MISCELLANEOUS PENSION BILLS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

S. 209, S. 511, S. 989, S. 1089, S. 1090, S. 1091, S. 1092, S. 1240, and S. 1958

DECEMBER 4 AND 5, 1979

PART 1 OF 2 PARTS

(December 4, 1979)

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MISCELLANEOUS PENSION BILLS

TUESDAY, DECEMBER 4, 1979

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:30 p.m., in room 2221, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the subcommittee), presiding.

Present: Senators Bentsen and Matsunaga.

[The press release announcing these hearings and the bills S. 209, S. 511, S. 989, S. 1089, S. 1090, S. 1091, S.1092, S. 1240, and S. 1958 follow:]

Press Release #H-75

P R E S S   R E L E A S E

FOR IMMEDIATE RELEASE
November 20, 1979

COMMITTEE ON FINANCE
UNITED STATES SENATE
SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS SETS HEARING ON NUMEROUS PENSION BILLS

Senator Lloyd Bentsen (D., Tex.), Chairman of the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance, announced today that the Subcommittee will hold hearings on December 4 and 5 on several pension bills.

The hearings will be held in Room 2221 Dirksen Senate Office Building and will begin at 2:30 P.M.

Senator Bentsen announced that the following bills would be the subject of the hearings:

S. 1089, introduced by Senator Bentsen, which would help simplify ERISA and reduce pension reporting requirements.

S. 209, introduced by Senators Williams and Javits, which would amend numerous sections of ERISA. (The hearings will not cover sections 201 - 205 of S. 209 which were the subject of earlier hearings.)

S. 511, introduced by Senator Matsunaga, relating to deferred compensation plans maintained by tax-exempt organizations.

S. 989, introduced by Senator Bentsen, relating to rollovers from money purchase pension plans.

S. 1090, 1091 and 1092, introduced by Senator Talmadge, relating to church pension plans.

S. 1240, introduced by Senator Long, relating to employee stock ownership plans (ESOPs).

S. 1958, introduced by Senator Matsunaga, relating to the prohibited transaction rules of ERISA.

Witnesses who desire to testify at the hearings should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D. C. 20510, by no later than the close of business on November 28, 1979.

Legislative Reorganization Act.--Senator Bentsen stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument.

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Subcommittee, but are to confine their oral presentations to a summary of the points included in the statement.

Witnesses who fail to comply with these rules will forfeit their privilege to testify.

Written Testimony.--Senator Bentsen stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by December 21, 1979, to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D. C. 20510.

P.R. #H-75

96TH CONGRESS
1ST SESSION

S. 209

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 for the purposes of simplifying, clarifying, and improving Federal law relating to the regulation of employee benefit plans, to foster the establishment and maintenance of plans, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 24 (legislative day, JANUARY 15), 1979

Mr. WILLIAMS (for himself and Mr. JAVITS) introduced the following bill; which was read twice and referred jointly to the Committees on Finance and Human Resources

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A BILL

To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 for the purposes of simplifying, clarifying, and improving Federal law relating to the regulation of employee benefit plans, to foster the establishment and maintenance of plans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

(a) This Act may be cited as the "ERISA Improvements Act of 1979".

(b) TABLE OF CONTENTS.—

TITLE I—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974—Continued

PART 5—ADMINISTRATION, ENFORCEMENT, AND ADJUSTMENTS IN APPLICABLE LAW

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

TITLE III—SPECIAL MASTER AND PROTOTYPE PLANS

TITLE IV—EMPLOYEE BENEFITS COMMISSION

SEC. 2. TECHNICAL AND CONFORMING CHANGES.

The Secretary of the Treasury and the Secretary of Labor shall, as soon as practicable but in any event not later than 90 days after the date of the enactment of this Act, submit to the Congress a draft of any technical and conforming changes in the Internal Revenue Code of 1954, and the Employee Retirement Income Security Act of 1974, respectively, which are necessary to reflect throughout such Code and Act the changes in the substantive provisions of law made by this Act.

SEC. 3. FINDINGS AND DECLARATION OF POLICY.

(a) The Congress finds that the paperwork burdens and compliance costs resulting from the implementation of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 affecting employee benefit plans and persons sponsoring such plans can be reduced in certain respects without jeopardizing the interests of employees in such plans and in the integrity of the assets of such plans; that the free flow of commerce and the implementation of such Act and Code have been restricted and hampered by assertions of applicability of Federal and State securities and other laws to certain employee benefit plans and certain collective funding vehicles for plans; and that present and future needs for retirement income can best be met by strengthening and improving private employee pension benefit plans and that it is in the national interest to do so.

(b) The Congress further finds that the free flow of commerce and the implementation of the provisions of the Employee Retirement Income Security Act of 1974 and of the Internal Revenue Code of 1954 have been restricted and hampered by administrative difficulties encountered by the Labor Department, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation; that duplications and overlapping of agency responsibility have resulted in costly delays, confusion, and excessive paperwork, and that the interests of participants in and beneficiaries under private sector employee benefit plans have been adversely affected thereby.

(c) It is hereby declared to be the policy of this Act to foster the establishment and maintenance of private employee pension benefit plans; to further improve such plans by clarifying, simplifying, and otherwise improving such Act and the provisions of such Code; to clarify prospectively the extent to which Federal and State securities and other laws may affect employee benefit plans and collective funding vehicles for plans which are subject to such Act; and to consolidate in a single agency the administration of the Employee Retirement Income Security Act of 1974 and certain provisions of the Internal Revenue Code of 1954 relating to employee benefit plans.

TITLE I—AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

Subtitle A—Declaration of Policy; Definitions

SEC. 101. DECLARATION OF POLICY.

Section 2 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new subsection:

"(d) It is hereby further declared to be the policy of this Act to foster the establishment and maintenance of employee benefit plans sponsored by employers, employee organizations, or both.".

SEC. 102. DEFINITIONS.

Section 3 of the Employee Retirement Income Security Act of 1974 is amended by—

(1) striking out subparagraphs (A), (B), (C), (D), (H) and (I) of paragraph (14) and inserting in lieu thereof, respectively, the following subparagraphs:

"(A) any fiduciary, counsel, or employee of such plan;

"(B) a person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan;

"(C) an employer any of whose employees are covered by such plan, if the employees of such employer constitute 5 percent or more of all employees covered by the plan;

"(D) an employee organization any of whose members are covered by such plan, if the members of such employee organization constitute 5 percent or more of all employees covered by the plan;

"(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) or a person described in subparagraph (B), (C), (D), (E), or (G); or

"(I) a 10 percent or more (in capital or profits) partner, or joint venturer in, a person described in subparagraph (B), (C), (D), (E), or (G).";

(2) inserting in paragraph (15) "brother, sister," immediately before "spouse," the first time it appears;

(3) striking out "The" in paragraph (20) and inserting in lieu thereof "Except as otherwise provided in sections 502(l) and 514(d) (2) and (3), the";

(4) (A) striking out clauses (i), (ii), and (iii) of subparagraph (A) of paragraph (37) and inserting in lieu thereof the following:

"(i) which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer,

"(ii) to which ten or more employers contribute, or to which more than one and fewer than ten employers contribute if the Secretary finds that treating such a plan as a multiemployer plan would be consistent with the purposes of this Act, and";

(B) redesignating clauses (iv) and (v) of paragraph (37)(A) as clauses (iii) and (iv), respectively, and

(C) striking out subparagraph (B) of paragraph (37) and inserting in lieu thereof the following new subparagraph:

"(B) For purposes of this paragraph, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) of the Internal Revenue Code of 1954, determined without regard to section 1563(e)(3)(C) of such Code) shall be deemed to be one employer.".

Subtitle B—Simplifying and Clarifying Amendments

PART 1—REPORTING AND DISCLOSURE

SEC. 111. DISCLOSURE OF STATUS UNDER PENSION PLANS.

Section 105 of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"DISCLOSURE OF STATUS UNDER PENSION PLANS

"SEC. 105. (a) (1) Each administrator of an employee pension benefit plan shall furnish to any plan participant or beneficiary who so requests in writing a statement indicating, on the basis of the latest available information—

"(A) for defined benefits plans, the total benefits accrued, or

"(B) for individual account plans, the balance in the account, and

"(C) for all plans, the proportion of accrued benefits or account balance which is nonforfeitable or the earliest date, assuming continued participation in the plan without a break in service, on which some or all benefits will become nonforfeitable.

"(2) In no case shall a participant or beneficiary be entitled under this subsection to receive more than one report described in paragraph (1) during any one 12-month period.

"(3) If the members of any class of participants or beneficiaries are annually furnished with a statement which contains the information required by this subsection, the requirements of this subsection shall be satisfied respecting the members of such class.

"(4) This subsection shall apply to a plan to which more than one unaffiliated employer is required to contribute only to the extent provided by regulations prescribed by the Secretary.

"(b)(1) Each administrator of an employee pension benefit plan shall report, in such manner and at such time as may be provided in regulations prescribed by the Secretary, to each plan participant who during a plan year—

"(A) (i) terminates his service with the employer, or

"(ii) has a 1-year break in service, and

"(B) is entitled to a deferred vested benefit under the plan as of the end of such plan year, and

"(C) with respect to whom retirement benefits are not paid under the plan during such plan year.

The report required under this subsection shall inform the participant of the nature, amount, and form of the deferred vested benefit to which he is entitled, and shall contain such other information as the Secretary may require.

"(2) Not more than one report shall be required under paragraph (A)(ii) with respect to consecutive 1-year breaks in service.

"(c)(1) Except as provided in paragraph (2) of this subsection, each employer shall, in accordance with regulations prescribed by the Secretary, maintain records with respect to each of his employees sufficient to determine the benefits due or which may become due to such employees. The employer shall furnish the plan administrator information necessary for the administrator to make the reports required by subsections (a) and (b).

"(2) If more than one employer adopts a plan, each such employer shall, in accordance with regulations prescribed by the Secretary, furnish to the plan administrator information necessary for the administrator to maintain the records and make the reports required by subsections (a) and (b). Such administrator shall maintain the records and, to the extent provided under regulations prescribed by the Secretary, make the reports, required by subsections (a) and (b).

"(3) If any person who is required under this section (other than under subsection (a)(1)) to furnish information or to maintain records fails to comply with such requirements, he shall pay to the plan a penalty of $10 for each employee with respect to whom such failure occurs, unless it is shown that such failure is due to reasonable cause.".

SEC. 112. EXEMPTIONS AND MODIFICATIONS.

(a) IN GENERAL.—Section 110 of such Act is amended to read as follows:

"EXEMPTIONS AND MODIFICATIONS

"SEC. 110. The Secretary may by regulation conditionally or unconditionally exempt any employee benefit plan or person, or any class of employee benefits plans or persons, from any requirement of this part or may modify any such requirement if he determines that such exemption or modification is—

"(1) appropriate and necessary in the public interest, and

"(2) consistent with the purposes of this title.".

(b) CONFORMING CHANGES.—(1) Section 104(a) of such Act is amended—

(A) by striking out paragraphs (2) and (3), and by redesignating paragraphs (4) and (5) as (2) and (3), respectively; and

(B) by striking out "paragraph (4)" in paragraph (3) (as redesignated) and inserting in lieu thereof "paragraph (2)".

(2) Section 107 of such Act is amended by striking out "104(a) (2) or (3)" in both places where it appears and inserting in lieu thereof "110".

(3) The last sentence of section 103(a)(3)(A) of such Act is amended by striking out "104(a)(2)" and inserting in lieu thereof "110".

(4) The second sentence of section 103 (a)(4)(A) of such Act is amended by striking out "104(a)(2)" and inserting in lieu thereof "110".

(5) Section 101(a)(2) of such Act is amended by striking out "(c)" immediately preceding the period and inserting in lieu thereof "(b)".

SEC. 113. ELIMINATION OF SUMMARY ANNUAL REPORT.

(a) IN GENERAL.—Section 104(b) of such Act is amended—

(1) by striking out paragraph (3) and redesignating paragraph (4) as (3), and

(2) by inserting before the period at the end of the last sentence of such redesignated paragraph the following: ", but the charge for furnishing a copy of the latest annual report may not exceed $10".

(b) CONFORMING CHANGE.—The third sentence of section 103(a)(3)(A) is amended by striking out "and the summary material required under section 104(b)(3)".

SEC. 114. IMPROVEMENT OF REPORTING REQUIREMENTS.

In order to avoid the reporting of unnecessary information, the Secretary and the Secretary of the Treasury shall develop reporting forms and requirements for employee benefit plans described in section 4(a) and not exempt under section 4(b) which, to the maximum extent feasible and consistent with the purposes of this Act and the Employee Retirement Income Security Act of 1974, take into account the different types and sizes of employee benefit plans. Not later than 12 months after the date of enactment of this Act, the Secretaries shall report to the Congress on the actions taken and proposed to be taken to implement this directive. Not later than 24 months after the enactment of this section, the Secretaries shall submit to the Congress their final written report on the implementation of this section.

SEC. 115. OPINIONS OF ACTUARIES AND ACCOUNTANTS.

Section 103(a) of such Act is amended—

(1) by inserting "except to the extent required by subparagraph (B)," in paragraph (3)(A) after "Such examination shall be conducted in accordance with generally accepted auditing standards,",

(2) by striking out "may" in paragraph (3)(B) and inserting in lieu thereof "shall",

(3) by striking out ", if he so states his reliance" in such paragraph,

(4) by striking out "may" in paragraph (4)(D) and inserting in lieu thereof "shall", and

(5) by striking out ", if he so states his reliance" in such paragraph.

SEC. 116. SCOPE OF ACCOUNTANT'S OPINION.

Section 103(a)(3)(C) of such Act is amended by striking out "need" and inserting in lieu thereof "shall".

SEC. 117. EFFECTIVE DATES.

The amendments made by sections 111 and 112 shall be effective on, and the amendments made by sections 113, 115, and 116 shall apply with respect to plan years beginning on and after, the date of enactment of this Act.

PART 2—MINIMUM STANDARDS

SEC. 121. RECIPROCAL AGREEMENTS.

Section 209 of the Employee Retirement Income Security Act of 1974 is amended in its entirety to read as follows:

"RECIPROCAL AGREEMENTS

"SEC. 209. Notwithstanding any other provision of this title, the contributions made with respect to the employment of an employee pursuant to a collective-bargaining agreement and payable to a pension or welfare plan maintained pursuant to that agreement (hereinafter in this section referred to as the 'away plan') may be transferred to a similar pension or welfare plan established pursuant to another collective-bargaining agreement under which the employee had previously become a participant (hereinafter referred to in this section as the 'home plan') if such transfer is pursuant to a written agreement between the administrator of the away plan and the administrator of the home plan. In any case where contributions received with respect to the employment of an employee are transferred from an away plan to a home plan in accordance with this section, such employment shall be considered as employment under the jurisdiction of the home plan for purposes of computing the accrued benefit and vesting of such employee, but the employer who contributed to the away plan on behalf of such employee shall not be deemed to be an employer maintaining the home plan solely because of such transferred contributions. The Secretary may by regulation establish additional conditions, and such variances and exemptions as are consistent with the purposes of this Act, in order to facilitate such transfer arrangements in the interest of portability and to protect the pension and welfare benefits of employees who become employed under two or more collective bargaining agreements associated with different pension or welfare plans.".

SEC. 122. TECHNICAL CORRECTION.

Section 204(b)(3)(E) of such Act is amended by striking out "a year of participation" and inserting in lieu thereof the following: "1,000 hours of employment".

SEC. 123. DETERMINING PARTICIPATION ON A PLAN YEAR BASIS.

The second sentence of section 202(a)(3)(A) of such Act is amended by inserting "(i)" after "first day of a plan year" and by inserting after "date his employment commenced" the following: "or (ii) in the case of a plan where rights and benefits under this part are determined on the basis of all of an employee's service without regard to the date on which the employee's participation in the plan commenced".

SEC. 124. SUMMATION OF DIFFERENT BENEFIT ACCRUAL RATES.

Section 210(a) of such Act is amended by adding at the end thereof the following new paragraph:

"(4) a multiemployer plan may provide that the accrued benefit to which a participant is entitled upon his separation from the service is—

"(A) (i) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates, or

"(ii) the sum of different rates of benefit accrual for different periods of participation, as defined by employment in different bargaining units, and

"(B) determined, for purposes of subparagraphs (A) and (C) of subsection 204(b)(1), by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.".

SEC. 125. SUSPENSION OF BENEFITS BECAUSE OF REEMPLOYMENT.

Section 203(a)(3)(B) of such Act is amended—

(1) by striking out "in the same trade" in clause (ii) and inserting in lieu thereof ", trade,"; and

(2) by striking out "'employed'." in the last sentence and inserting in lieu thereof the following: "which may, with respect to clause (ii), include self-employment. The permissible period of benefit suspension shall include a period determined pursuant to regulations promulgated by the Secretary in addition to the months in which the employment occurs to the extent necessary to prevent the periodic payment and suspension of pension benefits to workers who have not retired but who continue to work on an irregular basis. The imposition of a financial penalty on a pensioner who fails to report his employment as required by the

rules of a plan shall not be deemed a violation of the vesting requirements of this section. The amount of the financial penalty permitted by the preceding sentence shall be determined pursuant to regulations promulgated by the Secretary but in no event shall the penalty exceed an amount equal to one year's benefit.".

SEC. 126. REDUCTIONS IN RETIREMENT OR DISABILITY BENEFITS.

(a) Section 206(b) of such Act is amended—

(1) by inserting after "plan" in paragraph (1) the following: "or is receiving disability benefits under a welfare plan";

(2) by inserting immediately after "this Act" the following: "(or, in the case of a participant or beneficiary who is receiving disability benefits under a welfare plan, the date of enactment of the ERISA Improvements Act of 1979)"; and

(3) by adding at the end thereof the following new sentence: "A pension plan may not reduce or suspend pension benefits being received by a participant or beneficiary or pension benefits in which a participant who is separated from the service has a nonforfeitable right by reason of any payment made to the participant or beneficiary by the employer maintaining the plan as

the result of an award or settlement made under or pursuant to a workers' compensation law.".

(b) Section 201(1) of such Act is amended by inserting after "plan" the following: ", except as provided in section 206(b)".

SEC. 127. SURVIVOR PROTECTION.

(a) Section 205 of such Act is amended—

(1) by deleting subsection (a) and inserting in lieu thereof the following:

"(a) A pension plan may provide that the normal form of benefit is a form other than an annuity. If a pension plan provides for the payment of benefits in the form of an annuity (whether as the normal form or as an option), such plan shall provide for the payment of the annuity benefits in a form having the effect of a qualified joint and survivor annuity.";

(2) by deleting subsection (b) and inserting in lieu thereof the following:

"(b)(1) A plan which provides that the normal form of benefit is an annuity shall, with respect to any participant who under the plan is credited with at least 10 years of service for vesting purposes under section 203 and who dies before the annuity starting date, provide a survivor's annuity for the participant's spouse—

"(A) which begins on the annuity starting date (determined as if the participant had lived until the earliest retirement age under the plan, or the participant's actual date of death if later, and had retired on such date prior to death), if the spouse is living on such date, and

"(B) except as provided in paragraph (2), the payments under which are not less the payments which would have been made under the survivor's annuity to which such spouse would have been entitled if the participant had terminated employment on his date of death, had survived and retired on such annuity starting date, and had died on the day following such date.

"(2) If on the date of the participant's death, the actuarial equivalent of the survivor's annuity does not exceed $2,000, a plan described in paragraph (1) may distribute the survivor's benefit in the form of a lump sum, or in the form of installments commencing, not later than the annuity starting date specified in paragraph (1) (A).";

(3) by deleting subsection (c) and inserting in lieu thereof the following:

"(c) A plan which provides that the normal form of benefit is a form other than an annuity shall, with respect to any participant who under the plan has at least 10 years of service for vesting purposes under section 203 and who dies before receiving the percentage of his benefit which is nonforfeitable, provide (1) that the participant's benefit is distributed to the surviving spouse in the form of a lump sum, or in installments commencing, not later than 60 days after the end of the plan year in which the participant died, or (2) that the participant's benefit is distributed to the surviving spouse at such other time and in such manner as the plan and the surviving spouse may agree in writing.";

(4) by striking out "(whether or not an election has been made under subsection (c))" in subsection (d);

(5) by striking out subsection (e) and inserting in lieu thereof the following:

"(e)(1) Participants in plans subject to this section shall have the right to elect not to take joint and survivor annuities and the right to revoke such elections and to reelect, subject to the following terms and conditions:

"(A) A document explaining the terms and conditions of the joint and survivor annuity, and the rights and effects of, and procedures pertaining to, election, revocation, and reelection, shall be furnished to each participant a reasonable time before the date on which the participant completes 10 years of service for vesting purposes under section 203.

"(B) Any election, revocation or reelection shall be in writing. The right to elect, revoke, or reelect shall not extend beyond the date of a participant's death or retirement under the terms of the plan, whichever occurs earlier.

"(C) Respecting any participant, the document described in subparagraph (A) need not be furnished more than once if—

"(i) the plan's summary plan description includes an explanation, similar to the explanation described in subparagraph (A), which is generally applicable to all participants and which satisfies the requirements of section 102(a)(1); and

"(ii) the document described in subparagraph (A) makes prominent reference to the fact that the explanation contained therein may be of continuing importance to the participant and should be retained with the summary plan description.

"(2) The Secretary of the Treasury shall prescribe regulations to implement this subsection. Such regulations shall take cognizance of the difficulties certain multiemployer plans may have in furnishing the document described in paragraph (1)(A).";

(6) by striking out "subsection (c)" in subsection (f); and

(7) by striking out "joint and survivor annuity benefits under an election made under subsection (c)" in subsection (h) and inserting in lieu thereof "the sur-

vivors' benefits required under this section, to the extent such increased costs are attributable to the availability of such benefits prior to the normal retirement age under the plan".

(b) Not later than 1 year after the enactment of the ERISA Improvements Act of 1979, the Secretary of the Treasury shall develop versions of model language which can be adopted by various types of plans as amendments which comply with the requirements of this section. The Secretary shall facilitate to the maximum extent possible the administrative processing of determination letter applications resulting from this section.

(c) The amendments made by this section shall apply with respect to plan years beginning on or after the date which is 12 months after the date of enactment of this Act.

SEC. 128. ALIMONY AND SUPPORT PAYMENTS.

Section 206(d) of such Act is amended by adding at the end thereof the following new paragraph:

"(3) Paragraph (1) shall not apply in the case of a judgment, decree or order (including an approval of a property settlement agreement), pursuant to a State domestic relations law (whether of the common law or community property type), which—

"(A) affects the marital property rights of any person in any benefit payable under a pension plan or the legal obligation of any person to provide child support or make alimony payments, and

"(B) does not require a pension plan to alter the effective date, timing, form, duration, or amount of any benefit payments under the plan or to honor any election which is not provided for under the plan or which is made by a person other than a participant or beneficiary.".

PART 3—FUNDING

SEC. 131. FUNDING TO TAKE ACCOUNT OF FUTURE AMENDMENTS.

Section 302(c)(1) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following: "The funding method may take account, and for any plan year beginning after December 31, 1980, shall take account, of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits. In the event any such provision is not implemented at the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with regulations prescribed by the Secretary. A provision adopted but contingent on a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.".

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PART 4—FIDUCIARY RESPONSIBILITY

SEC. 141. GENERAL ASSET ACCOUNT.

Section 401(b) of the Employee Retirement Income Security Act of 1974 is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) In the case of a plan which is funded in whole or in part by a contract or policy of insurance issued by an insurer, the assets of the plan shall include the contract or policy under which the benefits are insured but shall not, solely by reason of the issuance of such contract or policy, include the assets of the insurer issuing the contract or policy except to the extent that such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account. For purposes of this paragraph, the term 'insurer' means an insurance company, insurance service, or insurance organization, qualified to conduct business in a State.".

SEC. 142. REFUND OF MISTAKEN CONTRIBUTIONS.

(a) Section 403(c)(2)(A) of such Act is amended by inserting before the period at the end thereof the following: "or, in the case of a collectively bargained plan maintained by more than one employer, within 6 months after the plan administrator knows that the contribution was made by a mistake of fact or knows that holding a contribution would contravene the provisions of section 302 of the Labor-Management Relations Act, 1947.".

(b) The amendment made by subsection (a) shall be effective as of January 1, 1975, but as regards contributions received by a collectively bargained plan maintained by more than one employer before the date of enactment of the ERISA Improvements Act of 1979, if knowledge by the plan administrator that a contribution was made by mistake or in contravention of section 302 of the Labor-Management Relations Act, 1947, occurred before such date of enactment, such knowledge shall be deemed to have occurred on such date of enactment.

SEC. 143. COFIDUCIARY RESPONSIBILITY.

Section 405 of such Act is amended by adding at the end thereof the following new subsection:

"(e) In the case of a fiduciary other than an individual, the term 'knowledge' in subsection (a)(3) shall mean knowledge actually communicated, or knowledge which, in the normal course of business, should have been communicated, to the fiduciary's officer or employee who is authorized to carry out the fiduciary's responsibilities, obligations, or duties or who in fact carries out such responsibilities, obligations, or duties, regarding the matter to which the knowledge relates.".

SEC. 144. EXEMPTION FOR RECIPROCITY ARRANGEMENTS.

Section 408(b) of such Act is amended by adding at the end thereof the following new paragraph:

"(10) Any transfer of contributions between plans pursuant to section 209, if a plan to which the contributions are tranferred pays not more than a reasonable charge for any administrative expenses reasonably incurred by a plan transferring such contributions.".

PART 5—ADMINISTRATION, ENFORCEMENT, AND ADJUSTMENTS IN APPLICABLE LAW

SEC. 151. ADVISORY COUNCIL.

Paragraph (3) of section 512(a) of the Employee Retirement Income Security Act of 1974 is amended by striking out "(at least one of whom shall be representative of employers maintaining or contributing to multiemployer plans)" and inserting in lieu thereof the following: "(one of whom shall be representative of employers maintaining or contributing to multiemployer plans and one of whom shall be representative of employers maintaining small plans)".

SEC. 152. IMPACT OF INFLATION ON RETIREMENT BENEFITS.

Section 513 of such Act is amended by adding at the end thereof the following new subsection:

"(d) The Secretary shall conduct a study of the feasibility and ramifications of requiring employee pension benefit plans to provide cost-of-living adjustments to benefits payable under such plans. The Secretary shall compile data and analyze the effect inflation is having and may be expected to have on retirement benefits provided by private pension plans. The Secretary shall submit the study required by this subsection to the Congress no later than 24 months after the date of enactment of the ERISA Improvements Act of 1979.".

SEC. 153. REMEDIES.

Section 502 of such Act is amended by—

(1) deleting "105(c)" in subsection (a)(4) and inserting in lieu thereof "105";

(2) by adding at the end of subsection (a) a new paragraph to read as follows:

"(7) by any employee, participant or beneficiary for damages due to reliance on a misrepresentation described in section 515.";

(3) redesignating subsection (b) as paragraph (1) of such subsection and adding a new paragraph (2), to read as follows:

"(2) The Secretary shall not initiate an action to enforce section 517.";

(4) deleting subsection (g) and inserting in lieu thereof the following:

"(g)(1) Except as provided in paragraph (2), in any action under this title by an employee, participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of the action to either party.

"(2) In any action under this title by a fiduciary on behalf of a plan to enforce the provisions of section 517 and in which a judgment in favor of the plan is awarded, the court shall allow a reasonable attorney's fee and costs of the action, to be paid by the defendant.";

(5) deleting "a participant" in subsection (h) and inserting in lieu thereof "an employee, participant", and inserting in subsection (k) "employee," before "participant";

(6) deleting "part 4" in subsection (h) and inserting in lieu thereof "parts 4 and 5"; and

(7) inserting immediately after subsection (k) a new subsection (l), to read as follows:

"(l) Except as provided by paragraph (3)—

"(1) no person or employee benefit plan shall be subject to liability or punishment, civil or criminal, or be required to reimburse or pay money or any other thing of value, as the direct or indirect result of a cause of action explicitly or implicitly alleging that the interest of an employee in an employee benefit plan is, or ought to be characterized as or deemed to be, a security for purposes of section 17(a) of the Securities Act of 1933 or section 10(b) of the Securities Exchange Act of 1934, or within the meaning of any State law which regulates securities;

"(2) no court of the United States shall have jurisdiction of an action or proceeding at law or in equity, to the extent such action or proceeding involves a cause of action explicitly or implicitly alleging that the interest of an employee in an employee benefit plan is, or ought to be characterized as or deemed to be, a security for purposes of section 17(a) of the Securities Act of 1933 or section 10(b) of the Securities Exchange Act of 1934, or within the meaning of any State which regulates securities; and

"(3) paragraphs (1) and (2) shall not apply respecting a cause of action based upon any act or omission which occurred before the date of enactment of the ERISA Improvements Act of 1979.".

SEC. 154. ADJUSTMENTS IN APPLICABLE LAW.

(a) Part 5 of subtitle B of title I of such Act is amended by—

(1) deleting "subparagraph (B)," in section 514(b)(2)(A) and inserting in lieu thereof "subparagraph (B) and subsections (d) (2) and (3),";

(2) deleting "Nothing" where it appears in section 514(d) and inserting in lieu thereof "(1) Except as provided in paragraphs (2) and (3), nothing"; and

(3) adding at the end of section 514(d) the following new paragraphs:

"(2) Notwithstanding any provision of law to the contrary, the interest of an employee in an employee benefit plan is not, and shall not be characterized as or deemed to be, a security for purposes of section 17(a) of the Securities Act of 1933 and section 10(b) of the Securities and Exchange Act of 1934, or within the meaning of any State law which regulates securities.

"(3) Notwithstanding any provision of law to the contrary, an interest or participation—

"(A) in a single or collective trust maintained by a bank or in a separate account maintained by an insurer, and

"(B) issued exclusively to one or more employee benefit plans

is not, and shall not be characterized as or deemed to be, a security for purposes of section 5 of the Securities Act of 1933 and section 12 of the Securities Exchange Act of 1934, or within the meaning of any State law which regulates securities, and such a trust or account holding exclusively assets of one or more such plans is not, and shall not be characterized as or deemed to be, an investment company within the meaning of the Investment Company Act of 1940 or any State law which regulates investment companies.".

(b) Such part is further amended by adding immediately after section 514 the following new subsections, to read as follows:

"MISREPRESENTATION

"SEC. 515. (a) It shall be unlawful for any person to knowingly misrepresent the terms and conditions of an employee benefit plan, the financial condition of a plan, or the status under the plan of any employee, participant or beneficiary.

"(b) No person shall be liable under subsection (a) respecting a document which is required to be disclosed to participants or beneficiaries or to be filed with the Secretary of Labor, the Pension Benefit Guaranty Corporation or the Secretary of the Treasury under this Act or the Internal Revenue Code of 1954, provided that such document satisfies the requirements of such Act or Code and duly promulgated regulations thereunder.

"(c) An employee benefit plan shall not be liable for damages resulting from a misrepresentation described in subsection (a).

"(d) Subsection (a) shall not apply as to any act or omission occurring before the date of enactment of the ERISA Improvements Act of 1979.

"CERTAIN FUNDING VEHICLES

"SEC. 516. (a) Not later than 12 montl : after enactment of the ERISA Improvements Act of 1979, the Secretary shall prescribe regulations to protect participants and beneficiaries of employee benefit plans which are or may be funded wholly or partially by a single or collective trust maintained by a bank or by a separate account maintained by an insurer, if such trust or account holds or is established to hold exclusively plan assets.

"(b) The regulations required by subsection (a) shall include—

"(1) standards to ensure full and fair disclosure of all material facts respecting such trust or account prior to and during the plan's participation in such trust or account, .

"(2) standards for accuracy in the advertising and publicizing of such trust or account, and

"(3) such other standards as the Secretary may specify to protect plan participants and beneficiaries and to assist plan fiduciaries to make appropriate choices from among available funding vehicles.

"(c) In carrying out his responsibilities under this section, the Secretary shall consult with Federal banking authorities, the Securities and Exchange Commission, and State authorities who regulate insurance.

"(d) Duly promulgated regulations of the Secretary pursuant to subsection (a) or other provisions of this title shall be enforceable as provisions of this title under sections 502(a) (3) and (5).

"(e) For purposes of this section—

"(1) the term 'bank' shall have the same meaning as in section 3(38)(B)(ii), and

"(2) the term 'insurer' shall have the same meaning as in section 401(b)(2).

"OBLIGATION OF EMPLOYER TO PAY CONTRIBUTIONS

"SEC. 517. Every employer who is obligated under the terms of a collectively bargained plan (or under the terms of a collective bargaining agreement related to such plan) to make periodic contributions to the plan shall, to the extent not inconsistent with law, make such contributions in accordance with the terms and conditions of such plan or such agreement.".

SEC. 155. PREEMPTION.

Section 514 of such Act is amended by—

(1) adding at the end of subsection (b)(2)(B) the following: "A State insurance law which provides that a specific benefit or benefits must be provided or made available by a contract or policy of insurance issued to an employee benefit plan is a law which relates to an employee benefit plan within the meaning of subsection

(a) and is not a law which regulates insurance within the meaning of subparagraph (A). A provision of State law which requires that a contract or policy of insurance issued to an employee benefit plan must permit a participant to convert or continue protection after it ceases to be provided under the employee benefit plan is a provision of a law described in subparagraph (A) and not a provision of law described in subsection (a).";

(2) adding a new paragraph (5) as follows:

"(5) (A) Except as provided in subparagraph (B), subsection (a) shall not apply to the Hawaii Prepaid Health Care Law (Haw. Rev. Stat. 393-1 through 51), as in effect on January 1, 1979, and to any other State law which is determined by the Secretary to—

"(i) be substantially identical to such Hawaii law on such date, and

"(ii) require benefits which are substantially identical in type and amount to those required or permitted under such Hawaii law on such date.

"(B) Subparagraph (A) shall not apply to any provision of a State law which the Secretary determines to be similar to any provision of parts 1, 4 and 5 of this subtitle.";

(3) adding a new subsection (b)(6) to read as follows:

"(6) Subsection (a) shall not apply respecting any judgment, decree, or order pursuant to a State domestic relations law (whether of the common law or community property type), if such judgment, decree or order is described in section 206(d)(3)."; and

(4) adding a new subsection (e) to read as follows:

"(e) For purposes of subsections (d) (2) and (3) and sections 515, 516, and 517, the term 'employee benefit plan' shall include any employee benefit plan—

"(1) defined in section 3(3), irrespective of whether the only participants in the plan are owner-employees as defined in section 401(c)(3) of the Internal Revenue Code of 1954, and

"(2) which is described in section 4(a) and not exempt under section 4(b).".

EFFECTIVE DATES

SEC. 156. (a) Except as otherwise provided by this Act, the provisions of this Act and the amendments made by this Act to the Employee Retirement Income Security Act of 1974 and to the Internal Revenue Code of 1954 shall be effective on the date of enactment of this Act.

(b) Section 514(d)(3), as amended, shall be effective 12 months after the enactment of this Act.

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 201. LUMP SUM DISTRIBUTIONS; PLANS TREATED AS SINGLE PLAN.

(a) GENERAL RULE.—Section 402(e)(4)(C) of the Internal Revenue Code of 1954 (relating to aggregation of certain trusts and plans) is amended to read as follows:

"(C) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under subparagraph (A)—

"(i) all trusts which are part of a plan shall be treated as a single trust,

"(ii) in the case of a multiemployer plan (as defined in section 3(37) of ~~the~~ Employee Retirement Income Security Act of 1974), all defined benefit plans maintained by an employer shall be treated as a single plan, and all defined contribution plans maintained by an employer shall be treated as a single plan,

"(iii) in the case of any plan not described in clause (ii), all pension plans maintained by an employer shall be treated as a single plan, all profit-sharing plans maintained by an employer shall be treated as a single plan, and all stock bonus plans maintained by an employer shall be treated as a single plan, and

"(iv) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of enactment of this Act.

SEC. 202. LUMP SUM DISTRIBUTIONS; SEPARATION FROM THE SERVICE.

(a) GENERAL RULE.—Section 402(e)(4) of the Internal Revenue Code of 1954 (relating to definitions and special rules) is amended by adding at the end thereof the following new subparagraph:

"(M) SEPARATION FROM THE SERVICE.—For purposes of subparagraph (A), in the case of any multiemployer plan (as defined in section 3(37) of the Employee Retirement Income Security Act of 1974), a separation from the service shall be deemed to have occurred in the case of any employee if such employee has not worked in service covered by the plan for a period of 6 consecutive months after severing his employment relationship with any employer maintaining the plan.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to plan years beginning after the date of enactment of this Act.

SEC. 203. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS AND CONTRIBUTIONS.

(a) IN GENERAL.—

(1) DEDUCTION ALLOWED.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to additional itemized deductions for individuals) is amended by redesignating section 221 as 222 and by inserting after section 220 the following new section:

"SEC. 221. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS CONTRIBUTIONS.

"(a) DEDUCTION ALLOWED.—In the case of an eligible employee, described in subsection (c), there is allowed as a deduction amounts paid in cash for a taxable year by such individual for the benefit of himself—

"(1) to a plan described in section 401(a) which includes a trust exempt from tax under section 501(a), "(2) to an annuity plan described in section 403(a),

"(3) to a qualified bond purchase plan described in section 405(a),

"(4) to an individual retirement account described in section 408(a), individual retirement annuity described in section 408(b), or for a retirement bond described in section 409, or

"(5) to a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable.

"(b) LIMITATION AND RESTRICTION.—

"(1) MAXIMUM DEDUCTION.—The amount allowable as a deduction under subsection (a) to an eligible employee for any taxable year may not exceed an amount equal to 10 percent of the compensation includible in his gross income for such taxable year, or $1,000, whichever is less.

"(2) ADDITIONAL LIMITATION.—No deduction is allowed for any amount paid to an account, annuity, or for a bond described in paragraph (4) of subsection (a) except to the extent of the excess of the amount determined under paragraph (1) over any amount paid by the eligible employee to a plan or trust described in paragraph (1), (2), (3) or (5) of subsection (a).

"(3) ALTERNATIVE DEDUCTION.—No deduction is allowed under subsection (a) for the taxable year if the individual claims the deduction allowed by section 219 or 220 for the taxable year.

"(4) EXCEPTION WHERE PLAN IS DISCRIMINATORY.—No deduction is allowed under subsection (a) for a highly compensated participant (as defined in subsection (c)(7)) unless the employer certifies in accordance with regulations prescribed by the Secretary that the plan satisfies the discrimination standards in subsection (c)(6).

"(5) EXCEPTION RESPECTING CERTAIN PLANS.—No deduction is allowed under subsection (a) for any amount paid by a participant to a plan described in paragraph (1), (2) or (3) of subsection (a) which was not in existence on January 1, 1978 (or to a successor to such a plan) if, under the terms of such plan (or successor plan), employee contributions are mandatory or employer contributions are not made unless contributions are made by employees.

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) ELIGIBLE EMPLOYEE.—For purposes of this section, the term 'eligible employee' shall mean an individual who is an employee without regard to section 401(c)(1) or is a member of a labor organization referred to in subparagraph (D) and who is an active participant for any part of the taxable year in—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a),

"(C) a qualified bond purchase plan described in section 405(a), or

"(D) a group retirement trust maintained by a labor organization described in section 501(c)(5) which is financed exclusively by assessments of individuals who are members of such labor organization, which was established prior to January 1, 1974, and in which the assessments paid to the trust by any participant are 100 percent nonforfeitable,

but not if such plan is established or maintained by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

"(2) REPORTS.—The Secretary shall promulgate regulations which prescribe the time and manner in which reports shall be filed by an employer receiving contributions deductible under this section and by any eligible employee making any such deductible contribution.

"(3) RECONTRIBUTED AMOUNTS.—No deduction shall be allowed under this section with respect to a rollover contribution described in section 402(a)(5), 402(a)(6), 402(a)(7), 403(a)(4), 403(a)(5), 403(b)(8), 408(d)(3), or 409(b)(3)(C).

"(4) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which are properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(5) MARRIED INDIVIDUALS.—In the case of an individual who is married (as determined under section 143), the maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(6) DISCRIMINATION STANDARDS.—

"(A) A plan satisfies the discrimination standards if the actual deferral percentage for highly compensated participants (as defined in paragraph (7)) for a plan year bears a relationship to the actual deferral percentage for all other participants for such plan year which meets either of the following tests:

"(i) The actual deferral percentage for the group of highly compensated participants is not more than the actual deferral percentage of all other participants multiplied by 1.5.

"(ii) The excess of the actual deferral percentage for the group of highly compensated participants over that of all other participants is not more than 3 percentage points, and the actual deferral percentage for the group of highly compensated participants is not more than the actual deferral percentage of all other participants multiplied by 2.5.

"(B) For purposes of subparagraph (A), the actual deferral percentage for a specified group of participants for a plan year shall be the average of the ratios (calculated separately for each participant in such group) of—

"(i) the amount deducted on behalf of each participant for such plan year, to

"(ii) the participant's total compensation for such plan year.

For purposes of the preceding sentence, the amount deducted on behalf of a highly compensated participant shall be determined without regard to the exception in subsection (b)(4).

"(7) HIGHLY COMPENSATED PARTICIPANT.—For purposes of this section, the term 'highly compensated participant' means any participant who is more highly compensated than two-thirds of all participants but only if such participant's compensation for a plan year equals or exceeds the salary of an employee of the United States who is compensated at a rate equal to the annual rate paid for step 1 of grade GS-12. No individual who participates during a plan year only in a group retirement trust described in subsection (a)(5) shall be considered a highly compensated participant for such year.".

(2) DEDUCTION ALLOWED IN ARRIVING AT ADJUSTED GROSS INCOME.—Section 62 of such Code

(defining adjusted gross income) is amended by inserting after paragraph (14) the following new paragraph:

"(15) DEDUCTION FOR CERTAIN CONTRIBUTIONS.—The deduction allowed by section 221 (relating to certain employee retirement savings contributions).".

(b) TAX TREATMENT OF CERTAIN DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—Subpart A of part I of subchapter D of chapter 1 of such Code (relating to retirement plans) is amended by inserting after subsection (l) of section 414 the following new subsection:

"(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For purposes of this title, other than for purposes of sections 401 (a) (4) and (5), 404, 410(b), 411, and 412, any amount which an employer is required to report pursuant to regulations promulgated under subsection (c)(2) of section 221, with respect to an amount paid by an eligible employee, as defined in subsection (c)(1) of section 221, as an employee retirement savings contribution, shall be treated as an employer contribution.".

(c) CONFORMING AMENDMENTS.—

(1) So much of section 72(f) of such Code as precedes paragraph (1) thereof is amended to read as follows:

"(f) SPECIAL RULES FOR COMPUTING EMPLOYEE'S CONTRIBUTIONS.—In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other consideration paid, amounts which an employer is required to report, pursuant to regulations promulgated under subsection (c)(2) of section 221, with respect to an amount paid by an eligible employee, as defined in subsection (c)(1) of section 221, as a retirement savings employee contribution shall be excluded, and amounts contributed by the employer shall be included, but only to the extent that—".

(2) Section 414(h) of such Code (Tax treatment of certain contributions) is amended by inserting after "any amount contributed" the following: "other than an amount described in subsection (m)".

(3) So much of section 4973(b) of such Code as follows paragraph (1)(A) thereof is amended to read as follows:

"(B) the amount allowable as a deduction under section 219, 220, or 221 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

"(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 408(d)(1),

"(B) the distributions out of the account for the taxable year to which section 408(d)(5) applies, and

"(C) the excess (if any) of the maximum amount allowable as a deduction under section 219, 220, or 221 for the taxable year over the amount contributed (determined without regard to sections 219(c)(5) and 220(c)(6)) to the accounts or for the annuities or bonds for the taxable year.

For purposes of this subsection, any contribution which is distributed from the individual retirement account, individual retirement annuity, or bond in a distribution to which section 408(d)(4) applies shall be treated as an amount not contributed.".

(d) Effective Date.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 204. CREDIT FOR THE ESTABLISHMENT OF QUALIFIED PLANS BY SMALL EMPLOYERS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"SEC. 44D. ESTABLISHMENT OF NEW SMALL BUSINESS EMPLOYER RETIREMENT PLANS.

"(a) GENERAL RULE.—In the case of a small business employer who maintains or makes contributions to or under a qualified employer retirement plan, there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to a percentage (determined under subsection (b)) of the amount allowable for the taxable year to such employer as a deduction under section 404.

"(b) DETERMINATION OF PERCENTAGE.—The percentage applicable under subsection (a) for a taxable year is—

"(1) 5 percent for the first taxable year for which a deduction under section 404 is allowable to the taxpayer,

"(2) 3 percent for each of the succeeding 2 taxable years, and

"(3) 1 percent for each of the 2 taxable years succeeding the 2 taxable years referred to in paragraph (2).

"(c) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

"(1) QUALIFIED EMPLOYER RETIREMENT PLAN.—The term 'qualified employer retirement plan' means—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a);

"(B) an annuity plan described in section 403(a); and

"(C) a qualified bond purchase plan described in section 405(a).

"(2) SMALL BUSINESS EMPLOYER.—The term 'small business employer' means an employer (within the meaning of section 404) which—

"(A) during the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed, had a monthly average of fewer than 100 employees, and

"(B)(i) if a corporation, had earnings and profits for the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed equal to no more than $50,000, or "(ii) if an unincorporated trade or business or a partnership, had net profits for the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed equal to no greater than $50,000.

