

**DESCRIPTION OF THE CHAIRMAN’S MARK  
OF THE  
“PRESERVING AMERICA’S TRANSIT  
AND HIGHWAYS ACT OF 2014”**

Scheduled for Markup  
By the  
SENATE COMMITTEE ON FINANCE  
on June 26, 2014

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



June 24, 2014  
JCX-75-14

# CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
I. HIGHWAY PROVISIONS .....	2
A. Highway Trust Fund Expenditure Authority .....	2
II. TAX COMPLIANCE AND MODERNIZATION PROVISIONS.....	4
A. Modification to the Heavy Vehicle Use Tax .....	4
B. Mortgage Reporting .....	5
C. Clarification of Six-Year Statute of Limitations in Case of Overstatement of Basis .....	6
D. Revocation or Denial of Passport in Case of Certain Unpaid Taxes .....	8
E. Modification of Required Distribution Rules for Pension Plans .....	10

## INTRODUCTION

The Senate Committee on Finance has scheduled a markup on June 26, 2014, of the “Preserving America’s Transit and Highways Act of 2014,” a bill to amend the Internal Revenue Code of 1986 to provide for the extension of highway fund expenditures, to provide revenues for highway programs, and for other purposes.<sup>1</sup> This document,<sup>2</sup> prepared by the staff of the Joint Committee on Taxation, describes the provisions of the bill.

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<sup>1</sup> Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

<sup>2</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman’s Mark of the “Preserving America’s Transit and Highways Act of 2014”* (JCX-75-14), June 24, 2014.

## I. HIGHWAY PROVISIONS

### A. Highway Trust Fund Expenditure Authority

#### In general

Six separate excise taxes are imposed to finance the Federal Highway Trust Fund program. Three of these taxes are imposed on highway motor fuels. The remaining three are a retail sales tax on heavy highway vehicles, a manufacturers' excise tax on heavy vehicle tires, and an annual use tax on heavy vehicles. A substantial majority of the revenues produced by the Highway Trust Fund excise taxes are derived from the taxes on motor fuels. The annual use tax on heavy vehicles expires October 1, 2017. Except for 4.3 cents per gallon of the Highway Trust Fund fuels tax rates, the remaining taxes are scheduled to expire October 1, 2016. The 4.3-cents-per-gallon portion of the fuels tax rates is permanent.<sup>3</sup>

Revenues from the excise taxes generally are dedicated to the Highway Trust Fund. Dedication of excise tax revenues to the Highway Trust Fund and expenditures from the Highway Trust Fund are governed by the Code.<sup>4</sup> The Code authorizes expenditures (subject to appropriations) from the Highway Trust Fund through September 30, 2014, for the purposes provided in authorizing legislation, as such legislation was in effect on the date of enactment of MAP-21.<sup>5</sup>

#### Highway Trust Fund expenditure purposes

Section 9503 contains the operative rules for transfer of revenues to the Highway Trust Fund and for expenditure of monies from the Trust Fund. In general, these rules provide for transfer of "gross receipts" from the Highway Trust Fund excise taxes to the Trust Fund. Amounts deposited in the Highway Trust Fund are divided between a Mass Transit Account and a residual, or Highway, Account.<sup>6</sup> The Mass Transit Account generally receives 2.86 cents per gallon of the Highway Trust Fund motor fuels excise taxes.<sup>7</sup> The balance of the motor fuels tax receipts and all receipts from the three non-fuels excise taxes are deposited in the Highway Account.

Highway Trust Fund expenditure purposes have been revised with each authorization Act enacted since establishment of the Highway Trust Fund in 1956. In general, expenditures

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<sup>3</sup> This portion of the tax rates was enacted as a deficit reduction measure in 1993. Receipts from it were retained in the General Fund until 1997 legislation provided for their transfer to the Highway Trust Fund.

<sup>4</sup> Sec. 9503. The Highway Trust Fund statutory provisions were placed in the Internal Revenue Code in 1982.

<sup>5</sup> Sec. 9503(c)(1). The short title for Pub. L. No. 112-141 is "MAP-21" and the law is also known as the "Moving Ahead for Progress in the 21<sup>st</sup> Century Act."

<sup>6</sup> Sec. 9503(e)(1).

<sup>7</sup> Sec. 9503(e)(2).

authorized under those Acts (as the Acts were in effect on the date of enactment of the most recent such authorizing Act, currently MAP-21) are specified by the Code as permitted Highway Trust Fund expenditure purposes.<sup>8</sup> The Code provides that the authority to make expenditures from the Highway Trust Fund for these purposes expires after September 30, 2014. Thus, no Highway Trust Fund expenditures may occur after September 30, 2014, without an amendment to the Code.

### **Description of Proposal**

The expenditure authority for the Highway Trust Fund is extended through December 31, 2014. The Code provisions governing the purposes for which monies in the Highway Trust Fund may be spent are updated to include amendments to MAP-21, or other legislation, authorizing expenditures for the period ending December 31, 2014, as such legislation is in effect on the date of enactment of the “Preserving America’s Transit and Highways Act of 2014.”<sup>9</sup> The proposal also transfers sufficient revenues from the General Fund to the Highway Trust Fund to ensure solvency through December 31, 2014.

