemembers.]*

- Directs the Treasury Secretary to produce a form allowing individuals to direct a portion of any tax refund directly to an individual retirement plan, beginning in 2007.

- Allows disabled people to contribute to an IRA, even if they do not have earned income.

- Allows the distributions from the retirement plans of deceased individuals to be rolled over tax-free into the retirement plans of non-spouse beneficiaries.

- Clarifies that distributions made to correct erroneous contributions under automatic enrollment plans are not subject to restrictions on 401(k) (defined contribution) withdrawals and other rules relating to regular distributions.

- Increases the allowable tax deduction for contributions:
  --to single-employer plans (up to 150% of plan liabilities)
  --to multi-employer plans (up to 140% of plan liabilities).'

- In the case of employer contributions to one or more defined <u>contribution</u> plans, the tax deduction limit would only apply to the extent that such contributions exceed 6% of the compensation otherwise paid or accrued during the year to beneficiaries under the plan.

- Codifies "best practices" standards for corporate-owned life insurance.

- Provides that tribal employees engaged in essential government functions (but not commercial operations, such as casinos, hotels or marinas) will be treated as government employees under the tax code and under ERISA.

- Eliminates the aggregate limit on the use excess funds from black lung benefit trusts to be used to fund retiree health for coal miners.

- Allows assets in excess of 120% of current liability to be used to fund retiree health benefits. Further, additional contributions to a defined benefit plan would be required when asset values fall below 120% of current liability (both single employer plans and collectively bargained plans).

- Makes a variety of reforms to the U.S. Tax Court.

Title IX: Increase in Pension Plan Diversification and Participation and Other Pension Provisions

- Allows employers to implement an automatic enrollment plan for 401(k) (defined contribution) plans. Employees could affirmatively change their contribution election or opt-out altogether (after being informed in writing of these choices)—but otherwise would be deemed enrolled in the employer's automatic 401(k) program (which would not *have* to include existing employees). The automatic deferral of compensation could not exceed 10% and could not be less than:
  --3% during the first applicable plan year;
  --4% during the second year;
  --5% during the third year; and
  --6% during and year thereafter.
  At least 70% of eligible employees would have to participate in the program for it to qualify, and employers would have to match contributions in amounts up to 50% of elections.

Title X: Provisions Relating to Spousal Pension Protection

- Entitles a divorced spouse to railroad retirement annuities independent of the actual entitlement of the employee.

- Extends certain railroad retirement benefits to surviving former spouses, pursuant to divorce agreements.

Title XI: Administrative Provisions

- Provides for no reduction in unemployment compensation as a result of pension rollovers.

Title XII: Provisions Relating to Exempt Organizations

NOTE: the bill does not contain controversial Senate charitable reform provisions that have drawn bipartisan concern.

- Provides an exclusion from gross income for certain distributions of up to $100,000 from a traditional individual retirement account (IRA) or a Roth IRA, which would otherwise be included in income. To qualify, the charitable distribution must be made to a tax-exempt organization to which deductible contributions can be made (in 2006 and 2007).

- Extends for all trades and businesses an enhanced deduction for donations of goods inventory equal to the lesser of (1) the taxpayer's basis plus one-half of the difference between fair market value and basis, and (2) twice the taxpayer's basis in the contributed inventory (in 2006 and 2007).

- Extends the current-law provision that adds public schools to the list of eligible donees for the enhanced deduction for contributions of qualified book inventory by C corporations (in 2006 and 2007).

- Raises the charitable deduction limit (in 2006 and 2007) from 30 percent of adjusted gross income to 50% of adjusted gross income for qualified conservation contributions, provided that such contribution does not prevent the use of the donated land for farming or ranching purposes. The charitable deduction limit is raised to 100 percent of adjusted gross income for eligible farmers and ranchers. The provision allows a taxpayer to carryforward the deduction for 15 years, provided that the taxpayer is a farmer or rancher in the year of the carryforward.

- Exempts certain blood collector organizations are exempt from certain excise taxes with respect to activities related to blood collection.

- Doubles the amount of excise taxes applicable to certain activities by charities, social welfare organizations, private foundations and exempt organization managers.

- Limits the basis for donated taxidermy property to the cost of preparing, stuffing, and mounting an animal. The value of the deduction would be equal to the lesser of basis or fair market value.

- Prohibits deductions for charitable contributions of clothing and household items, if such items are not in good used condition or better. A deduction could be denied for any item with minimal monetary value.

- Requires that, in the case of a charitable contribution of money, regardless of the amount, the donor would have to maintain a cancelled check, bank record, or receipt from the donee organization showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

- Lowers the thresholds for imposing accuracy-related penalties on a taxpayer who claims a deduction for donated property for which a qualified appraisal is required.

- Amends the definition of gross investment income to include capital gains, notional principal contracts, annuities, and other substantially similar investment income.