"(3) DISREGARD FOR AMOUNTS ATTRIBUTABLE TO EMPLOYER SECURITIES.—In determining the amount of the credit allowable under subsection (a) for any taxable year, any portion of the deduction allowed for such year which is attributable to the transfer to or under the plan of employer securities (as defined in section 407(d)(1) of the Employee Retirement Income Security Act of 1974) shall be disregarded.

"(d) APPLICATION WITH OTHER SECTIONS.—The amount of the deduction allowable under section 404 for any taxable year shall not be reduced because of the allowance of a credit under this section for the taxable year.

"(e) TERMINATIONS.—No credit is allowable under subsection (a) for any taxable year to an employer (or successor to such an employer) who terminates a qualified employer retirement plan during the taxable year.".

(b) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44D. Establishment of new small business employer retirement plans.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after the date of enactment of this Act.

SEC. 205. CONFORMING AMENDMENTS FOR ERISA CHANGES IN TITLE I.

(a) CONFORMING AMENDMENTS FOR SECTION 102.—

(1) Paragraph (2) of section 4975(e) of such Code (relating to definition of disqualified person) is amended—

(A) by striking out subparagraphs (A) through (D) and inserting in lieu thereof the following:

"(A) any fiduciary, counsel, or employee of such plan;

"(B) a person providing professional services to such plan, or a person providing nonprofessional services on a continuous basis to such plan;

"(C) an employer any of whose employees are covered by such plan, if the employees of such employer constitute 5 percent or more of all employees covered by the plan;

"(D) an employee organization any of whose members are covered by such plan, if the members of such employee organization constitute 5 percent or more of all employees covered by the plan;",

(B) by striking out subparagraph (I) and inserting in lieu thereof the following:

"(I) a 10 percent or more (in capital or profits) partner, or joint venturer in, a person described in subparagraph (C), (D), (E), or (G).";

(C) by inserting "brother, sister," immediately before "spouse," the first time it appears in paragraph (6);

(2) Subsection (f) of section 414 of such Code (relating to definition of multiemployer plan) is amended by—

(A) striking out subparagraphs (A), (B), and (C) of paragraph (1) of such subsection and inserting in lieu thereof the following:

"(A) which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer,

"(B) to which 10 or more employers contribute, or to which more than one and fewer than 10 employers contribute if the Secretary of Labor finds that treating such a plan as a multiemployer plan would be consistent with the purposes of this Act, and";

(B) redesignating subparagraphs (D) and (E) of paragraph (1) of such subsection as subparagraphs (C) and (D), respectively, and

(C) striking out paragraph (2) of such subsection and inserting in lieu thereof the following new paragraph:

"(2) For purposes of this subsection, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) determined without regard to section 1563(e)(3)(C)) shall be deemed to be one employer.".

(b) CONFORMING AMENDMENT FOR SECTION 111.—Subparagraph (C) of section 6057(a)(2) of such Code (relating to annual registration) is amended by redesignating clauses (ii) and (iii) as (iii) and (iv), and by inserting after (i) the following new clause:

"(ii) who has a 1-year break in service,".

(c) CONFORMING AMENDMENT FOR SECTION 121.—Subsection (l) of section 414 of such Code (relating to mergers and consolidations of plan or transfers of plan assets) is amended by striking out "A trust" and inserting in lieu thereof "except in the case of a reciprocal agreement described in section 209 of the Employee Retirement Income Security Act of 1974, a trust".

(d) CONFORMING AMENDMENT FOR SECTION 122.—Subparagraph (E) of section 411(b)(3) of such Code (relating to maritime industries) is amended by striking out "a year of participation" and inserting in lieu thereof "1,000 hours of employment".

(e) CONFORMING AMENDMENT FOR SECTION 123.—Subparagraph (A) of section 410(a)(3) of such Code (relating to definition of year of service) is amended by striking out "by reference to" and all that follows and inserting in lieu thereof the following: "by reference to—

"(i) in the case of an employee who does not complete 1,000 hours of service during the 12-month period beginning on the date his employment commenced, the first day of a plan year, and

"(ii) in the case of a plan where rights and benefits are determined on the basis of all of an employee's service, without regard to the date on which the employee's participation in the plan commenced.".

(f) CONFORMING AMENDMENT FOR SECTION 124.—Subsection (c) of section 413 of such Code (relating to plans maintained by more than one employer) is amended by inserting after paragraph (4) the following new paragraph:

"(4A) SUMMATION OF DIFFERENT BENEFIT ACCRUAL RATES.—The accrued benefit to which a participant is entitled upon a separation from the service is—

"(A)(i) the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates, or

"(ii) the sum of different rates of benefit accrual for different periods of participation, as defined by employment and different bargaining units, and

"(B) determined, for purposes of subparagraphs (A) and (C) of section 411(b)(1), by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to his period of actual participation.".

(g) CONFORMING AMENDMENT FOR SECTION 125.—Subparagraph (B) of section 411(a)(3) of such Code (relating to certain permitted forfeitures, suspensions, etc.) is amended—

(1) by striking out "the same trade" and inserting in lieu thereof "trade,", and

(2) by striking out "'employed'" in the last sentence of subparagraph (B) and inserting in lieu thereof the following: "'employed', which may, with respect to clause (ii), include self employment. The permissible period of benefit suspension shall include a period, determined pursuant to regulations promulgated by the Secretary of Labor, in addition to the months in which the employment occurs to the extent necessary to prevent the periodic payment and suspension of pension benefits to workers who have not retired but who continue to work on an irregular basis. The imposition of a financial penalty on a pensioner who fails to report his employment as required by the rules of a plan shall not be treated as a violation of the requirements of this section. The amount of the financial penalty permitted by the preceding sentence shall be determined pursuant to regulations promulgated by the Secretary of Labor, but in no event shall the penalty exceed an amount equal to one year's benefit.".

(h) CONFORMING AMENDMENT FOR SECTION 126.—Paragraph (15) of section 401(a) of such Code (relating to prohibited decreases in benefit levels) is amended by adding at the end thereof the following: "A trust shall not constitute a qualified trust under this section unless under the plan of which such trust is a part, the plan may not refuse pension benefits being received by a participant or beneficiary, or pension benefits in which a participant who is separated from the service has a nonforfeitable right by reason of any payment made to the participant or beneficiary by the employer maintaining the plan, as a result of an award or settlement made under or pursuant to a workers' compensation law.".

(i) CONFORMING AMENDMENT FOR SECTION 127.—Paragraph (11) of section 401(a) of such Code (relating to joint and survivor annuities) is amended—

(1) by inserting "(whether as the normal form or as an option)" after "annuity" the first time it appears in subparagraph (A);

(2) by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) A plan which provides that the normal form of benefit is an annuity does not meet the requirements of subparagraph (A) unless, with respect to any participant who, under the plan, is credited with at least ten years of service (for purposes of section 411) and who dies before the annuity starting date, the plan provides a survivor's annuity for the participant's spouse—

"(i) which begins on the annuity starting date (determined as if the participant had lived until the earliest retirement age under the plan, or the participant's actual date of death if later, and had retired on such date prior to death), if the spouse is living on such date, and

"(ii) except as otherwise provided in this subparagraph, the payments under which are not less than the payments which would have been made under the survivor's annuity to which such spouse would have been entitled if the participant had terminated employment on his date of death, had survived and retired on such annuity starting date, and had died on the day following such date.

If, on the date of the participant's death, the actuarial equivalent of the survivor's annuity does not exceed $2,000, a plan described in this subparagraph will not be considered not to meet the requirements of subparagraph (A) if it distributes the survivor's benefit in the form of a lump sum, or in the form of installments commencing not later than the annuity starting date specified in clause (i).";

(3) by striking out subparagraph (C) and inserting in lieu thereof the following:

"(C) A plan which provides that the normal form of benefit is a form other than an annuity shall not be treated as satisfying the requirements of this paragraph unless, with respect to any participant who under the plan has at least 10 years of service for purposes of section 411 and who dies before receiving the percentage of his benefit which is nonforfeitable, the plan provides that the participant's benefit will be distributed to the surviving spouse in the form of a lump sum, or in installments commencing, not later than 60 days after the end of the plan year in which the participant died.";

(4) by striking out "whether or not an election described in subparagraph (C) has been made under subparagraph (C)" in subparagraph (D);

(5) by striking out subparagraph (E) and inserting in lieu thereof the following:

"(E) A plan shall not be treated as satisfying the requirements of this paragraph unless participants in the plan have the right to elect not to take joint survivor annuities, and the right to revoke such elections and to reelect, under the following circumstances:

"(i) A document explaining the terms and conditions of the joint survivor annuity, the effect of an election, and the rights of, and procedures pertaining to, election and revocation, is furnished to each participant a reasonable time before the date on which the participant completes 10 years of service for the purposes of section 411.

"(ii) Any election, revocation, or reelection is in writing, and the right to elect, revoke, or reelect does not extend beyond the date of a participant's death or retirement under the terms of the plan, whichever first occurs.

"(iii) With respect to any participant, the document described in clause (i) need not be furnished more than once if—

"(I) the plan's summary plan description includes an explanation, similar to the explanation described in clause (i), which is generally applicable to all participants, and

"(II) the document described in clause (i) makes prominent reference to the fact that the explanation contained therein may be of continuing importance to the participant and should be retained with the summary plan description.";

(6) by striking out "(C) or" in subparagraph (F);

(7) by inserting after "joint and survivor annuity benefits" in subparagraph (G) the following: "as of the date on which a participant completes 10 years of service for purposes of section 411"; and

(8) by striking out "joint and survivor annuity benefits." in the last sentence of such paragraph and inserting in lieu thereof the following: "the survivors' benefits required under this paragraph, to the extent such increased costs are attributable to the availability of such benefits prior to the normal retirement age under the plan. Regulations of the Secretary under this paragraph shall take cognizance of the difficulty certain multiemployer plans may have in furnishing the document described in subparagraph (E)(i).".

(j) CONFORMING AMENDMENT FOR SECTION 125.—Paragraph (13) of section 401(a) of such Code (relating to assignment or alienation of benefits) is amended by adding at the end thereof the following new section: "For purposes of the first sentence of this paragraph, there shall not be taken into account any assignment or alienation of benefits under the plan required by a judgment, decree or order (including an approval of a property settlement agreement), pursuant to a State domestic relations law (whether of the common law or community property type), which—

"(A) affects the marital property rights of any person in any benefit payable under the plan or the legal obligation of any person to provide child support or make alimony payments, and

"(B) does not require the plan to alter the effective date, timing, form, duration or amount of any benefit payments under the plan or to honor any election which is not provided for under the plan or which is made by a person other than a participant or beneficiary.".

(k) CONFORMING AMENDMENT FOR SECTION 131.—Subparagraph (A) of section 412(c)(2) of such Code (relating to valuation of assets) is amended by adding at the end thereof of the following new sentence: "The funding method may take account, and for any plan year beginning after December 31, 1980, shall take account, of all provisions of the plan, including provisions which have not yet affected any participant as to entitlement to, or accrual of, benefits. In the event any such provision is not implemented at the time specified when the provision was adopted, the funding standard account shall be appropriately adjusted in accordance with the regulations prescribed by the Secretary. A provision adopted but contingent upon a future event shall be deemed not to be in effect as a provision of the plan prior to the occurrence of that event.".

(l) CONFORMING AMENDMENT FOR SECTION 142.—Paragraph (2) of section 401(a) of such Code (relating to exclusive benefit of employees and beneficiaries) is amended by inserting before the semicolon at the end thereof the following: "(but this paragraph shall not be construed, in the case of a collectively bargained plan maintained by more than one employer, to prohibit the return of a contribution within 6 months after the plan administrator knows that the contribution was made by a mistake of fact or knows that holding the contribution would contravene the provisions of section 302 of the Labor-Management Relations Act, 1947)".

(m) CONFORMING AMENDMENT FOR SECTION 144.—Subsection (d) of section 4975 of such Code (relating to exemptions from prohibited transaction rules) is amended—

(1) by striking out "or" at the end of paragraph (12),

(2) by striking out the period at the end of paragraph (13) and inserting in lieu thereof a semicolon and "or", and

(3) by inserting after paragraph (13) the following new paragraph:

"(14) any transfer of contributions between plans under section 209 of the Employee Retirement Income Security Act of 1974, if the plan to which the contributions are transferred pays not more than a reasonable charge for any administrative expenses reasonably incurred by the plan transferring the contributions.".

TITLE III—SPECIAL MASTER AND PROTOTYPE PLANS

SEC. 301. SPECIAL MASTER AND PROTOTYPE PLANS.

(a) IN GENERAL.—Subtitle B of title I of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new part:

"PART 6—SPECIAL MASTER AND PROTOTYPE PLANS

"SPECIAL MASTER AND PROTOTYPE PLANS

"SEC. 601. (a) For purposes of this section—

"(1) 'special master plan' means a master or prototype employee pension benefit plan which has been approved by the Secretary of Labor in accordance with subsection (d), all of the assets of which are controlled by one or more master sponsors,

"(2) 'master sponsor' means any person who is the sponsor of a special master plan and who—

"(A) has the power to manage, acquire, or dispose of any asset of an adopting employer's plan, and

"(B) is (i) registered as an investment advisor under the Investment Advisor's Act of 1940; (ii) is a bank, as defined in that Act; or (iii) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State,

"(3) 'adopting employer' means an employer any of whose employees are covered under a special master plan, or an association of such employers.

"(b) Notwithstanding any other provisions of this Act or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the responsibilities, duties, and obligations of an adopting employer under parts 1, 2, 3, and 4 of this subtitle shall be limited to making such timely contributions and payments, and furnishing such timely, complete, and accurate information, as may be required under the terms of the plan; and

"(2) the requirements of the Internal Revenue Code of 1954 which are applicable to the design of the plan of the adopting employer shall be deemed to be initially satisfied as of the date the adopting employer and master sponsor execute the special master plan joinder agreement.

"(c) Notwithstanding any other provisions of this Act or the Internal Revenue Code of 1954 to the contrary, in the case of a special master plan—

"(1) except as provided in subsection (e), the master sponsor shall be the administrator of and a fiduciary respecting each adopting employer's plan for the purposes of this Act of such Code;

"(2) the requirements of section 102(b), if otherwise satisfied, will not be violated if—

"(A) the plan description of an adopting employer's plan includes plan provisions common to the plans of all employers adopting the special master plan, together with a description of each type of variation from such common provisions that is permitted under the terms of the approval provided for in subsection (d), and an identification, by name of adopting employer, employer identification number, name of plan, and plan identification number of the employers who have adopted, and the plans containing, each such variation, and

"(B) the summary plan description of each adopting employer's plan describes provisions common to the plans of all employers adopting the special master plan, together with a description of any provisions of such adopting employer's plan which vary from such common provisions, with appropriate cross-references;

"(3) the requirements of section 103 of this Act and of section 6058 of the Internal Revenue Code of 1954, if otherwise satisfied, will not be violated merely because data in the annual report reflect the aggregate assets of the special master plan, if the annual report also includes an identification, by name of adopting employer, employer identification number, name of plan, and plan identification number, of the percentage of total special master plan assets attributable to each adopting employer's plan;

"(4)(A) the exemption described in section 408(b)(2) of this Act and in section 4975(d)(2) of the Internal Revenue Code of 1954 shall be applied as if any master sponsor of a special master plan or a party in interest respecting such plan for a reason other than by virtue of such person's being a fiduciary, and

"(B) the term 'bank or similar financial institution' in section 408(b)(6) of this Act and in section 4975(d)(6) of the Internal Revenue Code of 1954 shall be deemed to mean any master sponsor, and the term 'sound banking and financial practice' in such sections shall, in the case of a master sponsor other than a bank, be deemed to mean 'sound fiduciary practice'; and

"(5) no master sponsor shall have a responsibility, obligation, or duty under this Act or the Internal Revenue Code of 1954—

"(A) to ascertain whether information required to be furnished to the master sponsor by an adopting employer pursuant to the terms of a special master plan is accurate or complete,

"(B) due to the failure of an adopting employer to satisfy the requirements of subsection (b)(1), or

"(C) respecting the decision of an employer to adopt the master sponsor's plan, except as regards the advertising or publicizing of and disclosures concerning trusts and accounts described in section 516 of this Act.

"(d)(1) The Secretary of Labor and the Secretary of the Treasury shall prescribe such regulations, and furnish such rulings, opinions, forms, and other types of guidance as are necessary to implement this section. To the greatest extent consistent with the purposes of this Act and the Internal Revenue Code of 1954, such regulations and other types of guidance shall be designed to facilitate the development of special master plans and their adoption by employers. Initial regulations and forms, sufficient to enable perspective master sponsors to submit special master plans for approval, shall be issued on or before the effective date specified in section 301(c) of the ERISA Improvements Act of 1979.

"(2)(A) The Secretary shall approve a special master plan only if he determines that the plan of an adopting employer, in design and in operation, will satisfy the requirements of this section, and of other applicable requirements of this Act and of the Internal Revenue Code of 1954 (to the extent that such Act and Code are not inconsistent with this section).

"(B) The Secretary shall not approve any special master plan unless he has first submitted the plan to the Secretary of the Treasury for review, together with such information as the Secretary of the Treasury may request. The review of the Secretary of the Treasury shall be limited to the applicability of, and compliance with, the provisions of the Internal Revenue Code of 1954. The Secretary of the Treasury shall either concur in the approval or refuse to concur. If the Secretary of the Treasury refuses to concur, he shall specify the changes that must be made in the plan to obtain his concurrence. In the case of a refusal, the Secretary shall not approve the plan unless the specified changes are made. If the Secretary of the Treasury fails to concur or refuses to concur within 270 days after such submittal, the failure shall be deemed to be a failure described in section 7476(a)(2)(A) of such Code, and—

"(i) the master sponsor shall be deemed to be a 'plan administrator' for the purposes of subsection (b)(1) of such section,

"(ii) subsections (b)(2) through (b)(5) of such section shall not be applicable, and

"(iii) the special master plan shall be deemed to be a 'retirement plan' within the meaning of subsection (d) of such section.

"(3) Approval of special master plans and amendments to such plans shall be accomplished by a process carried out in the national office of the Secretary, until such time as he may establish procedures for field office approval under which uniformity of treatment by field offices is assured.

"(4) Upon approval of a special master plan, or of any amendment to such a plan for which approval is required, a special master plan certificate shall be issued to the master sponsor by the Secretary. Except as provided in paragraph (5), for a period of 60 months from the date of adoption of the plan by an employer or from the effective date of an amendment for which approval is required, such certificate or duly notorized copy thereof shall be prima facie evidence in any administrative or judicial proceeding that the terms and conditions of the plan meet the applicable requirements of this

Act and of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954.

"(5) The Secretary, after notice and hearing, and after consultation with the Secretary of the Treasury respecting the applicability of or compliance with the Internal Revenue Code of 1954, shall revoke the certificate described in paragraph (4)—

"(A) respecting the plan of any adopting employer, if he finds that there has been a failure on the part of the employer to observe the terms and conditions of the plan and that such failure has been detrimental to the rights of plan participants or beneficiaries under the terms and conditions of the plan, this Act, or such Code; and

"(B) respecting the special master plan, if he finds that there has been a failure to observe the terms and conditions of the plan or the provisions of this section on the part of the master sponsor and that such failure has been detrimental to the rights of plan participants under the terms and conditions of the plan, this Act, or such Code.

"(6) The certificate issued by the Secretary upon the approval of a special master plan, or upon the approval of an amendment to such a plan for which approval is required,

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shall specify the types of amendments, if any, for which approval need not be obtained.

"(7) Nothing in this section shall limit the power of the Secretary of the Treasury, after audit, to determine that the plan of any adopting employer, in operation, has failed to meet the applicable requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, but no such plan shall be treated as not having met such requirements for any plan year preceding the year in which the Secretary of the Treasury makes such determination unless the determination includes a finding that the failure to meet such requirements in any such preceding year was a result of intentional failure or willful neglect on the part of the adopting employer.

"(e)(1) Any adopting employer who fails to make such timely contributions and payments or who fails to furnish such timely, complete and accurate information as may be required under the terms of a special master plan shall, in accordance with the terms of such plan, be deemed to be the administrator of the plan (only to the extent the plan covers the employees of such adopting employer), as of the time specified in such plan, and as of such specified time the master sponsor shall cease to be the administrator and a fiduciary of such adopting employer's plan.".

"(2) To the extent that an adopting employer, under the terms of a special master plan, assumes responsibility for furnishing the summary plan description or other documents required to be furnished or otherwise made available to participants, beneficiaries, or employees under the provisions of part 1 of this subtitle, section 3001 of this Act or section 6057 of the Internal Revenue Code of 1954, such adopting employer shall be deemed to be the administrator of the plan (only to the extent the plan covers the employees of such employer), and the master sponsor shall not be the administrator regarding the responsibilities undertaken by such adopting employer.".

(b) The table of contents for the Employee Retirement Income Security Act of 1974 is amended by inserting immediately after the item relating to section 517 the following:

"PART 6—SPECIAL MASTER AND PROTOTYPE PLANS

"Sec. 601. Special master and prototype plans.".

(c) The amendments made by this section shall take effect 12 months after the date of enactment of this Act.

TITLE IV—EMPLOYEE BENEFITS COMMISSION

SEC. 401. EMPLOYEE BENEFITS COMMISSION.

(a) ESTABLISHMENT.—There is established, as an independent agency within the executive branch of the Government, the Employee Benefits Commission. The Commission is composed of—

(1) a chairman, who shall be the special liaison officer for the Secretary of Labor appointed under paragraph (1) of subsection (b),

(2) a vice chairman, who shall be the special liaison officer for the Secretary of the Treasury appointed under paragraph (2) of subsection (b), and

(3) three additional members appointed by the President, by and with the advice and consent of the Senate, selected from a list of nominees submitted jointly by the Secretary of Labor and the Secretary of the Treasury.

(b) LABOR AND TREASURY DEPARTMENT LIAISON OFFICERS.—

(1) There is established within the office of the Secretary of Labor, the position of special liaison officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of Labor and shall serve for a term of years in accordance with the provisions of subsection (c). The special liaison officer shall report regularly to the Secretary of Labor on the activities of the Commission.

(2) There is established within the office of the Secretary of the Treasury the position of special liaison

officer to the Employee Benefits Commission. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of the Treasury and shall serve for a term of years in accordance with the provisions of subsection (c). The special liaison officer for the Treasury shall report regularly to the Secretary of the Treasury on the activities of the Commission.

(c) TERMS OF OFFICE.—

(1) NUMBER OF YEARS.—Members of the Commission shall serve for terms of 6 years, except—

(A) the special liaison officer for the Secretary of the Treasury first appointed after the date of enactment of this Act shall serve for a term of 3 years, and

(B) of the 3 members of the Commission initially appointed under paragraph (3) of subsection (a), one shall serve for a term of 2 years, one shall serve for a term of 4 years, and one shall serve for a term of 6 years.

(2) SERVICE BEYOND EXPIRATION DATE.—A member of the Commission may serve as a member of the Commission after the expiration of his term until a

successor has taken office as a member of the Commission.

(3) VACANCY APPOINTMENTS.—An individual appointed to fill a vacancy occurring other than by the expiration of a term of office shall be appointed only for the unexpired term of the member such individual succeeds.

(4) POLITICAL AFFILIATION.—Not more than 3 members of the Commission may be affiliated with the same political party.

(d) COMPENSATION.—Members of the Commission shall receive compensation equivalent to the compensation paid at level III of the Executive Schedule.

(e) FUNCTIONS.—The Commission shall—

(1) formulate policy respecting Federal laws which now or may hereafter relate to employee benefit plans,

(2) administer and enforce titles I and IV of such Act, and

(3) administer and obtain compliance with—

(A) sections 401, 410, 411, 412, 413, 414, 6057, and 6058 of the Internal Revenue Code of 1954, and

(B) such other provisions of such Code as are designated under subsection (f), insofar as such sections and provisions relate to employee benefit plans defined in section 3(3) of the Employee Retirement Income Security Act of 1974 (irrespective of whether the only participants in such plans are owner-employees, as defined in section 401(c)(3) of such Code) which are described in section 4(a) of such Act and not exempt under section 4(b) of such Act, including, to the extent provided by presidential order under subsection (f), individual retirement accounts, annuities and bonds described in sections 408 and 409 of such Code.

(f) DESIGNATED SECTIONS.—Not later than 9 months after the enactment of this Act, the President shall by order designate such sections (or provisions of sections) of the Internal Revenue Code of 1954, in addition to the sections described in subsection (e)(3)(A), under which functions, duties, powers, or responsibilities presently exercised by the Secretary of the Treasury shall be exercised by the Commission. Such additional sections or provisions shall include those as may be necessary to effectuate the maximum feasible consolidation in the Commission of all functions of the Departments of Labor and of the Treasury respecting employee benefit plans and to otherwise carry out the purposes of this Act. For purposes of this subsection, the term "employee benefit plans" shall include any plan defined in section 3(3) of the

Employee Retirement Income Security Act of 1974 (whether or not the only participants in such plan are owner-employees, as defined in section 401(c)(3) of the Internal Revenue Code of 1954) which is described in section 4(a) of such Act and not exempt under section 4(b) of such Act, and shall also include an individual retirement account, annuity or bond described in section 408 or 409 of such Code.

(g) RULES, ETC.—The Commission shall prepare written rules for the conduct of its activities, shall have an official seal which shall be judicially noticed, and shall have its principal office in or near the District of Columbia (but it may meet or exercise any of its powers anywhere in the United States).

(h) ADMINISTRATIVE AUTHORITY.—

(1) STAFF DIRECTOR; GENERAL COUNSEL.—The Commission shall have a staff director and a general counsel who shall be appointed by the Chairman. The staff director and the general counsel shall be paid at a rate not in excess of the rate in effect for level IV of the Executive Schedule. With the approval of the Chairman, the staff director may—

(A) appoint and fix the compensation of such additional personnel as he considers necessary, and

(B) procure temporary and intermittent services to the same extent as authorized by section 3109(b) of title 5, United States Code.

(2) USE OF OTHER AGENCIES' RESOURCES.—In carrying out its responsibilities, the Commission may avail itself of the assistance, including personnel and facilities, of other agencies and departments of the United States Government. The heads of such other agencies and departments may make available to the Commission such personnel, facilities, and other assistance, with or without reimbursement, as the Commission may request.

SEC. 402. POWERS OF COMMISSION.

(a) IN GENERAL.—The Commission has the powers expressly granted to the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974 and, in addition, has the power—

(1) to require, by special or general orders, any person to submit in writing such reports and answers to questions as the Commission may prescribe, and such submission shall be made within such reasonable period of time and under oath or otherwise as the Commission may require;

(2) to administer oaths or affirmations;

(3) to require by subpena, signed by the chairman or the vice chairman, the attendance and testimony of witnesses and the production of all documentary evidence relating to the execution of its duties;

(4) in any proceeding or investigation, to order testimony to be taken by deposition before any person who is designated by the Commission and has the power to administer oaths and, in such instances, to compel testimony and the production of evidence in the same manner as authorized under paragraph (3);

(5) to pay witnesses the same fees and mileage as are paid in like circumstances in the courts of the United States;

(6) to initiate (through civil actions for injunctive, declaratory, or other appropriate relief), defend, or appeal from a decision in, any civil action in the name of the Commission for the purpose of enforcing the provisions of this Act, and titles I and IV of the Employee Retirement Income Security Act of 1974, or for the purpose of obtaining compliance with the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act, through its general counsel;

(7) to develop such prescribed forms, to make, amend, and repeal such rules, pursuant to the provi-

sions of chapter 5 of title 5, United States Code, and to issue such interpretations, opinions, and other forms of guidance as are necessary to carry out the provisions of this Act and titles I and IV of the Employee Retirement Income Security Act of 1974, and as are necessary to administer the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act;

(8) to conduct investigations and hearings, to encourage voluntary compliance, and to report apparent criminal law violations to the appropriate law enforcement authorities; and

(9) to certify to the Secretary of the Treasury that an employee benefit plan described in section 401(e)(3) of this Act—

(A) satisfies or does not satisfy (or has or has not satisfied) the requirements of in any of the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act, or

(B) satisfies or does not satisfy (or has or has not satisfied) the requirements of section 44C of the Internal Revenue Code of 1954.

(b) ENFORCEMENT OF ORDERS OF THE COMMISSION.—Any United States district court within the jurisdiction of which any inquiry is carried on may, upon petition by the Commission in case of refusal to obey a subpena or order of the Commission issued under subsection (a), issue an order requiring compliance therewith. Any failure to obey the order of the court may be punished by the court as contempt.

(c) TRANSFER OF FUNCTIONS.—All functions and duties of the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974 are transferred to, and shall be carried out by, the Commission, and all functions and duties of the Secretary of the Treasury under the sections and provisions of the Internal Revenue Code of 1954, described in section 401(e)(3) of this Act, insofar as such sections relate to employee benefit plans described in such section, are transferred to, and shall be carried out by, the Commission.

(d) TRANSFER PROVISIONS.—

(1) PERSONNEL, ETC.—All personnel, liabilities, contracts, property, and records determined by the Director of the Office of Management and Budget to be employed, held, or used primarily in connection with the functions of the Secretary of Labor and the Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974, and of the Secretary of the Treasury under the sections and provisions of the Internal Revenue Code of 1954, de-

scribed in section 401(e)(3) of this Act, insofar as such sections relate to employee benefit plans described in such section, are transferred to the Commission.

(2) TRANSFER OF PERSONNEL.—

(A) Except as provided in subparagraph (B), personnel engaged in functions transferred under paragraph (1) shall be transferred in accordance with applicable laws and regulations relating to the transfer of functions.

(B) The transfer of personnel pursuant to paragraph (1) shall be made without reduction in classification or compensation for one year after such transfer.

(3) PROCEDURAL EFFECTS OF TRANSFER.—

(A) All laws and regulations relating to the functions and duties transferred under this Act shall, insofar as such laws and regulations are applicable and not amended by this Act, remain in full force and effect. All orders, determinations, rules, and opinions made, issued, or granted under such laws by the Secretary of Labor, the Pension Benefit Guaranty Corporation, or by the Secretary of the Treasury, which are in effect at the time of the transfer provided by paragraph (1), and which are consistent with the amendments made by this Act, shall continue in effect to the same extent as if such transfer had not occurred.

(B) The provisions of this Act shall not affect any proceeding pending before the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury on the date of enactment of this Act.

(C) No suit, action, or other proceeding commenced by or against the Secretary of Labor, the Pension Benefit Guaranty Corporation, or the Secretary of the Treasury shall abate merely by reason of the transfer made under paragraph (1).

SEC. 403. TERMINATION OF TREASURY DEPARTMENT'S JURISDICTION.

(a) TERMINATION OF TREASURY JURISDICTION.—Except as provided in subsection (b), the Secretary of the Treasury shall not administer, seek to obtain compliance with, or otherwise exercise responsibility or power respecting the sections or provisions of the Internal Revenue Code of 1954 described in section 401(e)(3) of this Act, insofar as such sections relate to employee benefit plans described in such section.

(b) CERTIFICATIONS BY COMMISSION.—Certifications made by the Employee Benefits Commission to the Secretary of the Treasury pursuant to section 402(a)(9) of this Act shall be treated by the Secretary as if he had made such certifications himself.

SEC. 404. AGENCY COOPERATION.

Pursuant to procedures they shall jointly formulate and establish, the Employee Benefits Commission, the Secretary of Labor, and the Secretary of the Treasury shall make arrangements for—

(1) notification by the respective Secretaries to the Commission regarding information which concerns the Commission's functions under section 401(e), and

(2) notification by the Commission to the Secretaries regarding information which concerns their respective functions under laws relating to employee benefit plans.

SEC. 405. EFFECTIVE DATE AND REPEAL.

This title shall take effect 24 months after the date of enactment of this Act. Subtitle A of title III of the Employee Retirement Income Security Act of 1974 is repealed on such effective date.

96TH CONGRESS
1ST SESSION

S. 511

To amend section 457 of the Internal Revenue Code of 1954 to extend to deferred compensation plans maintained by tax exempt organizations the treatment conferred upon such plans maintained by State and local governments by the Revenue Act of 1978.

IN THE SENATE OF THE UNITED STATES

MARCH 1 (legislative day, FEBRUARY 22), 1979

Mr. MATSUNAGA introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend section 457 of the Internal Revenue Code of 1954 to extend to deferred compensation plans maintained by tax exempt organizations the treatment conferred upon such plans maintained by State and local governments by the Revenue Act of 1978.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

II—E

SECTION 1. DEFERRED COMPENSATION PLANS WITH RESPECT TO SERVICE FOR TAX EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Section 457 of the Internal Revenue Code of 1954 (relating to deferred compensation plans with respect to service for State and local governments) is amended—

(1) by inserting "OR TAX EXEMPT ORGANIZATIONS" after "GOVERNMENTS" in the caption of such section,

(2) by striking out "STATE" in subsection (a),

(3) by striking out "STATE" in the caption of subsection (b),

(4) by striking out "'eligible State deferred compensation plan'" in subsection (b) and inserting in lieu thereof "'eligible deferred compensation plan'",

(5) by striking out "State" each other place it appears in subsection (b) and inserting in lieu thereof "State or tax exempt organization",

(6) by striking out "State's general creditors" in subsection (b) and inserting in lieu thereof "general creditors of the State or tax exempt organization",

(7) by adding at the end of subsection (d) the following new paragraph:

"(10) TAX EXEMPT ORGANIZATION.—The term 'tax exempt organization' means an organization de-

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scribed in section 501(c) which is exempt from tax under section 501(a).",

(8) by striking out "OF STATE" in the caption of subsection (e),

(9) by striking out "State" the first time it appears in paragraph (1) of subsection (e) and inserting in lieu thereof "State or tax exempt organization", and

(10) by striking out "State" the second time it appears in paragraph (1) of subsection (e).

(b) CLERICAL AMENDMENT.—The table of sections for subpart B of part II of subchapter E of chapter 1 of such Code is amended by inserting "or tax exempt organizations" after "governments".

SEC. 2. EFFECTIVE DATE.

(a) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1979.

(b) TRANSITIONAL RULES.—

(1) IN GENERAL.—In the case of any taxable year beginning after December 31, 1979, and before January 1, 1983—

(A) any amount of compensation deferred under a plan of a tax exempt organization providing for a deferral of compensation (other than a plan described in section 457(e)(2) of such Code), and any income attributable to the amounts so deferred, shall be includable in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary, but

(B) the maximum amount of the compensation of any one individual which may be excluded from gross income by reason of subparagraph (A) and by reason of section 457(a) of such Code during any such taxable year shall not exceed the lesser of—

(i) $7,500, or

(ii) 33⅓ percent of the participant's includable compensation.

(2) APPLICATION OF CATCH-UP PROVISIONS IN CERTAIN CASES.—If, in the case of any participant for any taxable year, all of the plans are eligible deferred compensation plans maintained by tax exempt organizations (as defined in such section), then subparagraph (B) of paragraph (1) of this subsection shall be applied with the modification provided by paragraph (3) of section 457(b) of such Code.

(3) APPLICATION OF CERTAIN COORDINATION PROVISIONS.—In applying subparagraph (B) of paragraph (1) of this subsection and section 403(b)(2)(A)(ii)

of such Code, rules similar to the rules of section 457(c)(2) of such Code shall apply.

(4) Meaning of terms.—Except as otherwise provided in this subsection, the terms used in this subsection shall have the same meaning as when used in section 457 of such Code.

II

96TH CONGRESS
1ST SESSION

S. 989

To amend the aggregation rules of section 402 of the Internal Revenue Code of 1954 to permit a taxpayer to roll over a complete distribution from a money purchase pension plan even if there is no such distribution from another pension plan of the same employer in which the taxpayer is a participant.

IN THE SENATE OF THE UNITED STATES

APRIL 24 (legislative day, APRIL 9), 1979

Mr. BENTSEN introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the aggregation rules of section 402 of the Internal Revenue Code of 1954 to permit a taxpayer to roll over a complete distribution from a money purchase pension plan even if there is no such distribution from another pension plan of the same employer in which the taxpayer is a participant.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subparagraph (E) of section 402(a)(5) of the Internal Revenue Code of 1954 (relating to special rules for rollover amounts) is amended by adding to the end thereof the following new clause:

"(iii) Money purchase plan need not be aggregated with other pension plan of same employer.—A distribution from a money purchase pension plan maintained by an employer who also maintains another pension plan shall not be treated as failing to satisfy the requirement of subparagraph (D)(i)(II) because it fails to constitute a lump sum distributon within the meaning of subsection (e)(4)(A) if the failure is due to the application of the aggregation rules under subsection (e)(4)(C)(i). A distribution in a later taxable year of the balance to the credit of an employee under a defined benefit plan, a profit-sharing plan or a stock bonus plan shall be eligible for the benefits of this subparagraph but shall not be eligible for the benefits of subsection (e)(1).".

SEC. 2. The amendment made by the first section of this Act shall apply with respect to taxable years beginning after December 31, 1974.

II

96TH CONGRESS
1ST SESSION

S. 1089

To amend the Internal Revenue Code of 1954 and the Employee Retirement Income Security Act of 1974 to simplify compliance with Federal employee benefit plan requirements.

IN THE SENATE OF THE UNITED STATES

MAY 7 (legislative day, APRIL 9), 1979

Mr. BENTSEN introduced the following bill; which was read twice and referred jointly, by unanimous consent, to the Committees on Finance and Labor and Human Resources

---

A BILL

To amend the Internal Revenue Code of 1954 and the Employee Retirement Income Security Act of 1974 to simplify compliance with Federal employee benefit plan requirements.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "ERISA Simplification Act of 1979".

SEC. 2. ELIMINATION OF PBGC PREMIUM FORM.

Section 3004 of the Employee Retirement Income Security Act (relating to coordination between the Department of the Treasury and the Department of Labor) is amended by adding at the end thereof the following new subsection:

"(c) The Secretary of the Treasury shall collect any premium required by section 4006 of this Act as part of the annual report filed with the Internal Revenue Service by a plan. Such premiums shall be deposited in the pension benefit guaranty funds established under section 4005 of this Act.".

SEC. 3. ELIMINATION OF SUMMARY ANNUAL REPORT.

Section 104(b)(3) of ERISA is amended to read as follows:

"Administrators shall post a notice at the workplace of the employees which includes a brief description of the current financial status of the pension plan, a copy of the latest Summary Plan Description, the identification of the company official who can provide further information about the plan, and a statement explaining an employee's rights under the plan.".

SEC. 4. OPTION TO FILE PENSION FORMS WITH TAX RETURNS.

Section 3004 of the Employee Retirement Income Security Act (relating to coordination between the Department of the Treasury and the Department of Labor) is amended by adding at the end thereof the following new subsection:

"(d) Taxpayers shall have the option to file any forms required by this Act with the annual income tax forms required by the Internal Revenue Code of 1954.".

SEC. 5. BOOKKEEPING GUIDE FOR SMALL BUSINESS AND IRA GUIDE.

(a) Section 3004 of the Employee Retirement Income Security Act (relating to coordination between the Department of the Treasury and the Department of Labor) is amended by adding at the end thereof the following new subsection:

"(e) The Secretary of the Treasury and the Secretary of Labor shall publish a booklet to assist plan sponsors (particularly smaller businessmen) in developing or revising record keeping systems in order to simplify compliance with the provisions of this Act.".

(b) The Secretary of the Treasury shall publish a booklet for taxpayers summarizing the rules concerning individual retirement accounts.

SEC. 6. CIVIL ENFORCEMENT ACTIONS BY TREASURY DEPARTMENT.

Section 3002 of the Employee Retirement Income Security Act of 1974 (relating to procedures with respect to continued compliance with requirements relating to participation, vesting, and funding standards) is amended by adding at the end thereof the following new subsection:

"(e) The Secretary of the Treasury may bring a civil action to enforce compliance by a plan or a trust with the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954. Such an action is in addition to any procedures available to the Secretary under such Code for such purpose.".

SEC. 7. EFFECTIVE DATE.

The amendments made by this Act take effect for taxable years beginning after December 31, 1979.

II

96TH CONGRESS
1ST SESSION

S. 1090

To amend the Employee Retirement Income Security Act of 1974 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan.

IN THE SENATE

MAY 7 (legislative day, APRIL 9), 1979

Mr. TALMADGE (for himself, Mr. BENTSEN and Mr. BOREN) introduced the following bill; which was read twice and referred jointly to the Committees on Labor and Human Resources and Finance

---

A BILL

To amend the Employee Retirement Income Security Act of 1974 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, SECTION 1. Section 3(33), title I, of the Employee Retirement Income Security Act of 1974 is amended to read, as follows:

"(33)(A) The term 'church plan' means a plan established and maintained (to the extent required in clause (ii) of subparagraph (B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954.

"(B) The term 'church plan' does not include a plan—

"(i) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Internal Revenue Code of 1954), or

"(ii) which includes individuals less than substantially all of whom are described in subparagraph (A) and in clauses (ii) and (v) of subparagraph (C) (or their beneficiaries).

"(C) For purposes of this paragraph—

"(i) A plan established and maintained by a church or by a convention or association of churches shall include a plan established and maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

"(ii) The term 'employee' of a church or a convention or association of churches shall include: a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation; an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Internal Revenue Code of 1954 and which is controlled by or associated with a church or a convention or association of churches; and an individual described in clause (v) of subparagraph (C).

"(iii) A church or a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954 shall be deemed the employer of any individual included as an employee under clause (ii) of subparagraph (C).

"(iv) An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(v) If any employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Internal Revenue Code of 1954 and which is controlled by or associated with a church or a convention or association of churches, the church plan shall not fail to meet the requirements of this paragraph merely because it: retains his accrued benefit or account for the payment of benefits to him or his beneficiaries pursuant to the terms of the plan; or receives contributions on his behalf after his separation from such service, but only for a period of 5 years after the employee's separation from service, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7) of the Internal Revenue Code of 1954) at the time of such separation from service.

"(D) If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of the Internal Revenue Code of 1954 fails to meet one or more of the requirements of this paragraph and corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this paragraph for the year in which the correction was made and for all prior years. If a correction is not made within the correction period, the plan shall not be deemed to meet the requirements of this paragraph beginning with the date on which the earliest failure to meet one or more of such requirements occurred. The term 'correction period' means the period ending with the later of the following: (i) 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this paragraph; (ii) such period as may be set by a court of competent jurisdiction after a determination that has become final that the plan fails to meet such requirements, or, if the final court determination does not specify such period, a reasonable period depending upon all the facts and circumstances, but in any event not less than 270 days after the determination has become final; or (iii) any additional period which the Secretary determines is reasonable or necessary for the correction of the default."

SEC. 2. The amendments made by this Act shall be effective as of January 1, 1974.

II

96TH CONGRESS
1ST SESSION

S. 1091

To amend the Internal Revenue Code of 1954 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan.

IN THE SENATE OF THE UNITED STATES

MAY 7 (legislative day, APRIL 9), 1979

Mr. TALMADGE (for himself, Mr. BENTSEN and Mr. BOREN) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. Section 414(e) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(e) CHURCH PLAN.—

"(1) IN GENERAL.—For purposes of this part the term 'church plan' means a plan established and maintained (to the extent required in paragraph (2)(B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501.

"(2) CERTAIN PLANS EXCLUDED.—The term 'church plan' does not include a plan—

"(A) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513); or

"(B) which includes individuals less than substantially all of whom are described in paragraphs (1), (3)(B), or (3)(E) (or their beneficiaries).

"(3) DEFINITIONS AND OTHER PROVISIONS.—For purposes of this subsection—

"(A) A plan established and maintained by a church or by a convention or association of churches shall include a plan established and maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

"(B) The term 'employee' of a church or a convention or association of churches shall include—

"(i) a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation;

"(ii) an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 and which is controlled by or associated with a church or a convention or association of churches; and

"(iii) an individual described in paragraph (3)(E).

"(C) A church or a convention or association of churches which is exempt from tax under section 501 shall be deemed the employer of any individual included as an employee under paragraph (3)(B).

"(D) An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(E) If an employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization described in clause (ii) of paragraph (3)(B), the church plan shall not fail to meet the requirements of this subsection merely because it—

"(i) retains his accrued benefit or account for the payment of benefits to him or his beneficiaries pursuant to the terms of the plan; or

"(ii) receives contributions on his behalf after his separation from such service, but only for a period of five years after the employee's separation from service, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, it there are no such provisions in the church plan, within the meaning of section 72(m)(7)) at the time of such separation from service.

"(4) CORRECTION OF FAILURE TO MEET CHURCH PLAN REQUIREMENTS.—If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 fails to meet one or more of the requirements of this subsection and corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this subsection for the year in which the correction was made and for all prior years. If a correction is not made within the correction period, the plan shall not be deemed to meet the requirements of this subsection beginning with the date on which the earliest failure to meet one or more of such requirements occurred. The term 'correction period' means the period ending with the later of the following: (1) 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this subsection; (2) such period as may be set by a court of competent jurisdiction after a determination that has become final that the plan fails to meet such requirements, or, if the final court determination does not specify such period, a reasonable period depending upon all the facts and circumstances, but in any event not less than 270 days after the determination has become final; or (3) any additional period which the Secretary determines is reasonable or necessary for the correction of the default."

SEC. 2. The amendments made by this Act shall be effective as of January 1, 1974.

96TH CONGRESS
1ST SESSION

S. 1092

To amend section 403(b) of the Internal Revenue Code of 1954 with respect to computation of the exclusion allowance for ministers and lay employees of the church, and to amend sections 403(b)(2)(B), 415(c)(4), 415(d)(1), and 415(d)(2) and to add a new section 415(c)(8) to extend the special elections for section 403(b) annuity contracts to employees of churches, conventions, or associations of churches, and their agencies and to permit a de minimis contribution amount in lieu of such elections.