### **Effective Date**

The proposal is effective on the date of enactment.

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<sup>8</sup> The authorizing Acts that currently are referenced in the Highway Trust Fund provisions of the Code are: the Highway Revenue Act of 1956; Titles I and II of the Surface Transportation Assistance Act of 1982; the Surface Transportation and Uniform Relocation Act of 1987; the Intermodal Surface Transportation Efficiency Act of 1991; the Transportation Equity Act for the 21<sup>st</sup> Century, the Surface Transportation Extension Act of 2003, the Surface Transportation Extension Act of 2004; the Surface Transportation Extension Act of 2004, Part II; the Surface Transportation Extension Act of 2004, Part III; the Surface Transportation Extension Act of 2004, Part IV; the Surface Transportation Extension Act of 2004, Part V; the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users; the SAFETEA-LU Technical Corrections Act of 2008; the Surface Transportation Extension Act of 2010; the Surface Transportation Extension Act of 2010, Part II; the Surface Transportation Extension Act of 2011; the Surface Transportation Extension Act of 2011, Part II, Surface Transportation Extension Act of 2012, Temporary Surface Transportation Extension Act of 2012, and MAP-21.

<sup>9</sup> The proposal also updates the Code provisions governing the Leaking Underground Storage Tank Trust Fund, and the Sport Fish Restoration and Boating Trust Fund.

## **II. TAX COMPLIANCE AND MODERNIZATION PROVISIONS**

### **A. Modification to the Heavy Vehicle Use Tax**

#### **Present Law**

Section 4481 imposes a tax on the use of any highway motor vehicle that has a gross weight of at least 55,000 pounds. For vehicles with a gross weight of at least 55,000 pounds but not over 75,000 pounds, the tax is imposed at the rate of \$100 per year, plus \$22 for each 1,000 pounds in excess of 55,000 pounds. For vehicles with a gross weight of more than 75,000 pounds, the tax is \$550 per year.

#### **Description of Proposal**

Under the proposal, the maximum heavy vehicle use tax increases from \$550 to \$1,100. For vehicles with a gross weight of at least 55,000 but not over 97,000 pounds, the heavy vehicle use tax is imposed at the rate of \$100 plus \$22 for each 1,000 pounds in excess of 55,000. For vehicles with a gross weight of more than 97,000 pounds, the tax is \$1,100 per year.

#### **Effective Date**

The proposal is effective for heavy vehicle use after June 30, 2015.

## **B. Mortgage Reporting**

### **Present Law**

Any person who, in the course of a trade or business during a calendar year, received from an individual \$600 or more of interest during a calendar year on an obligation secured by real property (such as mortgage interest) must file an information return with the IRS and must provide a copy of that return to the payor.<sup>10</sup> The information return generally must include the name, address, and taxpayer identification number of the individual from whom the interest was received, and the amount of the interest and points received for the calendar year.

### **Description of Proposal**

Under the proposal, the following additional information is required to be included in information returns filed with respect to a debt secured by real property: (i) the unpaid balance with respect to the mortgage, (ii) the address of the property securing the mortgage, (iii) information with respect to whether the mortgage is a refinancing that occurred in the calendar year; (iv) real estate taxes paid from an escrow account, and (v) the loan origination date.

### **Effective Date**

The proposal applies to returns and statements due after December 31, 2014.

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<sup>10</sup> Sec. 6050H.

## **C. Clarification of Six-Year Statute of Limitations in Case of Overstatement of Basis**

### **Present Law**

Taxes are generally required to be assessed within three years after a taxpayer's return is filed, whether or not it was timely filed.<sup>11</sup> There are several circumstances under which the general three-year limitations period does not begin to run. If no return is filed,<sup>12</sup> if a false or fraudulent return with the intent to evade tax is filed, if private foundation status is terminated, or a gift tax for certain gifts is not properly disclosed, the tax may be assessed, or a proceeding in court for collection of such tax may commence without assessment, at any time.<sup>13</sup>

Other exceptions to the general rule result in an extension of the limitations period otherwise applicable. For example, the limitation period may be extended by taxpayer consent.<sup>14</sup> Failure to disclose or report certain information may also result in extensions of the statute of limitations. For example, failure to disclose a listed transaction as required under section 6011 on any return or statement for a taxable year will result in an extension that ensures that the limitations period remains open for at least one year from the date the requisite information is provided. The limitation period with respect to such transaction will not expire before the date which is one year after the earlier of (1) the date on which the Secretary is provided the information so required, or (2) the date that a "material advisor" (as defined in section 6111) makes its section 6112(a) list available for inspection pursuant to a request by the Secretary under section 6112(b)(1)(A).<sup>15</sup> In addition to the exceptions described above, there are also circumstances under which the three-year limitations period is suspended.<sup>16</sup>

A separate limitations period of six years from the date a return is filed is established for substantial omissions of items from gross income. An omission from gross income is substantial if the omission exceeds 25 percent of the gross income reported on the return or if the amount omitted exceeds \$5,000 and is attributable to a foreign financial asset within the meaning of section 6038D (without regard to dollar thresholds and regulatory exceptions to reporting based

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<sup>11</sup> Sec. 6501(a). Returns that are filed before the date they are due are deemed filed on the due date. See sec. 6501(b)(1) and (2).