- Provides that, upon written request by an appropriate state official, the Secretary could disclose information regarding organizations for which the IRS has denied or revoked tax-exempt status, certain other actions the IRS may have taken, and returns filed by tax-exempt organizations.

- Extends the present-law public disclosure requirements applicable to Form 990 to the unrelated business income tax returns of Section 501(c)(3) organizations.

Title XIII: Other Provisions

- Makes technical corrections to the *Mine Improvement and New Emergency Response Act of 2006*.

- Increases the authorization for Montana's "Going-To-The-Sun Road."

- Provides an exception to certain tax-exempt bond rules for certain hydroelectric facilities located in Alaska.

- Permanently extends the rules for Section 529 qualified tuition programs.

Title XIV: Tariff Provisions

- Suspends duties on liquid crystal device (LCD) panel assemblies for use in LCD direct-view televisions through 2009.

- Extends the suspension of duties on ceiling fans through 2009.

- Extends the suspension of duties on certain nuclear steam generators, reactor vessel heads, and pressurizers through 2010.

- Present law provides for temporary duty reductions or duty suspensions of certain fabrics made from worsted wool and for payments made under the wool trust fund. The fund consists of three special refund pools for importers of wool fabric, wool yarn, and wool fiber and top, and identifies all persons eligible for the refunds including U.S. manufacturers of these products. The bill would extend the current program for an additional two years through 2009.

- Includes the miscellaneous tariff suspensions or reductions taken from House-passed H.R. 4944, the *Miscellaneous Trade and Technical Corrections Act of 2006*, for which there are Senate companions introduced, which suspend or reduce the tariff rate on certain selected products.

- Clarifies that the 50% ad valorem duty on vessel repairs excludes the cost of equipment, repair parts, and materials that are installed on a vessel documented under the laws of the United States and engaged in the foreign or coasting trade, if the installation is done by members of the regular crew of such vessel while the vessel is on the high seas, in foreign waters, or in a foreign port, and does not involve foreign shipyard repairs by foreign labor.

- Extends narrow proclamation authority given to the President in CAFTA to implement certain changes to certain apparel rules of origin with respect to countries that have entered into letters of understanding concerning pocketing material with the United States and, subject to certain limitations, with respect to countries which have not entered into such letters of understanding with the United States.

Committee Action: The bill was introduced on July 28, 2006, with just a few hours for Members to read a 1000-page bill. The bill went straight to the floor.

Administration Position: The Statement of Administration Policy (SAP) for the original House version of H.R. 2830 was supportive of the legislation. However, the SAP noted that, "If the net effect of a final pension bill is to weaken funding requirements for pension plans relative to current law, the President's senior advisors will recommend a veto of that bill." Read the complete SAP here: http://www.whitehouse.gov/omb/legislative/sap/109-1/hr2830sap-h.pdf

A SAP for the bill is not yet available.

Cost to Taxpayers: A cost estimate for the bill is not yet available. For the original House version of H.R. 2830, CBO estimated that it would decrease mandatory spending by $116 million in FY2006, by $3.028 billion over the FY2006-FY2010 period, and by a net $305 million over the FY2006-FY2015 period. The bill would also decrease revenues by $155 million in FY2006, by $14.209 billion over the FY2006-FY2010 period, and by $71.828 billion over the FY2006-FY2015 period.

Does the Bill Expand the Size and Scope of the Federal Government?: A complete analysis of this legislation could not be completed to

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: CBO and the Joint Committee on Taxation reported (for the original House version of H.R. 2830) that the legislation contains no intergovernmental mandates (though a complete analysis of the new version of the bill was not possible before presstime). However, the legislation does contain private-sector mandates, as explained below in the CBO cost estimate for the original House bill (H.R. 2830):

> Some of the bill's changes to ERISA would impose mandates on sponsors and administrators of single-employer and multiemployer private-pension plans. CBO estimates that the direct cost to affected entities of the mandates in the bill, less the direct savings resulting from those mandates, would exceed the annual threshold specified in UMRA ($123 million in 2005, adjusted annually for inflation) in 2009 and thereafter. Most of that cost would result from the increase in premiums paid to the PBGC. JCT has determined that the tax provisions in the bill contain no private-sector mandates.

Constitutional Authority: Although a committee report citing constitutional authority for H.R. 4 is unavailable, the Ways & Means Committee, in House Report 109-232, Part 2 (for H.R. 2830), cites constitutional authority in Article I, Section 8, Clause 1 (the congressional

power to lay and collect taxes, duties, imposts, and excises) and in the 16th Amendment (the congressional power to lay and collect taxes on incomes, from whatever source derived).

The Education and the Workforce Committee, in House Report 109-232, Part 1, cites constitutional authority in court cases regarding ERISA, which themselves cited Article I, Section 8, Clause 3 (the congressional power to regulate interstate commerce).

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