IN THE SENATE OF THE UNITED STATES

MAY 7 (legislative day, APRIL 9), 1979

Mr. TALMADGE (for himself, Mr. BENTSEN, and Mr. BOREN) introduced the following bill; which was referred to the Committee on Finance

---

A BILL

To amend section 403(b) of the Internal Revenue Code of 1954 with respect to computation of the exclusion allowance for ministers and lay employees of the church, and to amend sections 403(b)(2)(B), 415(c)(4), 415(d)(1), and 415(d)(2) and to add a new section 415(c)(8) to extend the special elections for section 403(b) annuity contracts to employees of churches, conventions, or associations of churches, and their agencies and to permit a de minimis contribution amount in lieu of such elections.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. Section 403(b)(2) of the Internal Revenue Code of 1954 is amended by adding the following subparagraph:

"(C) NUMBER OF YEARS OF SERVICE FOR DULY ORDAINED, COMMISSIONED, OR LICENSED MINISTERS OR LAY EMPLOYEES.—For purposes of this subsection, all years of service by a duly ordained, commissioned, or licensed minister of a church, or by a lay person, as an employee of a church or a convention or association of churches or an agency of such church (or convention or association of churches) within the meaning of section 415(c)(4)(D)(iv) and described in clause (i) of paragraph (1)(A) of this subsection shall be considered as years of service for one employer, and all amounts contributed for annuity contracts by each such church (or convention or association of churches) or agency, during such years for such minister or lay person shall be considered to have been contributed by one employer.".

SEC. 2. Section 415(c)(4) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(4) SPECIAL ELECTION FOR SECTION 403(b) CONTRACTS PURCHASED BY EDUCATIONAL ORGANIZATIONS, HOSPITALS, AND HOME HEALTH SERVICE AGENCIES, AND CHURCHES, CONVENTIONS, OR ASSOCIATIONS OF CHURCHES, AND THEIR AGENCIES.—

"(A) In the case of amounts contributed for an annuity contract described in section 403(b) for the year in which occurs a participant's separation from the service with an educational organization, a hospital, a home health service agency, or a church or convention or association of churches or any agency of such church (or convention or association of churches), at the election of the participant there is substituted for the amount specified in paragraph (1)(B) the amount of the exclusion allowance which would be determined under section 403(b)(2) (without regard to this section) for the participant's taxable year in which such separation occurs if the participant's years of service were computed only by taking into account his service for the employer, as determined for purposes of section 403(b)(2), during the period of years (not exceeding 10) ending on the date of such separation.

"(B) In the case of amounts contributed for an annuity contract described in section 403(b) for any year in the case of a participant who is an employee of an educational organization, a hospital, or a home health service agency, or a church or convention or association of churches or any agency of such church (or convention or association of churches), at the election of the participant there is substituted for the amount specified in paragraph (1)(B) the least of—

"(i) 25 percent of the participant's includable compensation (as defined in section 403(b)(3)) plus $4,000,

"(ii) the amount of the exclusion allowance determined for the year under section 403(b)(2), or

"(iii) $15,000.

"(C) In the case of amounts contributed for an annuity contract described in section 403(b) for any year for a participant who is an employee of an educational organization, a hospital, a home health service agency, or a church or convention or association of churches or any agency of such church (or convention or association of churches), at the election of the participant the provisions of section 403(b)(2)(A) shall not apply.

"(D)(i) The provisions of this paragraph apply only if the participant elects its application at the time and in the manner provided under regulations prescribed by the Secretary. Not more than one election may be made under subparagraph (A) by any participant. A participant who elects to have the provisions of subparagraph (A), (B), or (C) of this paragraph apply to him may not elect to have any other subparagraph of this paragraph apply to him. Any election made under this paragraph is irrevocable.

"(ii) For purposes of this paragraph the term 'educational organization' means an educational organization described in section 170(b)(1)(A)(ii).

"(iii) For purposes of this paragraph the term 'home health service agency' means an organization described in subsection 501(c)(3) which is exempt from tax under section 501(a) and which has been determined by the Secretary of Health, Education, and Welfare to be a home health agency (as defined in section 1861(o) of the Social Security Act).

"(iv) For purposes of this paragraph the term 'church or convention or association of churches' shall have the same meaning as it does for purposes of section 414(e), and the term 'agency' shall mean an organization which is exempt from tax under section 501 and which is either controlled by, or associated with, a church (or convention or association of churches). An organization is associated with a church (or convention or association of churches) if it shares common religious bonds and convictions with that church.".

SEC. 3. Section 415(c) of the Internal Revenue Code of 1954 is amended by adding thereto the following paragraph:

"(8) CERTAIN TOTAL ANNUAL CONTRIBUTIONS AND ADDITIONS NOT IN EXCESS OF $10,000.—In the case of a participant eligible for the special elections provided in subsection (c)(4), notwithstanding the preceding provisions of this subsection, contributions and other additions with respect to such participant, when expressed as an annual addition (within the meaning of subsection (c)(2)) to such participant's account, shall not be deemed to exceed the limitation of subsection (c)(1) if such annual addition is not in excess of $10,000.".

SEC. 4. Section 415(d)(1) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(1) IN GENERAL.—The Secretary shall adjust annually—

"(A) the $75,000 amount in subsection (b)(1)(A),

"(B) the $25,000 amount in subsection (c)(1)(A),

"(C) in the case of a participant who is separated from service, the amount taken into account under subsection (b)(1)(B), and

"(D) the $10,000 amount in subsection (c)(8),

for increases in the cost of living in accordance with regulations prescribed by the Secretary. Such regulations shall provide for adjustment procedures which are similar to the procedures used to adjust primary insurance amounts under section 215(i)(2)(A) of the Social Security Act.".

SEC. 5. Section 415(d)(2) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(2) BASE PERIODS.—The base period taken into account—

"(A) for purposes of subparagraphs (A) and (B) of paragraph (1) is the calendar quarter beginning October 1, 1974,

"(B) for purposes of subparagraph (C) of paragraph (1) is the last calendar quarter of the calendar year before the calendar year in which the participant is separated from service, and

"(C) for purposes of subparagraph (D) of paragraph (1) is the calendar quarter beginning January 1, 1978.".

SEC. 6. Section 403(b)(2)(B) of the Internal Revenue Code of 1954 is amended to read, as follows:

"(B) ELECTION TO HAVE ALLOWANCE DETERMINED UNDER SECTION 415 RULES.—In the case of an employee who makes an election under section 415(c)(4)(D) to have the provisions of section 415(c)(4)(C) (relating to special rule for section 403(b) contracts purchased by educational institutions, hospitals, home health service agencies, and churches, conventions, or associations of churches, and their agencies) apply, the exclusion allowance for any such employee for the taxable year is the amount which could be contributed (under section 415) by his employer under a plan described in section 403(a) if the annuity contract for the benefit of such employee were treated as a defined contribution plan maintained by the employer.".

SEC. 7. The amendments made by section 1 of this Act shall be effective in determining the exclusion allowance under section 403(b)(2) for taxable years beginning after December 31, 1977. "Years of service" prior to January 1, 1978, and thereafter shall be aggregated in accordance with these amendments. The amendments made by sections 2 through 6 of this Act shall be effective for taxable years beginning after December 31, 1977.

II

96TH CONGRESS
1ST SESSION

S. 1240

To amend the Internal Revenue Code of 1954 to make permanent the provisions relating to the funding of employee stock ownership plans through the investment tax credit, to provide a credit against tax for contributions to an employee stock ownership plan based upon wages rather than investment in equipment, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 23 (legislative day, MAY 21), 1979

Mr. LONG (for himself and Mr. GRAVEL) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to make permanent the provisions relating to the funding of employee stock ownership plans through the investment tax credit, to provide a credit against tax for contributions to an employee stock ownership plan based upon wages rather than investment in equipment, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

(a) GENERAL RULE.—This Act may be cited as the "Employee Stock Ownership Improvements Act of 1979".

SEC. 2. TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN MADE PERMANENT.

(a) IN GENERAL.—Subparagraph (E) of section 46(a)(2) of the Internal Revenue Code of 1954 (relating to tax credit employee stock ownership plan percentage) is amended to read as follows:

"(E) TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN PERCENTAGE.—For purposes of this paragraph, the tax credit employee stock ownership plan percentage is the sum of—

"(i) a percentage (not in excess of 1 percent) which results in an amount equal to the amount described in, and actually transferred under, section 44D(a)(3)(A), and

"(ii) an additional percentage (not in excess of one-half of 1 percent) which results in an amount equal to the amount determined under section 48(n)(1)(B)).

This subparagraph shall apply to a corporation only if it meets the requirements of section 409A and only if it elects (at such time, in such form, and in such manner as the Secretary prescribes) to have this subparagraph apply.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to periods beginning after December 31, 1979.

SEC. 3. CREDIT FOR ESTABLISHING EMPLOYEE STOCK OWNERSHIP PLAN.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"SEC. 44D. EMPLOYEE STOCK OWNERSHIP PLAN CONTRIBUTIONS.

"(a) GENERAL RULE.—In the case of a corporation which—

"(1) establishes a plan that meets the requirements of section 409A,

"(2) which does not elect for the taxable year to have subparagraph (E) of section 46(a)(2) (relating to tax credit employee stock ownership plan percentage) apply (determined without regard to any carryback or carryover of excess credit), and

"(3) agrees, as a condition for the allowance of the credit allowed by this subsection—

"(A) to make transfers of employer securities to a tax credit employee stock ownership plan maintained by the corporation having an aggregate value not more than 1 percent of the amount of the aggregate participants' compensation (as defined in section 415(c)(3)) paid by the corporation during the taxable year, and

"(B) to make such transfers at the times prescribed in subsection (e)(1),

there is allowed as a credit against the tax imposed by this chapter for the taxable year, an amount equal to the amount transferred to the plan for the taxable year.

"(b) LIMITATION BASED ON TAX LIABILITY; CARRYOVER OF EXCESS CREDIT.—

"(1) LIMITATION.—The amount of the credit allowed under subsection (a) for the taxable year shall not exceed the liability of the taxpayer for tax under this chapter for the taxable year.

"(2) CARRYOVER OF EXCESS CREDIT.—If the amount of the credit determined under subsection (a) for the taxable year exceeds the amount of the limitation imposed by paragraph (1) for such taxable year (hereinafter in this paragraph referred to as the 'unused credit year'), such excess shall be a credit carryover to the taxable year following the unused credit year, and, subject to the limitation imposed by paragraph (1), shall be taken into account under subsection (a) in such following taxable year.

"(3) CERTAIN TAXES NOT CONSIDERED TAXES IMPOSED BY THIS CHAPTER.—For purposes of this section, any tax imposed for the taxable year by section 56 (relating to minimum tax for tax preferences), section 531 (relating to accumulated earnings tax), section 541 (relating to personal holding company tax), or section 1378 (relating to tax on certain capital gains of subchapter S corporations), and any additional tax imposed for the taxable year by section 1351(b)(1) (relating to recoveries of foreign expropriation losses), shall not be considered tax imposed by this chapter for such year.

"(c) LIMITATION WITH RESPECT TO CERTAIN COMPANIES.—In the case of a regulated public utility, no credit shall be allowed by subsection (a)—

"(1) if the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by reason of any portion of the credit allowable by subsection (a) (determined without regard to this subsection),

"(2) the base to which the taxpayer's rate of return for ratemaking purposes is applied, is reduced by reason of any portion of the credit allowed by subsection (a) (determined without regard to this subsection), or

"(3) any portion of the amount of the credit allowable by subsection (a) (determined without regard to this subsection) is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common shareholders.

"(d) SPECIAL RULES.—

"(1) TIMES FOR MAKING TRANSFERS.—The transfers required under subsection (a)(3) shall be made—

"(A) to the extent allocable to the credit allowed under subsection (a) for the taxable year, or allowed as a carryback to a preceding taxable year, not later than 30 days after the due date (including extensions) for filing the return for the taxable year, or

"(B) to the extent allocable to that portion of the credit allowable under subsection (a) which is allowed as a carryover in a succeeding taxable year, not later than 30 days after the due date (including extensions) for filing the return for such succeeding taxable year.

The Secretary may by regulations provide that transfers may be made later than the times prescribed in the preceding sentence whenever the amount of any credit, carryover, or carryback for any taxable year exceeds the amount shown on the return for the taxable year.

"(2) CERTAIN CONTRIBUTIONS OF CASH TREATED AS CONTRIBUTIONS OF EMPLOYER SECURITIES.—For purposes of this section, a transfer of cash shall be treated as a transfer of employer securities if the cash is, under the employee stock ownership plan, used within 30 days to purchase employer securities.

"(3) DISALLOWANCE OF DEDUCTION.—No deduction shall be allowed under section 162, 212, or 404 for amounts required to be transferred to a tax credit employee stock ownership plan under this section.

"(4) COMPENSATION.—For purposes of this section—

"(A) the term 'compensation' means compensation as defined in section 415(c)(3), and

"(B) a corporation shall not be treated as failing to meet the requirements of section 409A solely because it fails to meet the requirements of subsection (b)(2) of such section.

"(5) VALUE.—The term 'value' means value as defined in subparagraph (B) of section 48(n)(6).".

(b) The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44D. Employee stock ownership plan contributions.".

SEC. 4. DEDUCTIBILITY OF CERTAIN EMPLOYEE STOCK OWNERSHIP PLAN CONTRIBUTIONS, BEQUESTS, ETC.

(a) Section 404 of the Internal Revenue Code of 1954 (relating to deductions for employer contributions to qualified employee benefit plans) is amended by adding at the end thereof the following new subsection:

"(i) DIVIDENDS PAID DEDUCTION.—In addition to the deductions provided under subsection (a), there shall be allowed as a deduction to an employer the amount of any dividend paid by that employer during the taxable year with respect to employer securities (as defined in section 409A(l)) or with respect to qualifying employer securities (as defined in section 4975(d)(3)) if—

"(1) the employer securities or qualifying employer securities were held on the record date for the dividend by a tax credit employee stock ownership plan (as defined in section 409A) or an employee stock ownership plan (as defined in section 4975(e)(7)), and

"(2) the dividend received by the plan is distributed, not later than 60 days after the close of the plan year in which it is received, to the employees participating in the plan, in accordance with the plan provisions.".

(b) BEQUESTS; CHARITABLE CONTRIBUTIONS, ETC.—Section 409A of the Internal Revenue Code of 1954 (relating to tax credit employee stock ownership plans) is amended by redesignating subsection (n) thereof as subsection (o) and inserting after subsection (m) a new subsection to read as follows:

"(n) CERTAIN TRANSFERS TREATED AS CHARITABLE CONTRIBUTIONS.—For purposes of sections 170(b)(1), 642(c), 2055(a) and 2522, a contribution, bequest, or similar transfer of employer securities or qualifying employer securities to a tax credit employee stock ownership plan (as defined in subsection (a)) or an employee stock ownership plan (as defined in section 4975(e)(7)) shall be deemed a charitable contribution to an organization described in section 170(b)(1)(A)(vi), if—

"(A) such contribution, bequest, or transfer is allocated, pursuant to the terms of such plan, to the employees participating under the plan in a manner consistent with section 401(a)(4);

"(B) no part of such contribution, bequest, or transfer is allocated under the plan for the benefit of the taxpayer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of section 267(b), or any other person who owns more than 25 percent in value of any class of outstanding employer securities (as defined in subsection (l)) or qualifying employer securities (as defined in section 4975(e)(8)) under the provisions of section 318(a); and

"(C) such contribution, bequest, or transfer is made only pursuant to the provisions of such tax credit employee stock ownership plan or such employee stock ownership plan.".

SEC. 5. EXCEPTION FROM SECTION 415 LIMITATIONS FOR EXTRAORDINARY FORFEITURE ALLOCATIONS.

Section 415(c)(6) of the Internal Revenue Code of 1954 (relating to annual addition) is amended by adding at the end thereof the following new subparagraph:

"(C) In determining the limitation imposed by this section, if an employer maintains an employee stock ownership plan (as described in section 4975(e)(7)) which receives a loan or extension of credit for the acquisition of qualifying employer securities (as defined in section 4975(e)(8)) pursuant to the 'prohibited transaction' exemption set forth in section 4975(d)(3), extraordinary forfeitures (as determined under regulations prescribed by the Secretary) shall not be taken into account if, when combined with employer contributions necessary to permit the plan to amortize any loan or extension of credit received for purposes of acquiring qualifying employer securities, they would cause the limitations set forth in subparagraph (1) to be exceeded.".

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SEC. 6. LIMITATION ON STOCK DISTRIBUTIONS.

(a) Subparagraph (1) of section 409A(h) of the Internal Revenue Code of 1954 (relating to right to demand employer securities) is amended by inserting the words, "Except as provided in subparagraph (3)" before the words "A plan".

(b) Subsection 409A(h) of the Internal Revenue Code of 1954 (relating to the right to demand employer securities) is amended by adding a new paragraph at the end thereof, to read as follows:

"(3) A plan established by an employer whose charter or by laws restrict ownership of its employer securities to actual employees of the employer or to trusts which are described in section 401(a) and which require any former employee to resell any employer securities upon termination of service with the employer will not be deemed to fail to satisfy this section if it does not permit a terminated participant to exercise the right set forth in subparagraph (1).".

SEC. 7. VOTING RIGHTS.

Subsection (a) of section 401 of the Internal Revenue Code of 1954 (relating to requirements for qualification) is amended by striking out paragraph (22).

SEC. 8. CASH DISTRIBUTION OPTION AND PUT OPTION FOR STOCK BONUS PLANS.

Section 401(a) of the Internal Revenue Code of 1954 (relating to qualification requirements for employee benefit plans) is amended by inserting immediately after paragraph (21) the following new paragraph:

"(22) A stock bonus plan will not be deemed to have failed to satisfy the requirements of this section merely because it complies with the provisions set forth in section 409A(h).".

SEC. 9. AVAILABILITY OF ADDITIONAL PERCENTAGE FOR TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN.

Paragraph (9) of section 46(f) of the Internal Revenue Code of 1954 (relating to special rule for additional credit) is amended to read as follows:

"(9) SPECIAL RULE FOR ADDITIONAL CREDIT.—If the taxpayer makes an election under subparagraph (E) of subsection (a)(2), for a taxable year beginning after December 31, 1975, then, notwithstanding the prior paragraphs of this subsection, an amount of credit shall be allowed by section 38 which shall equal the ESOP percentage determined under subparagraph (E) of subsection (a)(2) unless—

"(A) the taxpayer's cost of service for rate-making purposes or in its regulated books of account is reduced by reason of any portion of such credit which results from the transfer of employer securities or cash to an employee stock ownership plan which meets the requirements of section 409A;

"(B) the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan; or

"(C) any portion of the amount of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common shareholders.".

SEC. 10. SPECIAL LIMITATION FOR EMPLOYEE STOCK OWNERSHIP PLANS.

Subparagraph (A) of section 415(c)(6) of the Internal Revenue Code of 1954 (relating to special limitations on allocations to participants' accounts under employee stock ownership plans) is amended to read as follows:

"(6) SPECIAL LIMITATION FOR EMPLOYEE STOCK OWNERSHIP PLAN.—

"(A) In the case of an employee stock ownership plan (as defined in subparagraph (B)), under which no more than one-third of the employer contributions for a year are allocated to the group of employees consisting of officers, shareholders owning more than 10 percent of the employer's stock (determined under subparagraph (B)(iv)), or employees described in subparagraph (B)(iii), the amount described in paragraph (c)(1)(A) (as adjusted for such year pursuant to subsection (d)(1)) for a year with respect to any participant shall be equal to the sum of (i) the amount described in paragraph (c)(1)(A) (as so adjusted) determined without regard to this paragraph and (ii) the lesser of the amount determined under clause (i) or the amount of employer securities allocated to a participant's account under the employee stock ownership plan.".

SEC. 11. CREDIT FOR THE ESTABLISHMENT OF EMPLOYEE STOCK OWNERSHIP PLANS BY SMALL EMPLOYERS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting immediately before section 45 the following new section:

"SEC. 44E. ESTABLISHMENT OF NEW EMPLOYEE STOCK OWNERSHIP PLAN BY SMALL BUSINESS EMPLOYER.

"(a) GENERAL RULE.—In the case of a small business employer who establishes an employee stock ownership plan, there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the lesser of—

"(1) the actual cost of establishing the plan, or

"(2) $5,000.

"(b) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

"(1) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' means a plan described in section 4975(e)(7).

"(2) SMALL BUSINESS EMPLOYER.—The term 'small business employer' means an employer (within the meaning of section 404) which during the taxable year immediately preceding the taxable year in which the credit allowable under subsection (a) is first claimed, had a monthly average of not more than 100 employees.

"(c) CLERICAL AMENDMENT.—The table of sections for such subpart is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44E. Establishment of new employee stock ownership plan by small business employer.".

SEC. 12. RETIREMENT SAVINGS BY TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN PARTICIPANTS.

(a) AMENDMENT OF SECTION 219.—Paragraph (4) of section 219(c) of such Code (relating to participation in governmental plans by certain individuals) is amended—

(1) by inserting "; PARTICIPATION IN CERTAIN TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS" after "INDIVIDUALS" in the caption of such paragraph, and

(2) by adding at the end thereof the following subparagraph:

"(C) CERTAIN TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.—A participant in a tax credit employee stock ownership plan described in section 409A is not considered to be an active participant in a plan described in subsection (b)(2) solely because of his participation in the tax credit employee stock ownership plan.".

(b) AMENDMENT OF SECTION 220.—Paragraph (5) of section 220(c) of such Code (relating to participation in government plans by certain individuals) is amended—

(1) by inserting "; PARTICIPATION IN CERTAIN TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS" after "INDIVIDUALS" in the caption of such paragraph, and

(2) by adding at the end thereof the following new sentence: "A participant in a tax credit employee stock ownership plan which meets the requirements of section 409A is not considered to be an active participant in a plan described in subsection (b)(3) solely because of his participation in the tax credit employee stock ownership plan.".

SEC. 13. MAKING OF QUALIFIED MATCHING EMPLOYEE CONTRIBUTIONS TO TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.

(a) IN GENERAL.—Subsection (n) of section 48 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended—

(1) by redesignating subparagraphs (C) and (D) of paragraph (1) as subparagraphs (D) and (E), respectively, and by inserting after subparagraph (B) the following new subparagraph:

"(C) EMPLOYER CONTRIBUTION OF QUALIFIED MATCHING EMPLOYEE CONTRIBUTIONS.—An employer which contributes to the tax credit employee stock ownership plan the qualified matching employee contributions (required by subparagraph (B)) on behalf of its employees, will be eligible to receive the matching tax credit employee stock ownership plan percentage, provided that all amounts transferred to the plan pursuant to subparagraph (B) are allocated in accordance with the provisions of section 409A(b).", and

(2) by striking out "No deduction" in paragraph (5) and inserting in lieu thereof the following: "Except as provided in section 404(j), no deduction".

(b) ALLOWANCE OF DEDUCTION.—Section 404 is amended by adding at the end thereof the following new subsection:

"(j) UNLIMITED DEDUCTION OF CONTRIBUTIONS TO TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN FOR WHICH CREDIT IS ALLOWED.—An employer which makes the contribution to a tax credit employee stock ownership plan set forth in section 48(n)(1)(C) shall be eligible for the deductions provided by this section without regard to the limitations imposed by subsection (a).".

SEC. 14. SPECIAL PROVISIONS FOR SMALL DISTRIBUTIONS FROM TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.

Section 402(a) of the Internal Revenue Code of 1954 (relating to taxability of a beneficiary of an employees' trust) is amended—

(1) by striking out "(2) and (4)" in paragraph (1) and inserting in lieu thereof "(2), (4) and (8)", and

(2) by adding at the end thereof the following new paragraph:

"(8) SPECIAL RULE FOR DISTRIBUTION OF EMPLOYER SECURITIES FROM TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN.—

"(A) GENERAL RULE.—If—

"(i) a lump-sum distribution consisting of employer securities (as described in section 409A(1)) is made to a participant (or beneficiary) from a qualified trust which is part of a tax credit employee stock ownership plan (as described in section 409A), and

"(ii) the participant was covered under the plan for at least three plan years,

then such distribution shall not be includable in gross income until the participant (or beneficiary) sells the employer securities.

"(B) LIMITATION ON AMOUNT.—The total amount of any such distribution which may be excluded from gross income shall not exceed $5,000.

"(C) TAXABILITY OF UNREALIZED APPRECIATION ON EMPLOYER SECURITIES.—Any unrealized appreciation on such employer securities will be taxable to the participant (or beneficiary)

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at the time the employer securities are sold and shall be treated as long-term capital gain (as defined in section 1222(3)).".

SEC. 15. USE OF NONVOTING STOCK IN EMPLOYEE STOCK OWNERSHIP PLANS.

Section 409A(1) of the Internal Revenue Code of 1954 (relating to the use of voting rights) is amended by adding the following new paragraph:

"(5) USE OF NONVOTING EMPLOYER SECURITIES.—If an employer has a class of nonvoting stock outstanding and the plan acquires such stock from a shareholder who has held such stock for a period of at least 24 months (or if the shareholder acquired such stock from another individual (other than the employer), the shareholder and such other individual together held such shares of stock for 24 months) such shares of stock shall have the same voting rights in the plan as they had in the hands of such shareholder.".

SEC. 16. VALUATION OF EMPLOYEE SECURITIES IN TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.

Section 48(n)(6)(B)(i) of the Internal Revenue Code of 1954 (relating to requirements for allowance of tax credit employee stock ownership plan percentage) is amended to read as follows:

"(i) in the case of securities listed on a national exchange, the average of closing prices of such securities for the 20 consecutive trading days immediately preceding the date of contribution to the plan, or".

SEC. 17. SPECIAL REQUIREMENTS FOR QUALIFIED PLANS.

(a) LIMITATIONS ON DEDUCTIONS.—Section 404(a) of the Internal Revenue Code of 1954 (relating to limitations on deductions for employer contributions to qualified plans) is hereby amended—

(1) by adding at the end of paragraph (3)(A) the following new sentence: "However, if the contributions are made to one or more stock bonus plans and to one or more profit-sharing plans, the limitations set forth in paragraph (7) shall be applicable.";

(2) by striking out "paragraphs (1) and (3), or (2) and (3), or (1), (2) and (3)," in paragraph (7) and inserting in lieu thereof the following: "paragraphs (1) and (3), or (2) and (3), or (1), (2), and (3), or a combination of one or more stock bonus plans and one or more profit-sharing plans under paragraph (3),".

(b) QUALIFICATIONS.—Section 401(d) of the Internal Revenue Code of 1954 (relating to requirements for qualification of trusts and plans benefiting owner-employees) is amended by adding immediately after paragraph (11) the following new paragraph:

"(12) Notwithstanding paragraph (1), if—

"(A) an employer which previously maintained a trust described in paragraph (1) incorporates through a transaction described in section 351,

"(B) after incorporation, the employer adopts a trust which satisfies the requirements of subsections (a) and

"(C) the assets of the trust described in paragraph (1) are transferred to the trust established by the employer following its incorporation in a transaction which satisfies the requirements of subsection (a)(12),

then the trust will be deemed to satisfy this section if the trustee administering its assets following the transfer to the new trust is any person who is permitted to serve as trustee of a trust described in section 401(a).".

SEC. 18. FLEXIBLE BENEFITS.

(a) CAFETERIA PLAN.—Section 125(d) of the Internal Revenue Code of 1954 (relating to cafeteria plans) is amended to read as follows:

"(d) CAFETERIA PLAN DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'cafeteria plan' means a plan under which—

"(A) all participants are employees, and

"(B) the participants may choose among two or more benefits, at least one of which is cash, property, or another currently taxable benefit.

"(2) DEFERRED COMPENSATION PLANS EXCLUDED.—The term 'cafeteria plan' does not include any plan which provides for deferred compensation other than that provided pursuant to a qualified cash or deferred arrangement (as defined in section 401(k)(2)).".

(b) CASH OR DEFERRED ARRANGEMENTS.—Section 401(k) of the Internal Revenue Code of 1954 (relating to cash or deferred arrangements) is amended—

(1) by striking out "or to the employee directly in cash," in paragraph (2)(A) and inserting in lieu thereof "make payments to the employee directly in cash, or provide other benefits under a cafeteria plan (as defined in section 125(d)),"; and

(2) by adding at the end of paragraph (2) the following new sentence:

"A qualified cash or deferred arrangement shall not include any arrangement involving the election of alternative benefits unless at least one of such benefits is cash, property, or another currently taxable benefit.".

SEC. 19. TECHNICAL CORRECTIONS TO THE REVENUE ACT OF 1978.

(a)(1) The title of section 409A of the Internal Revenue Code of 1954 (relating to qualification requirements for tax credit employee stock ownership plans) is amended by striking out "ESOPS" and inserting in lieu thereof "TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.".

(2) Section 409A is amended—

(A) by striking out "ESOP" each place it appears and inserting in lieu thereof "tax credit employee stock ownership plan,",

(B) by striking the last sentence in subsection (d) and inserting in lieu thereof "To the extent provided in the plan, the preceding sentence shall not apply in the case of separation from service, death, disability, or as provided in regulations prescribed by the Secretary with respect to current distributions of income on employer securities.",

(C) by inserting "or qualifying employer securities" after "employer securities" each place it appears in subsection (h),

(D) by inserting "(or another party as authorized by regulations as the Secretary may prescribe)" after "has a right to require that the employer" in subparagraph (h)(1)(B),

(E) by inserting "or of section 4975(e)(7)" after "the requirements of this section" in subparagraph (h)(2),

(F) by inserting "(or allocated to a participant's account in connection with matched employer and employee contributions)" after "under subsection (b)" in subsection (d),

(G) by inserting "common" before "stock" in subparagraph (l)(2)(B),

(H) by striking out "Noncallable" and by striking out "preferred," and inserting "Preferred," in subparagraph (l)(3), and

(I) by striking out "paragraph (1)" each place it appears in subparagraph (l)(3) and inserting in lieu thereof "paragraphs (1) and (2)", and

(J) by amending subsection (m) to read as follows:

"(m) NONRECOGNITION OF GAIN OR LOSS ON CONTRIBUTION OF EMPLOYER SECURITIES TO TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN.—No gain or loss shall be recognized to the taxpayer with respect to the transfer of employer securities to a tax credit employee stock ownership plan maintained by the taxpayer to the extent that such transfer is required under subparagraph (A) or (B) of section 48(n)(1).".

(b) Section 48 of the Internal Revenue Code of 1954 (relating to requirements for the tax credits applicable to tax credit employee stock ownership plan) is amended by striking out "ESOP" each place it appears in subsections (n) and (o) and inserting in lieu thereof "tax credit employee stock ownership plan".

(c) Section 6699 of the Internal Revenue Code of 1954 (relating to assessable penalties) is amended by striking out "ESOP" each place it appears and inserting in lieu thereof "tax credit employee stock ownership plan".

(d) Section 56 of the Internal Revenue Code of 1954 (relating to the imposition of the minimum tax on tax preferences) is amended by striking out "ESOP" each place it appears in subsection (c) and inserting in lieu thereof "tax credit employee stock ownership plan".

(e) Section 46 of the Internal Revenue Code of 1954 (relating to the additional credit for tax credit employee stock ownership plans) is amended—

(1) by striking out "ESOP" each place it appears in subparagraphs (a)(2) and (f) and inserting in lieu thereof "tax credit employee stock ownership plan",

(2) by striking out "subparagraph (B) of subsection (a)(2)" each place it appears in subsection (f)(9) and inserting in lieu thereof "subparagraph (E) of subsection (a)(2)", and

(3) by striking out "an employee stock ownership plan which meets the requirements of section 301(d) of the Tax Reduction Act of 1975" in subsection (f)(9)(A) and inserting in lieu thereof "a tax credit employee stock ownership plan which meets the requirements of section 409A".

(f) Subsection (g) of section 141 of the Revenue Act of 1978 (relating to tax credit employee stock ownership plans) is amended to read as follows:

"(g) EFFECTIVE DATES FOR TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection and subsection (h), the amendments made by this section shall apply with respect to qualified investment for taxable years beginning after December 31, 1978.

"(2) ELECTION TO HAVE AMENDMENTS APPLY DURING 1978.—At the election of the taxpayer, paragraph (1) shall be applied by substituting 'December 31, 1977' for 'December 31, 1978'. An election under the preceding sentence shall be made at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe. Such an election, once made, shall be irrevocable.

"(3) VOTING RIGHT PROVISIONS.—Section 409A(e) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall apply to plans to which section 409A of such Code applies, beginning with the first day of such application.

"(4) RIGHT TO DEMAND EMPLOYER SECURITIES, ETC.—Paragraphs (1)(A) and (2) of section 409A(h) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall apply to distributions after December 31, 1978, made by a plan to which section 409A of such Code applies.

"(5) ELECTION TO HAVE NEW PUT OPTION RULE APPLY.—The employer may elect to treat section 409A(h)(1)(B) of the Internal Revenue Code of 1954 (as added by subsection (a)) as applying to employer securities in a plan to which section 409A of such Code applies which are attributable to qualified investment for taxable years beginning before January 1, 1979.

"(6) SUBSECTION (f)(7).—The amendment made by subsection (f)(7) shall apply to years beginning after December 31, 1978.

"(7) RETROACTIVE APPLICATION OF AMENDMENT MADE BY SUBSECTION (d).—In determining the regular tax deduction under section 56(c) of the Internal Revenue Code of 1954 for any taxable year beginning before January 1, 1979, the amount of the credit allowable under section 38 of such Code shall be determined without regard to section 46(a)(2)(B) of such Code (as in effect before the enactment of the Energy Tax Act of 1978).

"(h) EFFECTIVE DATES FOR EMPLOYEE STOCK OWNERSHIP PLANS.—Paragraphs (5) and (6) of subsection (f) shall apply—

"(1) insofar as they make the requirements of subsections (e) and (h)(1)(B) of section 409A of the Internal Revenue Code of 1954 applicable to section 4975 of such Code, to stock acquired after December 31, 1979, and

"(2) insofar as they make paragraphs (1)(A) and (2) of section 409A(h) of such Code applicable to such section 4975, to distributions after December 31, 1979.".

(g) Section 4975(d)(3) of the Internal Revenue Code of 1954 (relating to prohibited transactions exemptions) is amended by striking out "leveraged".

(h) The first sentence of paragraph (8) of section 4975(e) of the Internal Revenue Code of 1954 (defining qualifying employer security) is amended to read as follows: "The term 'qualifying employer security' means any employer security within the meaning of section 409A(1).".

(i) Section 4975(e)(7) of the Internal Revenue Code of 1954 (relating to employee stock ownership plans) is amended—

(1) by striking out "leveraged" each time it appears, and

(2) by striking out the last sentence and inserting in lieu thereof the following: "A plan adopted and maintained by an employer which has a registration-type class of securities (as defined in section 409A(e)(4)) shall not be treated as an employee stock ownership plan unless it meets the requirements of subsections (e) and (h) of section 409A. A plan adopted and maintained by an employer which does not have a registration-type class of securities will not be treated as an employee stock ownership plan unless it meets the requirements of subsection (h) of section 409A.".

(j) Section 415(c)(6)(B)(i) of the Internal Revenue Code of 1954 (relating to special limitations for employee stock ownership plans) is amended to read as follows:

"(i) the term 'employee stock ownership plan' means an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a tax credit employee stock ownership plan (within the meaning of section 409A),".

(k) Section 401(a) of the Internal Revenue Code of 1954 (relating to plan qualification requirements) is amended by striking out "ESOP" in paragraph (21) and inserting in lieu thereof "tax credit employee stock ownership plan".

(l)(1) Subparagraph (E) of section 46(a)(2) is amended by inserting "and ending on" before "December 31, 1983" each place it appears.

(2) Subparagraph (B) of section 48(n)(2) is amended by adding "and" at the end of clause (i), by striking out clause (ii), and by redesignating clause (iii) as clause (ii).

(3) Paragraph (5) of section 48(o) is amended by inserting "percentage" after "attributable to the matching tax credit employee stock ownership plan".

SEC. 20. EFFECTIVE DATES.

(a) IN GENERAL.—Except as provided in subsections (b), (c), and (d), the provisions of this Act are effective for taxable years beginning after December 31, 1979.

(b) The provisions of sections 3 and 11 are effective for taxable years beginning after December 31, 1980.

(c) The provisions of section 18 are effective for taxable years beginning after December 31, 1978.

(d) The provisions of section 19 are effective for taxable years beginning after the dates specified therein.

II

96TH CONGRESS
1ST SESSION

S. 1958

To amend the Employee Retirement Income Security Act of 1974 for the purpose of facilitating the investment by employee pension benefit plans in qualifying employer real property.

IN THE SENATE OF THE UNITED STATES

OCTOBER 30 (legislative day, OCTOBER 15), 1979

Mr. MATSUNAGA introduced the following bill; which was read twice and referred jointly by unanimous consent to the Committees on Finance and Labor and Human Resources

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A BILL

To amend the Employee Retirement Income Security Act of 1974 for the purpose of facilitating the investment by employee pension benefit plans in qualifying employer real property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Employee Retirement Income Security Act of 1974 is amended—

(1) By striking out subclause (iii) of clause (A) of section 407(d)(3) and inserting in lieu thereof the following: "(iii) a money purchase plan which was in existence on the date of

enactment of this Act and which on such date invested primarily in qualifying employer securities or on such date invested in qualifying employer real property.".

(2) By striking out paragraph (4) of section 407(d) and inserting in lieu thereof the following:

"(4) The term 'qualifying employer real property' means one or more parcels of employer real property—

"(A) if, in the event a plan holds more than one parcel of employer real property, a substantial number of such parcels are dispersed geographically within or without a State;

"(B) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use;

"(C) even if all of such real property is leased to one lessee (which may be an employer, or an affiliate of an employer);

"(D) if the acquisition and retention of such property comply with the provisions of this part (other than section 404(a)(1)(B) to the extent it requires diversification, and sections 404(a)(1)(C), 406, and subsection (a) of this section);

"(E) if, in the event a plan holds only one parcel of employer real property, such parcel is subject to a lease—

"(i) which provides that the lessee pays all costs relating to such property, including maintenance, utilities, taxes, and insurance;

"(ii) which provides that obligations for principal and interest under any mortgage with respect to the property and for liability for tax under section 511 of the Internal Revenue Code of 1954 are to be paid fully from rents generated by such property, and under which the amount of such rents is sufficient to pay such obligations;

"(iii) which provides that lease rentals are personally guaranteed by one or more persons described in section 3(14); and

"(iv) which provides that, in the event of default, with respect to lease rentals the trustee may, in its sole discretion, relet the property or sell the property to any party, including a party described in section 3(14);

"(F) if, in the event a plan holds only one parcel of employer real property—

"(i) in the case of property which is acquired by the plan without incurring acquisition indebtedness, the cost of such property does not constitute more than 50 percent of the current value of plan assets as of the later of the date of acquisition or June 30, 1984;

"(ii) in the case of property which is acquired by the plan with acquisition indebtedness, the cost of such property does not constitute more than 50 percent of the current value of plan assets as of the later of the date of acquisition or June 30, 1984, and the acquisition indebtedness does not constitute more than 50 percent of the current value of plan assets as of the later of the date of acquisition or June 30, 1984.

"(G) if, in the event a plan holds only one parcel of employer real property, the annual rate of return on such property is at least as favorable to the plan as the annual rate of return on such property would be if such property was leased to an unrelated party in an arm's-length transaction;

"(H) if, in the event a plan holds only one parcel of employer real property, legal title to such property is held by an independent professional trustee;

"(I) if, in the event a plan holds only one parcel of employer real property, such property is administered by an independent professional trustee; and

"(J) if, in the event a plan holds only one parcel of employer real property, such lease is approved by an independent fiduciary which is unrelated to any party in interest and which has no other interest (other than its interest as trustee or nondiscretionary service provider) with respect to the transaction which might affect its best judgment.

Clause (iii) of subparagraph (E) shall not apply if the employer maintaining the plan is a corporation and the corporation is owned by more than fifteen shareholders and no shareholder owns 10 percent or more of the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation. For purposes of subparagraph (G), the comparability of the return shall be determined annually as of the last day of the plan year by an independent, qualified appraiser.".

These amendments shall take effect on the date of enactment.

Senator BENTSEN. This hearing will come to order.

As the chairman of this subcommittee, I will exercise my prerogatives and lobby a little bit first on my legislation.

This afternoon, the Private Pension Subcommittee of the Senate Finance Committee begins hearings on several important pension and related bills currently pending before the committee.

One of the objectives of these hearings is to further simplify ERISA so as to expand private pension coverage but, at the same time, protect the retirees against any possible loss of benefits.

One of the proposals under consideration, is S. 1089, the ERISA Simplification Act of 1979, which I introduced in May 1979. This bill has five major provisions.

First, the bill would abolish the unnecessary PBGC filing requirements. Presently, many pension plans must fill out a separate form which is submitted when termination insurance premiums are paid to the Labor Department's pension benefits guarantee corporation each year.

The filing requirement is in addition to the annual report, form 5500, which plans must file with IRS each year.

There is insufficient justification to require pension plans to file two forms in Washington each year, one for the Labor Department and one with IRS.

Under my bill, IRS would collect the insurance premium as part of form 5500 and the proceeds would be forwarded to PBGC. That would be similar to the present IRS collection system utilized to collect social security payroll taxes. About 85,000 pension plans would be relieved of the annual PBGC filing requirement under this proposal.

Second, the so-called summary annual report would be abolished under this proposal under existing law. Every year, employers must furnish each pension plan participant a summary annual report which describes many characteristics of the pension plan.

Employees have claimed that that information is not useful. Furthermore, it is costly for the employer to furnish this information.

My bill would repeal the requirement to furnish summary annual reports. However, in order to continue to make the information available to pension plan participants, the legislation would require the employer to simply post a notice at the workplace of the employees and include the following information:

A brief description of the current financial status of the pension plan, a copy of the latest summary plan description which otherwise is required by ERISA, the identification of a company official who can provide further information about the plan, and a statement explaining the employee's rights under the plan as otherwise required by ERISA.

Thus, employers will be relieved of the cost of furnishing summary annual reports to every participant each year. There would be a minimum cost to post the information at the workplace.

Third, taxpayers would specifically be given the option to file pension forms at the same time as income tax returns.

I am going to summarize this, because I see two of my very distinguished colleagues are here and we want to hear them.

Fourth, the bill would direct IRS to prepare a bookkeeping guide for pension plan sponsors to assist small businessmen in keeping necessary pension records.

Fifth, the bill would give the Secretary of the Treasury the same authority to bring a civil action to enforce minimum ERISA standards as the Secretary of Labor has under the present law.

We are very pleased to have two very distinguished Senators here to testify, Senators who have been at the forefront in the drafting and passage of ERISA and interested in private and public pensions.

I would like to call first on Senator Harrison A. Williams, Jr., U.S. Senator from New Jersey, my good friend, and then on Senator Javits of New York.

These two gentlemen have been in the forefront of this fight for a long time and we appreciate their advice and their counsel and the fact that they are, once again, expressing their interest by testifying here today.

STATEMENT OF HON. HARRISON A. WILLIAMS, A U.S. SENATOR FROM THE STATE OF NEW JERSEY

Senator WILLIAMS. Thank you very much, Mr. Chairman.

On behalf of the Labor and Human Resources Committee, a partner of this committee in the ERISA legislation, we certainly appreciate this opportunity to appear and to talk to the subjects that are common to both of our committees. I would like to speak particularly to S. 209, the ERISA Improvements Act, that Senator Javits and I introduced. It has been approved by the Labor and Human Resources Committee, and is before you now as well.

And I would like to have my statement included, if it could be, in full.

Senator BENTSEN. It will be included in full in the record.

Senator WILLIAMS. Mr. Chairman, I also request that S. 209 be included in the hearing record, together with the committee print "Summary and Analysis of Consideration."

Senator BENTSEN. Absolutely. It will be. Certainly.

While we are talking to the reporter, I want my statement and that of Senator Matsunaga in their entirety included.

[The material referred to follows. Oral testimony is continued on p. 182.]

I. Summary of the Bill

The bill is divided into four titles, as follows:
I. General Amendments to ERISA.
II. Amendments to the Internal Revenue Code of 1954.
III. Special Master and Prototype Plans.
IV. Employee Benefits Commission.
The bill is intended to achieve the following major objectives:

A. Strengthen and increase coverage of private sector retirement income and welfare benefit arrangements;

B. Provide greater assurance that employees and their families will receive benefits from such arrangements;

C. Clarify and simplify the Federal laws under which employee benefit plans operate and are regulated, and reduce paperwork burdens of plan sponsors, administrators and service providers;

D. Adjust the applicability of certain Federal and state laws as they relate to plans which are subject to ERISA; and

E. Streamline the administration and enforcement of ERISA and the Internal Revenue Code, insofar as it relates to employee benefit plans which are subject to ERISA.

TITLE I—GENERAL ERISA AMENDMENTS

The amendments in title I of S. 209 change many provisions of title I of ERISA.

The ERISA declaration of policy is amended to state explicitly Congress' policy that private sector employee benefit plans are to be encouraged and fostered. Also, the definition of "pension plan" is changed to give the Secretary of Labor explicit authority to treat legitimate severance pay or supplemental retirement income arrangements as welfare plans rather than pension plans.