<sup>12</sup> Sec. 6501(c)(3).

<sup>13</sup> Sec. 6501(c)(1) and (2).

<sup>14</sup> Sec. 6501(c)(4).

<sup>15</sup> Sec. 6501(c)(10).

<sup>16</sup> For example, service of an administrative summons triggers the suspension either (1) beginning six months after service (in the case of John Doe summonses) or (2) when a proceeding to quash a summons is initiated by a taxpayer named in a summons to a third-party record-keeper. Judicial proceedings initiated by the government to enforce a summons generally do not suspend the limitation period.

on existence of duplicative disclosure requirements).<sup>17</sup> Amounts that are disclosed on a return, even if not reflected in the amount recorded as gross income, are generally not considered to have been omitted for purposes of determining whether the 25 percent threshold was exceeded. For a trade or business, the threshold for determining a substantial omission is 25 percent of the gross receipts. For all others, an amount is considered to have been disclosed on a return if it is presented in a manner that is “adequate to apprise the Secretary of the nature and amount of such item.”<sup>18</sup> An overstatement of basis that contributes to an understatement of income due is not itself considered to be an omission of income, without regard to whether the return reveals the computation of basis.<sup>19</sup>

### **Description of Proposal**

In determining whether an amount greater than 25 percent of gross income was omitted from a return, the proposal provides that an understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission of gross income, without regard to whether or not the amount of unrecovered cost or basis claimed is disclosed on the return.

### **Effective Date**

The proposal applies to returns filed after the date of enactment, as well as to any other return for which the assessment period specified in section 6501 had not yet expired as of that date.

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<sup>17</sup> Sec. 6501(e)(1). Similar six year limitations periods are established for estate and gift taxes as well as excise taxes, based on 25 percent omissions from items required to be reported on the relevant tax returns. See secs. 6501(e)(2) and 6501(e)(3).

<sup>18</sup> Sec. 6501(e)(1)(B).

<sup>19</sup> *Home Concrete & Supply, LLC v. United States*, 132 S. Ct. 1836; 182 L. Ed. 2d 746 (2012). In deciding in favor of the taxpayer, the Supreme Court followed its interpretation of the word “omits” in a predecessor to section 6501. See, *The Colony Inc., v. Commissioner*, 357 U.S. 28 (1958). Having previously interpreted an unambiguous term in the statute, the Court held that a contrary interpretation by the Secretary in Treas. Reg. sec. 301.6501(e)-1 was invalid.

## **D. Revocation or Denial of Passport in Case of Certain Unpaid Taxes**

### **Present Law**

The administration of passports is the responsibility of the Department of State.<sup>20</sup> The Secretary of State may refuse to issue or renew a passport if the applicant owes child support in excess of \$2,500 or owes certain types of Federal debts, such as expenses incurred in providing assistance to an applicant to return to the United States. The scope of this authority does not extend to rejection or revocation of a passport on the basis of delinquent Federal taxes. Although issuance of a passport does not require a social security number or taxpayer identification number (“TIN”), the applicant is required to provide such number. Failure to provide a TIN is reported by the State Department to the IRS and may result in a \$500 fine.<sup>21</sup>

Returns and return information are confidential and may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to such information except as provided in the Internal Revenue Code.<sup>22</sup> There are a number of exceptions to the general rule of nondisclosure that authorize disclosure in specifically identified circumstances, including disclosure of information about federal tax debts for purposes of reviewing an application for a Federal loan<sup>23</sup> and for purposes of enhancing the integrity of the Medicare program.<sup>24</sup>

### **Description of Proposal**

Under this proposal, the Secretary of State is required to deny a passport (or renewal of a passport) to a seriously delinquent taxpayer and is permitted to revoke any passport previously issued to such person. In addition to the revocation or denial of passports to delinquent taxpayers, the Secretary of State is authorized to deny an application for a passport if the applicant fails to provide a social security number or provides an incorrect or invalid social security number. With respect to an incorrect or invalid number, the inclusion of an erroneous number is a basis for rejection of the application only if the erroneous number was provided willfully, intentionally, recklessly or negligently. Exceptions to these rules are permitted for emergency or humanitarian circumstances, including the issuance of a passport for short-term use to return to the United States by the delinquent taxpayer.

The proposal authorizes limited sharing of information between the Secretary of State and Secretary of Treasury. If the Commissioner of Internal Revenue certifies to the Secretary of the Treasury the identity of persons who have seriously delinquent Federal taxes as defined in

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<sup>20</sup> “Passport Act of 1926,” 22 U.S.C. sec. 211a et seq.

<sup>21</sup> Sec. 6039E.

<sup>22</sup> Sec. 6103.

<sup>23</sup> Sec. 6103(l)(3).

<sup>24</sup> Sec. 6103(l)(22).

this provision, the Secretary of Treasury or his delegate is authorized to transmit such certification to the Secretary of State for use in determining whether to issue, renew, or revoke a passport. Applicants whose names are included on the certifications provided to the Secretary of State are ineligible for a passport. The Secretary of State and Secretary of Treasury are held harmless with respect to any certification issued pursuant to this provision.