The reporting and disclosure rules are changed to provide an alternative method of document distribution for multiemployer plans, to eliminate the requirement that plans must annually furnish participants with summary annual reports, to provide greater flexibility for the Secretary of Labor to grant variances and exceptions from the statutory rules, to consolidate and simplify in one section the presently scattered rules relating to participants' status reports, and to clarify the roles of accountants and actuaries who perform services for plans.

The minimum standards provisions of title I are revised to make clear that certain types of reciprocity arrangements between collectively bargained plans are permissible. Other changes are made in the participation, vesting, accrual, and funding rules, primarily in recognition of the unique circumstances under which multiemployer plans operate. The permissibility of reducing welfare plan disability payments due to Social Security disability payment increases and reducing of pension plan retirement payments due to workers' compensation payments is clarified. Protection is provided for surviving spouses of deceased participants who completed substantial service under a plan before death. ERISA's rule prohibiting assignments or alienations of benefit rights is clarified to ensure that it will not be interpreted to preclude a plan's honoring certain property settlements, alimony or child support orders of state courts. The elapsed time method of measuring service for purposes of ERISA's minimum standards, already approved by Labor Department proposed regulations, is codified.

Regarding ERISA's fiduciary responsibility provisions, the rule governing the extent to which an insurance company's general account shall be deemed to hold assets of a plan which is signatory to a contract or policy issued by the insurer is clarified, as is the general cofiduciary responsibility rule as it relates to fiduciaries which conduct business in corporate, partnership or association form. The rule governing refunds of contributions made to collectively bargained plans is relaxed slightly. The prohibited transaction and related rules are changed in three respects: the ERISA definition of "party in interest" is narrowed to exclude persons who, as a practical matter, do not occupy positions in which they can exert influence over a plan; a new statutory exemption is provided for transfers of assets between plans which have entered into reciprocity arrangements; and the Secretary of Labor will be required to report to the Congress and to the President respecting those applications for administrative exemptions as to which final agency determinations have not been made expeditiously.

In the areas of administration and enforcement, the bill requires that one member of the Secretary of Labor's ERISA Advisory Council must be representative of small employers and directs the Secretary to study and report to the Congress on the feasibility and ramifications of mandatory cost of living increases for pension plans. Also, rules are established prohibiting misrepresentations to employees about plans subject to ERISA and requiring employers to make periodic contributions to collectively bargained plans.

ERISA's preemption rules are changed in several respects. Application of the antifraud provisions of the federal securities law to the relationship between an employee and an ERISA plan (or officials of the plan or plan sponsor) is nullified, and application of State securities laws to an ERISA plan is preempted. Preemption will not apply to certain State laws dealing with health care plans (although States will be preempted from specifying in insurance laws or regulations the types of benefits, other than conversion rights, which must be made available in policies or contracts issued by insurers to plans). Also, a conforming change is made to foreclose arguments that ERISA preempts state court orders dealing with property settlement, alimony, or child support payments described in the new explicit exception to the rule prohibiting assignments and alienations.

Numerous changes are made in ERISA's enforcement and federal court jurisdiction provisions to conform to substantive changes made elsewhere in ERISA by the bill.

TITLE II—INTERNAL REVENUE CODE AMENDMENTS

Changes are made in provisions of the Internal Revenue Code of 1954 which are analogous to the ERISA title I provisions amended by S. 209 and described above.

In addition, four other amendments to the Code are made. The first two (sections 201 and 202) deal with rollover or other favorable tax treatment for lump sum distributions made by tax-qualified plans. The bill amends the aggregation of plan rules to provide that, as respects multiemployer plans and plans for employees of organizations described in Code section 501(c) (3) or (5) (charitable, religious, etc., and labor, agricultural or horticultural associations) all defined benefit plans of an employer are to be treated as a single plan and all defined contribution plans are to be treated as a single plan. Also, an employee receiving a lump sum distribution from a multiemployer plan after not working in service covered under the plan for a period of six months would be eligible for rollover or other favorable tax treatment.

Section 203 of S. 209 amends the code to permit employees who are active participants in most tax-qualified plans to claim a deduction for certain contributions made to the plan in which they are participating or to an Individual Retirement Account. The deduction is limited to the lesser of $1,000 per year or 10 percent of annual compensation, and rules are included to prohibit discrimination in favor of the highly compensated.

To stimulate the creation of more private sector plans, section 204 of the bill includes a limited tax credit for small employers who establish or commence contributions to tax qualified plans. The credit is designed to offset the initial costs of plan design and implementation. Accordingly, the credit is a phased-down incentive of five years' duration, based on a percentage of allowable deductions for contributions made by the employer to the plan. In the year of the plan's establishment, the credit is five percent of allowable deductions. For each of the second and third years after establishment, it is three percent. For each of the next two years, it is one percent. The credit is not available for the sixth and subsequent years after the plan's establishment.

The staff of the Joint Committee on Taxation has estimated the revenue costs of sections 201-204 of S. 209, as follows:

> It is estimated that section 201 of the bill would reduce budget receipts by less than $5 million annually.
>
> It is estimated that section 202 of the bill would reduce budget receipts by less than $5 million annually.
>
> It is estimated that section 203 of the bill would reduce budget receipts by $480 million in fiscal year 1980, by $1,025 million in fiscal year 1981, by $1,145 million in fiscal year 1982, and by $1,330 million in fiscal year 1984.
>
> It is estimated that section 204 of the bill would reduce budget receipts by $5 million in fiscal year 1980, by $25 million in fiscal year 1981, by $50 million in fiscal year 1982, and by $90 million in fiscal year 1984.[1]

TITLE III—SPECIAL MASTER AND PROTOTYPE PLANS

Under title III of the bill, a "master sponsor," such as a bank, insurer, mutual fund, or savings and loan association, would develop one or more special master pension plans and would seek approval, at

[1] Staff of the Joint Committee on Taxation, "Description of S. 75, S. 94, S. 209 and S. 557" (Comm. Print 1979) (Hereinafter "Joint Committee Print").

the national office level, from the Secretary of Labor. The terms of approval may be conditioned by the Secretary, and the Secretary of the Treasury has an opportunity to add conditions related to applicable Internal Revenue Code provisions.

Once approval is obtained, the master sponsor makes the special master plan available to employers, subject to any conditions stipulated by the government. An adopting employer may establish and implement the plan without further determinations by the government. The master sponsor is the administrator and fiduciary of each adopting employer's plan, and the responsibilities of each adopting employer under ERISA and complementary provisions of the tax code are limited to complying with the terms of the plan, paying the costs of funding the plan (as to which the present tax code deductibility rules would apply), paying a servicing fee to the master sponsor, and furnishing the master sponsor with timely and accurate workforce data. Numerous safeguards are included to prevent abuse by either adopting employers or master sponsors.

TITLE IV—EMPLOYEE BENEFITS COMMISSION

Title IV of S. 209 consolidates in a single agency, the new "Employee Benefits Commission," the functions related to administration and enforcement of ERISA and complementary tax code provisions that are now scattered in three separate agencies: the Labor Department, the Treasury's Internal Revenue Service, and the Pension Benefit Guaranty Corporation.

The Employee Benefits Commission is composed of five members, including a chairman who is a special liaison for the Secretary of Labor and a vice-chairman who is a special liaison for the Secretary of the Treasury. All five members are Presidential appointments, subject to Senate confirmation, and serve six year, staggered terms. The chairman and vice chairman are nominated by the President from lists of candidates submitted, respectively, by the Secretary of Labor and the Secretary of the Treasury. The other three members are nominated by the President from a list of candidates submitted jointly by the two secretaries.

In addition to administering and enforcing ERISA and complementary tax code provisions, the Commission is to formulate policy respecting federal laws which relate to employee benefit plans.

The Commission is an on-budget agency; however, the portion of the Commission's activities attributable to title IV of ERISA (plan termination insurance) would continue to be financed by plan-paid premiums.

The Commission will commence its work, and the transfers of function and staff identified by title IV of S. 209 shall be completed by, the date which is two years after the enactment of S. 209. At that time, subtitle A of title III of ERISA (jurisdiction, administration, and enforcement) is repealed.

Opening Statement of Senator Bentsen

This afternoon the Private Pension Subcommittee of the Senate Finance Committee begins hearings on several important pension and related bills currently pending before the Committee.

One of the objectives of these hearings is to help simplify ERISA so as to expand private pension coverage but at the same time protect retirees against the loss of earned benefits.

One of the proposals under consideration is S. 1089, the ERISA Simplification Act of 1979, which I introduced on May 7, 1979.

My bill has five major provisions.

First, the bill would abolish the unnecessary PBGC filing requirement. Presently, many pension plans must fill out a separate form which is submitted when termination insurance premiums are paid to the Labor Department's Pension Benefit Guaranty Corporation (PBGC) each year. This PBGC filing requirement is in addition to the annual report (form 5500) which plans must file with IRS each year. There is insufficient justification to require pension plans to file two forms in Washington each year, one with the Labor Department and one with IRS. Under my bill, IRS would collect the insurance premium as part of the form 5500 and the proceeds would then be forwarded to PBGC. This would be similar to the present IRS system of collecting social security payroll taxes. About 85,000 pension plans would be relieved of the annual PBGC filing requirement under this proposal.

Second, the so-called summary annual report would be abolished under my proposal. Under existing law, every year employers must furnish to each pension plan participant a summary annual report (SAR) which describes many characteristics of the pension plan. Employees have complained that this information is not useful. Furthermore, it is costly for the employer to furnish this information annually. My bill would repeal the requirement to furnish summary annual reports. However, in order to continue to make information available to pension plan participants, the legislation would require employers to simply post a notice at the workplace of the employees which includes the following information:

A brief description of the current financial status of the pension plan;

A copy of the latest summary plan description which is otherwise required by ERISA;

The identification of the company official who can provide further information about the plan; and

A statement explaining employees' rights under the plan as otherwise required by ERISA.

Thus, employers will be relieved of the cost of furnishing summary annual reports to every participant every year. There should be minimal cost to post the information at the workplace.

Third, taxpayers would specifically be given the option to file pension forms at the same time as income tax returns. Taxpayers should be encouraged to prepare pension forms simultaneously with income tax forms. This will generally reduce the overall burden and could reduce legal and accounting fees.

Fourth, the bill would direct IRS to prepare a bookkeeping guide for pension plan sponsors to assist small businessmen in keeping necessary pension records. Several insurance companies use "recordkeeping kits" to ease ERISA compliance, particularly for smaller firms. IRS currently publishes dozens of booklets to help taxpayers comply with tax laws. IRS could easily prepare a simple document, or series of documents, to help firms comply with ERISA.

In addition, under this bill IRS would be directed to prepare a booklet summarizing the rules regarding eligibility for individual retirement accounts. This would be extremely helpful to millions of taxpayers interested in establishing IRA's.

Fifth, the bill would give the Secretary of the Treasury the same authority to bring a civil action to enforce minimum ERISA standards as the Secretary of Labor has under present law. The IRS power to "disqualify plans"—to remove tax-exempt status—is not always the most effective method to enforce ERISA. Full equity powers would provide much needed flexibility. Disqualification of a pension plan results in a tax burden on plan participants. Clearly, we do not want to penalize pension plan participants for a violation of ERISA committed by an employer, union or pension plan administrator. It makes no sense to penalize innocent parties.

These five provisions would help reduce the costs of complying with ERISA, particularly for smaller firms.

Also under consideration this afternoon is S. 989 which I introduced to correct a technical problem in section 402 of the Internal Revenue Code with respect to the tax treatment of certain distributions of private pension benefits.

Many businesses have more than one retirement plan for their employees. For example, a company might have what is known as a "defined benefit plan" as well as a so-called "money purchase plan." Under existing tax law, an employee who leaves a company and receives a pension distribution from one of the company pension plans but not from the other plan is denied favorable tax treatment on the money distributed. Favorable tax treatment is only allowed if the employee receives a complete distribution from both pension plans. This is known as the "aggregation rule." (Favorable tax treatment in these cases includes income averaging as well as tax-free roll-overs.)

Under S. 989, certain employees who participate in both a money purchase pension plan and another pension plan of the same company but who receive a distribution from only the money purchase plan would be allowed to rollover the distribution into a individual retirement account or another retirement plan. This would simply provide greater flexibility to many workers throughout the Nation.

Last year Congress enacted several technical tax amendments which I sponsored to facilitate the use of Individual Retirement Accounts and prevent inequities to many taxpayers. This bill is completely consistent with those changes.

At this point in the hearing record I would like to insert a copy of a statement by American Airlines in support of S. 989.

ESTIMATED REVENUE EFFECTS FOR BILLS RELATING TO DEFERRED COMPENSATION PLANS, PENSION PLANS AND EMPLOYEE STOCK OWNERSHIP PLAN [1]

[In millions of dollars]

Description of bills	Calendar year liabilities					
	1980	1981	1982	1983	1984	1985
S. 511 (Senator Matsunaga): Treatment of unfunded deferred compensation plans maintained by tax-exempt organizations	([2])	([2])	([2])	([2])	([2])	([2])
S. 989 (Senator Bentsen): Rollover of distribution from a money purchase pension plan	([3])	([3])	([3])	([3])	([3])	([3])
S. 1089 (Senator Bentsen): ERISA Simplification Act of 1979						
S. 1090 and S. 1091 (Senator Talmadge, Bentsen and Boren): Church plans permitted to continue after 1982 to provide benefits for employees of church-related organizations						
S. 1092 (Senators Talmadge, Bentsen and Boren): Changes in rules governing tax-sheltered annuities for ministers and lay employees of churches	([3])	([3])	([3])	([3])	([3])	([3])
S. 1958 (Senator Matsunaga): Investment by money purchase pension plan in employer real property	([4])	([4])	([4])	([4])	([4])	([4])
S. 1240 (Senators Long and Gravel): Employee Stock Ownership Improvements Act of 1979: [5]						
Sec. 2. TRASOP investment credit made permanent				([6])	−864	−1,065
Sec. 3. TRASOP wage based credit		−1,288	−1,956	−2,781	−4,327	−4,280
Sec. 4. Charitable deductions for certain bequests and dividends	([7])	([7])	([7])	([7])	([7])	([7])
Sec. 5. Change limitations for extraordinary forfeiture allocations	([3])	([3])	([3])	([3])	([3])	([3])
Sec. 9. Utility flowthrough amendment	([8])	([8])	([8])	([8])	([8])	([8])
Sec. 11. Tax credit for establishing a TRASOP	([3])	([3])	([3])	([3])	([3])	([3])
Sec. 12. Allow TRASOP participants to have IRA's	−6	−10	−12	−14	−16	−18
Sec. 13. Allow employer to pick up employee's contribution	−19	−38	−56	−83	−120	−176
Sec. 14. Tax deferral for TRASOP distributions	([3])	([3])	([3])	([3])	([3])	([3])
Sec. 17. Special requirements for qualified plans	−20	−23	−26	−30	−35	−40
Sec. 18. Flexible benefits	([3])	([3])	([3])	([3])	([3])	([3])
Total S. 1240	−45	−1,359	−2,050	−2,908	−5,362	−5,579

[1] For Hearings by the Subcommittee on Private Pension Plans and Employee Fringe Benefits on Dec. 4 and 5, 1979.
[2] A tax liability increase of less than $5 million annually would result from the limitations placed on the amount of allowable income deferral.
[3] Less than $5 million decrease.
[4] Although decreases in tax liability are indeterminate in the short-run the potential exists for substantial decreases in future years.
[5] Section numbers not listed have no revenue effect.
[6] Negligible.
[7] Indeterminate but should be a small revenue effect.
[8] Item presently in litigation, no significant revenue effect.

INTRODUCTION

The bills discussed in this pamphlet, S. 511, S. 989, S. 1089, S. 1090, S. 1091, S. 1092, S. 1958, and S. 1240, have been scheduled for a hearing on December 4–5, 1979, by the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance. The bills relate to deferred compensation plans, pension plans, and employee stock ownership plans. (In addition, the hearing will cover the provisions of S. 209, other than sections 201–205, which were covered in a prior subcommittee hearing. S. 209 (the ERISA Improvements Act of 1979) has been approved by the Committee on Labor and Human Resources; and that committee has prepared a summary and description of the provisions of that bill.)

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bills (other than S. 209). The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of each bill, indicating the present law treatment, an explanation of what changes each bill would make, and its effective date. (The estimated revenue effects of the bills will be supplied to the Subcommittee prior to the December 4 hearing.)

(A previous hearing was held on various pension-related tax bills by the Subcommittee on Private Pension Plans and Employee Fringe Benefits on April 3, 1979; on S. 75, S. 94, secs. 201–205 of S. 209, and S. 557. These bills related to deductions for individual retirement savings and the treatment of tax-qualified employee plans.)

I. SUMMARY

A. DEFERRED COMPENSATION PLANS

S. 511—Senator Matsunaga

Treatment of Unfunded Deferred Compensation Plans Maintained by Tax-Exempt Organizations

The bill would treat unfunded deferred compensation plans of tax-exempt organizations under the rules presently applicable to unfunded deferred compensation plans maintained by State and local governments.

B. PENSION PLANS

1. S. 989—Senator Bentsen

Rollover of Distribution From a Money Purchase Pension Plan

The bill would permit the tax-free rollover of a total distribution from a money purchase pension plan whether or not the recipient also receives total distributions from defined benefit plans maintained by the employer.

2. S. 1089—Senator Bentsen

ERISA Simplification Act of 1979

The bill would reduce paperwork under ERISA by (1) providing that premiums payable to the Pension Benefit Guaranty Corporation (PBGC) will be collected by the Internal Revenue Service and that the report presently sent to the PBGC with the premiums will be merged with a report presently filed with the IRS, and (2) eliminating the requirement that a summary annual report be furnished to employees and beneficiaries. Also, the bill would authorize the Secretary of the Treasury to bring a civil action to enforce compliance with the requirements imposed by the Internal Revenue Code on tax-qualified plans. Additionally, the bill would require the Treasury and Labor Departments to prepare a booklet relating to recordkeeping systems under ERISA and would require the Treasury to publish a booklet relating to individual retirement accounts.

3. S. 1090 and S. 1091—Senators Talmadge, Bentsen, and Boren

Church Plans Permitted to Continue After 1982 to Provide Benefits for Employees of Organizations Controlled by or Associated With Churches

Under present law, the church plan rules (including exemption from post-ERISA tax-qualification standards) are applicable with respect to coverage of employees of a church-related agency only for plans in existence on January 1, 1974, and only until January 1, 1983.

The bill would apply the church plan rules regarding coverage of employees of church-related agencies to plans not yet in existence on January 1, 1974, and would remove the December 31, 1982, expiration date for the rules.

4. S. 1092—Senators Talmadge, Bentsen, and Boren

Changes in Rules Governing Tax-Sheltered Annuities for Ministers and Lay Employees of Churches

Under present law, certain employees covered by tax-sheltered annuities are permitted special elections to increase employer payments to the annuities. The bill would extend to church employees the same limits on excludible employer payments for tax-sheltered annuities applicable under present law to teachers and certain other employees. Also, the bill would allow church employees to include service with all affiliated churches, etc. of the same religious denomination in determining the limitation on excludible employer payments for a tax-sheltered annuity.

5. S. 1958—Senator Matsunaga

Investment by Money Purchase Pension Plan in Employer Real Property

Under present law, a money purchase pension plan not in existence on September 2, 1974, may not invest more than 10 percent of its assets in qualifying employer real property. The bill would remove this limitation and would expand the definition of qualifying employer real property.

C. EMPLOYEE STOCK OWNERSHIP PLANS

S. 1240—Senators Long and Gravel

Employee Stock Ownership Improvements Act of 1979

The bill would make numerous changes to the rules governing TRASOPs and ESOPs and other qualified plans. The bill includes provisions which would:

(1) Make the TRASOP permanent;

(2) Allow a corporation a tax credit based on wages for contributions to a TRASOP as an alternative to an additional amount of investment tax credit;

(3) Allow a deduction for certain contributions to a TRASOP or an ESOP by persons other than the employer;

(4) Allow the allocation of extraordinary forfeitures to a participant's account under an ESOP;

(5) Delete the rule of present law which would, after December 31, 1979, require certain defined contribution plans to pass through to participants the voting rights on closely held stock allocated to participants accounts;

(6) Allow stock bonus plans to distribute cash subject to the employee's right to receive stock; and

(7) Give certain small business employers a credit of up to $5,000 for the cost of establishing an ESOP.

II. DESCRIPTION OF BILLS

A. DEFERRED COMPENSATION PLANS

S. 511—Senator Matsunaga

Treatment of Unfunded Deferred Compensation Plans Maintained by Tax-Exempt Organizations

Present law

On February 3, 1978, the Internal Revenue Service published proposed regulations which provided generally that, if under an unfunded plan or arrangement (other than a tax-qualified plan), payment of an amount of a taxpayer's fixed, basic, or regular compensation is deferred at the taxpayer's individual election to a taxable year later than that in which the amount would have been payable but for the election, the deferred amount will be treated as received in the earlier taxable year. These proposed regulations would have applied to plans maintained by private businesses, State and local governments, and tax-exempt organizations. However, the Revenue Act of 1978 provided that (1) benefits under unfunded deferred compensation plans maintained by private businesses are to be taxed under the law in existence before the publication of the proposed regulations, and (2) subject to certain limitations, benefits under State and local governmental (and rural electric cooperative) unfunded deferred compensation plans meeting certain standards are not to be taxed currently. The 1978 Act contained no provision regarding unfunded deferred compensation plans maintained by tax-exempt organizations (other than rural electric cooperatives).

Explanation of the bill

The bill would provide that, subject to certain limitations, an amount deferred under an eligible unfunded deferred compensation plan maintained by a tax-exempt organization would not be includible in a participant's gross income until paid or otherwise made available under the rules applicable to deferred compensation plans of State and local governments. Under the applicable limitations, the amount which could be deferred each year generally could not exceed the lesser of (1) $7,500, or (2) 33⅓ percent of compensation includible in the participant's gross income. A plan would be an "eligible" unfunded deferred compensation plan if it meets the standards applicable under present law to unfunded deferred compensation plans maintained by State and local governments.

Effective date

The provisions of the bill would generally be effective for taxable years beginning after December 31, 1979.

B. PENSION PLANS

1. S. 989—Senator Bentsen

Rollover of Distribution From a Money Purchase Pension Plan

Present law

An employee who receives a lump sum distribution from a tax-qualified pension, profit-sharing, or stock bonus plan may defer tax on the distribution by rolling over the proceeds (net of any employee contributions) within 60 days of receipt (1) to an IRA (an individual retirement account, annuity, or bond), or (2) to another qualified pension, etc., plan. The rollover rule also applies to the spouse of an employee who receives a lump sum distribution on account of the employee's death. A lump sum distribution from a qualified plan is eligible for favorable income tax treatment (e.g., 10-year income-averaging) if no portion of the distribution is rolled over.

A lump sum distribution is a distribution of the balance to the credit of an employee under a qualified pension, etc., plan, made within one taxable year of the recipient. Generally, the distribution must have been made on account of death, separation from service, or the attainment of age 59½. If an employer maintains more than one qualified plan, certain plans are aggregated for the purpose of determining whether the balance to the credit of an employee has been distributed. Under the aggregation rules, all pension plans (defined benefit and money purchase) maintained by the employer are treated as a single plan, all profit-sharing plans maintained by the employer are treated as a single plan, and all stock bonus plans maintained by the employer are treated as a single plan.

Explanation of the bill

The bill would allow an employee who receives a total distribution from a money purchase pension plan to roll over the distribution to an IRA or to another qualified plan where the employer also maintains a defined benefit pension plan covering the employee and a total distribution is not made from the defined benefit plan in the same taxable year. The bill would also apply to the spouse of an employee if the spouse receives such a total distribution on account of the employee's death.

If the recipient rolls over a total distribution from a money purchase pension plan under the bill and, in a subsequent taxable year, receives a total distribution from another qualified pension plan maintained by the employer, the later plan distribution could be rolled over tax-free but would not otherwise be eligible for the favorable income tax treatment accorded lump sum distributions.

Effective date

The provisions of the bill would apply for taxable years beginning after December 31, 1974.

2. S. 1089—Senator Bentsen

ERISA Simplification Act of 1979

Present law

Present law requires that sponsors or administrators of pension benefit plans file information annually for use by the Internal Revenue Service, the Department of Labor and, in the case of plans covered by termination insurance, the Pension Benefit Guaranty Corporation (PBGC). Generally, the annual reporting requirements for plans have been consolidated so that a single annual filing with the Internal Revenue Service satisfies all annual filing requirements imposed on pension benefit plans. In the case of defined benefit pension plans subject to the termination insurance provisions of the Employee Retirement Income Security Act of 1974 (ERISA), however, a separate annual filing is required in connection with the payment of insurance premiums to the PBGC (premium payments are required to be accompanied by Form PBGC-1 filed annually with the PBGC). Form PBGC-1 is generally required to be filed (and premium payments are due) within 7 months after the close of the plan year.

In addition, an employer who claims a deduction for a contribution to a pension benefit plan is required to provide certain information to the Internal Revenue Service on the income tax return or information return for the taxable year for which the contribution is made.

Under present law, within 210 days after the close of a plan year, plan participants are to be furnished by the plan with a summary annual report of the plan. The summary annual report includes information relating to the assets and liabilities of a plan, receipt and disbursements, and certain transactions.

Under present law, if the Internal Revenue Service determines that a pension, profit-sharing, or stock bonus plan does not meet the requirements for tax-qualification under the Internal Revenue Code, the Service treats the plan as nonqualified. This treatment may result in adverse tax consequences for employees and beneficiaries (benefits may become taxable before they are distributed or made available to employees and beneficiaries), employers (deductions for employer contributions may be disallowed), and a trust under the plan (the trust may not be tax-exempt). In addition, penalty excise taxes are imposed by the Code, and administered by the Internal Revenue Service, where employers fail to meet the funding standard of ERISA and where self-dealers engage in transactions prohibited by ERISA. Also, the Code provides penalty excise taxes where excess contributions are made to an H.R. 10 plan or an IRA (an individual retirement account or annuity, or a retirement bond). Further, the Code provides for civil penalties where specified reporting requirements are not met. The Code also provides for criminal penalties for certain willful failures to make a return, to keep records, or to supply information.

In addition to the penalties and tax sanctions provided by the Code with respect to pension, etc., plans, ERISA provides that the Department of Labor, and plan participants, beneficiaries, and fiduciaries can bring civil actions to enforce specified ERISA requirements or enjoin designated violations of the Act. In addition, the Department of Labor (and in some circumstances the Internal Revenue Service) may intervene in certain civil suits brought by plan participants, beneficiaries, or fiduciaries.

In addition to administering the termination insurance program, the PBGC is directed by ERISA to provide advice and assistance to individuals with respect to evaluating the economic desirability of establishing IRAs and the desirability of using tax-free rollovers with respect to lump sum distributions from pension plans.

Explanation of the bill

Under the bill, the Secretary of the Treasury, rather than the PBGC, would collect premiums under the termination insurance program. The report presently required to accompany premium payments by a plan (PBGC-1) would be merged with the annual report filed by the Internal Revenue Service. Under the bill, premium collections would be deposited in the pension benefit guaranty funds for use under the termination insurance program. The bill would also permit taxpayers to file forms required by ERISA at the same time the annual income tax return is required to be filed.

The bill would eliminate the requirement that plan participants and beneficiaries be furnished with a copy of a summary annual report of the plan. Under the bill, plan administrators would post at the work place of employees, a notice which would include a brief description of the financial status of the plan, a copy of the latest summary plan description, identification of a company official who can provide additional information about the plan, and a statement explaining an employee's rights under the plan.

Under the bill, the Secretary of the Treasury and the Secretary of Labor would be directed to publish a booklet to assist plan sponsors (particularly smaller businesses) in developing or revising recordkeeping systems in order to simplify compliance with ERISA. In addition, the Secretary of the Treasury would be required to publish a booklet for taxpayers summarizing rules for IRAs.

The bill also would authorize the Secretary of the Treasury to bring a civil action to enforce compliance by a plan or trust with the standards of the Internal Revenue Code with respect to tax-qualified plans.

Effective date

The provisions of the bill would be effective for taxable years beginning after December 31, 1979.

3. S. 1090 and S. 1091—Senators Talmadge, Bentsen and Boren

Church Plans Permitted to Continue After 1982 to Provide Benefits for Employees of Organizations Controlled by or Associated with Churches

Present law

Under present law, the standards provided by the labor law provisions of ERISA generally do not apply to the pension plan of a church for its employees. Church plans are also generally exempt from the tax qualification standards which correspond to the labor standards.

Under present law, a church plan may cover employees of a tax-exempt agency related to a church only if the plan was in existence on January 1, 1974. For taxable years beginning after December 31, 1982, a church plan no longer will be able to cover such employees.

Explanation of the bill

The bill would permit a church plan to cover employees of a tax-exempt agency controlled by or affiliated with a church or a convention or association of churches. This would include ministers and other clerical employees as well as lay employees of the church agency. Thus, for plans in existence on January 1, 1974, present law would be continued after December 31, 1982, and for other plans present law would be modified. Also, the bill would provide a period of time during which a plan intended to qualify as a church plan but failing to do so could be amended to so qualify without penalty.

Effective date

The provisions of the bill would be effective as of January 1, 1974.

4. S. 1092—Senators Talmadge, Bentsen and Boren

Changes in Rules Governing Tax-Sheltered Annuities for Ministers and Lay Employees of Churches

Present law

Under present law, employers which are tax-exempt organizations and public schools may make payments on behalf of their employees to purchase tax-sheltered annuities (sec. 403(b)). The amount paid by the employer for a tax-sheltered annuity is excluded from an employee's gross income to the extent that it does not exceed 20 percent of the employee's includible compensation times the number of the employee's years of service, and is reduced by amounts already contributed by the employer to the annuity. In computing the amount excludible from an employee's gross income, service with the contributing employer and payments by that employer are taken into account. In addition, the payments are subject to the limitations on contributions and benefits generally applicable to qualified retirement plans (sec. 415). Certain special elections (1) to increase these limitations on payments for tax-sheltered annuities, or (2) to increase the amount of the tax-sheltered annuity payments excludible from gross income, apply to employees of educational institutions, hospitals, and home health service agencies.

Explanation of the bill

The bill would provide that, with respect to a minister or lay employee of a church (or convention or association of churches), all years of service with the church, etc., and all contributions to tax-sheltered annuities by the church, etc., would be aggregated for purposes of determining the contribution to a tax-sheltered annuity excludible from gross income. In addition, the special elections (1) to increase the limitation on payments for tax-sheltered annuities, or (2) to increase the amount of the tax-sheltered annuity payments excludible from gross income, would apply to ministers and lay employees of a church, etc. Also, the annual limitation on contributions and for any employee eligible for the special elections would be at least $10,000, and would be adjusted for future cost-of-living increases.

Effective date

The provisions of the bill would be effective for taxable years beginning after December 31, 1977.

5. S. 1958—Senator Matsunaga

Investment by Money Purchase Pension Plan in Employer Real Property

Present law

Under ERISA a money purchase pension plan is not permitted to invest in employer real property other than qualifying employer real property and may not invest more than 10 percent of its assets in qualifying employer real property. This percentage limitation does not apply to a plan which on September 2, 1974, invested primarily in employer securities. For employer real property to constitute qualifying employer real property, it must generally consist of several parcels of leased real property which are geographically dispersed and are suitable for more than one use.

Explanation of the bill

The bill would generally permit money purchase pension plans to invest in qualifying employer real property without regard to any percentage limitation. In addition, the definition of qualifying employer real property would be expanded (1) to include a single parcel of real property meeting certain specified requirements, and (2) to consider multiple parcels of real property as geographically dispersed although they are located within a single State.

Effective date

The provision of the bill would be effective on its date of enactment.

C. EMPLOYEE STOCK OWNERSHIP PLANS

S. 1240—Senators Long and Gravel

Employee Stock Ownership Improvements Act of 1979

1. Tax credit employee stock ownership plan (TRASOP) made permanent (sec. 2 of the bill and sec. 46(a)(2)(E) of the Code)

Present law

Under present law, the provisions of the Code which allow a tax credit to a corporate employer for amounts contributed to a TRASOP (an employee stock ownership plan funded with an additional percentage of investment tax credit) will expire on December 31, 1983.

Explanation of the provision

Under the bill, the tax credit available to an employer for contributions to a TRASOP would be made permanent.

Effective date

The provision would be effective for periods beginning after December 31, 1979.

2. Credit for establishing TRASOP (sec. 3 of the bill and new sec. 44D of the Code)

Present law

Under present law, a corporate employer is entitled to an additional percentage point of investment tax credit (i.e., 11 percent rather than 10 percent) if it contributes an amount equal to the additional credit to a TRASOP. In addition to the 1 percent credit, up to ½ percent of extra investment tax credit is allowed where an employer contributes the extra credit amount to the TRASOP and the employer's extra contribution is matched by employee contributions.

Explanation of provision

Under the bill, a corporate employer maintaining a TRASOP, could elect to take a tax credit for a contribution to the TRASOP based on a percentage of payroll in lieu of an additional percentage of investment tax credit. This wage base credit would be nonrefundable and could not exceed 1 percent of the aggregate participants' compensation of a plan participant for the year.

Effective date

The provision would be effective for taxable years beginning after December 31, 1980.

3. Deduction of certain TRASOP and ESOP contributions, bequests, etc. (sec. 4 of the bill and secs. 404 and 409A of the Code)

Present law

Under present law, a corporation is not entitled to deductions for dividends paid to shareholders.

Under present law, a corporate employer is allowed, within certain limits, a deduction for contributions to certain tax-qualified plans; however, no person other than the employer is allowed a deduction for such a contribution.

Explanation of provision

Under the bill, a corporation would be entitled to a deduction for dividends paid during the taxable year on employer securities held by a TRASOP or by an employee stock ownership plan (ESOP), provided that the dividend received by the plan is distributed to the employees participating in the plan not later than 60 days after the end of the plan year in which it is received.

Under the bill, an individual could make a contribution or bequest of employer securities to a TRASOP or to an ESOP, and such contribution could qualify as a charitable contribution and would be deductible by the individual (within the normal limits on the deductibility of charitable contributions). To qualify as a charitable contribution under this provision, the contribution or bequest of employer securities to a TRASOP or an ESOP could not be allocated under the plan for the benefit of the donor, any person related to the donor, or any person who owns more than 25 percent in value of any class of outstanding employer securities. The TRASOP or ESOP would specifically have to provide for the acceptance of such contributions and bequests.

Effective date

The provisions would be effective for taxable years beginning after December 31, 1979.

4. Exception from section 415 limitations for extraordinary forfeiture allocations (sec. 5 of the bill and sec. 415(c)(6) of the Code)

Present law

Under present law, contributions and other additions (including forfeitures) to a participant's account under a qualified defined contribution plan generally cannot exceed the lesser of $25,000 (adjusted annually for inflation since 1974) or 25 percent of the participant's compensation. In the case of certain ESOPs or TRASOPs, the dollar limit is doubled.

Explanation of provision

Under the bill, the limitation on contributions and other additions to a participant's account under an ESOP would be increased if extraordinary forfeitures under the plan (as determined under regulations), when combined with the employer contributions necessary to permit the plan to amortize a loan, exceeded the present-law limitation on contributions and other additions on behalf of a participant.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

5. Limitation on stock distributions (sec. 6 of the bill and sec. 409A(h) of the Code)

Present law

Under present law, a participant in either a TRASOP or an ESOP must have the right to demand that benefits be distributed in the form of employer securities.

Explanation of provision

The bill would create an exception to the present-law rule that a participant entitled to a distribution from a TRASOP or an ESOP must have the right to demand the distribution in the form of employer securities. Under the bill, a TRASOP or an ESOP could not be required to distribute employer securities to a participant entitled to a distribution if the charter or by-laws of the employer (1) restricted ownership of employer securities to present employees of the employer or to qualified plans, and (2) required an employee to resell such securities upon termination of service.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

6. Voting rights (sec. 7 of the bill and sec. 401(a)(22) of the Code)

Present law

Under present law, a tax-qualified defined contribution plan is required to pass through voting rights on employer securities to plan participants with respect to major corporate issues in certain circumstances. The vote pass-through applies if (1) the employer which established the plan does not have a class of publicly traded stock, (2) the plan acquired employer securities after December 31, 1979, and (3) after the acquisition more than 10 percent of the plan's assets are employer securities.

Explanation of provision

The bill would delete the provision of present law which, after December 31, 1979, would require certain contribution plans which hold more than 10 percent of its assets in employer securities to pass through voting rights to participants on major corporate issues.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

7. Cash distribution option and put option for stock bonus plans (sec. 8 of the bill and new sec. 401(a)(22) of the Code)

Present law

Under present law, stock bonus plans must generally distribute stock to participants entitled to a distribution. A TRASOP or an ESOP which is a stock bonus plan, however, may distribute cash, subject to a participant's right to demand that benefits be distributed in the form of employer securities.

Explanation of provision

The bill would permit a stock bonus plan to distribute cash to a participant entitled to a distribution, subject to the participant's right to demand that benefits be distributed in the form of stock. If the stock is not readily tradable on an established market, the participant would have the right to require the employer to repurchase the stock.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

8. Availability of additional percentage for TRASOPs (sec. 9 of the bill and sec. 46(f) of the Code)

Present law

Under present law, a corporation is allowed an additional investment tax credit of up to one and one-half percent if the corporation makes contributions in that amount to a TRASOP. However, the credit is not available to public utilities if the agencies which regulate them do not comply with normalization rules concerning the credit.

Explanation of provision

The bill would make a technical change to the provision of present law which allows a public utility an investment tax credit of up to one and one-half percent if the utility makes a contribution equal to the amount of additional investment tax credit to a TRASOP and if there is compliance with certain normalization rules concerning the credit.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

9. Special limitation for employee stock ownership plans (sec. 10 of the bill and sec. 415(c)(6)(A) of the Code)

Present law

Under present law, the dollar limitation on contributions with respect to a participant in a TRASOP or in an ESOP may be increased, provided certain requirements with respect to allocations are met. The amount of increase is the lesser of (1) the existing limitation on contributions or other additions to a participant's account, or (2) the amount of employer securities contributed to the employee stock ownership plan.

Explanation of provision

Under the bill, the increase in the contribution limitation for TRASOPs or ESOPs (provided certain requirements are met with respect to allocations under the plan) would be the lesser of (1) the existing limitation on contributions or other additions to a participant's account, or (2) the amount of employer securities allocated to a participant's account (rather than securities contributed to the plan).

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

10. Tax credit for the establishment of ESOPs by small employers (sec. 11 of the bill and new sec. 44E of the Code)

Present law

Under present law, generally an employer would be allowed a deduction for the cost of establishing an ESOP.

Explanation of provision

Under the bill, a small business employer which established an ESOP would be allowed a credit against its Federal income tax in an amount equal to the lesser of $5,000 or the actual cost of establishing the plan. A small business employer is defined as an employer which had a monthly average of not more than 100 employees during the taxable year immediately preceding the taxable year for which the ESOP is established.

Effective date

The provision would be effective for taxable years beginning after December 31, 1980.

11. Retirement savings by TRASOP participants (sec. 12 of the bill and sec. 219(c)(4) of the Code)

Present law

Under present law, an employee who is an active participant in a tax-qualified plan during a year is not eligible to make deductible contributions to an IRA (individual retirement account, individual retirement annuity, or retirement bond. Therefore, if an employee is an active participant in a TRASOP during a year, such employee is ineligible for an IRA.

Explanation of provision

Under the bill, an individual who is an active participant in a TRASOP would not be precluded from making deductible contributions to an IRA solely because of participation in the TRASOP.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

12. Making of qualified matching employee contributions to TRASOPs (sec. 13 of the bill and sec. 48(n) and new sec. 404(j) of the Code)

Present law

Under present law, a corporate employer is entitled to an additional percentage point of investment tax credit (i.e., 11 percent rather than 10 percent) if it contributes an amount equal to the additional credit to a TRASOP. In addition up to ½ percent of extra investment tax credit is allowed where an employer contributes the extra amount to the TRASOP and the employer's extra contribution is matched by employee contributions.

Explanation of provision

Under the bill, an employer would be allowed to contribute both the matching employer and employee contributions to a TRASOP. If the employer made both matching employer and employee contributions, the employer would be allowed a deduction for the amount of the matching employee contributions in addition to the additional ½ percent of extra investment tax credit for the amount of the matching employer contributions.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

13. Special provisions for small distributions from TRASOPs (sec. 14 of the bill and sec. 402(a) of the Code)

Present law

Under present law, if employer securities are distributed in a lump sum distribution from a tax-qualified plan, the basis of the securities (i.e., the value of the securities when contributed to or acquired by the plan) is includible in income by the recipient in the year of the distribution. The net unrealized appreciation on the employer securities is not taxed until the securities are sold or exchanged.

Explanation of provision

Under the bill, if employer securities are distributed in a lump sum distribution from a TRASOP, and if the participant from whose account the distribution is made was a participant in the plan for at least three years, then the lesser of $5,000 or the basis in the employer securities would be excluded from the recipient's gross income.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

14. Use of nonvoting stock in TRASOPs and ESOPs (sec. 15 of the bill and sec. 409A(l) of the Code)

Present law

Under present law, the only type of closely held employer security which can be contributed to a TRASOP or an ESOP is common stock issued by the employer having a combination of voting power and dividend rights equal to or in excess of the class of common stock of the employer having the greatest voting power and the class of stock of the employer having the greatest dividend rights.

Explanation of provision

The bill would permit another type of closely held employer security to be contributed to a TRASOP or an ESOP. A TRASOP or an ESOP could acquire nonvoting common stock of a closely held employer if (1) the stock was acquired from a shareholder, but not from the corporation, and (2) the stock was held by shareholders for at least 24 months prior to the acquisition by the TRASOP or the ESOP.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

15. Valuation of employer securities in TRASOPs (sec. 16 of the bill and sec. 48(n)(6)(B)(i) of the Code)

Present law

Under present law, the value of employer securities listed on a national exchange which are contributed to a TRASOP is the average of closing prices for such securities for the 20 consecutive trading days immediately preceding the due date for filing the employer's tax return for the year (including extensions).

Explanation of provision

Under the bill, the value of employer securities listed on a national exchange contributed to a TRASOP would be the average of the closing prices of such securities for the 20 consecutive trading days immediately preceding the date of contribution to the plan.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

16. Special requirements for qualified plans

Present law

Under present law, an employer is generally allowed a deduction for profit-sharing or stock bonus plan contributions which do not exceed 15 percent of the compensation of all employees under the profit-sharing or stock bonus plan. If the contributions are made to two or more profit-sharing or stock bonus trusts, such trusts will be looked at as one trust for the purpose of applying the limitation on contributions.

Under present law, if a qualified plan (i.e., H.R. 10 plan) provides for contributions or benefits for an employee who is considered to be an "owner-employee," the assets of such plan must be held by a bank, an insured credit union, or other approved trustee, or invested in an insurance contract. An owner-employee is an individual who owns the entire interest in an unincorporated trade or business or in the case of a partnership who has more than a 10 percent interest in the partnership. Under present law, if this plan is later merged into or transfers assets to a plan which does not cover an owner-employee the plan receiving assets from the restricted plan is also required to have as its trustee a bank, etc.

Explanation of provision

Under the bill, an employer generally would be allowed a deduction for contributions to one or more profit-sharing plans and one or more stock bonus plans which does not exceed 25 percent of the compensation of employees under the plans.

Under the bill, if a qualified plan which provides contributions or benefits for a person who is an owner-employee is merged into or transfers assets to a qualified plan which does not cover an owner-employee, the plan receiving assets from the restricted plan would not be required to have a bank or other independent trustee as its trustee.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

17. Flexible benefit

Present law

Under present law, a cafeteria plan is an employee benefit plan under which a participant may choose between taxable benefits and one or more nontaxable welfare benefits. Such plans are not permitted to provide deferred compensation.

Explanation of the provision

The bill would permit a cafeteria plan to provide deferred compensation under the rules applicable to cash or deferred profit-sharing and stock bonus plans.

Effective date

The provision would be effective for taxable years beginning after December 31, 1979.

OPENING STATEMENT OF HON. SPARK M. MATSUNAGA, ON VARIOUS PENSION BILLS

Mr. Chairman, I would like to express my sincere gratitude to you for holding these hearings, despite your busy schedule and your deep concern with the Crude Oil Windfall Profits Tax Bill now before the Senate. Senators, including myself, whose bills are the subject of these hearings are indebted to you, Mr. Chairman, for this opportunity to solicit public testimony.

By enactment in 1974 of the Employee Retirement Income Security Act, commonly referred to as ERISA, Congress intended to resolve numerous problems in the pension area. However, ERISA has failed to resolve some of the issues it was intended to meet, and the legislation itself has raised various difficulties.

Witnesses testifying before this Subcommittee will no doubt address themselves to these issues. Of particular concern to me, as a Senator from Hawaii, are (1) ERISA's preemption of Hawaii's health insurance law and (2) ERISA's prohibition of investment in employer-occupied real property by profit sharing plans. With reference to my first concern, together with my colleague from Hawaii, Senator Inouye, and an official delegation representing the State of Hawaii and the Hawaii State Federation of Labor, AFL-CIO, I testified at a joint hearing of the Committees of Labor and Human Resources and Finance in August 1978 in strong support of legislation to exempt the Hawaii Prepaid Health Care Act of 1974 from the preemption provisions of the Employee Retirement Income Security Act of 1974.

As introduced by Senator Williams and Senator Javits and as ordered reported by the Committee on Labor and Human Resources, section 155 of S. 209, the ERISA Improvements Act of 1979, provides the requested exemption for the Hawaii Prepaid Health Care Act. However, there are significant differences in the scope of the provision as it was introduced and as it was reported by the Labor and Human Resources Committee.