A seriously delinquent tax debt generally includes any outstanding debt for Federal taxes in excess of \$50,000, including interest and any penalties, for which a notice of lien or a notice of levy has been filed. This amount is to be adjusted for inflation annually, using calendar year 2014, and a cost-of-living adjustment. Even if a tax debt otherwise meets the statutory threshold, it may not be considered seriously delinquent if (1) the debt is being paid in a timely manner pursuant to an installment agreement or offer-in-compromise, or (2) collection action with respect to the debt is suspended because a collection due process hearing or innocent spouse relief has been requested or is pending.

#### **Effective Date**

The proposal is effective on January 1, 2015.

## **E. Modification of Required Distribution Rules for Pension Plans**

### **Present Law**

Minimum distribution rules<sup>25</sup> apply to employer sponsored tax-favored retirement plans<sup>26</sup> and individual retirement arrangements (“IRAs”). In general, under these rules, distribution of minimum benefits must begin no later than a required beginning date and a minimum amount must be distributed each year.<sup>27</sup> Minimum distribution rules also apply to benefits payable with respect to an employee (or IRA owner) who has died. The regulations provide a methodology for calculating the required minimum distribution from an individual account under a defined contribution plan or from an IRA.<sup>28</sup> In the case of annuity payments under a defined benefit plan or an annuity contract, the regulations provide requirements that the stream of annuity payments must satisfy. Failure to comply with the minimum distribution requirement results in an excise tax imposed on the individual who was required to take the distributions equal to 50 percent of the required minimum amount not distributed for the year.<sup>29</sup> The excise tax may be waived in certain cases. For qualified retirement plans, satisfying the minimum distribution requirement under the plan terms and in operation is also a qualification requirement for the trust of the plan to remain tax-exempt.

### **Required beginning date**

For traditional IRAs, the required beginning date is April 1 following the calendar year in which the employee (or IRA owner) attains age 70½. For employer-sponsored tax-favored retirement plans, for an employee other than an employee who is a five-percent owner in the year the employee attains age 70½, the required beginning date is April 1 after the later of the calendar year in which the employee attains age 70½ or retires. For an employee who is a five-percent owner under an employer-sponsored tax-favored retirement plan in the year the employee attains age 70½, the required beginning date is the same as for IRAs even if the employee continues to work past age 70½.

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<sup>25</sup> Sections 401(a)(9), 403(b)(1), 408(a)(6), 408(b)(3), and 457(d)(2).

<sup>26</sup> Tax-favored employer-sponsored retirement plans include qualified retirement plans and annuities under sections 401(a) and 403(a), tax-deferred annuity plans under section 403(b), and governmental eligible deferred compensation plans under section 457(b). Tax-favored retirement plans are of two general types: defined benefit plans, under which benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts; and defined contribution plans, under which benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses. Minimum distribution requirements also apply to eligible deferred compensation plans under section 457(b) of tax-exempt employers.

<sup>27</sup> Under section 408A(c)(5), these lifetime requirements do not apply to a Roth IRA.

<sup>28</sup> Reflecting the direction from Congress in section 823 of the Pension Protection Act (Pub. L. No. 109-280), pursuant to Treas. Reg. sec. 1.401(a)(9)-1, A-2(d), a governmental plan within the meaning of section 414(d) or an governmental eligible deferred compensation plan is treated as having complied with the statutory minimum distribution rules if the plan complies with a reasonable and good faith interpretation of those rules.

<sup>29</sup> Section 4974.

## **Lifetime rules**

While an employee (or IRA owner) is alive, distributions of the individual's interest are required to be made (in accordance with regulations) over the life or life expectancy of the employee (or IRA owner), or over the joint lives or joint life expectancy of the employee (or IRA owner) and a designated beneficiary.<sup>30</sup> For defined contribution plans and IRAs, the required minimum distribution for each year is determined by dividing the account balance as of the end of the prior year by a distribution period which, while the employee (or IRA owner) is alive, is the factor for the employee (or IRA owner's) age from the uniform lifetime table included in the Treasury regulations.<sup>31</sup> This table is based on the joint life and last survivor expectancy of the individual and a hypothetical beneficiary 10 years younger. The distribution period for annuity payments under a defined benefit plan or annuity contract (to the extent not limited to the life of the employee (or IRA owner) or the joint lives of the employee (or IRA owner) and a designated beneficiary) is generally subject to the same limitations as apply to individual accounts.

## **Distributions after death**

### Payments over a distribution period

The after-death minimum distributions rules vary depending on (i) whether an employee (or IRA owner) dies on or after the required beginning date or before the required beginning date, and (ii) whether there is a designated beneficiary for the benefit.<sup>32</sup> Under the regulations, a designated beneficiary is an individual designated as a beneficiary under the plan or IRA.<sup>33</sup> Similar to the lifetime rules, for defined contribution plans and IRAs ("individual accounts"), the required minimum distribution for each year after the death of the employee (or IRA owner) is

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<sup>30</sup> Section 401(a)(9)(A).

<sup>31</sup> Treas. Reg. sec. 1.401(a)(9)-5. For an individual with a spouse as designated beneficiary who is more than 10 years younger (and thus the number of years in the couple's joint life and last survivor expectancy is greater than the uniform lifetime table), the joint life expectancy and last survivor expectancy of the couple (calculated using the table in the regulations) is used. For this purpose and other special rules that apply to the surviving spouse as beneficiary, a former spouse to whom all or a portion of an employee's benefit is payable pursuant to a qualified domestic relations order (within the meaning of section 414(p)) is treated as the spouse (including a surviving spouse) of the employee for purposes of section 401(a)(9).

<sup>32</sup> In the case of amounts for which the employee or IRA owner's surviving spouse is the beneficiary, the surviving spouse generally is permitted to do a tax-free rollover of such amounts into an IRA (or account of a tax-favored employer-sponsored plan of the spouse's employer) established in the surviving spouse's name as IRA owner or employee. The rules applicable to the rollover account, including the minimum distribution rules, are the same rules that apply to an IRA owner or employee. In the case of an IRA for which the spouse is sole beneficiary, this is can be accomplished by simply renaming the IRA as an IRA held by the spouse as IRA owner rather as a beneficiary.

<sup>33</sup> Treas. Reg. sec. 1.401(a)(9)-4, A-1. The individual need not be named as long as the individual is identifiable under the terms of the plan (or IRA). There are special rules for multiple beneficiaries and for trusts named as beneficiary (where the beneficiaries of the trust are individuals). However, the fact that an interest under a plan or IRA passes to a certain individual under a will or otherwise under State law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan or IRA.

generally determined by dividing the account balance as of the end of the prior year by a distribution period.

If an employee (or IRA owner) dies on or after the required beginning date, the basic statutory rule is that the remaining interest must be distributed at least as rapidly as under the method of distribution being used before death.<sup>34</sup> Under the regulations, for individual accounts, this rule is also interpreted as requiring the minimum required distribution to be calculated using a distribution period. If there is no designated beneficiary, the distribution period is equal to the remaining years of the employee's (or IRA owner's) life, as of the year of death.<sup>35</sup> If there is a designated beneficiary, the distribution period (if longer) is the beneficiary's life expectancy calculated using the life expectancy table in the regulations, determined in the year after the year of death.<sup>36</sup>

If an employee (or IRA owner) dies before the required beginning date and any portion of the benefit is payable to a designated beneficiary, the statutory rule is that distributions are generally required to begin within one year of the employee's (or IRA owner's) death (or such later date as prescribed in regulations) and are permitted to be paid (in accordance with regulations) over the life or life expectancy of the designated beneficiary. If the beneficiary of the employee (or IRA owner) is the individual's surviving spouse, distributions are not required to commence until the year in which the employee (or IRA owner) would have attained age 70½. If the surviving spouse dies before the employee (or IRA owner) would have attained age 70½, the after-death rules apply after the death of the spouse as though the spouse were the employee (or IRA owner). Under the regulations, for individual accounts, the required minimum distribution for each year is determined using a distribution period and the period is measured by the designated beneficiary's life expectancy, calculated in the same manner as if the individual died on or after the required beginning date.<sup>37</sup>

In cases where distribution after death is based on life expectancy (either the remaining life expectancy of the employee (or IRA owner) or a designated beneficiary), the distribution period generally is fixed at the employee's (or IRA owner's) death and then reduced by one for each year that elapses after the year in which it is calculated. If the designated beneficiary dies during the distribution period, distributions continue to the subsequent beneficiaries over the remaining years in the distribution period.<sup>38</sup>

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<sup>34</sup> Section 401(a)(9)(B)(i).

<sup>35</sup> Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(2).

<sup>36</sup> Treas. Reg. sec. 1.401(a)(9)-5, A-5(a)(1).

<sup>37</sup> Treas. Reg. sec. 1.401(a)(9)-5, A-5(b).

<sup>38</sup> If the distribution period is based on the surviving spouse's life expectancy (whether the employee or IRA owner's death is before or after the required beginning date), the spouse's life expectancy generally is recalculated each year while the spouse is alive and then fixed the year after the spouse's death.

The distribution period for annuity payments under a defined benefit plan or annuity contract (to the extent not limited to the life of a designated beneficiary) is generally subject to the same limitations as apply to individual accounts.

#### Five-year rule

If an employee (or IRA owner) dies before the required beginning date and there is no designated beneficiary, then the entire remaining interest of the employee (or IRA owner) must generally be distributed by the end of the fifth calendar year following the individual's death.<sup>39</sup>

#### Defined benefit plans and annuity distribution

The regulations provide rules for the amount of annuity distributions from a defined benefit plan, or from an annuity purchased by the plan from an insurance company, that are paid over life or life expectancy. Annuity distributions are generally required to be nonincreasing with certain exceptions, which include, for example, (i) increases to the extent of certain specified cost of living indexes, (ii) a constant percentage increase (for a qualified defined benefit plan, the constant percentage cannot exceed five-percent per year), (iii) certain accelerations of payments, and (iv) increases to reflect when an annuity is converted to a single life annuity after the death of the beneficiary under a joint and survivor annuity or after termination of the survivor annuity under a qualified domestic relations order.<sup>40</sup> If distributions are in the form of a joint and survivor annuity and the survivor annuitant both is not the surviving spouse and is younger than the employee (or IRA owner), the survivor annuitant is limited to a percentage of the life annuity benefit for the employee (or IRA owner). The survivor benefit as a percentage of the benefit of the primary annuitant is required to be smaller (but not required to be less than 52 percent) as the difference in the ages of the primary annuitant and the survivor annuitant become greater.