Earlier this year, before the Labor and Human Resources Committee, the Department of Labor testified in support of a narrow experimental exemption only for Hawaii. Such an exemption would be similar to the provision included in S. 209 as it was introduced. This provision would specifically exempt the Hawaii Prepaid Health Care Act from ERISA and establish the Hawaii Act as a national standard for any subsequent exemptions from ERISA for any other State which will have enacted mandatory, comprehensive, employer-based health insurance laws.

During its markup session on the legislation, the Labor and Human Resources Committee elected to broaden section 155 to permit virtually any State health insurance law to qualify for an exemption under ERISA.

I am supportive of both versions of section 155, since either version would clarify a serious legal ambiguity concerning the preemption authority of ERISA, which prompted Standard Oil Company of California to file suit against the State of Hawaii.

In November 1977, the Federal District Court in California ruled against the State of Hawaii in this suit and cited the need for specific exemption authority under ERISA for State health insurance laws, such as the Hawaii Prepaid Health Care Act. The court decision is currently under appeal by the State. Official representatives from the State of Hawaii are here today to testify in support of the health insurance exemption provision in S. 209 and to provide the Subcommittee on Private Pensions and Employee Fringe Benefits with a status report on the State's appeal of the Federal District Court decision.

In my second area of concern, ERISA's prohibition of investment in employer real property by profit-sharing plans, has also proven very troublesome. The State of Hawaii has less than one million people, but it has about 1,000 profit-sharing plans. These plans allow workers to share in the success of their employer's business, which in turn creates an identity of interest with the employer. The result is a more productive workforce.

Because land is such a scarce and precious commodity in Hawaii, to provide an even greater incentive to its employee-members, many of Hawaii's profit-sharing plans had invested in employer-owned real property, prior to enactment of ERISA. Ownership of land, especially of the workers' own workplace, had created an observable sense of pride and selfworth. Moreover, the rapid increase in real estate appreciation, compared with the sad performance of other equity investments, had proven the wisdom of investing in real estate.

However, ERISA now forbids investment in employer-occupied real property, unless the employee plan invests in multiple parcels, geographically dispersed. Profit sharing plans in Hawaii are modest. Most of the affected plans have but one parcel of real estate. They have sought administrative exemption from this prohibition, but have been unsuccessful in getting relief from the Department of Labor, which refused to acknowledge the simple reality that ownership of multiple parcels must first begin with one. Furthermore, initial investments in employer-occupied real property have proven profitable for the workers, since employers in past cases in Hawaii have sold real estate at terms very favorable to profit-sharing plans. Yet, the rules promulgated to implement ERISA now prohibit this type of transaction.

Ironically, ERISA permits employee plans to buy employer stocks. The logic of permitting an employee plan to own employer stocks and not employer assets—in this case, land—escapes me. In the light of the constant flux in stock prices, and the smallness of many employers' businesses, without a ready market for their stocks, I believe that ownership of land is a safer and better investment for employee plans. My bill, S. 1958, was introduced in recognition of this reality.

Finally, I would like to discuss the problems addressed by S. 511, a bill which I introduced earlier this year.

Since 1960, the Treasury had sanctioned deferred compensation plans under its administrative interpretation of the constructive receipt and cash equivalency doctrines. However, the Treasury subsequently viewed the growing use of deferred compensation arrangements as undermining effective tax administration. In a letter to Finance Committee Chairman Russell Long, dated May 4, 1977, then Treasury Secretary Michael Blumenthal noted the use of such plans even when employees were apparently in constructive receipt of compensation. Secretary Blumenthal also noted that State and local govenments and tax exempt organizations could establish such plans for their workers without meeting the nondiscrimination rules and the contribution limitation imposed by ERISA for qualified pension plans.

The Treasury sought to change its administrative practices by issuing proposed regulations on February 3, 1978. The regulations would have subjected deferred amounts to current taxation. The proposed regulations alarmed many employers who utilized these deferred compensation arrangements.

In an effort to reach a suitable legislative compromise the Congress enacted Section 457 of the Code. This provision permits continued deferral of compensation for State and local government workers, subject to a percentage limitation and set dollar maximum. The Revenue Act of 1978 also retained the unfunded deferred compensation plan for private, taxable entities.

The Revenue Act of 1978 partially resolved the controversy. However, it made no provision for unfunded deferred compensation arrangements for tax exempt organizations. Section 132 of the Revenue Act expressly allows the prior rulings, regulations, and case law, to apply only for employers other than a state and other than an exempt organization. This action thus excluded the programs of numerous exempt organizations.

In the light of last year's action, we must approach this issue from a practical viewpoint. We can pass legislation authorizing exempt organization deferred compensation arrangements, covering most situations and most individuals, or we can leave these organizations stymied in their effort to establish legal deferred arrangements. My bill, S. 511, would place tax exempt organizations under the same provision for State and local governments; it would answer the needs of most organizations and allow them to cover most of their peoples' needs.

I am anxious to hear the views of the witnesses on these and other issues.

Again, let me express my gratitude for the Chairman's efforts in convening these hearings.

Senator WILLIAMS. Of course, I am very, very pleased that I am here at the same time with Senator Javits who, with you, Mr. Chairman, myself, and others, been a partner in these employee benefit plan matters for a long time.

We are encouraged by these hearings, Mr. Chairman, and Senator Matsunaga. We appreciate your initiative in getting the legislative effort underway in this committee as regards the pension bills that are before you.

The ERISA improvements act, S. 209, as amended and approved by the Committee on Labor and Human Resources, I suggest is balanced legislation intended to achieve five major goals. I would like to summarize these briefly, if I could.

First, S. 209 will stimulate more private sector retirement income arrangements. It contains incentives for employers to establish tax-qualified plans and enhances employer-sponsored plans by permitting limited deductions for contributions made to those plans or IRA's by covered employees.

Also the "special master plan" concept in title III builds upon an already established administrative practice to provide a way for employers to adopt and maintain sound plans yet avoid most of the burdens normally associated with ERISA's reporting, disclosure, and fiduciary rules.

Second, the bill provides greater assurances that employees who are covered by plans will actually receive retirement income. Although our oversight and review of operations under ERISA over the past 5 years did not indicate a need for major, conceptual change, we did identify certain provisions which, in our judgment, do not fully reflect the policy goals we sought to reach in 1974. These have to do with supplemental pension payments, joint and survivor annuities, offsets of pensions by workers' compensation payments, and misrepresentation.

Third, the "Improvements Act" makes a number of changes intended to clarify the law, simplify compliance and reduce paperwork and red tape. These amendments will be helpful to all plans but will be of particular value for small plans and multiemployer plans—two groups which have had special difficulty in adjusting to ERISA's rules. In this regard, we heard testimony a few weeks ago on your simplification bill, S. 1089. I believe the basic similarity of intent between that bill and portions of our bill can provide a foundation upon which further and more comprehensive legislative progress may be based.

Fourth, S. 209 makes several adjustments in the relationship between ERISA and other Federal and State laws. Our oversight during the past 2 years has highlighted several problems which arise under ERISA's sweeping preemption rules. In terms of policy, the most difficult problem concerns state health care laws. After thorough deliberation, we concluded that the policy of Federal uniformity which supports ERISA's sweeping preemption—weakened as it is by the lack of substantive Federal law requirements respecting health care benefits—cannot justify the abrogation of State laws which mandate or regulate substantive aspects of employer sponsored health care plans.

Fifth, the bill seeks to streamline administration and enforcement by combining the ERISA-related functions of the Labor Department, IRS, and PBGC in a single agency which will have no responsibility other than the faithful execution of the provisions of ERISA and pertinent parts of the tax code. Without underestimating the difficulties of creating a new agency, we nevertheless believe consolidation to be preferable to a continuation of the present arrangement.

Looking to the future, it is our view that the increasing magnitude and urgency of the issues surrounding retirement income is inevitable, and that those issues merit the focused consideration and resolution which can only be provided by a single executive branch focal point. Regarding whether the single agency proposal in our bill would necessitate any change in congressional oversight and legislative responsibility, let me say that I see no reason to change the present responsibilities of the Tax and Labor Committees.

Mr. Chairman, I appreciate this opportunity to testify in support of S. 209 and commend your continuing efforts in this important field. I know I speak for all the members of the Labor Committee in saying that I look forward to our joint progress during the next session.

Senator BENTSEN. Thank you very much, Senator.

I think you two Senators have really set a unique and excellent example of bipartisan support and leadership on this issue.

[The prepared statement of Senator Williams follows:]

REMARKS OF HARRISON A. WILLIAMS, JR., CHAIRMAN, COMMITTEE ON LABOR AND HUMAN RESOURCES

The ERISA Improvements Act, as amended and approved by the Committee on Labor and Human Resources, is balanced legislation intended to achieve five major goals.

First, S. 209 will stimulate more private sector retirement income arrangements. It contains incentives for employers to establish tax-qualified plans and enhances employer-sponsored plans by permitting limited deductions for contributions made to those plans or IRAs by covered employees. The "special master plan" concept in title III builds upon an already established administrative practice to provide a way for employers to adopt and maintain sound plans, yet avoid most of the burdens normally associated with ERISA's reporting, disclosure, and fiduciary rules.

Second, the bill provides greater assurances that employees who are covered by plans will actually receive retirement income. Although our oversight and review of operations under ERISA over the past five years did not indicate a need for major, conceptual change, we did identify certain provisions which, in our judgement, do not fully reflect the policy goals we sought to reach in 1974. These have to do with supplemental pension payments, joint and survivor annuities, offsets of pensions by workers' compensation payments, and misrepresentation.

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Mr. Chairman, I appreciate this opportunity to testify in support of S. 209 and commend your continuing efforts in this important field. I know I speak for all the members of the Labor Committee in saying that I look forward to our joint progress during the next session.

Senator BENTSEN. I would like to now call on Senator Javits for any comments.

STATEMENT OF HON. JACOB JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator JAVITS. Thank you very much, Mr. Chairman.

I ask unanimous consent that my statement be made a part of the record.

Senator BENTSEN. Without objection.

Senator JAVITS. Mr. Chairman, I will not duplicate anything that has been said except for one thing. I was here when the original ERISA bill came out of the Finance Committee absolutely stripped naked. There was nothing in it.

Both Senator Williams and I were deeply mortified, and we fought on and then you came along Mr. Chairman. I have said this before, and I would like to say it again, and to say it publicly; you were our savior on the Finance Committee. Without you, as assisted by Senator Nelson, there never would have been an ERISA.

Those are big words, but I would like you to know, Mr. Chairman, it is one of the greatest things, in my opinion, that you have ever done.

Senator BENTSEN. That is very generous, Senator.

Senator JAVITS. We are all profiting from ERISA for this reason. Demographically our population is getting older. It is going to be a big challenge as the years go on to get the younger worker to support the older worker, and the path we are now taking in the increase in social security taxes shows that.

In addition, I think that freedom is compromised if social security becomes the only staff of life for older people as we get more and more older people.

So the right outlet from the point of view of building up retirement assets is this area of pension plans plus IRA's, but this area of pension plans particularly because it involves so very directly the employer contribution and so very directly the fruitfulness of American investment.

These are vast, vast sums of money for retirement.

As we all know, there are now probably between a quarter and a half of a trillion dollars in the various trust funds for these pension plans. They are becoming a fantastically important element of investment.

We speak of the need for vast capital investment in this country. Here is an enormous resource for intelligent capital investment, and one of our challenges, and the Chair recognized very early on—we have talked about it many times—will be ultimately to do our utmost to see, without interfering with the freedom of investment decisions, that this social money, which is what it is, is intelligently invested.

How to do it, we have not yet adequately thought about. The idea of some compulsory percentage for mortgages has been discussed, but it does not appeal to any of us.

We will find a way, but I need to emphasize the vast pool of investment capital and the fact that this law answers a great national need arising from the demography which is involved, that is so many more older people.

We need more retirement plans in order to be fair to the younger worker and because it is an absolute essential to putting some kind of an effective ceiling on social security taxes.

The other point that I would like to make, Mr. Chairman, is I hope that as time goes on we will make workers feel seriously about their investment in these plans. It is just as important and effective as the piece of paper they may have from some industrial company by way of stocks or bonds, or in savings bank deposits. This is the greatest insurance policy that they will probably ever have, especially under the new law.

I emphasize these things because we spent 5 years being attacked for paperwork, for complications, for hard-to-get exemptions from ERISA's prohibited transaction provisions.

But in looking at the trees, I think we have a right to look at the forest.

Mr. Chairman, I believe in your bill with whatever little differences we develop and in our bill with whatever little differences we may develop.

I know how you feel about the single agency. You know how we feel about civil enforcement powers to the IRS. We will work it out. I have no doubt about it whatever.

We are now getting to the main point which is that time and experience will validate this concept, broaden it, deepen it, enable us to do an infinitely better job for the American people.

Mr. Chairman, on the preemption, we have saved the Hawaii statute; we have saved the California statute and probably others by the amendments which were sponsored by Senator Kennedy and Senator Cranston and I am glad that we did.

Where great progress is made in the States, my concept of federalism is that we must encourage those kinds of splits between the States and the Federal Government. I do not believe that we can back away from the fact that this is a federal system in which a citizen has the right to come to the Federal Government for justice or efficiency where he cannot get it at the local level: *Provided* That we have given the local level every opportunity to perform.

But the obligation on us is to give the States every opportunity to perform and not to knock them down when they do, which is the situation with this particular preemption.

With respect to the *Daniel* case, I think that we have dealt very effectively with that case in our bill. We have eliminated the application of the Federal securities law antifraud provision, and we have included in ERISA an effective antifraud rule. Thus, in my judgment, we have paid attention to the substantive element without introducing yet another agency and another complicating factor, both in terms of administration and in terms of the time and responsibility of the businessman respecting their pension plans.

And I also call attention to the survivors' right under our bill's joint and survivor annuity provision in getting something out of the plan after 10 years of resting by the deceased participant.

I realize that the gamble is essential to effective pension plans. No doubt about that. Senator Williams and I have always emphasized that. However, where a fair adjustment can be made which will preserve some rights for a highly deserving class, like widows, we should do it if we possibly can. And in our judgment we can, so we have included it in our bill.

Again, Mr. Chairman, we thank you very much for this hearing. We had the honor of hearing you on your bill. As far as I am concerned, we will give it the most thoughtful consideration, very much leaning toward doing what you want done, just as I hope that that will be the same position taken here in the Finance Committee on the matters that we have put up to you in our bill.

Senator BENTSEN. Thank you very much, Senator. What you have said is very helpful to us and very encouraging.

I would like to defer to my colleague, Senator Matsunaga, who has had a long-time interest in this subject.

Senator MATSUNAGA. Thank you, Mr. Chairman. I wish to join Senator Williams and Senator Javits in again thanking the chairman for scheduling these hearings. There is much to be done to resolve the problems which have arisen since the enactment of ERISA in 1974. I wish to thank both Senator Williams and Senator Javits for the leadership that they have shown in this area and for the courtesy they extended to the witnesses from Hawaii who appeared before the Committee on Labor and Human Resources.

The exemption for State mandated health plans substantially similar to Hawaii's program in your bill, S. 209, was subsequently expanded by the Labor Committee. However, your willingness at the very outset to correct ERISA's preemption of Hawaii's program is very much appreciated. The attention and care you gave to the problem greatly impressed the Hawaiian witnesses who appeared before your committee. On their behalf, I thank you.

Senator WILLIAMS. Obviously they impressed us.

Senator MATSUNAGA. Thank you.

Should we run into difficulty in enacting a wide exemption applicable to all States, we would need to fall back on a narrower exemption for State programs similar to Hawaii or perhaps just for Hawaii. Would you support this position on the floor of the Senate?

Senator WILLIAMS. You mean if the State health care law preemption provision of this legislation were stalled for any reason and did not come to the floor of the Senate?

Senator MATSUNAGA. Right.

Senator WILLIAMS. It is certainly worth our consideration.

Senator JAVITS. Yes. Just for the same reasons, Senator Matsunaga, that we are hopeful to deal in time with these multiemployer plans. In other words, we do not want this thing ever to bog down for impracticality.

Senator MATSUNAGA. There is a second area of concern for me; that is ERISA's restriction of investment in employer real property by profit-sharing plans. ERISA prohibits such investments unless the plan owns multiple parcels that are geographically diversified. Small plans might purchase one piece or even two pieces of real estate, but single parcel ownership is forbidden. I have introduced S. 1958 to modify the ERISA rule and yet provide safeguards. Would you care to respond to my legislative proposal?

Senator WILLIAMS. Is this the idea that is incorporated in your bill?

Senator MATSUNAGA. Yes.

Senator WILLIAMS. This has been considered. Staff has analyzed it. We have analyzed it and feel that there is a great deal of merit here and would look favorably upon that.

Senator MATSUNAGA. I appreciate it very much.

Senator JAVITS. That is fine. We both feel that way.

Senator BENTSEN. Thank you very much, gentlemen. I appreciate your testimony.

Senator WILLIAMS. Thank you.

Senator JAVITS. Thank you.

[The prepared statement of Senator Javits follows:]

STATEMENT OF SENATOR JACOB K. JAVITS

Mr. Chairman, I want to express my sincere thanks for your calling of these hearings on a number of pension-related bills, including S. 209, the ERISA Improvements Act of 1979. Senator Williams and I have worked on this measure and its predecessor bill for over two years, and I commend it highly to your Subcommittee for consideration. The Senate Labor and Human Resources Committee marked-up and approved S. 209 on May 16 and has prepared a very helpful Summary and Analysis of the bill. I second Senator Williams' request that this document be included in the record of these hearings.

Before turning to S. 209, I would like to say a few words about ERISA, (the Employee Retirement Income Security Act of 1974), the law we are proposing to amend. ERISA was a giant step toward the improvement of the private pension system. It has done more to contribute to the retirement income security of older Americans than any law since the Social Security Act of 1935. ERISA stands for the proposition that promises made to working men and women about their pensions will be kept. The national shame of broken pension promises has been greatly reduced by ERISA, and the once common fear of losing hard-earned pensions "due to the fine print" is rapidly being dissipated.

Mr. Chairman, you well know the difficulties we faced in enacting ERISA. Without you, I doubt that we would have gotten ERISA through the Finance Committee. You were indeed—as I have publicly said before—our savior on the Finance Committee. I remain appreciative of what you have done, and I am gratified that we are working together again to shape a package of amendments which will improve ERISA.

As Senator Williams, our esteemed Chairman of the Labor Committee, has already testified, S. 209 is balanced legislation which aims at achieving five major goals. These goals include encouraging growth in the coverage and benefits under private retirement income arrangements. We believe that more and better private pension plans are necessary because the population of the United States is growing older. Based upon present demographic trends including low fertility rates, low mortality rates and the aging of the post war baby boom, there will probably be early in the next century an unusually large number of older people and comparatively few younger workers. If we do make sure that adequate resources are built up now to provide retirement income in the future, we may not be able to provide adequately for all of our older citizens. Younger workers will resist shouldering greater tax burdens to provide for their more numerous elders, and intergenerational conflict will result, similar to but more severe than the turmoil we have seen over increased Social Security taxes.

The one provision of S. 209 that I would like to focus on today would save from ERISA preemption certain state health care statutes. I know that Senator Matsunaga, a member of this Subcommittee, is particularly interested in this provision because a federal district court has held that ERISA preempts Hawaii's very progressive Prepaid Health Care Act. The Hawaii law requires employers in the state to provide minimum basic health care benefits for their employees, and is a model of fine social legislation. In order to accommodate the bona fide state interest in protecting its citizens by assuring better health care services—an interest which is consistent with the Federal interest expressed through ERISA of assuring improved protections under pension and welfare plans—the Labor Committee has decided to except from ERISA's general preemption certain state laws including Hawaii's. I urge the members of this Subcommittee to give careful consideration to this provision.

In conclusion, Mr. Chairman, I commend you again for holding these hearings and offer my fullest cooperation in trying to work out a comprehensive set of ERISA amendments which the Congress can enact in 1980.

Senator BENTSEN. Our next witness will be the Honorable Daniel Halperin, Deputy Assistant Secretary of the Treasury.

STATEMENT OF HON. DANIEL I. HALPERIN, DEPUTY ASSISTANT SECRETARY OF THE TREASURY

Mr. HALPERIN. Thank you, Mr. Chairman.

We will have a written statement. Unfortunately, it is not available today, but we hope to have it in a few days and to submit it for the record. The statement will express our positions on all the various bills before you.

I would like today to concentrate on a few proposals which will highlight what we see as the principal themes of ERISA which underlie our overall positions on these bills.

First of all, there are the minimum standard requirements of ERISA. In this connection, I would like to refer to S. 1090 and S. 1091 which are before you today.

Prior to ERISA, employees in certain circumstances were not entitled to participate in a pension plan unless they worked for a substantial time and were deprived of pension benefits unless they completed long periods of service, sometimes requiring that they stay employed until normal retirement age. One of the principal provisions of ERISA was to preclude long waiting periods before employees are eligible to participate. Generally this period cannot be more than 1 year. Second, benefits once earned must fully vest within 10 to 15 years after service begins.

However, these protections do not apply to plans established by churches or governments.

We can understand that certain organizations might have financial difficulties in meeting certain of the requirements of ERISA. However, we are dubious about the desirability of providing adequate pensions for a few long-service employees at the expense of others who fail to complete the required period of service. The latter group are left without any retirement protection at all, left without the retirement protection they may have expected.

On the other hand, if they behave as though pensions were not forthcoming—if they save with the possibility in mind that they will not receive anything from the employer's pension plan—we can, for those people who eventually receive benefits, have in effect a wasteful double savings, as they reduce their standard of living during their working years by unnecessary amounts in order to provide twice for retirement.

Thus we are concerned about continuing exemptions in the minimum vesting and participation standards of ERISA for certain groups such as church and government plans. We have difficulty with the provision of S. 1090 and 1091 which would expand this exemption from the minimum standards to agencies or organizations which are controlled by, or associated with, churches.

In some of our conversations with representatives of these organizations, they have indicated to us that they do not seek exemption from any minimum standards provision itself, but rather have difficulty with some of the more technical provisions of the Internal Revenue Code. The protections offered by these technical provisions may be just as important. However, we recognize the necessity of balancing all the interests here and we are prepared to consider each particular rule of the code separately to determine if the particular burdens it may place on the traditional method in which churches have operated outweigh the benefits that the provision provides for employees in general.

However, we see no justification for expansion of the complete exemption from ERISA from churches to church-related agencies. Therefore, we have opposed S. 1090 as it stands. Our position on this bill and on S. 1091 will be set forth in detail in the written statement we are submitting for the record.

As an indication of the fact that we are prepared to balance the various interests involved in the area of minimum standards, I would like to refer briefly to our position on section 123 of S. 209. Stated briefly, ERISA requires that employees must be included in a pension plan after 1 year of service. In order to prevent undue delay, the statute requires that, for each employee hired, the period of service must be measured from the date of hire.

Prior to ERISA, employers generally measured service by plan years for everybody and did not have the possibility of 365 different measuring periods, depending upon the time that particular employees are hired.

S. 209 gives employers the option to measure service on a plan-year basis if the plan includes employees retroactive to their day of hire. We would prefer a more liberal approach. We do not think there would be a great deal lost if employers were allowed to use plan years for all purposes and included people in the plan as of the first day of the plan year following their completion of a plan year of service.

We think retroactivity is unnecessary in this case.

This points out that simplification is possible and it can be achieved if all interests do not insist on pushing their particular goals to the ultimate.

As an illustration of this, let me turn to S. 989 which I think also illustrates another underlying principle of ERISA, namely, that benefits once earned should be available during the retirement years.

ERISA furthers this particular goal by providing an opportunity for employees who have received a distribution from a pension plan before their period of retirement to avoid current tax on the distribution by rolling it over into an individual retirement account, an IRA.

Unfortunately, under ERISA, eligibility for this rollover treatment was tied to the receipt of a lump sum distribution which was also the threshold for the right to have access to the special 10-year averaging provisions in the code.

So we have two benefits with one test for eligibility. We have come to realize that it is a mistake to tie the two together. The rules for lump sum distributions and access to special averaging are extraordinarily complex, in order to preclude undue abuse of the special averaging provisions. In contrast, rollovers should be encouraged and strict eligibility requirements as to the availability of the rollover are inappropriate. We therefore support the principles of the chairman's bill, S. 989, and would further support simplification of the eligibility for rollovers.

On the other hand, there is little justification for the special averaging provisions, the other arm of a lump sum distribution.

Rather than mitigating the harsh tax consequences of large distributions in 1 year, special averaging encourages individuals to take lump sums in order to reduce the overall tax burden. This is not only inconsistent with the policy of ERISA that money be available for the entire period of retirement, but also is a cause of enormous complexity in both the conditions for eligibility and the actual calculation of the tax.

Maybe there are certain special circumstances where the special averaging does avoid a potentially harsh result, but we believe that if we are serious about achieving simplification we cannot insist on retaining every marginal advantage for taxpayers no matter how complex.

The interests must be balanced.

Another theme that underlies our positions in this area is our feeling that there must be equity in the distribution of the tax benefits provided by the Internal Revenue Code and ERISA.

Examining to the question of tax equity, we find another example which illustrates that taxpayers do not object to complexity itself. That is, they do not object to it when it works in their favor.

S. 1092 deals with the special so-called catchup exemptions to the limits on contributions to section 403(b) annuities. Section 403(b) annuities are special opportunities available for employees of certain tax-exempt organizations. There are limits on the amounts that may be contributed to these annuities. There are special exceptions to these limits for employees of educational institutions and other organizations.

S. 1092 would expand these special exemptions to employees of churches and would add an additional safe harbor for contributions up to $10,000 per year indexed for inflation.

We generally support the policy of section 415 to limit the amount that can be set aside under favorable tax treatment. This is essential if tax equity is to be maintained.

Moreover, we believe that section 403(b) which provides for favorable tax benefits without regard to the normal nondiscrimination requirements, is poor tax policy. In this context, it is very difficult to support expanding the advantages of section 403(b) over those for normal retirement plans. These plans, as I have said, are limited in many cases to higher paid employees as compared to qualified plans which must cover a broad cross-section of all employees in the company.

However, we are conscious of the enormous complexities of the present rules in section 415. I am told that nearly 70 pages of draft regulations are required in order to explain the detailed exceptions to the 415 limits. I was familiar before I came into the Government with three- and four-page forms that employees needed to fill out in order to determine the amount that can be set aside under these provisions.

I doubt if very many people compute these amounts correctly. We think that it is important to eliminate this enormous complexity. Therefore, we would not oppose a rule which would set forth a special de minimis amount which could be set aside each year in lieu of the section 415 and 403(b) limits.

We believe that this amount should be $7,500 not the $10,000 indexed for inflation as provided in the bill. We think that this new special exception should be in lieu of all the others and not on top of the existing complexity. Again, our position on this proposal is set out in detail in our written statement.

We find another example of the opportunity to achieve favorable retirement benefits which arises in connection with your bill, Senator Matsunaga. Your bill, S. 511, is intended to deal with a particular aspect of this problem.

Taxable corporations have a strong incentive to provide retirement benefits in the form of qualified plans. This is the only means by which the normal taxable corporation can get a current deduction while avoiding current income to their employees and allowing the amount set aside to be invested in a tax-exempt manner. This is not true, however, in the case of a tax-exempt organization.

A tax-exempt organization, of course, does not care about the tax deduction so that if it establishes a so-called unfunded plan—a plan where there is no trust in which the assets are held—employees do not have current income. Even if it sets aside a portion of the assets to back up its promise to pay deferred compensation, the earnings on the fund generally retain the advantage of tax exemption which is available to tax exempt organizations.

So these tax exempt employers do have the advantage of deferral and the advantage of tax-free investment without a qualified plan. Moreover, under ERISA, unfunded pension plans can be maintained by tax-exempt organizations only if they are primarily for the benefit of highly compensated individuals.

Proposed regulations were issued by the IRS in February 1978 which would prevent deferral of income where employees have an option to receive cash currently.

In the 1978 Revenue Act, Congress precluded the imposition of these regulations in the case of taxable corporations and established special rules which would limit the amount that can be set aside for employees of State and local governments.

However, no action was taken with respect to tax-exempt organizations and the Internal Revenue Service was not prohibited from applying the February 1978 regulations to employees of these organizations.

We continue to believe that it is appropriate to limit the opportunity for the more highly paid employees of tax-exempt organizations to achieve the benefits of qualified plans—income deferral and tax free investment—without satisfying the nondiscrimination requirement.

Therefore we issued a news release earlier this year seeking additional comments on the possible application of the proposed regulations to employees of tax-exempt organizations. Last week we held a hearing on these proposals.

Commentators pointed out possible administrative difficulties in applying the regulations. Thus, we can see advantages to a legislative solution along the lines of your bill S. 511.

This proposal, which applies section 457 of the Internal Revenue Code to tax exempt employers, places outside limits on the total amount which may be deferred, whether or not employees exercise an individual option. Thus, it avoids evidentiary problems in determining whether or not such an option exists.

Because we are uncertain at the moment of the probability that S. 511 will become enacted, we believe that it may be proper to proceed with preparation of a final regulation in this area but we certainly do want to explore with this committee the possibility of a legislative solution to this problem which might be acceptable to all.

I think in general that is something we can say about all the areas under consideration. I think we generally have common goals and we ought to be able to reach commonly acceptable solutions.

That concludes my statement. Thank you.

Senator BENTSEN. Mr. Halperin, Senator Javits was talking a while ago about 5 years that we have taken flak over ERISA and that is right. I noticed that while he was giving me some of the credit for authoring it, some buzzing going on in the back. I do not know whether it was credit or not. I frankly think it is.

I think that the objectives of ERISA are laudable and they are great goals and we are accomplishing much of them, but a lot of things have happened along the way with a major piece of legislation like that where we have seen inequities develop and where we did not anticipate this or anticipate that and a degree of complexity that we do not think is necessary.

One of the things that concern me is that you get a situation where there is a disqualification of a pension plan and you have a real tax penalty that can be imposed on the pensioners, and they may be totally innocent in the process. It can be an administrator who has violated the law, an employer or a union.

Do you not think that Treasury should have some civil remedies here to enforce ERISA? Treasury has it in a number of other instances. You have an antidumping provison in some other areas and most of the agencies do have such.

S. 1089 provides that.

Mr. HALPERIN. Mr. Chairman, this problem is one on which I think we agree. We agree that the sole remedy of disqualifying a plan for any violation in many cases can be unfortunate and there ought to be alternatives to disqualification. The IRS in practice does try to work out alternative solutions to disqualification and avoid it whenever it can.

We are studying the problem. In fact, we have a meeting set up next week with representatives of an American Bar Association

Tax Section subcommittee which has been working on the problem and has submitted to us recommendations for alternative solutions.

I think that when you come to the question of civil injunction actions then, as we testified in our statement on S. 1089 before the Committee on Labor and Human Resources, there are several things that one must look at.

First of all, if we are dealing with the question of minimum standards those provisions which also exist in title I of ERISA, the Labor Department already has the ability through injunctive actions to bring about corrections of a plan's failure to meet those standards. So the issue comes up as to whether or not that power ought to exist in the Internal Revenue Service as opposed to the Department of Labor. That is a subject on which, as indicated earlier, there are some differences of opinion, both on the Hill and other places.

We think this ought to be discussed in connection with the administration's report on the reorganization plan which is due at the end of January.

When it comes to other areas of plan qualification where there are not any parallels to title I, you have the question of nondiscrimination. A question that comes up here is, what does the injunctive action require if an employer, for example, covers a small group of employees in a plan. The employer asserts that the plan is qualified because it covers a nondiscriminatory group. Then the Internal Revenue Service comes in and holds, despite the employer's claim that covering only 10 percent of the employees does not produce a qualified plan; that they really need to cover 80 percent or 90 percent in order to have a qualified plan.

Can the IRS be given the authority to bring an action for an injunction arguing that the employer must bring all of these other people into the plan? That may increase the cost of the plan tremendously and the employer may well say, if that is what I have to do in order to get the benefits of the Internal Revenue Code, I would rather not have the benefits of the Internal Revenue Code. I would rather have a nonqualified plan without the particular tax benefits.

I think that we have to examine very carefully whether injunctions are the right remedy and exactly what kinds of injunctive power we are going to have. We are certainly exploring the possibility of more discrete penalties, perhaps penalties on those who are responsible for the violation. This would not impinge upon the benefits that would be paid to the innocent employees.

Can the penalty, for example, be limited to the employer without affecting the tax treatment of the employees or without affecting the tax treatment of the trust. If the plan discriminates in favor of high-paid employees, can the penalty be tailored so it only affects the benefits of the high-paid employees and does not affect the benefits of the low-paid employees?

I think we certainly agree with your goal. We are trying to work very hard at coming up with a solution. We are not sure we can go along with the bill as it exists, but we hope to have alternative proposals for you very shortly.

We have no quarrel with the idea that disqualification alone is the wrong way to go.

Senator BENTSEN. You heard some testimony a moment ago about joint survival rules. We have had a number of persons who said, well, that is going to require amending the plans and can be quite costly to smaller plans. I think every member of this committee is concerned about protecting spouses. Certainly I am.

But I would like some work out of your staff telling us what we are talking about. Are we talking about minimal benefits as related to substantial work and cost in the amendment of the plans, or is the reverse true? Is it a minimal problem in the amendment, and should we try to adjust ratewise and actuarially to put the joint survival rules in the position as suggested by other legislation here?

Mr. HALPERIN. I think there are some very serious problems there. I think there are some basic questions which need to be answered. We need to bring them to the surface.

You can get involved in the rhetoric of saying that spouses need protection if the worker dies, and obviously I have no quarrel with that. I think there is a big jump between that and going to some of the joint and survivor provisions that have been suggested.

For example, S. 209 I believe requires that a survivor annuity be paid in any case in which a participant has 10 years of service. Take the most extreme case. If an employee were to die, say, at age 35 after completion of 10 years of service, the amount that employee will have accrued under a pension plan is going to have very little to do with the needs of the spouse and children at the death of the employee. Adequate protection for the spouse and children has to come through life insurance above and beyond the pension plan. It certainly is not clear that requiring that the plan do double service, both as retirement protection and life insurance protection in case of death at a very young age is at all sensible.

I think there is a lot more to be said in favor of survivor protection after retirement. We certainly do not want the case where the worker dies at age 65 and the spouse is left penniless. That is a very different story than worrying about the situation at age 35.

I think those are some very key questions that need to be answered.

We are not sure that S. 209 is the right answer on those provisions. I can certainly see the concern that there are going to be some fairly small death benefits being provided at presumably some administrative cost to the plan.

Senator BENTSEN. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman.

Mr. Halperin, the Internal Revenue Service held hearings on proposed regulations dealing with nonqualified deferred comparison for tax exempt organization. Will the IRS or the Treasury pursue this matter further?

What do you intend to do?

Mr. HALPERIN. Senator, as I said in my statement, we think there is a problem there. We think that employees of tax-exempt organizations today have, through salary reduction arrangements, the opportunity to achieve the benefits of qualified plans—deferral of tax and tax free investment—without meeting any of the nondiscrimination requirements.

Under ERISA, these plans are limited to those which primarily benefit high-paid employees. Again, there is not the broad cross-section of employees being favored by the these salary reduction type arrangements.

We think that something needs to be done. We take very seriously the comments made to us at the hearing that some of the rules we have proposed might not be easily administered, and that some difficult line drawing would be required as to whether people really did have a choice to receive compensation currently.

Senator MATSUNAGA. Do you feel the controversy can be resolved administratively or must it be resolved legislatively?

Mr. HALPERIN. I think that there are certain questions. First of all, some people would question our authority to deal with it administratively. Ultimately, the courts would have to decide that.

Second, we certainly cannot do some of the things administratively that you could do by legislation. A legislative solution may result in simpler rules to apply than an administrative solution.

So that I think there is a lot to be said for a legislative solution. If we can all get together on one, I think we would prefer it.

Senator MATSUNAGA. Fine.

Perhaps it would be wiser to pursue the legislative route as provided in S. 511. On another matter, are you familiar with my bill S. 1958? Would you care to comment on that bill?

Mr. HALPERIN. Yes. We would like to defer to the Labor Department on that. That is within their jurisdiction.

Senator MATSUNAGA. Fine.

Thank you.

Senator BENTSEN. Thank you very much, Mr. Secretary. We appreciate your testimony.

Mr. HALPERIN. Thank you.

Senator BENTSEN. I look forward to receiving the information I requested.

[The prepared statement of Mr. Halperin follows. Oral testimony is continued on p. 238.]

Department of the TREASURY NEWS
WASHINGTON, D.C.

Melton

STATEMENT OF DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY FOR TAX POLICY
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON PRIVATE PENSION PLANS AND
EMPLOYEE FRINGE BENEFITS OF THE
SENATE FINANCE COMMITTEE
December 4, 1979

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to present the views of the Treasury Department on several bills relating to private pension plans. My remarks will deal with the following bills: S. 209, The ERISA Improvements Act of 1979; S. 511, regarding the treatment of unfunded deferred compensation plans maintained by tax-exempt organizations; S. 989, regarding rollover of distributions from a money purchase plan; S. 1089, the ERISA Simplification Act of 1979; S. 1090, 1091, and 1092, relating to church plans and tax sheltered annuities; and, S. 1240, the Employee Stock Ownership Improvements Act of 1979. We defer to the Department of Labor with respect to S. 1958 regarding investments by a money purchase pension plan in employer property.

M-278

S. 209
ERISA Improvements Act of 1979

S. 209 represents a revision of S. 3017 introduced in the last Congress as to which this Department expressed its views in hearings on August 15, 1978.

These comments are in reference to those provisions of S. 209 which affect the Internal Revenue Code and matters involving the jurisdiction of the Treasury Department in the administration of ERISA, except sections 201 through 205 on which we testified on April 3, 1979.

Section 102(4): Multiemployer Plans

Under present law, certain standards enacted under ERISA for all plans are relaxed if a plan meets the definition of the term "multiemployer plan." For example, the funding of a multiemployer plan may take place over a longer period of time than for other plans. Moreover, a multiemployer plan can provide that benefits accrued for employees of an employer prior to the time the employer joined the plan can be disregarded if the employer leaves the plan.

Among other requirements in order to be a multiemployer plan, the plan must be one to which more than one employer is required to contribute, and no employer can make 50 percent or more of the aggregate contributions for a plan year. Section 102(4) of the bill would remove the latter requirement, although it would require 10 or more employers to contribute to the plan. The number of contributing employers could be fewer than 10 (but more than one) if the Secretary of Labor finds that treating such a plan as a multiemployer plan would be consistent with the purposes of ERISA.

The Treasury is opposed to this provision of the bill in the absence of alternative safeguards, and believes that the treatment of multiemployer plans should be separately considered in connection with the Pension Benefit Guaranty Corporation's recommendations on termination insurance for those plans.

Sections 121 and 144: Exemption for Reciprocity Arrangements

These two sections operate to provide a form of portability for collectively-bargained plans. Under section 121, a plan "participant" receiving benefits under an "away plan" may have the contributions made for him to the away plan transferred back to the participant's "home plan." Service under the away plan would be picked up by the home plan in computing benefits and for purposes of vesting; however, the employer contributing to the away plan would not be considered a maintainer of the home plan merely because of the transferred contribution. Section 144 amends the prohibited transactions section to allow the transfer of contributions on the condition that the home plan pays a reasonable administrative charge to the away plan. The problems addressed in the bill are in part due to present fiduciary rules and in part due to other substantive rules of ERISA and involve the possible treatment of the away plan employer as a maintainer of the home plan.

Treasury supports the proposal in general, but feels that there is a need to study further the possibility of administrative rather than legislative relief. Such administrative relief may be in the form of allowing certain de minimis transfers of liabilities and assets between plans without application of complex rules. We are unsure of the effect of the bill in certain circumstances such as the employee's continued right to benefits accrued under the away plan, should the employee not return to the home plan. There is also a need to add provisions to protect both the home and away plans in the event of plan terminations, and from the possible abusive use of the provision. Some limitations on the scope and extent of reciprocal transfers may serve this need. Consideration of this proposal should be deferred until consideration is given to the comprehensive proposals regarding multiemployer plans submitted by the Pension Benefit Guaranty Corporation.

Section 123: Determining Participation on a Plan Year Basis

Section 202(a)(3)(A) of ERISA defines the term "year of service" for purposes of determining an employee's eligibility to participate in a benefit plan. The general rule under this provision is that a year of service is any twelve-month period during which an employee has not less than 1,000 hours of service, and the beginning date for the computation of such a twelve-month period coincides with the date the employee began employment. This section of the bill would add a special rule to allow the twelve-month period to coincide with the plan year if the plan provides for participation, vesting, and other rights and benefits under ERISA on the basis of all of the employee's service without regard to the date on which the employee's participation in the plan commenced.

This section will generally allow some administrative simplification of plans, which we support. However, even as modified, we believe that the rule causes more administrative cost than is warranted by the additional benefits provided. For instance, in a defined contributon plan the rule may require the reallocation of employer contributions after a plan year has ended. For a defined benefit plan funded through level premium insurance contracts, special procedures or plan provisions must be established for first year entrants. There is a substantial need to relax the administracive burden of maintaining plans, except in cases where substantial federal policies are involved. Treasury therefore believes that the participation rule should allow unconditonally for the testing of the first year of service by reference solely to plan years, thus allowing plans to provide for participation commencing with the first plan year following a plan year in which 1,000 hours is completed.

Section 124: Summation of Different Accrual Rates

This provision is addressed to multiemployer plans and allows the computation of benefits on the basis of various accrual rates experienced during an employee's career. In part, the intent is to insure that the benefit accrual rate used in a participant's final work years is not required to be applied to service performed in earlier years.

This provision is unclear in its effect on the benefit accrual requirements aimed at the prevention of backloaded benefits. For example, a plan may provide a benefit of $1 for each year of service in division X, and a benefit of $5 for each year in division Y. On its face, the bill would permit such a calculation. However, if under the facts and circumstances all employees were placed in division X for their first 10 years of employment, and in division Y for the years thereafter, a form of backloading would occur which is and should remain prohibited.

There are three alternative methods for computing the minimum portion of the normal retirement benefit due a participant separated from covered service prior to normal retirement age. The results which appear to be sought under the bill would generally be permitted under the method described in section 204(b)(1)(B); however, that method prohibits a plan benefit rate applicable to a participant's later service that exceeds 133 percent of the participant's current benefit accrual rate. The plan may be amended at any time and without limit so long as the rate applicable to future service does not exceed 133% of the rate applied to current service.

We believe that backloading in excess of the 133 percent amount should be permitted only if the other conditions of the section 204(b)(1)(A) or (C) methods are met. Those provisions allow greater latitude in backloading, but are designed so that the final benefit rate is given partial effect in the earlier years should a participant terminate before reaching normal retirement age.

Because they are computed on the basis of all service under the plan, under the (A) and (C) methods, improvements in plan benefits by amendment may have a substantial impact on participants terminating immediately after the amendment and prior to normal retirement age. Under the 133 percent method (method (B)), an amendment to the accrual rate need not cause an increase in the total accrued benefit determined immediately after the amendment.

Assume for example that a plan provides an accrued monthly benefit of $15 for each year of service up to 25 years, and a total monthly benefit of $500 for 25 or more years of service. This method would not meet the (B) test because of the accelerated benefit in the 25th year, and would not meet the (C) method test because the benefit does not accrue ratably. The method would meet the (A) test because the $15 annual accrual is at least 3 percent of the total possible benefit of $500. If the plan were amended to provide an accrual of $22.50 per year (up to 25) and a total benefit of $750 for 25 years or more, the plan would again fail the (B) and (C) test but would meet the 3 percent (A) test. However, a participant with 20 years of service would have a total benefit accrual of $300 (20 x 3% x $500) just before the amendment and should have a total accrued benefit of $450 (20 x 3% x $750) immediately after the amendment. The bill would change this result so that the projected benefit for this employee would be $550 (20/25 x $500 plus 5/25 x $750) and thus immediately after the amendment the accrued benefit would be $330 (20 x 3% x $550).

To the extent the changes proposed by the bill conflict with the balanced goals of the three present methods, Treasury opposes the change. To the extent that the present goals are unaffected by the bill, the proposed changes would seem to be unnecessary. Therefore, Treasury does not support the proposed changes in the minimum standards for benefit accrual.

Section 125: Suspension of Benefits

This provision places additional restrictions on retired beneficiaries of multiemployer plans who reenter the work force in the same trade. The Treasury Department supports the Department of Labor's recommendation that no decision be made until completion of review of public comment on the regulation proposed under section 203(a)(3)(B) of ERISA.

Section 127: Joint and Survivor Annuity

The changes proposed in S. 209 to ERISA's joint and survivor annuity rules are highly technical. Yet they raise broad and significant policy issues that must be addressed before any changes are effected. Under both Title I of ERISA and section 401(a) of the Internal Revenue Code, special rules apply if a plan provides for the payment of benefits in the form of an annuity.* Under those rules, the annuity benefits must be paid in the form of a qualifying joint and survivor annuity to the participant and his or her spouse unless the participant elects not to receive payment of the benefit in that form. These rules apply generally where the participant is entitled to receive benefit payments at or after reaching normal retirement age, or at a plan's early retirement age if it has one. The vesting rules of ERISA and the Code provide that employer-derived benefits may be forfeited upon the death of a participant (before or after retirement), except in the case of a survivor annuity payable under the joint and survivor annuity rules. Thus, the employer-derived benefits (other than the survivor annuity) can be forfeited even where a participant is fully vested and dies prior to the commencement of any benefit payments.