#### Prohibited payments

A single-employer defined benefit pension plan is required to comply with certain funding-based limitations on benefits and benefit accruals.<sup>41</sup> Among the limitations is a requirement that, if the plan's adjusted funding target attainment percentage ("AFTAP"), is less than 60 percent for a plan year, the plan is not permitted to make any prohibited payments after the valuation date for the plan year. If the plan sponsor of a defined benefit plan is a debtor in a case under title 11, United States Code, or similar Federal or State law, the plan is generally not

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<sup>39</sup> Section 401(a)(9)(B)(ii) provides that the entire interest must be distributed within 5 years of the employee's death. Treas. Reg. sec. 1.401(a)(9)-3, A-2 provides that this requirement is satisfied if the entire interest is distributed by the end of the fifth calendar year following the employee's death. There are provisions in the regulations allowing a designated beneficiary to take advantage of the 5-year rule. See Treas. Reg. secs. 1.401(a)(9)-4, A-4, and 1.4974-2, A-7(b).

<sup>40</sup> Treas. Reg. sec. 1.401(a)(9)-6, A-14.

<sup>41</sup> Secs. 401(a)(29) and 436. Parallel rules apply under section 206(g)(3) of the Employee Retirement Income Security Act of 1974 (Pub. L. No. 93-406) ("ERISA"). Most governmental plans and church plans are excepted from these requirements and the anticutback requirement described below.

permitted to make a prohibited payment unless or until the plan's AFTAP is not less than 100 percent. If a defined benefit plan's AFTAP for the a plan year is more than 60 percent but less than 80 percent, generally a distribution of 50 percent of the otherwise prohibited payment is permitted to be made.

A plan's funding target attainment percentage is the ratio, expressed as a percentage, that the value of the plan's assets (generally reduced by certain amounts attributable to contributions exceeding required contributions) bears to the plan's funding target for the year (that is the present value of benefits already earned under the plan). A plan's AFTAP is determined in the same way, except that the value of the plan's assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees made by the plan during the two preceding plan years.

A prohibited payment is generally any amount in excess of the monthly amount paid under a single life annuity to a participant or beneficiary whose annuity starting date occurs during any period that the limitation is in effect. A prohibited payment also includes any payment to purchase an annuity contract from an insurance company or any other payment specified by the Secretary.

### **Plan amendment and anticutback requirements**

Present law provides a remedial amendment period during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements.<sup>42</sup> In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

The Code and ERISA generally prohibit plan amendment that reduce accrued benefits, including amendments that eliminate or reduce optional forms of benefit with respect to benefits already accrued except to the extent prescribed in regulations.<sup>43</sup> This prohibition on the reduction of accrued benefits is commonly referred to as the "anticutback rule."

### **Description of Proposal**

#### **In general**

The proposal includes three basic modifications to the minimum distribution requirement: (i) a change to the definition of required beginning date for five-percent owners, (ii) an expansion of the five year rule for required distributions after the death of an employee (or IRA owner), and (iii) a rule to coordinate the minimum distribution requirement and the prohibited payment requirement.

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<sup>42</sup> Section 401(b).

<sup>43</sup> Section 411(d)(6) and ERISA section 204(g).

### **Required beginning date for five-percent owners**

Under the proposal, if an employee becomes a five-percent owner after age 70½ but before retiring and thus before the employee's required beginning date with respect to tax-favored retirement plans of the employee's employer, the required beginning date for that employee becomes April 1 of the year following the year that the employee becomes a five-percent owner.

Other than the modification to the required beginning date for five-percent owners, the proposal generally makes no changes to the required minimum distribution rules during the lifetime of the employee (or IRA owner). Thus, for example, the proposal is not expected to result in a change to the regulations under which the required minimum distribution for each year during the lifetime of the employee (or IRA owner) is generally determined by dividing the account balance as of the end of the prior year by a distribution period which is the number corresponding to the employee's (or IRA owner's) age for the year from the uniform lifetime table included in the Treasury regulations.

### **Expansion of five-year rule**

#### **General rule**

Under the proposal, the five-year rule is the general rule for all distributions after death (regardless of whether the employee (or IRA owner) dies before, on, or after the required beginning date) unless the designated beneficiary is an eligible beneficiary as defined in the proposal. Thus, in the case of an ineligible beneficiary, distribution of the employee (or IRA owner's) entire benefit is required to be distributed by the end of the fifth calendar year following the year of the employee or IRA owner's death.