Section 127 of S. 209 would, in substance, change the vesting and joint and survivor annuity rules. First, the surviving spouse of a participant in a plan normally providing annuity benefits would be entitled to a survivor benefit where the participant has ten years of service and dies before receiving the vested percentage of his or her employer-derived account balance or benefits.

*Under the Internal Revenue Service regulations interpreting this provision, the special rules apply only where the annuity is a life annuity. Thus, a plan's provision for the payment of an annuity for a term certain or for a term measured by the life expectancy of the recipient would not, in itself, result in application of the special rules.

Second, in plans not normally providing annuity benefits, any death benefit must be paid to the surviving spouse of the particpant. No alternative is allowed.

The fundamental question here is whether the vesting rule which allows forfeiture of employer-derived benefits upon death is a correct approach. The existence of any retirement plan implies that employees have received reduced immediate compensation in favor of the diversion of that compensation into the retirement plan. It can be argued that death should not result in the loss of the diverted compensation. On the other hand, at least in the context of a defined benefit plan, the diversion can be viewed as something like the purchase of an annuity. It is not illogical to accept the loss of future annuity payments on death, even if the annuitant dies before any payments have been made.

The second question follows only if, as a result of examinaton of the first question, the possibility of forfeiture upon death still remains. The question then is whether the death to be focused upon is solely that of the plan participant or is to include his or her spouse. The current joint and survivor annuity rules, in effect, mean that both deaths must be taken into account in some situations. However, the current rules deal with the problem in a very confused and somewhat arbitrary manner.

The third question is whether, assuming there should be survivor benefit requirements of some sort, the participant should be allowed to elect against the payment of those benefits to the surviving spouse. For example, is it appropriate that the survivor benefits provided by the plan be paid to the participant's spouse if the spouse has sufficient other income, or is legally separated from a participant who is caring for other dependents?

We believe these issues should be dealt with specifically before this provision is adopted.

<u>Section 128: Alimony and Support Payments</u>

This provision suspends the restrictions on the assignment and alienation of plan benefits in the case of a judgment, decree, or order affecting marital property rights in pension benefits or affecting alimony or child support obligations. We are in agreement with the remarks made by the Department of Labor. We would add, however, that it should be made clear that the effect of this provision is to clarify the law, and although the change is made effective on the date of enactment, it is not to be interpreted as a determination that such a plan provision or practice would have violated ERISA prior to that date.

Section 131: Funding to Take Account of Future Amendments

This provision provides that for plan years after 1980 the plan's funding method shall take account of all provisions of the plan including provisions which have not yet affected any participant as to the entitlement to or accrual of benefits. A provision adopted which is contingent on a future event shall not be deemed to be in effect as a provision of the plan before the event occurs. Under this proposal, employers would be allowed to amend a plan prospectively to provide that at a future date the rate of accrual of benefits will increase or decrease, and such a prospective increase or decrease in the plan's benefits may be given an immediate effect in the computation of the minimum funding standard. The effect of the bill is to reverse the Internal Revenue Service's present position, contained in Revenue Ruling 77-2, that the funding standard account is affected only in the subsequent year when the plan provision actually becomes effective.

There is some possibility for abuse in the adoption of the proposed rule. It would be possible for both the funding standard and the deduction rules to be manipulated through the prospective amendment of plan benefits, followed by the rejection of such changes when the time for their effective application arrived.

The Treasury Department recommends the adoption of the amendment contained in this section; however, the provision should be limited to negotiated plans where there is a bargaining agreement governing the future amount of contributions or benefits and the changes will actually take effect within the term of the present bargaining agreement. The provision should also provide the Administration with authority to limit abuses by applying the rules on the basis of facts and circumstances rather than solely on the basis of the written bargaining agreement and the plan documents.

Section 142: Refund of Mistaken Contributions

Under the present rules of ERISA, section 403(c)(2)(A) provides that a contribution made by an employer resulting from a mistake of fact may be returned to the employer up to one year after the payment of the contribution. Section 142 of the bill would allow a mistaken contribution to a collectively bargained plan maintained by more than one employer to be returned within one year after the discovery of the mistake by the plan administrator.

Section 403(c)(2)(A) was not mirrored in the Internal Revenue Code provisions dealing with qualified plans as were many of the ERISA standards; however, through Revenue Ruling 77-200, the Internal Revenue Service has applied essentially similar rules for plan qualification purposes, including specific rules for the measurement of the amount to be refunded.

Treasury supports the change proposed by section 142, and, if enacted, the Internal Revenue Service would modify its ruling accordingly.

Section 301: Master and Prototype Plans

In addition to the other measures in the bill designed to encourage more savings for retirement, S. 209 would establish mechanisms for special master plans.

The bill proposes that the master plan sponsor--the bank, insurance company, or other investment manager--be considered the plan administrator and named fiduciary for purposes of Title I of ERISA. We concur in the Labor Department's support of this part of the proposal.

As you know, the Internal Revenue Service is an enthusiastic supporter of, and has developed several different types of, master and prototype plans. The major difference between S. 209 and existing IRS procedures for master plans for corporate employers--from the perspective of the tax law--is that under the bill employers are given the protection normally afforded only after a determination letter is issued, without the need to apply for such a letter. The IRS does not believe such a provision is workable unless a plan covers all employees and has full and immediate vesting. In the absence of this requirement, a determination of qualification cannot be made without examination of the plan's participation and vesting rules as they would apply to the specific employer's workforce.

The bill provides that, notwithstanding the general qualification of the master plan, the Internal Revenue Service may, upon audit, determine that the plan, in operation, does not satisfy the qualification requirements.

This finding may not be retroactive unless there is also a finding that the failure was intentional or due to willful neglect. It is difficult to determine whether a particular failure is due to intentional or willful neglect. In many cases of small plans, records are unavailable and development of proof of the willfulness required by the bill would be extremely difficult. The effect of such difficulty would perhaps invite many plans to take advantage of the situation believing that in all probability if they were caught they would merely be required to make a prospective change.

Title IV: Dual Jurisdiction and Employee Benefit Commission

As you know, the President's Reorganization Plan Number 4 went into effect on December 31, 1978. This plan to divide rulemaking jurisdiction between the Departments of Treasury and Labor is described in the testimony of the Department of Labor. We are confident that this plan is reducing substantially the difficulties caused by previously overlapping rulemaking authority. The plan is designed to be evaluated by the end of January 1980. Therefore, we believe it would be premature to enact a single agency structure at this time as S. 209 suggests.

We have not supported the single agency concept to date in part because we are reluctant to thrust a new administrative system on the pension industry before there has been a more in-depth analysis of the problems it raises.

There are two major areas of concern to the Treasury Department. First, a single agency will not eliminate the need to coordinate with the Internal Revenue Service; the agencies will have to begin again to learn to cooperate on a different basis. Second, reducing the role of the Internal Revenue Service in determining eligibility for tax benefits may impair equity in the tax system.

The first concern arises because the private pension system is now based on tax incentives and penalties. Like other single agency proposals, S. 209 uses these incentives and penalties, recognizing that the potential loss of tax benefits may be a more effective deterrent than the threat of injunctive relief or other action by an agency other than the IRS. Under S. 209, the new agency would certify the tax qualification or disqualification of a plan to the Service. Such qualification affects issues left to the Service, including taxation of participants on distribution, the employer's deduction, and possibly the assessment and collection of excise taxes under sections 4971 through 4975 of the Internal Revenue Code.

A few isolated precedents exist for certification by another agency to the IRS for tax purposes. In general, however, these cases involve a single factual determination made at a single point in time.* In contrast, in the area of tax-qualified pension plans, tax qualification must be based on the operation of the plan. The result must be continued certification of operational facts as affecting tax liability; initial qualification does not suffice.

This procedure would require coordination of tax audits with the other agency or, if all functions are transferred, presumably an entirely separate audit of pension issues with IRS auditors instructed not to raise such matters. If the IRS is required to await determinations by another agency, its ability to conclude audits of the employer and all plan particpants would be impaired. If an employer's plan fails to be certified for a tax year in which other tax issues are also present, and the total tax liability of the employer must be litigated, substantial coordination of the issues raised would be required between the IRS and the new agency. In other words, new types of dual jurisdiction would exist.

Under S. 209, the Internal Revenue Service would not be entitled to apply the excise tax that is now used to deter the underfunding of pension plans. However, this valuable enforcement tool would be available to the new agency only if transferred to it by the President; in the absence of his action, neither agency would be entitled to use the excise tax deterrent. Further, such a transfer would add to the duties of the new agency the assessment, litigation in the United States Tax Court and collection of such taxes. These duties are in all other cases reserved to the Internal Revenue Service. If the bill were modified to allow the Internal Revenue Service to impose the tax, another area of dual jurisdiction would be established.

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*Examples of certification include, under prior law, the Department of Commerce certifying import injury for purposes of determining a taxpayer's entitlement to a special five-year loss carryback established under the Trade Expansion Act, and the War Production Board certifying facilities as war emergency facilities in connection with the special amortization rules applicable to those facilities. Under present law, there is a similar certification procedure with respect to the amortization of pollution control facilities (I.R.C. section 169); there is also special treatment for gain or loss under SEC orders (I.R.C. section 1081) and FCC policy changes for radio stations (I.R.C. section 1071).

Furthermore, the more "certification" one places in a single agency, the more likely it is that tax equity may be compromised. S. 209 would transfer the Code's qualification standards (including nondiscrimination and limits on benefits for the highly compensated) to the new agency. Discriminatory treatment and excessive contributions may seriously compromise tax equity and yet may have little to do with retirement security, as evidenced by the fact that they are not presently a concern of the Department of Labor. Therefore, continued IRS authority over these issues seems appropriate.

S. 511
Unfunded Deferred Compensation Plans of Tax-Exempt Organizations

On March 15, 1978 we testified before this Committee with respect to S. 1587 as it related to regulations proposed by the Internal Revenue Service on February 3, 1978. These regulations affected arrangements under which employees were offered an opportunity to request a deferral of payment of compensation to a later time, often with the expectation that the deferred amounts would be put aside by the employer in a separate fund under the control of the employer. We believed that in some cases very substantial amounts were being deferred. We also believed that these arrangements might be discriminatory in their availability among classes of employees, and that by their voluntary nature they undercut the likelihood that the employer would establish a funded qualified deferred compensation arrangement. We stated that the doctrines of constructive receipt would apply to these salary reduction arrangements and that deferral should be permitted only if some restrictions applied.

On May 4, 1978 we wrote to Chairman Long again raising issues of discrimination in tax-deferred salary reduction arrangements and offered proposed legislation.

In our letter to Senator Long we expressed particular concern as to employees of tax exempt organizations and governments and we recommended that with respect to such employees compensation be taxed currently if it is either segregated from the general assets of the employer or it is fixed by statute (or contract) and the employee is given an option whether to receive it or not. However, the above result would not apply to participants in a broad-based plan if the benefits were nondiscriminatory, and not in excess of the qualified plan deferral limits.

The Revenue Act of 1978 prevented the application of rules such as those proposed on February 3, 1978 to employees of a taxable entity. The reason for the exemption of taxable entities from the proposed rules was the conclusion that in the case of a taxable employer a deduction for deferred compensation would be postponed until includable by the employee. Thus there would be relatively little change in tax receipts from deferral as opposed to treating the deferred compensation as currently taxable to the employee and currently deductible by the employer. This result is not true, of course, in the case of a tax exempt employer where there is no deduction for the wage payments.

Therefore, the 1978 Act provision exempting taxable entities explicitly excluded tax exempt organizations from the umbrella provided to those taxable organizations. We believe that this distinction is justified because of the tax exempt organization's general exemption from tax on its investments, and because such an organization would be unaffected by the deduction deferral. Because of these differences, there would be little tax encouragement to establish a qualified plan. For example, under one set of assumptions, in the case of a highly compensated employee, the annual cost to a taxable employer to provide an after tax $100 monthly annuity changes from $183 to $114 if a qualified plan is used, rather than a self-funded investment pool.* This is a reduction of 38 percent. Because the tax exempt employer gains no benefit from the "deduction" and is exempt from tax on its own income, the cost of a qualified plan ($114) is no less than the cost that would be incurred if the investment of the deferred amount were retained by the exempt employer, assuming the employee was not taxed until actual payments were made. We are particularly reluctant to see the exempt organization placed in a tax neutral position between a funded qualified plan and a non-funded plan because, under Title I of ERISA, the non-funded plan must be maintained primarily for highly compensated employees.

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*The assumptions are: an individual marginal tax rate of 23 percent, an average corporate tax rate of 25 percent on the accumulated investments and 46 percent on deductions, an 8 percent rate of return on investments, a 30 year period to accumulate the fund, and a 14.12 year period over which the annuity payments are made. It is often stated that taxable corporations have an advantage in the payment of compensation because the deduction reduces the cost to 54 cents on the dollar. This is only true if the corporation pays compensation out of what would otherwise be after-tax profits. However, a corporation in entering a particular activity must expect to earn enough to cover its costs (including salaries) plus an adequate return on its investment, after taxes on its profit. Thus, if the net return is to remain constant, an additional $1 of gross revenue must be received for each additional $1 of compensation payable if the payment is deductible; and if not deductible, the additional revenue must be sufficient to cover both the tax on the income and the amount of the nondeductible payment.

Section 457, added to the Internal Revenue Code by the Revenue Act of 1978, limits the use of non-funded salary reduction plans for employees and independent contractors furnishing services to state and local governments. These rules limit the percentage of compensation that may be deferred as well as the absolute dollar amount. Although these limitations clearly mitigate the disproportionate benefit under such arrangements previously gained by highly compensated employees and contractors, the legislation does not provide specific anti-discrimination rules. This is in contrast to the nondiscrimination test provided in the 1978 Act for two other salary reduction arrangements, cafeteria plans and cash-and-deferred profit-sharing and stock bonus plans.

As stated above no action was taken in the 1978 Revenue Act with respect to tax exempt organizations. Therefore, this past June the Internal Revenue Service published a news release seeking additional comments on the possible application of the 1978 proposed regulations to employees of tax exempt organizations. After receiving substantial written comment, a public hearing was held on November 27, 1979.

The purpose of the hearing was to explore further the appropriate standards which might be used in determining the existence of a deferral option. We requested specific comments on the appropriateness of tests based on specific written evidence, on the alteration of an individual's current compensation pattern, and on the fact that amounts were set aside by the organization to meet the deferred obligation.

Commentators indicated their belief that in many cases it would be difficult to determine whether amounts were segregated from the general asssets of the organization. Furthermore they expressed concern that such a test might create an unfair distinction between employees electing to defer compensation whose employers segregated assets, and other electing employees whose employers did not.

We continue to believe, however, that it is appropriate to limit the opportunity for the more highly paid employees of tax exempt organizations to achieve the benefits of qualified plans -- income deferral and tax free investment -- without satisfying the non-discrimination requirment.

We recognize that proceeding on the course of rulemaking by regulation has its limitations, and a regulation could involve problems of administrability. Thus we can see advantages to a legislative solution along the lines of section 457 of the Internal Revenue Code applicable to employees of state and local governments. As noted above, this section places limits on the total amount which may be deferred, whether or not the employee exercises an individual deferred option. This would avoid evidentiary problems in establishing whether or not such an option exists. We also continue to believe that section 457 could be improved by incorporation of nondiscriminatory requirements.

Because we are uncertain at the moment of the probability that S. 511 will become enacted, we believe that it may be proper to proceed with preparation of a final regulation relating to deferred compensation arrangements for employees of tax-exempt organizations, but we certainly want to continue to explore the possibility of a legislative solution acceptable to all. Because I believe that we have common goals, I believe strongly that this is possible.

S. 989 -- Special "Rollover" Rules

S. 989 would provide that, for purposes of determining whether a qualified plan participant has received a "lump sum distribution," money purchase pension plans need not be aggregated with other defined benefit pension plans of the same employer. This would allow an employee who receives a distribution of the balance to his or her credit in a money purchase pension plan to "rollover" the distribution into either an individual retirement account or another qualified plan, even if the employee is also entitled to receive payments under defined benefit pension plan in subsequent taxable years.

S. 989 achieves the same result as H.R. 4298 which we recently discussed in hearings before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee, on September 27, 1979. We would like to take this opportuinity to again express our views concerning what has become a very important and extraordinarily complex corner of the law in the hope we can begin a dialogue that will lead to both greater simplicity and greater equity.

S. 989 involves so-called "lump sum distributions" from pension plans. Such distributions have for a number of years been entitled to various forms of special tax relief. The most recent was provided by the Employee Retirement Income Security Act of 1974 (ERISA) which amended the Code to allow special 10-year forward income averaging for lump sum distributions. Roughly, this treats the distribution as if it were received ratably over a 10-year period and was the only income earned for each such year. The ostensible purpose of such relief was to mitigate the impact of a progressive tax on individuals who receive extraordinarily large amounts of income in one year and perhaps to recognize the general applicability of lower marginal rates after retirement.

Since the special tax relief for lump sum distributions seems to be based on the assumption that the taxpayer would have little or no other income in his post retirement years, it is appropriate that the taxpayer not be entitled to additional pension benefits. Although the law does not fully reflect this theme, in order to qualify as a lump sum distribution, the distribution must constitute, among other things, a distribution of the total balance to the credit of the employee in all similar tax-qualified plans. For this purpose, similar plans are determined by type; that is, all pension plans (both defined benefit and money purchase plans) are similar, all profit-sharing plans are similar, and all stock bonus plans are similar.

Under these rules, if an employee recieves a distribution of the balance to his or her credit in a money purchase pension plan, but also particpates in a defined benefit plan and does not receive a total distribution from that plan, the employee would not be entitled to treat the money purchase plan distribution as a lump sum distribution.

The special tax relief for lump sum distributions may have a perverse effect. Rather than mitigating against the harsh tax effects of a large one-time distribution, it may actually be encouraging such distributons in order to take advantage of a reduced tax burden compared to what would be owed if ratable distributions were provided. This encouragement of lump sum distributions is inconsistent with the policy of ERISA to provide security for all retirement years.

In recognition of this result, Congress in 1974 provided for "rollovers"; that is, taxpayers receiving lump sum distributions from qualified plans can avoid current tax by "rolling over" the distribution into an individual retirement account or annuity ("IRA") or another tax-qualified plan. Tax would be payable only as periodic distributions were made from the IRA or other plan.

There seems to be little justifiction for obtaining special income tax treatment for lump sum distributions when rollovers are available. At the very least, such special treatment should be limited to those situations where an employee or an employee's beneficiary receives a total distribution of the balance to the credit of the employee from all qualified plans in which the employee participates. This would eliminate the abuses available through planning for participation in multiple plans.

In 1974 rollovers were generally limited to lump sum distributions and lump sum distribution treatment was specifically restricted in order to avoid abuse of the special averaging provisions. However, in the course of the past five years, we have begun to realize that since rollovers are consistent with the policy of encouraging individuals to save for retirement and to have assets available for their retirement period, eligibility for rollovers need not be tied to "lump sum distributions."

S. 989 continues this trend. It allows an employee who receives a distribution from a money purchase pension plan to treat the distribution as eligible for rollover even though the employee continues to have an interest in a defined benefit pension plan. However, it would not allow the employee the benefit of special tax treatment for distributions from the defined benefit pension plan.

We support the concept of expanding the types of distributions eligible for rollover treatment. In fact, in light of the substantial retirement plan policies which are served by rollovers, we believe that the rules relating to when a plan distribution is eligible for rollover treatment should be substantially liberalized. In general, we would support an approach which would allow any plan distribution to be rolled over except a distribution which was being made in connection with a life annuity or a term certain annuity.

This would simplify the law in the area of rollovers and would prevent some harsh results. For example, under current law if an employee receives a distribution of the balance to his or her credit in a plan during one taxable year, the amount received is eligible for rollover treatment. However, if an additional amount is received in a subsequent year, current law prohibits that subsequent amount from being rolled over into another retirement vehicle and the subsequent distribution is not eligible for special tax treatment. Under the rule we have proposed this subsequent amount could also be rolled over.

We do not believe it would be appropriate to extend the special rollover rule to payments under a life annuity or payments under a term-certain annuity for the substantial period because of the abuses which might result. For example, an employee who begins to receive an annuity at age 60 could obtain substantial deferral of tax by rolling over each annuity payment into an IRA. No distributions would be required to be made from the IRA until the participant reached age 70 1/2 and then the amounts which would be required to be distributed would be less than the amounts otherwise includible in the employee's income from the qualified plan. Since the purpose of allowing for tax-favored retirement plans is to provide for retirement savings, we believe a rollover in these annuity situations would be inappropriate since the ultimate beneficiary of the retirement plan might be someone other than the employee or the employee's beneficiary.

If the Committee finds these proposals to be of interest, we would be glad to work with staff members of the Committee and the Joint Committee staff to develop specific legislative proposals.

Finally, I would like to address the issue of the bill's effective date. The current effective date provision states that the amendment will be effective with respect to taxable years beginning after December 31, 1974. We object to this retroactive approach. Giving retroactive effect to tax laws substantially increases the complexities in administration of the tax laws. In addition, a retroactive rule would, in effect, penalize those who acted and planned under the law previously in effect and who cannot now restructure their transactions. Therefore, we urge an amendment to the bill deleting this retroactive effect.

S. 1089 -- The ERISA Simplification Act of 1979

Introduction

Treasury supports the continuing effort to reduce the overall paperwork burdens on plan administrators and employers, consistent with the purpose of ERISA to provide participants, beneficiaries and the administering agencies with adequate information. Although it is imperative that those responsible for plans not be impeded by excessive or unnecessary paperwork we believe that ERISA represents a very important advance in the protection of the benefits promised to retired employees and their beneficiaries. In the structure of rights and remedies there is strong emphasis placed upon the individual participant's initiative, as well as oversight by governmental agencies. Neither the individual nor the interested agencies can function as intended by ERISA if they have either too much of the wrong kind of information, or too little of the right kind. In either case the result is counterproductive.

The ERISA agencies are continuing their efforts to seek the proper balance. Much has been done in the last year but we acknowledge that there is more to be done. We welcome the recommendations of the Congress and the opportunity to enter into a dialogue on this important subject.

Section 2: Collection of Premiums by the IRS

Section 2 of the bill provides for the collection of the Pension Benefit Guaranty Corporation premium through the use of the plan's annual report, Form 5500, filed with the IRS. In general, this issue is primarily of concern to PBGC and we support the conclusions reached by PBGC with regard to the needs of their program.

I would like to highlight one issue, however. The intended function of the Internal Revenue Service with respect to the information reported on the form is not clear. Because the process of validating the payment of premiums is of primary concern to the PBGC, we recommend that even if this provision is adopted, the PBGC should continue to have full authority to conduct investigations and enforcement actions with respect to premiums.

Section 3: Elimination of Summary Annual Report

Section 3 of the bill would eliminate the requirement that certain statements of the plan's financial condition be provided annually to all participants. In substitution, the bill would provide for a summary of that information and the source for obtaining additional information to be posted at various work places. Since this area is of primary concern to the Department of Labor we defer to that Department as to this section of the bill.

Section 4: Filing of Forms with Income Tax Returns

Section 4 of the bill provides that "taxpayers shall have the option to file any forms required by (ERISA) with the annual income tax forms required by the Internal Revenue Code...".

This presents certain difficulties. First, many plans are maintained by more than one employer, and the responsibility for filing the appropriate documents rests primarily on the plan administrator rather than on the employers. Thus, there is no single employer's tax return to coordinate with the plan's filing.

Second, a plan's filing is geared to plan years, while the employer's income tax return relates to the particular taxable period used for income tax purposes. The income tax year and the plan year do not necessarily coincide, even when there is a single employer maintaining the plan. To the extent that the plan year ends early in the tax year of the employer the bill would permit an extension of the filing of the annual report for several months until the income tax return is due. At its worst this would result in a delay of 11 months from the time that the annual return for the plan would otherwise be due. This result would be undesirable from the standpoint of the agencies whose duty it is to administer the programs based on these annual reports, as well as from the standpoint of participants and other interested individuals looking to the reports for valuable information.

Under Code section 6072(b), the income tax filing date for a corporation is the 15th day of the third month following the close of the taxable year. The time for filing partnership and individual tax returns is the 15th day of the fourth month. Under Code section 6081, extensions may be granted for filing income tax returns for periods up to six months.

The plan's return (Form 5500) is required to be filed not later than the last day of the 7th month following the close of the plan year, unless an extension of time up to 2 1/2 months is granted by the Service. For this purpose, an extension of time for filing the employer's income tax return will automatically be treated as an extension of time to file the Form 5500 in the case of a single employer plan. Therefore, for an employer with a conventional single employer plan and a plan year coinciding with its tax year, there would be no difficulty in filing the two returns at the same time.

Further there would be no difficulty for a single employer to obtain IRS approval for a change of plan year to coincide with the tax year. Thus, in those situations where the goal of the bill is attainable -- a single employer plan with identical tax and plan years -- legislation is not necessary to achieve it.

A final comment should be made regarding other forms required by ERISA but which are not filed on a regular basis. For example, timely reports must be made to the Internal Revenue Service with respect to mergers and consolidations of plans in order to give the Internal Revenue Service an opportunity to intervene in a transaction. These forms are unrelated to the particular tax year of the employer and in most cases are unrelated to a plan year end. This provision of the bill should not in any event be extended to such forms.

Section 5: Bookkeeping Guide for Small Businesses

The bill provides for two types of guides to be published with respect to ERISA. First, the bill requires the Department of the Treasury and Labor to publish a booklet to assist plan sponsors (particularly small businesses) in developing or revising record keeping systems to simplify compliance with ERISA. The problems of small businesses are of particular concern in connection with the cost of compliance with ERISA. Because they lack economies of scale the reporting and compliance requirements lay a particularly heavy burden on them. Although various aspects of compliance and reporting have been dealt with in privately published materials, it would be helpful for the government to provide in one place a summary of the current thinking on the subject by both agencies. However, since we have limited resources available, we would prefer the flexibility to determine how our resources should be allocated. Naturally we do welcome suggestions from others, and in particular from Congress.

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The second guide provided for by the bill is in the form of a booklet prepared by the Secretary of the Treasury for taxpayers summarizing the rules concerning individual retirement accounts. The Internal Revenue Service has published such a document, Publication 590, entitled "Tax Information on Individual Retirement Arrangements." The last publication was dated January 1979, and a revised version of this publication is currently being worked on with the hope that it might be available prior to the filing date for the 1979 income tax returns. Because the law affecting IRAs has been in a state of flux, it is difficult to determine when such a summary type booklet should be published, since there is always another change just over the horizon. The Treasury believes in the value of these booklets and will continue to provide information for the public on this subject as rapidly as is possible under the circumstances.

Section 6: Civil Enforcement Actions by Treasury Department

The bill provides the Secretary of the Treasury with authority to bring a civil action to enforce compliance by a plan or trust with the requirements of the Internal Revenue Code applicable to so-called qualified plans. Under present law, the failure to comply with such requirements results in "disqualification" leading to adverse tax consequences including possible denial of a tax deduction for the employer, taxation of the income of the trust and possibly less favorable tax treatment for employees and their beneficiaries. The bill is obviously intended to provide alternative sanctions. The Internal Revenue Service has been studying the question of alternatives to plan disqualification and we understand that a Committee of the Tax Section of the American Bar Association has also been interested in this problem. We welcome the initiative of this Committee in developing a more widespread dialogue on this very important issue. However, certain questions must be faced in considering whether the approach of the bill should be adopted.

The provisions of the Internal Revenue Code related to qualified plans can be divided into several parts.

First, there are the portions of the Internal Revenue Code which parallel provisions in Title I of ERISA relating to participation, vesting and funding. With respect to such provisions the Secretary of Labor already has the authority under section 502(b) of ERISA to bring injunctive actions to enforce compliance. The question of the division of responsibility between Labor and Treasury is being studied in connection with the President's Reorganization Plan number 4 as to which the Office of Management and Budget is required to submit a report to Congress by January 31. A transfer of civil litigation authority from the Department of Labor to the Internal Revenue Service is among the alternatives presently under study and it seems appropriate to defer consideration until the study is completed.

The second set of provisions in the Internal Revenue Code deal with nondiscrimination requirements. That is, a qualified plan may not discriminate in favor of higher paid employees. Under present law an employer has discretion as to whether or not to establish a plan. Once a plan is established it must comply with Title I requirements; however, it need not comply with the nondiscrimination requirements. The bill suggests that at least once a plan claims the benefit of qualified status it can be forced to comply with the requirements of the Internal Revenue Code. This raises significant questions. Suppose, for example, an employer establishes a plan for salaried employees who comprise 10 percent of the employees of the company. If the Internal Revenue Service finds that the exclusion of hourly paid employees results in a discriminatory plan will the employer be required to cover the remaining 90 percent of the employees?

Third, there are provisions in the Internal Revenue Code which neither affect discrimination nor are parallel to provisions in Title I.

As an overall matter, if it is decided that injunctive relief is appropriate in all or some of these circumstances we must decide whether it is consistent with the traditional role of the Internal Revenue Service which up to now, at least on the surface, has been to determine taxpayer's appropriate liability from particular activity and not to enforce any one mode of conduct. It is also necessary to consider whether injunctive action by either Labor or the Internal Revenue Service should be in addition to possible plan disqualification as it is today or whether in some circumstances, at least, injunctive relief should entirely replace plan disqualification as a sanction. It has been our belief that the self-enforcing aspect of the Internal Revenue Code would be severly weakened if the Internal Revenue Service could only require taxpayers to do what they should have been doing all along.

S. 1090, S. 1091 and S. 1092 -- Amendments Relating to Church Plans

S. 1090 and S. 1091

S. 1090 and S. 1091 would amend the definition of church plan in Title I of ERISA and in the Internal Revenue Code.

Under current law, a church plan is defined as a plan established by a church or by a convention or association of churches which is exempt from tax under section 501 of the Code. In addition, a special temporary rule provides that if a plan was in existence on January 1, 1974, it will be treated as a church plan if it was established and maintained by a church or convention or association of churches and one or more agencies of such church (or convention or association), if the church and each such agency is exempt from tax under section 501. However, this temporary rule does not apply for any plan year beginning after 1982. The term church plan does not include a plan maintained by more than one employer, if one or more of the employers in the plan is not a church or a convention or association of churches which is exempt from tax under section 501 of the Code.

S. 1091 would make three changes in this definition. First, a church plan would include a plan established and maintained by an organization, the principal purpose of which is the administration or funding of a plan for the provision of retirement benefits for employees of a church or a convention or association of churches. We understand that this would allow a program of a church pension board to be considered a church plan.

In proposed Treasury regulations issued on April 8, 1977, no provision was made to allow a program maintained by a pension board or other separately incorporated organization to maintain a church plan. Through written comments and at a public hearing held on October 6, 1977 with respect to the proposed regulations, commentators suggested that the term church plan should include a plan which is administered by a separately incorporated organization such as a pension board or a bank. We agree that such a provision is appropriate.

However, S. 1091 would go substantially further by permitting a plan which is established and maintained by the administering organization to be considered a church plan. For the reasons set forth below, we do not feel it is appropriate to expand the definition of a church plan this far.

Second, the bill would define the term "employee," for purposes of determining who may participate in a church plan, to include any duly ordained, commissioned or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation. The term would also include any employee of an organization which is controlled by or associated with the church or a convention or association of churches so long as such organization is exempt from tax under section 501. These provisions would substantially expand the concept of church plan and by allowing church agencies to be included in church plans would effectively make the temporary rule contained in current law permanent.

The effect of the current rule is that employees of church agencies will, after 1982, be entitled to the full protection provided by ERISA. We believe this is beneficial.

While Congress took account of the special status of churches, and of governments, in exempting church plans and government plans from the basic participation, vesting and funding requirements of ERISA, it seems to us that such exceptions should be kept to a minimum. If benefit levels for employees of a church agency remain the same but more employees become eligible to participate and to receive a vested benefit, the cost of maintaining a qualified plan for a church agency will probably increase. However, the policy of ERISA is to provide more assurance that covered workers will receive benefits promised by a plan. One aspect of this policy is a prohibition against using a given amount of contributions to provide a higher benefit for a few employees and nothing or a minimal benefit for others. Therefore, we oppose the provision of S. 1091 which would extend the temporary rule relating to church agencies and which would prevent the full requirements of ERISA from applying to church agency plans. However, it might be appropriate to treat certain agencies, such as missionary boards, as part of a church plan where such agencies are performing functions which one church alone could not afford. Moreover, some representatives of these organizations have indicated to us that they do not seek exemption from the minimum standards but rather they have difficulty with some of the more technical provisions of the Code. The protections afforded by these provisions may be just as important. However, we recognize the necessity to balance the interests. We are prepared to consider each particular rule separately to determine if the peculiar burdens it may place upon the traditional mode in which churches have operated outweigh the benefits provided. However, we see no justification for expansion of the complete exemptions from ERISA.

The third area of change which would be made by S. 1091 relates to the rules of the proposed regulations which would cause a plan to lose its church plan status if one of the churches maintaining the plan fails to meet all the requirements. S. 1091 would provide that in such a case, if the plan corrects it's failure to meet such requirements within a specified correction period, the plan would be deemed to meet the requirements for the year in which the correction was made and for all prior years.

We believe this goes too far. However, we also believe that the rule in the proposed regulations which would cause a plan to lose its church plan status if one of the churches maintaining the plan fails to meet all requirements was unduly harsh. We believe it is appropriate to provide that a plan will be allowed to retain its church plan status if a church which does not meet the requirements disassociates itself from the plan after notice from the Internal Revenue Service of its failure to meet the requirements. This approach would retain substantial incentives to comply with the church plan requirements and yet would relieve the complying members of a church plan from the harsh results which had been proposed in a situation where one church failed to meet the requirements.

S. 1092

S. 1092 would substantially expand the ability of church employees to make relatively large contributions to certain retirement plans during their later years of service.

The bill relates to section 403(b) annuities and would expand the years of service taken into account in computing the "exclusion allowance" under section 403(b)(2). Under current law, a taxpayer may take into account only periods of service with his or her current employer for purposes of computing the exclusion allowance.

We understand that current law may create different treatment for employees of churches organized under a hierarchial basis as opposed to employees of churches organized on a congregational basis. An employee who transfers from one church to another in a hierarchial structure remains with the same employer and, thus, does not lose credit for past periods of service for purposes of computing the exclusion allowance under section 403(b). However, such a transfer in a congregational structure may result in a change of employers and the loss of prior service for purposes of computing the exclusion allowance.

Under S. 1092, all periods of service with all churches would be considered as periods of service for one employer. We do not object to this provision.

The second area of change proposed by S. 1092 concerns the limitations on contributions to section 403(b) plans under Code section 415(c). This section provides in general that the contributions and other additions allocated to a participant in a defined contribution plan may not exceed the lesser of a specified dollar amount or 25 percent of the participant's compensation. Sction 415(c)(4) currently provides more liberal limits for certain employees whose employers maintain section 403(b) annuity plans. The employees subject to these special limitations do not include church employees. The legislative history of this special provision indicates that it was added to the Code in order to enable covered employees to "catch up" on contributions in the later years of their careers to make up for contributions which were not economically feasible during earlier periods.

S. 1092 would extend the special limitations in section 415(c)(4) to employees of churches and, in addition, would create a de minimis allowance under which the limitations of section 415 would not be violated by any contribution of $10,000 or less. Further, the $10,000 amount would be adjusted for increases in the cost of living.

We generally support the policy reflected in section 415 of the Code which seeks to limit the portion of earnings which can be set aside on a tax-favored basis. We also support the general requirement that plans established by an employer must cover a broad cross section of employees in order to receive favorable tax treatment. Since section 403(b) annuity plans are not required to cover a broad cross section of employees, we do not believe the special preference for tax-exempt institutions embodied in section 403(b) reflects sound tax policy, nor do we believe the special exception from section 415 which is available for certain section 403(b) plans is justifiable. Not only are the plans described in section 403(b) given a preference over qualified plans with respect to both coverage and in certain circumstances the application of the section 415 limits, but the special rules in section 415(c)(4) are extremely complex and a burden on employers and employees. Given our concerns with respect to both section 403(b) plans and exceptions from the section 415 limits, we cannot support the changes proposed by S. 1092. However, we would not oppose an expansion of the eligibility for special treatment under section 415(c)(4) if a specific de minimis amount were included in section 415(c)(4) in lieu of the currently complex rules in that section. We would propose that the de minimis amount be $7,500 per year without a built-in adjustment for inflation.

S. 1240
The Employee Stock Ownership
Improvements Act of 1979

S. 1240, the Employee Stock Ownership Improvements Act of 1979, would make a number of changes in the law relating to employee stock ownership plans and would also affect certain other provisions in the Internal Revenue Code relating to employee benefits. My statement will discuss each section of S. 1240 separately.

Section 2: Permanent Investment Tax Credit

An employer is currently entitled to an additional investment credit for contributions to an employee stock ownership plan. The additional tax credits are based on qualified investments made by the employer. Under current law, these additional investment credits are not available with respect to qualified investments made after December 31, 1983.

Section 2 of the bill would make the additional investment tax credits permanent. We estimate that the additional revenue loss from this provision would be $864 million in 1984 and $1.065 billion in 1985.

As we testified before the Senate Finance Committee on July 20, 1978, present law discriminates in favor of certain industries because it ties the availability of employee stock ownership to the investment base of the industry. There is no rationale behind providing one worker a level of contribution different from that received by another worker simply because their employers have invested different amounts of money in plant and equipment. Current law favors workers in capital intensive industries.

We believe that if Congress enacts further legislation which provides for the purchase of stock through a tax credit, it would be preferable to base the determination of eligibility on the wages paid by an employer rather than on the employer's investments in certain types of assets. Because of our concern over the discriminatory nature of the current investment credit approach, we oppose section 2 of the bill which would make the investment credit employee stock ownership plan provisions permanent.

Section 3: Labor Credit ESOPs

Section 3 of the bill would amend the Internal Revenue Code to allow an employer to obtain a one percent tax credit if the employer contributes employer securities, or cash used to acquire employer securities, to an employee stock ownership plan in an amount equal to one percent of the compensation of participants under the plan. This wage base or "labor" credit ESOP would not be allowed if the employer has taken advantage of the investment credit ESOP under the Code. In general, the plan maintained under this section would be required to satisfy the same standards as any other ESOP, although the limitation on compensation which is taken into account for purposes of allocating contributions under the investment credit provisions would not apply.

As indicated above, we favor a wage base or "labor" credit ESOP over the current investment credit ESOP provisions. However, we cannot support the approach described in section 3 of S. 1240 as currently proposed for two reasons.

First, we believe that the labor credit approach should stand alone and should not be offered as an alternative to the investment credit ESOP. Allowing the choice of labor or investment credit ESOPs will, we believe, continue to discriminate in favor of employees in certain capital intensive industries. Perhaps more important, the revenue cost of continuing the investment credit approach and adding a labor credit provision would be substantial. We estimate that the cost of the provisions in sections 2 and 3 of the bill for the first year that the labor credit becomes effective, that is, for years beginning after December 31, 1980, would be $1.288 billion rising to $4.28 billion by 1985. We would favor a phase-in of the labor credit as the current investment credit provisions terminate. That is, the labor credit described in section 3 of the bill would be available beginning in years after the investment credit was no longer available.

Second, we do not believe that it is appropriate to eliminate the limitation on compensation for purposes of allocating employer contributions to the plan. Under the current investment credit approach, employer contributions are allocated to employees in the ratio of each employee's compensation to total compensation of all employees, but no more than $100,000 of compensation is taken into account with respect to any employee.

In terms of broadening stock ownership, it appears to us to be counterproductive to provide a $100,000 executive with 10 times as much stock as a $10,000 a year worker. In general pension plan law, this type of allocation is allowed on a theory of equal percentage wage replacement. However, in the case of an ESOP which is funded through tax credits, and which is designed to expand stock ownership, this type of allocation appears to work against the express goal of the program. While we would suggest a lower limit on the compensation which may be taken into account for purposes of the allocation of labor credit, we definitely oppose an attempt to remove the current limitation from the allocation formula. Finally, in this regard, we also believe that if the base for the credit is to be related to compensation, it is appropriate to use some base which can be readily calculated by employers such as wages subject to income tax withholding. Using a wage base for the credit should require as little extra administration for employers as possible and should not require regulatory activity to define compensation for purposes of ESOPs.

Section 4: Deductibility of Dividends, Bequests, etc.

Section 4 of the bill would make two substantial changes in the Internal Revenue Code.

First, subsection (a) of this section would amend the Code to provide a deduction for dividends paid to an employee stock ownership plan if dividends received by the plan are distributed within a certain period to employees participating in the plan.

Second, subsection (b) of section 4 would amend the Code to allow a contribution, bequest or similar transfer of employer securities to an ESOP to be deemed a charitable contribution and therefore deductible if the contribution meets certain conditions.

The provision allowing a deduction for dividends is a limited form of integration of the corporate and individual income taxes. It would result in taxation of corporate income at only one level. Integration of the corporate and individual income taxes is a problem of extreme complexity which both we and the Congress have begun to examine on an overall basis. We believe the question should be addressed in terms of overall integration mechanisms and should not be limited to a single situation such as stock held by a particular form of employee benefit plan. Therefore, we oppose this provision in section 4 of the bill.

This section of the bill would also allow a charitable deduction for contributions of employer securities or other property to an ESOP. We believe that contributions to an ESOP, as well as any other type of retirement plan, provide compensation to employees. Subject to the special rules for contributions to retirement plans, they should continue to be treated for tax purposes as compensation. Contributions to a plan by a person other than the employer are, in substance, a contribution to capital of the employer rather than a charitable contribution in any traditional sense. Therefore, "gifts" to such an entity should not be treated as charitable gifts. Rather, to the extent they are actually made, they should be treated as noncharitable transfers.

Section 5: ESOP Exception to Forfeiture Limitations

Certain provisions of the Internal Revenue Code currently limit the contributions and other "additions" which may be allocated to a participant's account in a defined contribution plan. One of the other additions is the amount of forfeitures allocated in a year. Section 5 of the bill would provide that "extraordinary forfeitures" (as defined in regulations) in an ESOP would not be taken into account to the extent they would cause the maximum annual addition limitations to be exceeded for a year. We understand that this provision is intended to allow an employer to amortize an employee stock ownership plan loan under the Code without regard to whether there were substantial forfeitures in a year.

The current limitations on annual additions to qualified plans are intended to impose reasonable limits on the amount which may be set aside in a tax-favored manner for an employee each year. We support the policies reflected in these limitations.

While we recognize that forfeitures during the year may cause problems in the repayment of an ESOP loan, we believe there are alternatives to the approach described in section 5 of the bill which would alleviate the problems for the employer. First, we would suggest that the issue of forfeitures could be avoided if employees had at all times a 100 percent vested and nonforfeitable interest in shares of employer stock allocated to their accounts. In addition to avoiding the forfeiture problem this would support the policies of expanded stock ownership by assuring employees that stock allocated to them would be distributed to them. Second, we understand that it is common practice in the area of ESOP loans to make special provision in the repayment schedule for the contingency of extraordinary forfeitures. We believe that either 100 percent vesting or such special provisions are preferable to an exemption from the current limitations.

Section 6: Limitation on ESOP Distributions

Under the current provisions of the Code, an employee stock ownership plan may distribute cash in lieu of employer securities provided that the participant has a right to demand a distribution in employer securities. Section 6 of S. 1240 would amend this provision to allow a plan to distribute only cash and not stock and to avoid the election by participants if, under the charter or bylaws of corporation, only actual employees of the employer or qualified trusts are allowed to hold employer securities.

We believe this provision would interfere with the goal of broadening stock ownership. Although we recognize that some employers object to allowing nonemployees to hold stock, we believe the appropriate response for such employers is to avoid the use of plans requiring the distribution of employer securities to former employees. Since this provision would allow, through a simple amendment of the bylaws of a corporation, an opportunity to avoid distributions of employer securities, and since such avoidance could result in both adverse tax consequences to employees and a narrowing of the class of individuals who own securities, we cannot support it.

Section 7: Voting Rights in Certain Closely-held Securities

The 1978 Revenue Act amended the Internal Revenue Code to provide, in general, that any defined contribution plan which has more than 10 percent of its assets invested in securities of an employer which are not publicly traded and which acquires employer securities after December 31, 1979, must allow participants to direct the trustee as to how such securities are to be voted in certain major corporate matters.

Section 7 of S. 1240 would repeal this provision of the Code.

We are opposed to this provision of the bill. Investment of pension plan assets in the stock of the employer is inconsistent with the goal of providing retirement security. In effect, the employee is less protected than an unsecured creditor of the employer, a result totally inconsistent with the goal of ERISA to require funding of pension benefits. Such an investment can only be justified on the grounds that it will increase the interest and productivity of employees if they have an ownership interest. However, this interest must be real. We believe that for employees to have a meaningful interest in employer securities, it is both necessary and appropriate to allow employees to direct the trustee in the manner in which such securities are to be voted.

We are preparing a study as requested by the Senate Finance Committee regarding the extent to which voting rights should be passed through to participants in defined contribution plans which invest in employer securities. We hope to have this study completed in the near future. However, our tentative conclusion is that voting rights should be made available to participants in such plans because such rights may increase the motivation and productivity of employees which, we understand, are among the underlying purposes for encouraging employee stock ownership plans.

Section 8: Cash Distribution Option for Stock Bonus Plans

Under current law, a stock bonus plan which is not part of an employee stock ownership plan must provide for distributions to participants in the form of employer securities. A stock bonus plan is not entitled to take advantage of the cash distribution option currently provided for employee stock ownership plans.