#### **Eligible beneficiaries**

For eligible beneficiaries, an exception to the five-year rule (for death before the required beginning date under present law) applies whether or not the employee (or IRA owner) dies before, on, or after the required beginning date. The exception (similar to present law) generally allows distributions over life or life expectancy of an eligible beneficiary beginning in the year following the year of death. Eligible beneficiaries includes any beneficiary who, as of the date of death (or in the case of a joint and survivor annuity, the annuity starting date for the employee or IRA owner), is the surviving spouse of the employee (or IRA owner), is disabled, is a chronically ill individual, is an individual who is not more than 10 years younger than the employee (or IRA owner), or is a child of the employee (or IRA owner) who has not reached the age of majority. In the case of a child who has not reached the age of majority, calculation of the minimum required distribution under this exception is only allowed through the year that the child reaches the age of majority.

Further, under the proposal, the five-year rule also applies after the death of an eligible beneficiary or after a child reaches the age of majority. Thus, for example, if a disabled child of an employee (or IRA owner) is an eligible beneficiary of a parent who dies when the child is age 20 and the child dies at age 30, even though 52.1 years remain in the life expectancy of the child calculated for the child's age (21) in the year after the employee's (or IRA owner's) death, the

disabled child's remaining beneficiary interest must be distributed by the end of the fifth year following the death of the disabled child. If a child is an eligible beneficiary based on having not reached the age of majority before the employee's (or IRA owner's) death, the five-year rule applies beginning with the earlier of date of the child's death or the date that the child reaches age of majority. The child's entire interest must be distributed by the end of the fifth year following that date.

As under present law, if the surviving spouse is the beneficiary, a special rule allows the commencement of distribution to be delayed until end of the year that the employee (or IRA owner) would have been age 70½. If the spouse dies before distributions were required to begin to the spouse, the surviving spouse is treated as the employee (or IRA owner) in determining the required distributions to beneficiaries of the surviving spouse.

#### Definition of disabled and chronically ill individual

Under the proposal, disabled means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to end in death or to be for long-continued and indefinite duration.<sup>44</sup> Further under the definition, an individual is not considered to be disabled unless proof of the disability is furnished in such form and manner as the Secretary may require. The substantial gainful activity for this purpose is the activity, or a comparable activity, in which the individual customarily engaged prior to the arising of the disability (or prior to retirement if the individual was retired at the time the disability arose).<sup>45</sup>

Under the proposal, the definition of a chronically ill individual for qualified long-term care insurance<sup>46</sup> is incorporated by reference with a modification. Under this definition, a chronically ill individual is any individual who (1) is unable to perform (without substantial assistance from another individual) at least two activities of daily living for an indefinite period (expected to be lengthy in nature)<sup>47</sup> due to a loss of functional capacity, (2) has a level of disability similar (as determined under regulations prescribed by the Secretary of Treasury in consultation with the Secretary of Health and Human Services) to the level of disability described above requiring assistance with daily living based on loss of functional capacity, or (3) requires substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment. The activities of daily living for which assistance is needed for purposes of determining loss of functional capacity are eating, toileting, transferring, bathing, dressing, and continence.

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<sup>44</sup> The definition of disabled in section 72(m)(7) is incorporated by reference.

<sup>45</sup> Treas. Reg. sec. 1.72-17(f). Under the regulations, in determining whether an individual is disabled, primary consideration is given to the nature and severity of the individual's impairment. However, consideration is also given to other factors such as the individual's education, training, and work experience. Whether an impairment in a particular case constitutes a disability is determined with reference to all the facts in the case.

<sup>46</sup> Section 7702B(c)(2).

<sup>47</sup> Section 7702B(c) only requires this period to be at least 90 days.

## Defined benefit plans and annuities

The expansion of the five-year rule under the proposal applies to all after-death distributions under all retirement plans subject to the required minimum distribution requirements, including annuity distributions under defined benefit plans, and under annuity contracts purchased from insurance companies under defined contribution plans. Thus, for example, under the proposal, after the death of an employee (or IRA owner), distribution in the form of the survivor life annuity (including a distribution that began before death as a joint and survivor annuity) is only permitted to an eligible beneficiary. In the case of a joint and survivor annuity that commences to the employee or IRA owner while alive, the determination of whether a beneficiary is an eligible beneficiary is made as of the annuity starting date for the employee or IRA owner rather than as of the date of death of the employee or IRA owner. Thus, any change in status, such as recovery from a disability or a divorce, does not change a beneficiary of the survivor portion of a joint and survivor annuity from being treated as an eligible beneficiary.

### **Coordination with the prohibited payment requirement**

Under the proposal, any required minimum distribution from a defined benefit plan for an employee or beneficiary for a period during which the plan is subject to the limitation on prohibited payments must not exceed the maximum payment allowable to such employee or beneficiary, without violating the prohibition on prohibited payments. The Secretary of the Treasury is directed to prescribe regulations for the application of this rule, including how this rule applies to minimum required distributions after the plan is no longer subject to this limitation.

## **Effective Date**

### **Required beginning date change for five-percent owners**

For the proposal changing the definition of required beginning date for employees who become five-percent owners after age 70½, the proposal applies to any employee who becomes a five-percent owner with respect to plan years ending in calendar years beginning before, on, or after the date of the enactment. If an employee became a five percent owner with respect to a plan year ending in a calendar year which began before January 1, 2016, and the employee has not retired before the end of such calendar year, the employee is treated as having become a 5-percent owner with respect to the plan year ending in the 2016 calendar for purposes of this rule.