Section 8 of S. 1240 would amend the Code to allow a stock bonus plan to take advantage of the same provisions currently applied to employee stock ownership plans. Specifically, this provision would allow stock bonus plans to distribute cash in lieu of employer securities provided that participants are entitled to elect to receive employer securities.

While we believe that the underlying principles of tax-favored retirement savings for employee stock ownership plans should be satisfied through the required distribution of employer securities, we also recognize that certain administrative savings are possible if the cash distribution option, subject to the participant's right to demand employer securities, is available for a plan. Therefore, we do not object to this provision of the bill.

Section 9: Anti-flow-through Rules

Under current law, the additional investment tax credit for contributions to an employee stock ownership plan is not allowed if a taxpayer's cost of service for ratemaking purposes or the base through which the taxpayer's rate of return is applied for ratemaking purposes is reduced by reason of the investment tax credit ESOP percentages, or if any portion of the tax credit which results from an ESOP contribution is treated for ratemaking purposes in anyway other than as though it had been contributed by the taxpayer's common shareholders.

Section 9 of S. 1240 would make a minor change in the wording of this provision.

We do not object to this change.

Section 10: Special ESOP Annual Addition Limitations

Under current law, the dollar amount of the annual addition to a participant's account in an employee stock ownership plan may be twice the normal amount if employer contributions of securities are made to the plan. Section 10 of S. 1240 would allow the annual addition exception to apply if the employer contributes cash for the purpose of acquiring stock for the account of participants under the plan.

We do not object to this provision. However, we believe it may be dealt with administratively and we are currently reviewing regulations which would reach the same result.

Section 11: Credit for Establishing an ESOP

Section 11 of S. 1240 would allow a small business employer who establishes an employee stock ownership plan to take a credit against tax in an amount equal to the lesser of $5,000 or the actual cost of establishing the plan. For purposes of this provision, a small business employer is defined as an employer having a monthly average of not more than 100 employees. This credit would be available for taxable years beginning after December 31, 1980.

We believe that it may be desirable for employees to have a stake in their employer's success. Such an approach may reduce divisions between management and labor and increase the incentive to work. However, we also believe that the ideal form for providing a stake in the success of-an employer varies from company to company and individual to individual. Past history indicates that employers and employees will develop such arrangements without further tax benefits. We also believe that it is appropriate for the Government to remain neutral in the portfolio decisions of individual plans.

Therefore, we oppose the addition of a tax credit for establishing a plan. Under current law, the costs to an employer of establishing any employee benefit plan are deductible and we believe that this is a sufficient benefit to the employer.

Section 12: IRAs for ESOP Participants

Under current law, an employee who is an active participant in a tax-qualified plan may not make deductible contributions to an individual retirement account or annuity ("IRA").

Section 12 of S. 1240 would amend the Internal Revenue Code to provide that a participant in a tax credit employee stock ownership plan would not be deemed to be an active participant for purposes of the IRA deduction provisions solely because of his or her participation in a tax credit ESOP.

We believe this is undesirable. The intent of the Congress in enacting the IRA provisions was to make tax-favored retirement savings available to individuals who do not have this benefit through their employers. The provision in the bill would again favor ESOPs over other plans and could result in substantial benefits to certain employees. For example, our studies indicate that IRAs are largely utilized under the current rules by high income individuals. The provision in section 12 of the bill would exacerbate that problem, since the tendency would be for highly-paid employees to utilize the IRA deduction while receiving proportionately large contributions to the ESOP.

There are other broad-based approaches to the issue of additional retirement savings through IRAs which are being developed in the Congress. At least two such proposals have been made by members of the Senate Finance Committee. We believe the approaches currently under consideration which attempt a broad-based solution to the problems offer a better overall approach and should be considered on their merits. Because of the narrow focus of section 12 of the bill, we cannot support it. However, we recognize that in cases where the only qualified plan maintained by an employer is a tax credit ESOP, some employees may wish to participate in a IRA rather than the ESOP, and yet the qualified status of the ESOP may be adversely affected if the plan allows eligible employees to elect to establish an IRA rather than participating in the ESOP. Therefore, we would be willing to consider with the Committee a narrowly drawn provision which would allow a tax credit ESOP to make such an election available.

Section 13: Special Rules for Matching Employee Contributions

Under current law, an employer is entitled to an additional one-half percent investment tax credit if the employer contributes employer securities (or cash used to acquire employer securities) to a tax credit employee stock ownership plan, and the employer contributions are matched by employee contributions.

Section 13 of S. 1240 would modify this rule to allow the employer to contribute directly on behalf of the employees the matching employee contributions. Although the contributions of the matching amounts would not entitle the employer to an additional tax credit, section 13 of the bill would amend the Code to provide that the employer would be entitled to a deduction for such contributions.

As we indicated above, we believe the current provisions basing employee stock ownership on qualified capital investment are inherently discriminatory and should be abandoned. Even if such provisions are not abandoned, we question whether the proposal in section 13 of the bill would comport with that we understand to be the basic thrust of the matching contribution provisions, namely, an employee's individual choice to invest in the employer.

Section 14: Tax Deferral for Distributions from ESOPs

Current law provides that if a lump sum distribution from a qualified plan includes securities of the employer corporation, net unrealized appreciation attributable to those securities is not currently included in the recipient's gross income. The currently taxable portion is equal to the trustee's basis in the securities distributed, and may be subject to the special 10-year averaging device allowed for certain lump sum distributions. The net unrealized appreciation is not taxed until the securities are sold and at that time the appreciation is treated as a long-term capital gain.

Section 14 of the bill would amend the Code to provide that if a participant is covered under a tax credit employee stock ownership plan for at least three years, and receives a lump sum distribution for the plan which consists of employer securities, then the lesser of the entire amount of the distribution or $5,000 would be excluded from the recipient's gross income in the year of the distribution.

We believe that the present provisions allowing net unrealized appreciation to escape current tax are inappropriate and that such appreciation should be currently taxed in the same manner as any other type of lump-sum distribution. No significant policy objective is achieved by singling out employer securities for this special deferral. However, the provision in section 14 of the bill would go beyond the present special treatment and would exempt from current tax even the amount currently subject to tax at the time the distribution is received.

This provision would exacerbate the current dichotomy between lump sum distributions containing employer securities and those that do not. We do not believe that any policy objective would be served by this approach and therefore we object to this provision.

Section 15: Use of Nonvoting Stock

The Code currently provides that an employee stock ownership plan may use nonvoting common stock only if the stock is readily tradable. If there is no readily tradable common stock of the employer, then the employer must use voting common stock or preferred stock which is convertible into voting common stock in an ESOP.

Section 15 of S. 1240 would allow an employer which has no readily tradable stock to use nonvoting stock if that stock meets certain conditions.

We believe that in order for employee stock ownership to be meaningful, the classes of stock which may be held by an employee stock ownership plan should be defined in a manner which gives employees interest in their employer. While we believe there are justifications for allowing the use of nonvoting stock when it is readily tradable, we see no such justifications in the case of closely-held nonvoting stock and therefore we object to this provision.

Section 16: Valuation of Employer Securities

The Code currently provides that employer securities are valued for purposes of contributions to a tax credit employee stock ownership plan on the basis of their average closing prices for the twenty consecutive day trading period immediately preceeding the due date for filing the tax return for the year in which the ESOP credit is claimed.

Section 16 of S. 1240 would amend the Code to provide that the value of the tax credit ESOP securities contributed to a plan would be determined on the basis of the average closing prices for the twenty consecutive day trading period immediately preceeding the date of the contribution of the securities to the plan.

We do not object to this provision.

Section 17: Special Employee Benefit Provisions

Under current law the maximum amount which may be deducted for contributions to a stock bonus plan and a profit sharing plan is, in the aggregate, 15 percent of the compensation paid to participants for a year.

Section 17 of the bill would increase this amount to 25 percent of compenstion where the employer maintains both a profit sharing plan and a stock bonus plan.

We estimate that this amendment would generate a revenue loss of $20 million in 1980, rising to $40 million by 1985.

We oppose as a matter of policy this attempt to increase the deductible limits on contributions to both a profit sharing plan and a stock bonus plan. We recognize that the result of our approach may be to favor money purchase pension or defined benefit pension plans over profit sharing or stock bonus plans. However, we do not view this as inappropriate since we believe pension plans provide participants with benefits which are more certain than profit sharing or stock bonus plans, and give greater assurance that benefits will be available at retirement.

Section 17 of S. 1240 would also change a provision relating to plans benefitting "owner-employees." Currently, if a non-incorporated employer maintains a qualified retirement plan, the trustee of plan assets must be a bank or a trust company except in certain narrowly defined situations. Section 17 of the bill would provide that if an employer incorporates through a transaction which constitutes a tax-free incorporation under the Code, and adopts a qualified plan after incorporation, the assets of the plan which was maintained prior to incorporation may be transferred to the trustee of the corporate plan. Since the corporate plan trustee does not necessarily have to be a bank, this would in effect remove a restriction from current law.

We do not object to this change.

Section 18: Cafeteria Plan Expansion

The 1978 Revenue Act added to the Internal Revenue Code provisions relating to cafeteria or flexible benefit plans. As currently defined, a cafeteria plan may not include any plan which provides for deferred compensation.

Section 18 of the bill would amend the definition of cafeteria plan in the Code to allow a cafeteria plan to include a cash or deferred profit sharing or stock bonus arrangement as defined in another section of the Code. The amended definition would be effective for taxable years beginning after December 31, 1978.

We do not object to this provision.

Section 19: Technical Corrections

Section 19 of the bill would make a number of technical corrections in the Code provisions relating to employee stock ownership plans which were added or amended by the 1978 Revenue Act. We have worked closely with the staff of the Senate Finance Committee and the staff of the Joint Committee on Taxation in considering proposed technical revisions to the 1978 legislation. A number of the changes described in section 19 of S. 1240 are or will be included in the Technical Corrections Act which was favorably reported by the Senate Finance Committee on November 29, 1979.

Senator BENTSEN. Our next witness will be the Honorable William Hobgood, Assistant Secretary of Labor.

We are delighted to have you. If I get up from time to time, it is because we have some legislation on the Floor I am interested in and I have to take care of some responsibilities there.

STATEMENT OF HON. WILLIAM HOBGOOD, ASSISTANT SECRETARY OF LABOR

Mr. HOBGOOD. I understand, Mr. Chairman. Thank you.

Joining me today, on my left, is Ian Lanoff, Administrator for the Pension and Welfare Benefit Plans; on my right, Monica Gallagher, Associate Solicitor of the Department of Labor for Plan Benefits Security.

Mr. Chairman, Senator Matsunaga, I am happy to appear before you today to discuss several bills which would amend the Employee Retirement Income Security Act including S. 1089, the ERISA Simplifiction Act of 1979, S. 209, the ERISA Improvements Act of 1979, and S. 1958, a bill dealing with qualifying employer real property.

I have a prepared statement I would like to submit for the record.

Senator BENTSEN. We will take it in its entirety. If you will summarize it?

Mr. HOBGOOD. Thank you.

In my remarks today, I will just touch on a few of the main points.

Mr. Chairman, despite being relatively new in this position I am well aware of the significant role you and the other members of the Committee on Finance played in enacting ERISA and your continuing interest in its administration. I am informed that your leadership and the work of this subcommittee have directly contributed to the adopting of key administrative improvements, the most significant of which being the development of Reorganization Plan No. 4 which divided authority in the rulings and regulations areas between the Department of Labor and the Department of the Treasury.

Also, in response to initiatives taken here, the Department made specific, in its prudence regulation that investments in smaller and newer companies were not imprudent per se. We also revised schedule B actuarial reporting in order to collect reliable information regarding the financial status of private pension plans.

Finally, in recognition of your intent in developing the concept of simplified employee pension plans to ease reporting for small employers, we recently proposed to defer to IRS requirements for such plans. I hope to build on this record and to continue the open and successful communication that has marked your subcommittee's relationship with the ERISA program in its developmental years.

Senator BENTSEN. Let me thank you.

A lot of progress has been made. You have been helpful in that regard.

Mr. HOBGOOD. Thank you.

We approach our analysis of S. 1089 in the same spirit of cooperation and in anticipation of your further assistance in our efforts to improve ERISA administration. We believe administrative improvements can be, and have already been, made without legislative change. We believe this is the best approach. In analyzing S. 1089, we have kept in mind our ability to accomplish the desired improvements administratively. After concluding our remarks on S. 1089, we will turn to S. 209 and other bills.

Mr. Chairman, section 2 of S. 1089 would allow a plan to pay the annual premium owed to the Pension Benefit Guaranty Corporation to, and file the related form with, the IRS as part of its annual report. We will defer on this provision to IRS and the PBGC. Section 3 of S. 1089 would eliminate the requirement that the summary annual report be mailed each year to plan participants and beneficiaries. In place of the mailing of the summary annual report, the bill would require the plan administrator to post at the employees' workplace a brief description of the current financial status of the plan, a copy of the latest summary plan description, and a name of an official who could provide further information. The bill apparently does not include any provision for retirees and beneficiaries to receive the information other than by coming to the workplace.

We believe we have already accomplished much of what this proposal intends by recently streamlining the summary annual report to make it easier to prepare and understand. It would be preferable, in our view, to wait until the new summary annual reports have been utilized for a period of time before considering the procedure proposed by S. 1089.

After such a trial period, we will be in a position to determine whether the paperwork burden and expense to plans of individual mailings of summary annual reports outweigh the benefit to participants and beneficiaries, and if so, what would be the best way to reduce those burdens. However we do not believe further changes are necessary or appropriate at this time.

Section 4 would allow the taxpayer to file any pension forms at the same time as income tax returns. We do not believe that the intended benefits of this provision would warrant the uncertainty it would necessarily produce as to when the documents would be received and who would be eligible to utilize it.

In addition, we are concerned that this proposal could cause difficulties for our enforcement program. Plan forms are to be filed by the plan administrator, who may or may not be the same person—or entity—as the plan sponsor—taxpayer. Even when they are the same, in many cases the plan and the employer have different tax years. Furthermore, taxpayers often get extensions for the filing of their income tax returns.

We are concerned it could cause difficulties for our enforcement programs.

Finally, section 6 provides Treasury with civil enforcement authority over plans which do not comply with minimum standards. Under the present division of authority, the Secretary of the Treasury may refer such matters to the Department of Labor for civil enforcement action. While we defer to the Treasury on the desirability of its having further authority, we have no reason to believe, based on our experience to date, that the current division of enforcement authority is unsatisfactory.

Providing Treasury with direct civil enforcement authority would, to some extent, be duplicative and thus uneconomical. Realinement of the enforcement powers will be addressed as part of the evaluation of alternative structures under Reorganization Plan No. 4. Accordingly, we do not believe this provision should be enacted at the present time.

Mr. Chairman, we submitted earlier in the year a detailed analysis of S. 209. Thus, I will limit my remarks on that bill to several major areas of special concern to the Department in S. 209.

I would like to focus on three proposals which the Department supports. These are proposals to improve spousal benefits which would largely benefit women, to expand health care protection, and to prohibit misrepresentation.

In the area of spousal benefits, S. 209 contains provisions that would amend ERISA's joint and survivor protections by requiring plans to provide a survivor's benefit for the spouse of a participant who had completed 10 years of service credited for vesting but dies before reaching early retirement age.

Coverage under the new joint and survivor provision would be voluntary, as participants could elect out of this form of benefit and also could revoke the election at a later date. In addition, this provision would permit plans to pass any added costs resulting from the survivor's benefit on to the participant.

The new joint and survivor requirement contained in S. 209 represents an important protection for the spouses of pension plan participants. Under the existing law, the surviving spouse of a participant with many years of service who dies prior to reaching early retirement age may nevertheless receive no benefits. This primarily affects widows between the ages of 45 and 60, many of whom have little work experience and very limited, if any, sources of income.

In addition, these widows often find themselves in circumstances where they are not eligible for Government child support or welfare benefits and are too young to receive social security benefits. We understand that Treasury has certain technical problems with this area and we defer to them on those problems.

Another provision of S. 209 which we believe will aid women permits the enforcement of certain State court judgments that order an employee benefit plan to make benefit payments to a participant's former spouse in satisfaction of claims arising under either a family support law or a community property law in limited circumstances.

The bill would make clear that the sections of ERISA which provide that a participant's pension benefits may not be assigned or alienated do allow the enforcement of State court support, alimony and community property orders against a plan when the participant is already in pay status, the so-called two check situation. Other applications of State property law would continue to be preempted.

This approach statutorily clarifies the interpretation of the existing law this administration has taken.

Another section of S. 209 provides a special exemption from Federal preemption for State laws requiring employers to directly or indirectly provide health care benefits or services to employees and their dependents, or regulating such arrangements. Such laws, insofar as they affect employee benefit plans, are now preempted under ERISA.

Of course, we place great importance on providing adequate health care to the Nation's work force, but we are concerned with how the regulatory scheme of ERISA and that of a State will interrelate when applied to the same group of employee benefit plans in that State.

We would, therefore, suggest that S. 209 be limited to permitting the preemption exemption in one State. We believe that the model State should be Hawaii, which has enacted a law requiring employers located there to provide health care benefits for workers in the State. The Hawaii law embodies a unique and precedent setting experiment in the provision of health benefits which is well worth trying. We are willing therefore, to support a study of the Hawaii model.

In light of the possible complications, we would suggest that instead of relaxing the preemptive effect of ERISA so as to allow all States to immediately adopt laws regulating employee benefit plans, the Department, in consultation with Hawaii report back to you after a reasonable period. At that point, consideration can be given to the appropriateness of extension to other States.

S. 209 includes provisions regarding misrepresentations in connection with pension plans. They provide that section 17 of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934—antifraud coverage under the Federal securities laws—would not be applicable to interests in an employee benefit plan.

These interests would be directly protected under a new section 515 of ERISA, and violations of that section would be actionable under a new section 502(a)(7). Section 515 would take account of the specific characteristics of plans and the regulatory pattern of ERISA by providing generally that documents prepared in accordance with the reporting and disclosure rules of ERISA and the regulations thereunder would not be covered by this section, and that the plan itself could not be guilty of a misrepresentation without the ambit of the provision.

Misrepresentation is of great concern to us since no fraud is more cruel than fraud which can cause employees to face unexpected financial hardship in their retirement years. Since plan participants and prospective participants may be seriously harmed by fraudulent misrepresentations, we believe some form of additional legal protection against fraud in connection with employee benefit plans should be considered.

A narrowly drafted amendment to ERISA may provide an appropriate solution. Thus, we support the principle of a precisely drawn antifraud provision. We will be happy to work with the Congress to assure that the provision meets the needs of the participants, the employers, and the Government. I am confident that it will be possible to develop a provision which will insure that workers are not victimized by misrepresentations in connection with employee benefit plans.

The ERISA Improvements Act of 1979 contains a number of incentives to stimulate growth of pension plans and to encourage employee contributions for retirement. These include provisions that grant tax credits to certain small employers establishing pension plans, allow the establishment of special master plans and allow tax deductions for employee contributions to pension plans or to individual retirement accounts.

We share the bill's objective of extending retirement income coverage to additional workers since slightly less than half of wage and salary workers participate in private pension plans, and even less actually receive benefits.

The bill directs incentives to those areas of greatest need. Much of the potential for increased coverage exists among the small employers for whom the tax credit and special master plans are intended. There is also a need for greater equity in the tax treatment of employee contributions for retirement to promote greater pension benefits, as the Department of Treasury has testified on a number of occasions. On the specific methods of accomplishing these objectives, we defer to the Department of the Treasury.

S. 209 also includes provisions prohibiting the decrease of disability benefits under welfare plans because of increases in social security benefits and the decrease of pension benefits because of workers' compensation awards. We support the disability benefit provision because we believe the same rule should apply to disability benefits under welfare plans as applies to all benefits under pension plans, including disability benefits. We also are concerned about workers' compensation offsets. We have recently completed a cost study in this area and will be consulting with other interested agencies shortly in order to reach an administrative position on the proposal. We will report to you on our position when we have completed our consultations.

Before concluding my discussions of S. 209, I would like to briefly address two issues that affect S. 209, but also are raised in several other bills—one is paperwork reduction and the other is prohibited transaction exemptions. We have made great strides in the last few years in reducing unnecessary paperwork and are constantly considering new ideas for further reductions, especially for small plans.

We have sufficient authority under the statute to continue this reduction when we believe the burden of the paperwork outweighs the benefits of the information as a means of protecting the participant and the beneficiary. We are proud of the steps we have taken, and believe we have already accomplished the promises we made during the reorganization to eliminate, reduce, and simplify paperwork. However, I can promise you we will continue our efforts in this area.

We are also proud of what we have done in the exemption area as part of reorganization. One of the most significant aspects of the reorganization was that the Department would assume exclusive jurisdiction over ERISA's fiduciary standards and prohibited transactions provisions—including the authority to issue administrative exemptions.

I have included statistics that demonstrate the improvements I have made in the exemption process. Let me simply say here that there has been a significant and satisfying improvement.

The administration will be reporting shortly on how the reorganization has worked and on future recommendations. It is safe to say at this point, however, that the reorganization has accomplished a significant and beneficial change, especially with regard to exemptions.

In the short time since reorganization, we have had great success in reducing our backlog and shortening the time it takes to rule on applications. We have every intention of continuing the priority attention we are devoting to this area. Therefore, we see no need for legislation.

You have requested our views on a number of other bills. Most of these are tax measures and we will defer to the IRS on those; however before concluding I would like to briefly comment on S. 1958, which deals with investments by pension plans in qualifying employer real property.

S. 1958 would amend the definition of qualifying employer real property to facilitate investment by small plans in employer real property. This would be done by substituting a number of other specific conditions in place of the geographical dispersion rule currently incorporated in the definition of qualifying real property. If these conditions were met it would be lawful under the proposal, without an exemption, for a plan to acquire and hold a single parcel of employer real property.

The bill adopts as conditions many of the types of safeguards we apply in approving a prohibited transaction exemption application under present law. However, we do not believe that the legislative imposition of a single set of conditions for every case is necessarily sound. In view of the flexibility of the existing exemption process, we do not believe that legislative modification of the definition of qualifying employer real property is necessary at this time.

This concludes my prepared remarks. We would be happy to answer any questions you may have.

Senator MATSUNAGA. Thank you very much, Mr. Hobgood.

As you know, Hawaii profit-sharing plans filed applications with the Department of Labor seeking exemptions from the prohibited transaction rules. They were instructed to withdraw the applications until the grace period expires in 1984. This uncertainty, of course, leaves the plans in a very precarious situation. Although we have less than a million people in Hawaii, we have over 1,000 profit-sharing plans. Most of these plans are relatively small and the present requirement of geographic diversification—what isthe other term used?

Mr. HOBGOOD. Geographical dispersion.

Senator MATSUNAGA. Geographical dispersion in many instances would be impossible to meet by the small plans.

Ownership of real property must begin with the purchase of the first parcel and the first purchase usually involve employees real property, since the employer is inclined to offer a favorable selling price.

The logic escapes me that we permit plans to invest in stocks of the employer but not assets as in the case of real property. Experience especially in the last few years has shown investments in stocks to be in constant flux and even in decline, whereas investments in real estate have enjoyed tremendous gains especially in areas such as Hawaii and Washington D.C. where land is scarce. You can look towards appreciation of property and not minor appreciation, but major appreciation. Any prudent man would say land in Hawaii just as land in Washington, D.C. is a good investment in comparison, stocks have proved a risky investment.

Why cannot the Department of Labor see the benefit of plan investment in real property, including employer real property?

Mr HOBGOOD. Senator, I am aware of your particular concerns in this regard and we have discussed it. I might have Mr. Lanoff respond more specifically to some thoughts he may have on that.

Mr. LANOFF. Thank you.

Senator Matsunaga, we at the Labor Department have not denied the exemption applications that have been filed on behalf of the plans that you mentioned. Rather, we have simply suggested to them that, in light of the fact that they can currently engage in these transactions because of the existence of the transitional rule—within ERISA as it currently exists—they may wish to come back and apply to us at a more appropriate time in order to seek the relief that they will need some time in the future.

Under the transitional rule of section 414(c)(2) of ERISA, these plans have until June 30, 1984, in which they may engage in these transactions. Our only concern in asking them to withdraw at this time was that they might be asking us to rule on the basis of factual situations in 1979, to grant exemptions for transactions that they will not be engaging in until June 30, 1984.

We simply have suggested to them that they may wish to return some time from now, when the facts that are before us are the ones that are more likely to exist at that magic date of June 30, 1984.

Senator MATSUNAGA. The transitional provision does not provide for purchase of single parcels of employer real property within the transitional period; the transition provision only prvides for purchases of employer real property prior to the act.

Mr. LANOFF. To the extent that these plans are applying for exemptions that are not covered by the transitional rules, we are ruling upon those.

Senator MATSUNAGA. The application of the transitional clause is not in question. The problem arises after the transitional period ends. Will the Department require divestiture of such property after the transition period. The problem also arises with regard to purchase of employer real property after the act.

Mr. LANOFF. Basically under the prohibited transaction provisions of ERISA, a plan that could not take advantage of the transitional rules would come to us and file an exemption application. We would rule upon that exemption application based on the criteria contained in the statute. We would examine the circumstances of the particular plan's situation.

In cases where the purchase does not qualify for transitional relief, we have considered exemption applications on their merits. Under certain circumstances relief has been granted. But I wanted to clear up any misunderstanding regarding the Department's position with respect to some of these plans that have come in for exemptions extending beyond June 30, 1984, on property covered by the transitional rule. We have asked them to withdraw the applications because the transitional rule will permit them to continue to engage in these transactions until 1984.

We are happy to entertain any application that is necessary at this time. Of course, in light of the improvements we made under reorganization, we should be able to rule upon the application expeditiously.

Senator MATSUNAGA. Are you saying here that the Department has not denied any application?

Mr. LANOFF. What I am saying, is that there is a group of applications, I am told, numbering approximately 10, where we have asked the plans to withdraw because of the availability of the transitional rule.

I understand some of those included in that 10 are applications by profit-sharing plans located in the State of Hawaii.

Senator MATSUNAGA. The Department has advised plans to wait until the expiration of the grace period before seeking exemption. This has created uncertainty, and employers have refused to enlarge or improve the realty because of the plans ownership of the property in the future is uncertain.

I would want to eliminate this uncertainty.

Mr. LANOFF. We certainly would be interested in that, as well. We have not, and do not, intend to ask these plans to wait until June 30, 1984, to come and apply for exemptions. We basically are simply saying that 5 years before the time the transitional rules would expire is too early for us to rule. At some other time in the future, perhaps a year, 2 years from now, it is more likely that the facts that exist will be the same facts that exist in June of 1984 so that we would simply prefer to wait.

Senator MATSUNAGA. As you well know, the Department of Labor has been criticized for its slowness in not only promulgating regulations but also in implementing regulations.

Don't you think that it would be much more expeditious for us to legislate and clarify the issue now? Maybe this would help the Department of Labor.

Mr. LANOFF. I hope that most of that criticism no longer is being made of the Department. For example, we have already ruled upon more applications in 1979, 639, than we did in all of the previous 5 years of ERISA's history. So we are at a point right now where we can rule on these fairly expeditiously.

I would invite any plan that needs an exemption to apply for the exemption. We are willing to examine the application and to rule favorably, if the circumstances permit.

Senator MATSUNAGA. Is it your position that you can handle this matter administratively without new legislation?

Mr. LANOFF. Yes; it is, Senator.

Senator MATSUNAGA. Your administrative rule would permit plans to own just one parcel of employer realty?

Mr. LANOFF. In any case, it will depend on the facts and circumstances of the case and the prohibited transaction criteria in law. We are asked to examine the application based on certain criteria in the law.

It is very possible that the plans that apply will be able to meet these criteria. We will have to judge that as they apply.

Senator MATSUNAGA. You would not require geographic dispersion?

Mr. LANOFF. Under the appropriate circumstances we would decide whether there is the necessity in this particular case for geographic dispersion. If there are other protections for participants and beneficiaries in a certain plan, it may well be in that particular case we can grant an exemption. That is a flexibility we may have under the law, and the discretion that we would like to be able to exercise within the law.

Senator MATSUNAGA. I would think that the Department of Labor would welcome congressional assistance to resolve this problem and settle this weighty issue which requires such lengthy administrative consideration.

Mr. LANOFF. Senator, we are concerned about different factual situations and we believe that prohibited transaction procedures give us an opportunity to examine each particular case on its own merits and assure protection for the participants and beneficiaries of the plans.

Senator MATSUNAGA. You would not object strenuously, would you?

Mr. LANOFF. At this time, yes, Senator Matsunaga.

Senator MATSUNAGA. You will?

Mr. LANOFF. Yes.

Senator MATSUNAGA. I see. That is all; thank you, Mr. Chairman.

Senator BENTSEN. Thank you, Senator.

I am not going to testify as to Hawaii real estate, but I will state that real estate most places does not always go up. I have seen some real losses in real estate.

We had some real abuses that were called to our attention of employers who unloaded their real estate on their pension plans and that was one of the reasons we took some of the steps we did, and it remains a concern to me.

They are trying to schedule some votes on the floor. That is what I have been checking on.

Thank you, gentlemen, very much.

Mr. HOBGOOD. Thank you.

[The prepared statement of Mr. Hobgood follows:]

STATEMENT OF WILLIAM HOBGOOD, ASSISTANT SECRETARY OF LABOR FOR LABOR-MANAGEMENT RELATIONS

Mr. Chairman and members of the subcommittee, I am happy to appear before you today to discuss several bills which would amend the Employee Retirement Income Security Act (ERISA) including S. 1089, the "ERISA Simplification Act of 1979", S. 209, the "ERISA Improvements Act of 1979", and S. 1958, a bill dealing with qualifying employer real property.

Mr. Chairman, despite being relatively new in this position, I am well aware of the significant role you and the other members of the Committee on Finance played in enacting ERISA and your continuing interest in its administration. I am informed that your leadership and the work of this Subcommittee have directly contributed to the adopting of key administrative improvements, the most significant of which being the development of Reorganization Plan Number 4 which divided authority in the rulings and regulations areas between the Department of Labor and the Department of Treasury. Also, in response to initiatives taken here, the Department made specific in its prudence regulation that investments in smaller and newer companies were not imprudent per se. We also revised schedule B actuarial reporting in order to collect reliable information regarding the financial status of private pension plans. Finally, in recognition of your intent in developing the concept of simplified employee pension plans (SEPs) to ease reporting for small employers, we recently proposed to defer to IRS requirements for such plans. I hope to build on this record and to continue the open and successful communication that has marked your Subcommittee's relationship with the ERISA program in its developmental years.

We approach our analysis of S. 1089 in the same spirit of cooperation and in anticipation of your further assistance in our efforts to improve ERISA administration. We believe administrative improvements can be, and have already been, made without legislative change. We believe this is the best approach. In analyzing S. 1089, we have kept in mind our ability to accomplish the desired improvements administratively. After concluding our remarks on S. 1089, we will turn to S. 209 and the other bills.

Mr. Chairman, section 2 of S. 1089 would allow a plan to pay the annual premium owed to the Pension Benefit Guaranty Corporation (PBGC) to, and file the related form with, the IRS as part of its annual report. We will defer on this provision to IRS and the PBCG.

Section 3 of S. 1089 would eliminate the requirement that the summary annual report (SAR) be mailed each year to plan participants and beneficiaries. In place of the mailing of the summary annual report, the bill would require the plan administrator to post at the employees workplace a brief description of the current financial status of the plan, a copy of the latest summary plan description, and a name of an official who could provide further information. The bill apparently does not include any provision for retirees and beneficiaries to receive the information other than by coming to the workplace.

We believe we have already accomplished much of what this proposal intends by recently streamlining the summary annual report to make it easier to prepare and understand. It would be preferable, in our view, to wait until the new summary annual reports have been utilized for a period of time before considering the procedure proposed by S. 1089. After such a trial period, we will be in a position to determine whether the paperwork burden and expense to plans of individual mailings of summary annual reports outweigh the benefit to participants and beneficiaries, and if so, what would be the best way to reduce those burdens. However, we do not believe further changes are necessary or appropriate at this time.

Section 4 would allow the taxpayer to file any pension forms at the same time as income tax returns. We do not believe that the intended benefits of this provision would warrant the uncertainty it would necessarily produce as to when the documents would be received and who would be eligible to utilize it. In addition, we are concerned that this proposal could cause difficulties for our enforcement program. Plan forms are to be filed by the plan administrator, who may or may not be the same person (or entity) as the plan sponsor (taxpayer). Even when they are the same, in many cases the plan and the employer have different tax years. Furthermore, taxpayers often get extensions for the filing of their income tax returns. In such cases the suggested provision could result in a long delay in the filing of pension plan forms, thereby preventing information needed for enforcement from being promptly available.

Section 5 requires the Secretaries of Treasury and Labor to publish a booklet to assist small businesses with recordkeeping needed to comply with the Act and requires Treasury to publish a booklet summarizing the rules on individual retirement accounts. As a rule, we do not believe it is necessary for a statute to explicitly state the form of informational material that we should provide to the public; however, if there is a need for such information on recordkeeping we would be happy to work with Treasury on developing such a pamphlet. We do not believe legislation would be necessary to do this. I would point out that we have already published a small plan reporting and disclosure guide.

Finally, section 6 provides Treasury with civil enforcement authority over plans which do not comply with minimum standards. Under the present division of authority, the Secretary of the Treasury may refer such matters to the Department of labor for civil enforcement action. While we defer to the Treasury on the desirability of its having further authority, we have no reason to believe, based on our experience to date, that the current division of enforcement authority is unsatisfactory. Providing Treasury with direct civil enforcement authority would, to some extent, be duplicative and thus uneconomical. Realignment of the enforcement powers will be addressed as part of the evaluation of alternative structures under Reorganization Plan No. 4. Accordingly, we do not believe this provision should be enacted at the present time.

Mr. Chairman, we submitted earlier in the year a detailed analysis of S. 209. Thus, I will limit my remarks on that bill to several major areas of special concern to the Department in S. 209.

I would like to focus on three proposals which the Department supports. These are proposals to improve spousal benefits, which would largely benefit women, to expand health care protection, and to prohibit misrepresentation.

In the area of spousal benefits, S. 209 contains provisions that would amend ERISA's joint and survivor provisions and would addresss difficult issues regarding the relationship of ERISA and State domestic relations law.

The bill would add to existing joint and survivor protections by requiring plans to provide a survivor's benefit for the spouse of a participant who had completed 10 years of service credited for vesting but dies before reaching early retirement age. Coverage under the new joint and survivor provisions would be voluntary, as participants could elect out of this form of benefit and also could revoke the election at a later date. In addition, this provision would permit plans to pass any added costs resulting from the survivor's benefit on to the participant.

The new joint and survivor requirement contained in S. 209 represents an important protection for the spouses of pension plan participants. Under the existing law, the surviving spouse of a participant with many years of service who dies prior to reaching early retirement age may nevertheless receive no benefits. This primarily affects widows between the ages of 45 and 60, many of whom have little work experience and very limited, if any, sources of income. In addition, these widows often find themselves in circumstances where they are not eligible for Government child support or welfare benefits and are too young to receive social security benefits. We understand that Treasury has certain technical problems with this area and we defer to them on those problems.

Another provision of S. 209 which we believe will aid women permits the enforcement of certain State court judgments that order an employee benefit plan to make benefit payments to a participant's former spouse in satisfaction of claims arising either under a family support law or a community property law in limited circumstances.

The bill would make clear that the sections of ERISA which provide that a participant's pension benefits may not be assigned or alienated do allow the enforcement of State court support, alimony and community property orders against a plan when the participant is already in pay status, the so-called "two check" situation. Other applications of State property law would continue to be preempted. This approach statutorily clarifies the interpretation of the existing law this Administration has taken in two recent cases involving this issue, one in a noncommunity property State case, the *Cartledge* case, and the other in a community property State case, the *Stone* case. S. 209, in legislatively reaffirming the Administration's interpretation of sections 206 and 514 of ERISA, has succeeded in striking an appropriate balance in this most difficult area between the interest of the States in the area of domestic relations and the uniform national regulation of employee benefit plans under ERISA.

Another section of S. 209 provides a special exemption from Federal preemption for State laws requiring employers to directly or indirectly provide health care benefits or services to employees and their dependents, or regulating such arrangements. Such laws, insofar as they affect employee benefit plans, are now preempted under ERISA.

Of course we place great importance on providing adequate health care to the Nation's work force, but we are concerned with how the regulatory scheme of ERISA and that of a State will interrelate when applied to the same group of employee benefit plans in that State. We would, therefore, suggest that S. 209 be limited to permitting the preemption exception in one State. We believe that the model State should be Hawaii, which has enacted a law requiring employers located there to provide health care benefits for workers in the State. The Hawaii law embodies a unique and precedent setting eperiment in the provision of health benefits which is well worth trying. We are willing, therefore, to support a study of the Hawaii model.

In light of the possible complications, we would suggest that instead of relaxing the preemptive effect of ERISA so as to allow all States to immediately adopt laws regulating employee benefit plans, the Department in consultation with Hawaii report back to you after a reasonable period. At that point, consideration can be given to the appropriateness of extension to other States.

S. 209 includes provisions regarding misrepresentations in connection with pension plans. They provide that section 17 of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934—antifraud coverage under the Federal securities laws—would not be applicable to interests in an employee benefit plan. These interests would be directly protected under a new section 515 of ERISA, and violations of that section would be actionable under a new section 502(a)(7). Section

515 would take account of the specific characteristics of plans and the regulatory pattern of ERISA by providing generally that documents prepared in accordance with the reporting and disclosure rules of ERISA and the regulatins thereunder would not be covered by this section, and that the plan itself could not be guilty of a misrepresentation within the ambit of the provision.

Misrepresentation is of great concern to us since no fraud is more cruel than fraud which can cause employees to face unexpected financial hardship in their retirement years. Since plan participants and prospective participants may be seriously harmed by fraudulent misrepresentations, we believe some form of additional legal protection against fraud in connection with employee benefit plans should be considered.

A narrowly drafted amendment to ERISA may provide an appropriate solution. Thus, we support the principle of a precisely drawn antifraud provision. We will be happy to work with the Congress to assure that the provision meets the needs of the participants, the employers, and the Government. I am confident that it will be possible to develop a provision which will ensure that workers are not victimized by misrepresentations in connection with employee benefit plans.

The ERISA Improvements Act of 1979 contains a number of incentives to stimulate growth of pension plans and to encourage employee contributions for retirement. These include provisions that grant tax credits to certain small employers establishing pension plans, allow the establishment of special master plans and allow tax deductions for employee contributions to pension plans or to Individual Retirement Accounts. We share the bill's objective of extending retirement income coverage to additional workers since slightly less than half of wage and salary workers participate in private pension plans, and even less actually receive benefits.

The bill directs incentives to those areas of greatest need. Much of the potential for increased coverage exists among the small employers for whom the tax credit and special master plans are intended. There is also a need for greater equity in the tax treatment of employee contributions for retirement to promote greater pension benefits, as the Department of Treasury has testified on a number of occasions. On the specific methods of accomplishing these objectives, we defer to the Department of the Treasury.

S. 209 also includes provisions prohibiting the decrease of disability benefits under welfare plans because of increases in social security benefits and the decrease of pension benefits because of workers' compensation awards. We support the disability benefit provision because we believe the same rule should apply to disability benefits under welfare plans as applies to all benefits under pension plans, including disability benefits. We also are concerned about workers' compensation offsets. We have recently completed a cost study in this area and will be consulting with other interested agencies shortly in order to reach an Administration position on the proposal. We will report to you on our position when we have completed our consultations.

Before concluding my discussion of S. 209, I would like to briefly address two issues that affect S. 209, but also are raised in several other bills—one is paperwork reduction and the other is prohibited transaction exemptions. We have made great strides in the last few years in reducing unnecessary paperwork and are constantly considering new ideas for further reductions, especially for small plans. We have sufficient authority under the statute to continue this reduction when we believe the burden of the paperwork outweighs the benefits of the information as a means of protecting the participant and the beneficiary. We are proud of the steps we have taken, and believe we have already accomplished the promises we made during the Reorganization to eliminate, reduce, and simplify paperwork. However, I can promise you we will continue our efforts in this area.

We are also proud of what we have done in the exemption area as part of Reorganization. One of the most significant aspects of the Reorganization was that the Department would assume exclusive jurisdiction over ERISA's fiduciary standards and prohibited transactions provisions—including the authority to issue administrative exemptions. In the four years, 1975-1978, prior to the Reorganization, a total of 609 applications were resolved. In the 11-month period since the Reorganization took effect, we have resolved 631 exemption applications. During the past 11-month period we have received 423 requests—a number significantly higher than we would have expected based on historical data. We attribute this increase in requests to the fact that potential applicants can now expect the Department to respond to their submission in a more timely manner. Despite this increase in requests, we have been able to reduce our inventory of pending applications of open cases from 539 at the beginning of calendar year 1979 to 331 as of December 1st.

The Administration will be reporting shortly on how the Reorganization has worked and on future recommendations. It is safe to say at this point, however, that the Reorganization has accomplished a significant and beneficial change, especially with regard to exemptions. In the short time since Reorganization, we have had great success in reducing our backlog and shortening the time it takes to rule on applications. We have every intention of continuing the priority attention we are devoting to this area. Therefore we see no need for legislation.

You have requested our views on a number of other bills. Most of these are tax measures and we will defer to the IRS on those; however, before concluding I would like to briefly comment on S. 1958 which deals with investments by pension plans in qualifying employer real property.

S. 1958 would amend the definition of qualifying employer real property to facilitate investment by small plans in employer real property. This would be done by substituting a number of other specific conditions in place of the geographical dispersion rule currently incorporated in the definition of "qualifying" real property. If these conditions were met, it would be lawful under the proposal, without an exemption, for a plan to acquire and hold a single parcel of employer real property.

The bill adopts as conditions many of the types of safeguards we apply in approving a prohibited transaction exemption application in this area under present law. However, we do not believe that the legislative imposition of a single set of conditions for every case is necessarily sound. In view of the flexibility of the existing exemption process, we do not believe that legislative modification of the definition of qualifying employer real property is necessary at this time.

This concludes my prepared remarks. We would be happy to answer any questions you may have.

Senator BENTSEN. Our next witness will be Mr. Donald Alexander, of the firm Morgan, Lewis & Bockius, former Commissioner of Internal Revenue. We are pleased to have you.

You played a very prominent role in this legislation.

STATEMENT OF DONALD C. ALEXANDER, ESQ., MORGAN, LEWIS & BOCKIUS

Mr. ALEXANDER. Thank you, Mr. Chairman.

I have a written statement which I do not propose to read, but I would like to have it entered in the record.

Senator BENTSEN. It will be.

Mr. ALEXANDER. Mr. Chairman, I am here simply to discuss your bill, S. 1089, and I think it would be a sound step forward.

I believe that the three sections dealing with the reduction of the paperwork burden are constructive. They are constructive because they are instructive to the people downtown. As much for that as for the individual merit of enacting these provisions, Mr. Chairman. Having been downtown, I am fully aware of the need for constant congressional interest in reducing the burdens of legislation but maintaining the protections of such legislation.

Sections 2, 3, and 4 of your bill would assist, I think, in meeting both those objectives.

Section 6 is a matter of great importance. It would give Internal Revenue the right to bring civil actions to remedy matters that call out for correction, but not the kind of correction that the Deputy Assistant Secretary said a few minutes ago is the wrong way to correct.

Internal Revenue has a corrective weapon now, that is, the disqualification of the plan, and frequently that is about the worst thing that could happen to the people whose interests are being abused or misused by what calls out for Internal Revenue's correction.

Senator BENTSEN. When you refer to the Assistant Secretary, you are talking about of Treasury, I suppose.

Mr. ALEXANDER. Treasury. I did not hear much support for that concept from the last Assistant Secretary. I said Deputy Assistant Secretary.

Senator BENTSEN That is right.

Mr. ALEXANDER. Yes, sir. I am not a bit surprised that the Department of Labor is not eagerly embracing this proposal. If I were in their shoes, I would not either, but I think it is necessary.

The Deputy Assistant Secretary, Mr. Halperin, did say that Treasury is going to meet with some representatives of the American Bar Association Tax Section to discuss additional remedies, which he said were necessary. I agree that additional remedies are necessary, but I think you have provided a pretty good one in section 6.

Section 6 might have accompanying it a committee report which would make it clear that this remedy might be used where warranted, but not used indiscriminately. It might make it clear that in a situation where the remedy would be ineffective, such as that described by Mr. Halperin, it would not be used.

But this additional tool would have been of great help to the Internal Revenue Service when I was there in some cases that are a matter of public record, one of which was discussed in a long article in the Wall Street Journal on November 15, 1979, "Stalled Clean-up. Teamsters Defy. Labor Agency Takes Steps for Outside Control of Pension Fund."

The Internal Revenue needs this power, irrespective of the fact that Labor already has it. Why?

Two reasons. No. 1, the Internal Revenue's jurisdiction and that of Labor are not coextensive, as Mr. Halperin made clear. No. 2, Labor has limited resources and it has its own set of interests and its own priorities.

So, Mr. Chairman, section 6, or something like it, should become law, and I think that you have done a great service toward the furtherance of the proper administration of ERISA as to which you played a major part, as I recall so well, in its enactment.

Senator BENTSEN. What about the argument that this is duplicative work? The Assistant Secretary of Labor said you just end up with inefficiency because you duplicate each other's work.

Mr. ALEXANDER. I do not think that is going to happen very often. If it does, I think it is a fairly small price to pay for improving the IRS's ability to carry out its responsibilities here.