### **Expansion of five-year rule**

#### General effective date

For determining minimum required distributions after the death of an employee (or IRA owner), the proposal is generally effective for distributions with respect to employees (or IRA owners) who die after December 31, 2015.

### Delayed effective date for governmental and collectively bargained plans

In the case of a governmental plan (as defined in section 414(d)), for determining minimum required distributions after the death of an employee, the proposal applies to distributions with respect to employees who die after December 31, 2017.

In the case of a collectively bargained plan,<sup>48</sup> for determining minimum required distributions after the death of an employee, the proposal applies to distributions with respect to employees who die in calendar years beginning after the earlier of two dates. The first date is the later of (1) the date on which the last collective bargaining agreement ratified before the date of enactment terminates,<sup>49</sup> or (2) December 31, 2015. The second date is December 31, 2017.

In the case of any distribution from a governmental or collectively bargained plan to an ineligible beneficiary with respect to any employee who dies after December 31, 2015 but before January 1, 2018 (or such earlier effective date as may apply under a collectively bargained plan), any amount distributed after the end of the fourth calendar year after the date of death of the employee is not eligible for rollover to an IRA.<sup>50</sup> Any amount distributed from an employer-sponsored retirement plan that is rolled over to an IRA is subject to the required minimum distribution rules for the IRA as amended by this proposal.

### Five year rule after the death of a beneficiary

In the case of an employee (or IRA owner) who dies before the effective date for the plan, if the designated beneficiary of the employee (or IRA owner) dies on or after the effective date for the plan, the proposal applies to any beneficiary of the designated beneficiary as though the designated beneficiary were an eligible beneficiary. Thus, the entire interest must be distributed by the end of the fifth calendar year after the death of the designated beneficiary. For this purpose, the effective date is the date on or after which the employee (or IRA owner) must die in order for the modification to apply (January 1, 2016 under the general effective date).

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<sup>48</sup> A collectively bargained plan is a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers.

<sup>49</sup> The date that the last agreement terminates is determined without regard to any extension thereof agreed to on or after the date of the enactment of this proposal. Further, any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by this proposal shall not be treated as a termination of such collective bargaining agreement.

<sup>50</sup> Sections 402(c)(11), 403(b)(8), and 457(e)(16) allow a designated beneficiary under an employer-sponsored eligible retirement plan to rollover in a direct trustee-to-trustee transfer an eligible rollover distribution from the plan to an inherited individual retirement arrangement. Section 402(c)(4)(B) defines an eligible rollover distribution as not including any required minimum distribution. In Notice 2007-7, 2007-1 CB 395, A-17 through A-19 provide guidance on determining the amount of any distribution to a designated beneficiary that is a required minimum distribution and thus not eligible for rollover.

### Certain annuities grandfathered

The modification to the after-death minimum distribution rules does not apply to a qualified annuity that is a binding annuity contract in effect on the date of the enactment and at all times thereafter. To be a qualified annuity, the annuity must be a commercial annuity,<sup>51</sup> or an annuity payable by a defined benefit plan, under which the annuity payments are over the lives of such employee (or IRA owner) and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee (or IRA owner) or the life expectancy of such employee (or IRA owner) and a designated beneficiary) in accordance with the required minimum distribution regulations for annuity payments (as in effect before enactment of this proposal). In addition to these requirements, to be a qualified annuity, annuity payments to the employee (or IRA owner) must begin before the date of enactment and the employee (or IRA owner) must have made an irrevocable election before that date as to the method and amount of the annuity payments to the employee or any designated beneficiaries. Alternatively, if an annuity is not a qualified annuity solely based on annuity payments not having begun irrevocably before the date of enactment, an annuity can be a qualified annuity if the employee (or IRA owner) has made an irrevocable election before the date of enactment as to the method and amount of the annuity payments to the employee (or IRA owner) or any designated beneficiaries.

### **Coordination with prohibited payment requirement**

The proposal coordinating required minimum distributions with the limitation on prohibited payments applies to plan years beginning after December 31, 2014. However, no inference is intended as to the proper coordination between the required minimum distribution rule and the prohibited payment rules for plan years beginning before January 1, 2015.

### **Plan amendments made pursuant to the proposal**

A plan amendment made pursuant to the proposal (or regulations issued thereunder) may be retroactively effective and will not violate the anticutback rule, if, in addition to meeting the other applicable requirements, the amendment is made on or before the last day of the first plan year beginning after December 31, 2017 (or in the case of a governmental or collectively bargained plan, December 31, 2019), or a later date prescribed by the Secretary.

A plan amendment will not be considered to be pursuant to the proposal (or applicable regulations) if it has an effective date before the effective date of the provision under the proposal (or regulations) to which it relates. Similarly, the proposal does not provide relief from the anticutback rule for periods prior to the effective date of the relevant portion of the proposal (or regulations) or the plan amendment. In order for an amendment to be retroactively effective and not violate the anticutback provisions, the plan must be operated in accordance with the amendment beginning with such retroactive effective date.

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<sup>51</sup> For this purpose, commercial annuity is defined in section 3405(e)(6).