Senator BENTSEN. Does not the IRS and Treasury have that authority already in a number of other instances?

Mr. ALEXANDER. Treasury has the authority in a number of other instances as Mr. Halperin stated. The addition of this tool to the authority of IRS to carry out its work would give IRS in that real world out there the legal right to do what it tries to do as a practical matter, using this very awkward and overpowering weapon of disqualification.

Senator BENTSEN. Do not most departments have such authority?

Mr. ALEXANDER. I believe they do in many instances, Mr. Chairman, particularly when they have a function like that of IRS, trying to carry out regulatory responsibilities rather than tax collecting responsibilities.

Senator BENTSEN. Senator Matsunaga?

Senator MATSUNAGA. I have no questions. I understand that we will soon have a vote on the Senate floor.

Senator BENTSEN. Thank you very much, Mr. Alexander.

[The prepared statement of Mr. Alexander follows:]

STATEMENT OF DONALD C. ALEXANDER

My name is Donald C. Alexander and I am a partner in the Washington office of Morgan, Lewis & Bockius. I am appearing at the invitation of the Subcommittee primarily to discuss S. 1089, the ERISA Simplification Act of 1979. I am here solely in my personal capacity.

As a past Commissioner of Internal Revenue and member of the Commission on Federal Paperwork, and as present Vice Chairman of the Citizens Committee on Paperwork Reduction, I am greatly concerned about the heavy paperwork and other burdens imposed by Government upon the American public. However, the Government must obtain the information necessary to function effectively and efficiently. To obtain such information at minimum public burden and cost means (1) confining requests to only that information which is really needed, (2) stating information requests in a comprehensible manner and limiting them to the minimum feasible number and frequency, and (3) sharing information to reduce overlapping requests to the maximum extent consistent with personal privacy.

Congress shares the responsibility for the paperwork burden. Section 103 of ERISA, which sets forth massive and detailed requirements with respect to annual reports, is a glaring example of Congressionally-imposed paperwork. It is encouraging to see that both the Executive Branch and Congress have recently been trying to reduce ERISA paperwork demands. S. 1089 contains provisions designed to reduce ERISA paperwork further and to assist the Internal Revenue Service to administer ERISA more effectively.

It seems to me that the objectives of Sections 2, 3, and 4 of S. 1089 are basically sound. Section 2 would abolish the Pension Benefit Guaranty Corporation's form and place on the IRS the responsibility of collecting the PBGC insurance premium as part of its reporting obligation. Elimination of duplicative forms is a goal we all support, and the Internal Revenue Service knows how to handle money. Section 3 would replace the summary annual report by a notice to be posted at the employees' work place. This is a good idea, provided the proposed new requirement would not be construed to call for a mass of financial or acturial detail which create confusion. Section 4 of S. 1089, which provides the alternative of filing pension forms with annual income tax forms, might be conditioned by defining the circumstances under which this right would be exercised.

Finally, I believe that the Internal Revenue Service should have the right to enforce compliance through a civil action as provided in Section 6 of S. 1089. The tool—or weapon—of disqualification of a plan is poorly suited to the duty of IRS to protect, rather than destroy, rights of participants and beneficiaries. IRS' function in this field is regulatory, not tax-collecting, and disqualification frequently would have a greater adverse impact upon innocent participants and beneficiaries than upon the person or company guilty of creating the situation which the IRS must remedy.

While the reassignment of functions under the present Reorganization Plan diminishes to some extent IRS' need for this additional remedy, it by no means eliminates such need. Moreover, the right of IRS to refer matters to the Department of Labor is not an adequate solution. Labor has limited resources; its jurisdiction is not coextensive with that of IRS; and it has its own interests and priorities.

However, if power to enforce ERISA through civil action is given to IRS through the Treasury, I recommend that the legislative history make it clear that this right should not be indiscriminately employed. Instead, it should be used only when clearly necessary to preserve the integrity of retirement plans, prevent abuse and protect participants and beneficiaries.

For reasons which I have stated before, I am opposed to the creation of a single agency to administer and enforce the laws regarding private retirement plans. This well-intended change would be counter-productive.

Senator BENTSEN. Our next witness is Ms. Karen Ferguson, Pension Rights Center.

She is not here.

Our next witness will be Mr. Robert Georgine, National Committee for Multi-Employer Plans. Oh, I see. Ms. Ferguson is here. Come along.

STATEMENT OF KAREN FERGUSON, PENSION RIGHTS CENTER

Ms. FERGUSON. Mr. Chairman, I am Karen W. Ferguson, Director of the Pension Rights Center. I am here this afternoon to make what, for us, is an unusual request. I am here to ask you to defer consideration of this legislation.

I am making this request——

Senator BENTSEN. All legislation?

Ms. FERGUSON. The legislation under consideration today, the two major bills.

Senator BENTSEN. That is quite a list. Are you asking us to defer all of those?

Ms. FERGUSON. Specifically, consideration of the ERISA Improvements Act, S. 209 and the ERISA Simplification Act, S. 1089, simply because those bills, if enacted, would substantially cut back some of the most important protections provided by ERISA.

These protections relate to substantive rights, disclosure, and fiduciary provisions. If enacted, they would represent not only a decisive step backward, but a step taken without any knowledge on the part of—and certainly no participation by—the individuals adversely affected.

I am asking you to defer consideration of this legislation until you can hear from the individuals who will be hurt by these bills.

Ordinarily, we oppose delay of all kinds. I am suggesting it here because, quite frankly, I think that it is likely to be extremely difficult for the members of the subcommittee to tell workers and retirees who have specific rights under ERISA that you propose to enact legislation that will take away those rights.

For example, I think you would find it difficult to tell a factory worker who worked 9 years and 10 months that you are proposing to change the law so that companies can deny pensions to people who have rights to benefits under the ERISA "1,000-hour rule." Specifically, that you are proposing to take those rights away in favor of a rule that requires everyone (except those so favored by their companies or unions that they are put on a layoff or leave of absence status) to remain on their job until the last day of their 10th year.

You could tell this man that according to the Senate Labor and Human Resources Committee there is only a theoretical possibility that he would lose out under the new proposed "elapsed time" rule and that on the whole employees are more likely to benefit from the new rule, but it simply will not be very convincing.

In fact, there already are a number of individuals in this factory worker's position—we have heard from several and know that the Labor Department has heard from others. These are people who are likely to point out to you that if adoption of the elapsed time rule will really produce the cost savings claimed by the large companies seeking its adoption, they certainly can afford to give pensions to the few individuals who do not quite make it to that last day of the 10th year.

My guess is that you would also find it somewhat awkward to tell a retired asbestos worker, forced to go back to work to keep up with inflation, that you are proposing legislation that will result in the suspension of his pension. You can try telling him that he is a double dipper and that, according to the Labor and Human Resources Committee the purpose of the suspension of benefits rule is to prevent him from competing with employees of preretirement age, but he is likely to point out that under his union's rules he cannot get work unless all active participants are fully employed. He is also likely to tell you, as he told us, that he cannot be assured of a steady enough employment to substitute his work income for his pension income.

Finally, can you really tell a truckdriver that the Labor Department's new summary annual report form is of "questionable value" and that, in the words of the Labor and Human Resources Committee, "it is a relatively costly item for plans to prepare and distribute?"

This truckdriver and others that I spoke with at a recent workshop are counting on the new summary annual report form to make all the difference in making other plan participants aware of what is being done with their pension money.

The new summary annual report will tell these participants if their plan is getting a reasonable return on its investments, who is managing the money, whether there are party-in-interest transactions and loans and leases in default, and most important, it will alert the other participants that they have a right to receive more detailed information that will show them exactly where their money is invested.

From this truckdriver's perspective, it is absolutely essential that participants be given information that they can take with them and study at their convenience. Posting this information makes no sense to them. People have to be able to take it with them, take it home and study it.

The factory worker, the pensioner, and the truckdriver I have just described are real people. Each can speak effectively on his own behalf and each would be willing to testify before this subcommittee. Their participation would result, not in a "media show," but in an extremely meaningful dialogue that could greatly assist this subcommittee in its deliberations.

There are also now for the first time other groups, both at the grassroots and national level, prepared to speak on behalf of participants and beneficiaries. Although there is, as yet, no group calling themselves "The Pension Rights Committee of Texas" or "Hawaii," there is a group calling themselves the "Pension Rights Committee of Rhode Island." The members of this group are deeply concerned about the survivors benefit provisions contained in the legislation under consideration. There are also other groups around the country whose views would contribute significantly to the legislative process.

When I last testified before this subcommittee, I would not have even thought to suggest that national organizations with broad constituencies should be invited to participate in hearings such as the one being held this afternoon. The issues seemed too technical and too remote from the priority concerns of other groups.

That has changed markedly, thanks in large measure to the outreach efforts of the President's Commission on Pension Policy made at the urging of the Citizens' Commission on Pension Policy.

The most dramatic evidence of the change was last Friday's President's Commission meeting. The subject was the impact of pension programs on women and minorities. Eleven organizations and individuals representing women, two groups representing minorities, the Communications Workers of America and the Citizens' Commission on Pension Policy testified.

The statements were well-considered and showed an indepth understanding of the complexities of pension issues. After the hearing, I spoke to several of the people who had testified. They all said that they would have been very pleased to appear at this hearing had they had sufficient time for preparation.

In short, I am asking that you put off deciding the issues that are before you today until you have had time to hear from the individuals directly concerned, and their representatives. It is all too easy to disregard people's rights if you have never met them.

Our staff stands ready to work with yours to contact these people and organizations and to arrange for their participation in future hearings.

I do not want to leave you with the impression that there are no provisions in the bills that we find acceptable. There are, of course, good provisions in these bills, notably the clarification of the rights of divorced spouses under State court orders and the rights of participants not to have their pensions offset by workers compensation and social security disability payments.

There are also provisions such as those relating to preretirement age survivor's benefits and misrepresentation that could become good, if modified.

We would, of course, like to see these provisions go through, but we do not want to see you trade off the rights of a divorcee for the rights of a pensioner, or the rights of a disabled worker for the rights of an active worker forced to stop work just short of the last day of his 10th year.

In conclusion, I would like to register our very strong protest to the revision of the preamble of ERISA proposed in S. 209. The bill would add to the ERISA preamble the statement that it is "the policy of this Act to foster the establishment and maintenance of employee benefit plans." This statement of policy, if adopted, would be based on a proposed finding that the present and future needs for retirement income can best be met by strengthening and improving private employee pension benefit plans, and that it is in the national interest to do so.

Congress considered the issue of whether private pension plans can be fostered, during the debate on ERISA. You concluded in 1974 not that plans should be fostered, but that plans should be fostered if they could provide sufficient benefits to enough people to justify the tremendous tax expenditure involved.

Once the President's Commission has made its recommendations as to whether and to what extent the private pension system should be fostered, it will be time for Congress to consider this extremely important issue. Surely it should not be decided without the facts, and without full debate.

Senator BENTSEN. Thank you very much, Ms. Ferguson. We have a vote on in the Senate. You have given some very interesting testimony.

Thank you very much.

Senator BENTSEN. Our next witness is Mr. Robert Georgine, the National Coordinating Committee for Multi-Employer Plans.

Mr. Georgine?

I have asked Senator Matsunaga to go on to vote and he will be returning and when we get five lights up there I will be leaving and we will recess this, but the hiatus should not be long.

For your information, the one amber light on the right means we are in session; the white light means we are voting; two lights would mean we were in recess; three would be a quorum call; four would be end of the day's session; five is half-way through the rollcall; six is end of the morning business; and seven, the machine is broken.

Now, Mr. Georgine.

STATEMENT OF ROBERT GEORGINE, NATIONAL COORDINATING COMMITTEE FOR MULTI EMPLOYER PLANS, ACCOMPANIED BY GERALD FEDER AND JACK CURRAN

Mr. GEORGINE. Thank you very much, Mr. Chairman, both for the opportunity to testify here this afternoon and second for the education on the lights.

Senator BENTSEN. We get a Pavlovian reaction to them around here.

Mr. GEORGINE. I am testifying before you today as chairman of the National Coordinating Committee for Multi-Employer Plans.

The coordinating committee is a nonprofit organization whose sole purpose is to represent the interests of the 8 million people who are participants in negotiated multiemployer pension and welfare plans. These pensions provide benefits for workers in such industries as building and construction, maritime, the needle trades, retail and service trades.

Our affiliates include over 100 international unions, national pension and welfare funds, and local Taft-Hartley trusts. Together, they represent the great majority of participants in multiemployer plans.

Because of the frequent job changes in these industries, a multiemployer plan, that is one that provides an employee with credit for service with a number of participating employers, is often the only way to insure that these employees will get a pension. Indeed, such multiemployer plans provide a measure of portability on a voluntary basis which does not exist in other plans.

Multiemployer plans have special characteristics not fully recognized under the present law. Frankly we believe that participants in multiemployer plans, and those who sponsor them through collective bargaining are at a crossroads. The challenges to their continued existence come from many directions.

In some instances, the industries in which they exist are dying, on a national or a regional basis. In addition, in industries such as construction, the level of employment resulting in contributions to the plans has still not recovered from the recession of the mid-1970's and furthermore, increasing numbers of employers are going nonunion and taking with them the work which would otherwise produce income to these funds.

Finally, ERISA has the potential for inflicting the stroke which breaks the backs of our plans, instead of helping them to flourish.

The impact of these trends and their potential result will be far-reaching and adverse to the aging members of our population who will be deprived of any pension coverage.

We appreciate the opportunity we have had to testify before you previously about our needs and are pleased to see that S. 209 includes many of the provisions which we feel are necessary if our plans are to flourish, such as provisions to facilitate our reciprocity agreements, a more flexible definition of multiemployer plans, provisions permitting suspension of benefits upon reemployment, provisions to impose a statutory duty on employers to make contributions to collectively bargained plans, and several other provisions which I have addressed more fully in my prepared statement.

Senator BENTSEN. Mr. Georgine, we will stand in recess until Senator Matsunaga returns.

[A brief recess was taken.]

Senator MATSUNAGA. The subcommittee will come to order.

When the subcommittee recessed, we had Mr. Robert Georgine testifying.

Will you proceed?

Mr. GEORGINE. Yes, sir. Thank you.

We appreciate the opportunity we have had to testify before you previously about our needs and are pleased to see that S. 209 includes many of the provisions which we feel are necessary if our plans are to flourish, such as provisions to facilitate our reciprocity agreements, a more flexible definition of multiemployer plans, provisions permitting suspension of benefits upon reemployment, provisions to impose a statutory duty on employers to make contributions to collectively bargained plans, and several other provisions which I have addressed more fully in my prepared statement.

One of the most important features of S. 209 is section 154 which would clarify once and for all the fact that a participant in a typical pension plan is not purchasing a security when he or she goes to work. The Supreme Court's decision in the *Daniel* case is thereby confirmed.

However, the bill contains an antifraud provision which embodies most of the pitfalls inherent in the antifraud standards of the securities law.

At the outset, I note for the record that those of us who are willing to accept the responsibility for the establishment and implementation of these plans are forced to make a terrible choice. We must either acquiesce in punitive legislation or risk having our testimony misunderstood by some and clearly distorted by others.

Mr. Chairman we have recently been asked whether we think that union officers and corporate personnel managers should be able to get away with fraud. That is like asking when did you stop beating your wife.

In the first place, the record does not exist that such wholesale fraud is occurring and if it does exist, no one has shared the documentation with me and our staff.

Third, Mr. Chairman, the vague standard in this bill is in total conflict with the other disclosure standards of ERISA which require plans to disclose specified information to participants in a specified manner. The case by case approach inherent in S. 209 will provide a gold mine for the legal profession, but not much else.

ERISA is designed to impose certain obligations on plan sponsors and other fiduciaries toward participants in their plans and their beneficiaries. There is no question in my mind that ERISA already prohibits plan sponsors and fiduciaries from perpetrating a fraud on those persons ERISA is designed to protect: participants and their beneficiaries.

But S. 209 throws out a net over every person, including many who have no reason to believe they are covered by ERISA. These persons will have to be prepared to defend even baseless actions charging them with having knowingly misrepresented the plan as many as perhaps 20 or 30 years before the action commenced.

Of course, although this legislation appears to be aimed at those individual persons, it will be used as a device to dip into the perceived deep pockets of the unions or employers whom they represent.

Mr. Chairman, at least in the case of labor organizations, those deep pockets which will be emptied contain nothing more than the hard-earned dues money of working men and women. They should not be available to be tapped by the speculators and their lawyers, as the Supreme Court has described the potential unscrupulous plaintiffs in fraud cases.

Many of our substantive arguments were made to the Supreme Court in the *Daniel* case, and I ask that our amicus brief in that case be included in the record.

Senator MATSUNAGA. Without objection, it is so ordered.

[The material referred to follows. Oral testimony is continued on p. 298.]

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-753

INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, *Petitioner*,

v.

JOHN DANIEL, *Respondent*.

No. 77-754

LOCAL 705, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, AND LOUIS F. PEICK, *Petitioners*,

v.

JOHN DANIEL, *Respondent*.

On Writ of Certiorari to
the United States Court of Appeals for the Seventh Circuit

MOTION OF THE NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Pursuant to Rule 42(3) of the Rules of this Court, the National Coordinating Committee for Multiemployer Plans ("NCCMP") respectfully moves for leave to file the accompanying brief as *amicus curiae*. Petitioners have consented to the filing of this brief; respondent has not.

INTEREST OF THE NCCMP

Multiemployer plans were formed in construction and other transient trades or industries where workers are generally employed too briefly by any one employer to earn benefits in that employer's plan. Such plans are created and funded pursuant to collective bargaining agreements and receive contributions from more than one employer. The NCCMP is a nonprofit, tax-exempt organization, formed after enactment of the Employee Retirement Income Security Act of 1974 ("ERISA") to participate in the development of government regulations under ERISA and other laws affecting multiemployer plans. Fifty trade unions and multiemployer pension plans (but not the particular unions or plans involved in this case) are affiliated with the NCCMP, and its plans are fairly representative of all the nation's multiemployer plans, covering in the aggregate 7.5 million employees. While the decision below has far-reaching consequences for pension plans generally, the consequences are particularly adverse for multiemployer plans, for the reasons set forth in the accompanying brief.

The NCCMP urges reversal of the judgment below, but in no way approves of unduly restrictive continuity-of-service provisions. Such provisions are not common in multiemployer plans. The NCCMP's concern is that affirmance of the ruling below—that an employee covered by a negotiated, noncontributory, involuntary, defined-benefit pension plan "purchases securities" by commencing and continuing employment—would have far-reaching, adverse consequences upon its pension plans.

FACTS AND QUESTIONS OF LAW DEVELOPED BY THE NCCMP

The NCCMP brief focuses on issues which it believes may not be adequately presented elsewhere, including: (a) the particularly adverse impact that the court's holding below would have on collectively-bargained multiemployer plans; and (b) the fundamental differences between coverage under a negotiated, noncontributory, involuntary, defined-benefit pension plan and interests which this Court has characterized as "securities" within the meaning of the securities laws.

The NCCMP therefore moves for leave to file the accompanying brief as *amicus curiae*.

Respectfully submitted,

PAUL S. BERGER
MELVIN SPAETH
ROBERT H. WINTER
K. PETER SCHMIDT
HADRIAN R. KATZ
1229 19th Street, N.W.
Washington, D.C. 20036
(202) 872-6784

Of Counsel:
ARNOLD & PORTER
1229 19th Street, N.W.
Washington, D.C. 20036
GERALD M. FEDER
1201 Connecticut Ave., N.W.
Washington, D.C.

Dated: May 22, 1978

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v.

JOHN DANIEL, *Respondent*.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF OF THE NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

The National Coordinating Committee for Multiemployer Plans ("NCCMP") submits this brief as *amicus curiae* to urge this Court to reverse the holding below [1] that a worker covered by the typical collectively-bargained defined-benefit pension plan is a "purchaser" of a "security" within the meaning of the securities laws.

I. INTEREST OF THE NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

The nature and purpose of the NCCMP is set forth in the accompanying motion for leave to file this brief. As set forth *infra*, pp. 27-32, the NCCMP submits that the decision below will have particularly significant adverse effect upon multiemployer plans. The NCCMP is concerned that affirmance of the lower court's ruling may cause the termination of many multiemployer plans, which are more difficult to create than single-employer plans. The lower court's ruling would in effect retroactively expand the number of workers eligible for pension benefits. It would also greatly increase the plans' administrative and litigation costs by adding securities laws exposure to the extensive existing requirements administered by the Departments of Labor and the Treasury.[2] All additional

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[1] *Daniel* v. *International Brotherhood of Teamsters*, 561 F.2d 1223 (7th Cir. 1977), App. 209a.

[2] The dual administration of ERISA (by the Departments of Labor and the Treasury) has already been a source of conflict and confusion, resulting, inter alia, in legislative proposals to divide jurisdiction into discrete areas, or to put all adminstrative responsibility into a single government agency. *See, e.g.*, S. 901, 95th Cong., 1st Sess. (1977); H.R. 4340, 95th Cong., 1st Sess. (1977), *summarized*, Pens. Plan Guide (CCH) ¶ 23,268 (1977). Treble administration (including the Securities and Exchange Commission) can only exacerbate an already difficult situation.

costs must ultimately be borne by workers covered by multiemployer plans and inevitably will cause a reduction in accruals of future benefits, or even a curtailment of coverage.

II. THE NATURE OF MULTIEMPLOYER PLANS

Multiemployer plans were originally developed in industries in which job changes are frequent and there is little continuity in the employer-employee relationship. For example, employees in the construction industry are generally hired for a specific project, and their employment terminates when the job is finished. In other industries, competitive conditions, business failures, or recurring layoffs prevent the establishment of a stable employer-employee relationship. In such situations, a multiemployer plan—which provides an employee with credit for service with a number of employers—may be the only vehicle for providing meaningful pension rights.

The multiemployer plan involved in this proceeding, and the typical plan affiliated with the NCCMP, have the following common characteristics: (i) they are established and maintained pursuant to the collective bargaining process; (ii) they are involuntary in that there is no individual choice whether to participate—all employees subject to the relevant provisions of the collective bargaining agreement are covered (within the limits of the plan's eligibility requirements) in the plan; (iii) they are noncontributory in that the employers make all payments to the plan; and (iv) they provide a "defined benefit" in that an employee who meets the plan's eligibility and vesting requirements is entitled at retirement only to a specific monthly benefit in a fixed amount.

A financially sound plan requires a proper actuarial relationship between employer contributions and employee benefits. Although contributions of employers in defined-benefit plans most often vary with the time worked or the units produced by covered employees, contributions are not made for the accounts of particular employees. No employee has any legal title or interest in the employer's contributions to a defined-benefit plan, or (apart from his possible pension eligibility under the rules of the plan) in the assets of the plan itself.[3] Indeed, the defined benefit levels supportable by a given level of contributions are invariably based on the actuarial assumption that some number of workers ultimately will die, move, or transfer to other industries and thus will never qualify for pension benefits, and that benefits will be paid only to employees with a long-term relationship with employers served by the multiemployer plan.

III. SUMMARY OF REASONS FOR REVERSAL

1. Coverage under a negotiated, noncontributory, involuntary, defined-benefit pension plan does not involve the "issuance of a security" within the meaning of the securities acts as consistently interpreted by this Court. The lower court erred in holding that such coverage involves an "investment contract." Under *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946), and *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), the concept of an "investment contract" for the purposes of the securities laws contemplates an inducement to investors to participate in the capital markets. These pension plans established by collective-bargaining agreements contain no such inducement.

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[3] *See* Article 13 of the Amended Trust Agreement (as amended) of the Local 705 Pension Fund Trust Agreement, App. 64a.

Moreover, like ordinary annuities and unlike securities, the benefits received under these pension plans are defined in advance and do not vary with the success of any investment program. Economic reality compels the conclusion that a worker who takes a job requiring coverage under a defined-benefit pension plan is not thereby "investing" in a "security."

2. A balancing of public policy considerations is required before the courts extend the judicially-implied private right of action under Rule 10b-5. The applicable public policy considerations here point strongly to the conclusion that the extension of such right by the lower court was inappropriate. Allowing employees to sue pension plans under the securities laws would (a) lead to particularly vexatious litigation, the outcome of which would turn on hazy issues of historical fact, often capable of proof only by oral testimony; (b) produce results inconsistent with the careful balancing of competing equities which Congress struck in enacting ERISA; and (c) create exposure so large as to threaten destruction of many pension plans, particularly multiemployer plans, and in any event to defeat the legitimate expectations of millions of workers.

IV. REASONS FOR REVERSAL

The lower court reached out to apply the federal securities laws in an attempt to correct what it perceived to be an egregious wrong committed against Mr. Daniel.[4] The court did not stop to consider whether the unprecedented result it reached was really necessary, i.e., whether there were remedies under com-

[4] The restrictive continuity-of-service requirements applied to Mr. Daniel are not commonly found in other multiemployer plans.

mon law[5] and federal labor law[6] as Mr. Daniel claimed. In ruling that he was entitled to sue under the antifraud provisions of the securities laws, the court exposed all pension plans to damage suits for breach of duties of disclosure under the securities acts—duties no one ever supposed they had. The court's decision confirms the ancient wisdom that "hard cases make bad law," *Northern Securities Co.* v. *United States*, 193 U.S. 197, 400 (1904) (Holmes, J., dissenting).

A. There was no "investment contract"

The lower court improperly held that this case involved the "purchase" of a "security" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934. The term "security" is defined in the 1933 Act to mean

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[5] For example, the New York Court of Appeals recently applied principles of contract and trust law to ensure grant of a pension to a worker who, because of a one-year break-in-service, was denied benefits after 28 years of service. *Mitzner* v. *Jarcho*, No. 76 (N.Y. Feb. 22, 1978).

[6] Plaintiff pleaded alleged facts and claimed entitlement to relief under two separate provisions of the labor laws: (1) section 302(c)(5) of the Taft-Hartley Act, 29 U.S.C. § 186(c)(5), which requires that pension funds be established for the "sole and exclusive benefit of the employees," *see, e.g., Lugo* v. *Employees Retirement Fund*, 366 F. Supp. 99, 102 (E.D.N.Y. 1973) ([a] plaintiff who places in issue the exclusionary eligibility requirements of a trust fund places in issue the question whether the fund is a section 302 trust fund"), *aff'd*, 529 F.2d 251 (2d Cir.), *cert. denied*, 429 U.S. 826 (1976); and (2) the duty of fair representation required of unions by section 9(a) of the National Labor Relations Act, 29 U.S.C. § 159(a), *see, e.g., Vaca* v. *Sipes*, 386 U.S. 171, 177 (1967).

"any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." 15 U.S.C. § 77b(1).[7]

Coverage under pension plans of the type involved in this case—collectively bargained, noncontributory, involuntary, with defined benefits—is not a "security" in any conventional sense. The court below held, however, that such coverage constitutes an "investment

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[7] The definition of security in the 1934 Act is similar:

"The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." 15 U.S.C. § 78c(10).

contract." That term is not defined in the securities acts, but *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946), held that "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."

We shall show that coverage under a plan such as that at issue here lacks essential elements of the *Howey* test: the worker makes neither an investment decision nor an investment, and the worker does not participate in the plan in expectation of profits.

1. There was no investment decision.

In a noncontributory, involuntary pension plan, the worker makes no investment. The employer makes the contributions, as required by the collective bargaining agreement.[8] The court below nevertheless concluded that the employees were purchasers of securities on the theory that the employer's contribution was constructively made by the employees. 561 F.2d at 1231-33, App. 222a-25a. Even under this analysis, however, there is no investment.

The court's reasoning ignores the teaching of this Court that economic realities must be considered in applying the *Howey* test. As stated in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975):

> "The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the

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[8] Most multiemployer plans share with the plan described in *Connolly* v. *PBGC*, No. 76-2777, slip op. at 4 (9th Cir. May 4, 1978), the feature that "[p]ension credits are earned even if the employer fails to contribute the full amount of his obligation." This is further evidence that no individual employee makes an investment.

> Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto."

As a matter of economic reality, a worker whose terms of employment are established in labor-management negotiations does not act in any respect as an "investor" when he accepts or continues employment. The fact that the terms of his employment require that he be covered by a noncontributory pension plan, does not make him an investor in the "capital market." While the worker has legally protected interests—under common law, federal labor law and the Employee Retirement Income Security Act of 1974, 88 Stat. 829 ("ERISA")—these interests are not the interests of "investors."

In cases in which the Court has held a financial interest to be an investment contract—and therefore a security—as a matter of economic reality the person acquiring the interest made an investment decision. *See, e.g., SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 348-49 (1943); *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 298-300 (1946); *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967). In each of these cases it was critical that there was a scheme to induce persons to invest in the particular enterprise involved as opposed to other recognized methods of participating in the capital markets—for example, by purchasing stocks, bonds or mutual fund shares. Indeed, in each instance the interest sold as an investment contract was *advertised and sold* *as an investment.* In *Joiner*, for example, the Court held that in determining whether an investment is a security one must consider

> "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this [the 1933 Act], it is not inappropriate that promoters' offerings be judged as being what they were represented to be." 320 U.S. at 352-53.

Similarly, in *Howey*, the Court noted that the sellers were

> "offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. They are offering this opportunity to persons who reside in distant localities and who lack the equipment and experience requisite to the cultivation, harvesting and marketing of the citrus products. Such persons have no desire to occupy the land or to develop it themselves; *they are attracted solely by the prospects of a return on their investment.*" 328 U.S. at 299-300 (emphasis added).

See also Tcherepnin v. *Knight*, *supra*, 389 U.S. at 338-39; *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967).

The essential facts here bear no resemblance to those in which investment decisions have been found: jobs are not advertised as opportunities to invest in the capital market;[9] the union negotiates all job-related

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[9] Booklets or other materials describing pension plans can hardly be considered "promoters' offerings." The individual does not customarily even receive such materials before or at the time that he decides to accept employment covered by the plan, and that practice was endorsed in ERISA.

issues, including terms of the pension plan. The employee has no choice but to be covered by the plan if he accepts employment.

2. There was no expectation of profit

When an individual acquires an investment contract, he subjects his capital to risk in the hope of receiving dividends, interest, or appreciation. An employee who is covered by a noncontributory, defined-benefit pension plan, however, has no capital at risk and no expectation of dividends, interest, or appreciation. His only expectation is receipt of the defined benefits provided under the plan if he meets the eligibility requirements. To be sure, the plan's assets will be invested by the trustees of the plan. However, the benefits an individual employee may ultimately receive do not depend upon the results achieved. Even if the plan's investment program were unusually successful, the recipient would not be entitled to increased benefits. If, on the other hand, the investment program were not successful, the employee would still be entitled to the same defined benefits.[10]

The Seventh Circuit nonetheless reasoned that an employee covered by a pension plan has an expectation of "profits" in that (a) the plan's assets are invested, and (b) the pension benefits received by the employee could exceed the amount which his employer contributed by reason of his employment. 561 F.2d at 1231-34, App. 226a-28a. These factors are not "profits" in the sense this Court has deemed relevant in determining whether financial interests are

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[10] ERISA requires that contributions meet funding standards which have the objective of ultimately funding the defined benefits, and benefits may be guaranteed by the Pension Benefit Guaranty Corporation. See Title IV of ERISA.

securities. *SEC* v. *Variable Annuity Life Insurance Co. of America (VALIC)*, 359 U.S. 65 (1959); *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202 (1967). Under these cases, the decisive factor in applying the *Howey* test is whether the benefit to be received varies with the success of the plan's investment program. The analysis in these cases points strongly to the conclusion that coverage under a defined-benefit pension plan is not a "security."

The issue in *VALIC* and *United Benefit Life* was whether variable annuities are "securities" even though ordinary annuities are not.[11]

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[11] Ordinary annuities are expressly exempted from registration by section 3 (a) (8) of the 1933 Act, 15 U.S.C. § 77c(a)(8). Congress declared that its intention was merely to

> "[make] clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. The insurance policy *and like contracts* are not regarded in the commercial world as securities offered to the public for investment purposes. The entire tenor of the act would lead, *even without the specific exemption*, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible." H.R. Rep. No. 85, 73d Cong., 1st Sess. 15 (1933) (emphasis added), *cited in VALIC*, 359 U.S. at 74 n. 4 (Brennan & Stewart, JJ., concurring).

Furthermore, the "[Securities and Exchange] Commission has taken the position that insurance or endowment policies or annuity contracts issued by regularly constituted insurance companies were not intended to be securities, and that in effect § 3 (a) (8) is supererogation." 1. L. Loss, *Securities Regulation* 497 (2d ed. 1961) (footnote omitted).

The Court has specifically agreed with Professor Loss' conclusion that section 3(a) (8) was superfluous. *Tcherepnin* v. *Knight, supra*, 389 U.S. at 342 n. 30:

> "Congress specifically stated that 'insurance policies are not to be regarded as securities subject to the provisions

Under an ordinary annuity contract an individual makes payment to the issuing company, in a lump sum or on a periodic basis, in return for which the issuing company typically promises to make periodic payments during the individual's retirement years. As in the case of defined-benefit pension plans, the payments received by the individual are at a fixed level defined in advance in accordance with actuarial assumptions, including an assumed rate of return on the annuity company's investments. The total amount that the individual will ultimately receive depends on how long he lives. In contrast, variable annuities—which, unlike defined-benefit pension plans, permit the periodic payments received by the individual to depend on investment results—have been held to be securities.

In explaining why it was rational for Congress to subject variable annuities to regulation under the securities laws while leaving ordinary annuities to regulation by state insurance authorities, the concurring justices in *VALIC* stated that:

> "This congressional division of regulatory functions is rational and purposeful in the case of a traditional life insurance or annuity policy, *where the obligations of the company were measured in fixed-dollar terms and where the investor could not be said, in any meaningful sense, to be a sharer in the investment experience of the company*. In fact, one of the basic premises of state

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> of the act,' [citation omitted], and the exemption from registration for insurance policies was clearly supererogation."

Therefore, ordinary annuity contracts are not "securities" for purposes of federal securities regulation. To the extent that defined-benefit pension plans are in economic reality "like contracts," they too are not "securities."

regulation would appear to be that in one sense the investor in an annuity or life insurance company *not* become a direct sharer in the company's investment experience; that his investment in the policy or contract be sufficiently protected to prevent this." 359 U.S. at 77-78 (Brennan & Stewart, JJ., concurring) (emphasis added).

The *VALIC* Court stated:

> "While all the States regulate 'annuities' under their 'insurance' laws, traditionally and customarily they have been fixed annuities, offering the annuitant specified and definite amounts beginning with a certain year of his or her life. The standards for investment of funds underlying these annuities have been conservative. The variable annuity introduced two new features. First, premiums collected are invested to a greater degree in common stocks and other equities. Second, benefit payments vary with the success of the investment policy. . . ." 359 U.S. at 69.

The Court held in *VALIC* that a variable annuity is a security because the benefits received vary with investment performance, not because of actuarial risk that as a result of early death the annuitant will receive little or no benefit. The Court said:

> "Moreover, actuarially both the fixed-dollar annuity and the variable annuity are calculated by identical principles. Each issuer assumes the risk of mortality from the moment the contract is issued. . . . It is this feature, common to both, that respondents stress when they urge that this is basically an insurance device.
>
> "The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a *pro rata* share of

> what the portfolio of equity interests reflects—which may be a lot, a little, or nothing." 359 U.S. at 70-71 (footnotes omitted).[12]

Nothing, therefore, more clearly dramatizes the error of the court below than the fact that the disclosure required by the court was not related to market performance but only to the actuarial risk of nonvesting.

Moreover, even if, *arguendo*, a defined-benefit plan could be said to include some element of "profit," it would not follow that there is a "security" within the meaning of the securities laws, because in economic reality any profit would be an incidental aspect of the entire "transaction." The Court so held in *Forman*, in determining that shares of stock in a housing cooperative were not "securities." In that case it was conceded that the housing cooperative could earn income from commercial leases that would result in reduction of the rental payments to be paid by the tenant-shareholders. The Court said:

> "The short of the matter is that the stores and services in question were established not as a means of returning profits to tenants, but for the purpose of making essential services available for the residents of this enormous complex. By statute these facilities can only be 'incidental and appurtenant' to the housing project. [Citation omitted.] Undoubtedly they make Co-op City a more attractive housing opportunity, but the possibility of some rental reduction is not an 'expec-

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[12] The annuity involved in *United Benefit Life* was similarly held to be a security because the benefits which the annuitant would receive upon retirement were not defined in advance, but instead were variable, depending directly and importantly on the success of the annuity company's investment activities. *See* 387 U.S. at 210-11.

tation of profit' in the sense found necessary in *Howey*." 421 U.S. at 856-57 (footnotes omitted). Economic reality compels the conclusion that a worker who takes a job which provides coverage under a defined-benefit pension plan is not thereby "investing" in a "security."

B. Public policy militates against extending private rights of action under the securities laws

Even accepting the lower court's conclusion that an employee "purchases" a "security" simply by taking a job, it does not follow that he may sue under Rule 10b-5.[13]

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[13] Section 10(b) of the 1934 Act provides:

> "It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

The private right of action under Rule 10b-5 is a creature of the judiciary, not of Congress.[11] This Court said in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977):

> "Congress did not expressly provide a private cause of action for violations of § 10(b). Although we have recognized an implied cause of action under that section in some circumstances, *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, [404 U.S.] at 13 n.9, we have also recognized that a private cause of action under the antifraud provisions of the Securities Exchange Act should not be implied where it is 'unnecessary to ensure the fulfillment of Congress' purposes' in adopting the Act. *Piper* v. *Chris-Craft Industries, Inc.*, [430 U.S.] at 41. *Cf. J.I. Case Co.* v. *Borak*, 377 U.S. 426, 431-433 (1964)."

Extension of the private right of action under Rule 10b-5 to new classes of claimants therefore turns on (i) whether such extension is necessary to fulfill Congress' purposes in passing the securities acts; and (ii) a judicial balancing of the "policy considerations" involved, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737, 749 (1975). Extension of a private right of action under the federal securities laws, is not neces-

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> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person
>
> in connection with the purchase or sale of any security."

Plaintiff in the court below also alleged a cause of action under section 17(a) of the 1933 Act which similarly does not by its terms provide for a private right of action.

[11] As this Court has made clear, federal courts should not automatically imply private rights of action under statutes that specify violations but provide no express private remedies. *Cort* v. *Ash*, 422 U.S. 66 (1975).

sary in this case. As discussed above, *supra* pp. 8-9, 6, Congress' purpose in enacting the federal securities laws was to regulate the capital markets, not non-contributory, defined-benefit pension plans; and, Mr. Daniel claimed relief under both common law and labor laws. As we now show, extension of a private right of action is unwise as a matter of policy, since it would have substantial adverse effects upon pension plans and would be inconsistent with ERISA.

1. Extension of private rights of action would lead to vexatious litigation

The Court stated in *Blue Chip* that Rule 10b-5 litigation presents a significant "danger of vexatiousness different in degree and in kind than that which accompanies litigation in general" and noted "the possibility 'that unduly expansive imposition of civil liability will lead to large judgments payable in the last analysis by innocent investors for the benefit of speculators and their lawyers,'" 421 U.S. at 739, quoting Judge Friendly's concurring opinion in *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969), 404 U.S. 1005 (1971).

Here, there is no less a likelihood that large lawsuits would be commenced against collectively-bargained pension plans. Millions of workers have suddenly been transformed into holders of "securities" of pension plans, some of whom, like Mr. Daniel, "purchased" those "securities" over 20 years ago. The circumstances under which these "securities" were "sold" to persons who may now lay claim to disappointed pension expectations will make such persons and the plans which covered them fair game for class action specialists. It is the plan participants and beneficiaries, however, who must ultimately bear the costs of that litigation, since pension plans exist solely for their benefit.

The specific "disclosure" required by the holding of the lower court—"the actuarial probability . . . that a member actually will receive pension benefits"—is itself likely to be challenged as misleading.[15] A study recently commissioned by the Department of Labor[16] on the potential effect of the lower court holding (hereinafter "Department of Labor Study") concluded that

> "any statement provided to a participant about his individual probability of receiving a pension and probably be [*sic*] false and misleading, since it is virtually impossible to provide accurate information on this subject."[17]

The likelihood that a given employee will receive pension benefits not only turns on such factors as the vitality of the industry (especially in the case of multiemployer plans) and the health of the individual employee, but also depends in large measure upon whether that employee chooses to remain employed in the industry or go elsewhere. Thus, while actuarial assump-

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[15] *See* F. Cummings, *The Daniel Case—Disclosure or Mandatory Oddmaking*, Pension World, November 1977, at 37. Mr. Cummings describes the party making the disclosure required by the Seventh Circuit as "a new kind of oddsmaker—a 'vesting bookie' . . . ." *Id.*

[16] Grubbs, Report to the Secretary of Labor—Potential Effects of *Daniel* (March 20, 1978) (hereinafter "DOL Study").

[17] DOL Study at I-5. Moreover, it is far from clear what actuarial assumptions should be made. Unanswered questions include whether the probability should be based on assumptions derived from the experience of all participants, or that of different subgroups based on categories such as age, sex, job classification, etc.; whether the probability is that of achieving 100 percent or some lesser degree of vesting; and whether the probability is only for new entrants into the plan or for existing participants as well. DOL Study at IV-5.

tions concerning "turnover" of employees may be useful in calculating the future liabilities of a pension plan and the contribution rate necessary to fund such liabilities, individual "turnover" is subject to a number of factors, some of which are solely within the knowledge and control of the individual employee. Aggregate actuarial data will thus be misleading rather than informative with respect to the probability that an individual employee will remain in the plan long enough to qualify for a benefit. Under the lower court's decision, however, a person who failed to meet the eligibility requirements of virtually any pension plan in the country could demonstrate a failure to disclose this "actuarial probability" and seek relief under Rule 10b-5.[18]

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[18] The SEC suggested in its *amicus* brief to the court below (pp. 5, 58) that pension plans will be affected by the decision below only if they engaged in actual fraud. It is true that *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), established that a defendant did not violate Rule 10b-5 unless he acted with "scienter," a "mental state embracing intent to deceive, manipulate, or defraud," *id.* at 193 n.12. In its pretrial brief in *SEC* v. *National Student Marketing Corp.*, Civ. Action No. 225-72 (D.D.C.), dated December 6, 1976, however, the SEC contended that even in private damage cases under *Hochfelder*, " 'scienter' may be proven without evidence of specific intent to deceive but by evidence of 'gross negligence' or other knowing conduct." SEC Brief at 165. Citing *Herzfeld* v. *Laventhol, Krekstein, Horwath & Horwath*, 540 F.2d 27 (2d Cir. 1976); *Bailey* v. *Meister Brau, Inc.*, 535 F.2d 982 (7th Cir. 1976); and *McLean* v. *Alexander*, 420 F. Supp. 1057 (D. Del. 1976), the SEC contended that this modified negligence standard has been the lower courts' response to the *Hochfelder* definition of the culpability necessary to establish a violation of Rule 10b-5. SEC Brief at 165. *See also, e.g., Franke* v. *Midwestern Oklahoma Development Authority*, 428 F. Supp. 719, 725 (D. Okla. 1976). Furthermore, the SEC contends that it need not prove scienter at all in injunctive actions.

Furthermore, extension of a private right of action under Rule 10b-5 to the pension plan context would not be limited to failures to disclose the actuarial probability of receiving a benefit. Even assuming, *arguendo*, that meaningful disclosure of actuarial probability can be readily made, the disclosure issues that could be presented in litigation are many. Any alleged failure to disclose or any misstatement concerning size and timing of benefits, investment policies or any other matter that bears on the value of the worker's "investment" might provide grist for the Rule 10b-5 class action mill. If the potential employee is truly making an investment decision to purchase a "security," presumably the "issuer" of that security would be required to disclose to him adequate information concerning the investment policies of the pension plan, its financial soundness, the financial soundness of employers having a contractual obligation to contribute to the plan and similar matters. Insofar as we are aware, no noncontributory pension plan has made such disclosure to potential beneficiaries.[19]

This Court also noted in *Blue Chip* that extending the private right of action under Rule 10b-5 to defrauded offerees of securities would confront courts and juries with "many rather hazy issues of historical

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SEC Brief at 164-65. Yet an injunction might include rescissionary and collateral relief in the nature of money damages, *see, e.g., SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971).

[19] It is noteworthy that in *SEC* v. *Shenker*, Civ. Action No. 77-1787 (D.D.C. 1977), the SEC further expanded its view of the application of the antifraud provisions to employee benefit plans, by moving from the concept of disclosure about terms and conditions of participation in a plan to the investment policies and fiduciary conduct of plan officials—welfare plan officials as well as those of a pension plan.

fact, the proof of which [would] depend almost entirely on oral testimony." 421 U.S. at 743. The nature of this proof, the Court indicated, might subject defendants to a kind of legalized blackmail, forcing settlements even in groundless cases. Such dangers are equally apparent here. Retroactive application of a "failure to disclose" rule (back to 1955 in Mr. Daniel's case [20]) necessarily involves "hazy issues of historical fact," the resolution of which depends on oral testimony as to what the worker was told when first employed. Indeed, the lower court's conclusion that a "sale" was involved relies, in part, on Mr. Daniel's affidavit

> "that he would not have worked for a Local 705 covered employer if he had been advised about the continuous nature of the 20-year requirement before receiving a pension." 561 F.2d at 1243, App. 245a.

The court also found that

> "[w]hen an employee decides to retain his job his decision results in his continuing to give value in the future in his further acquisition of interests in the pension fund." *Id.*

Proof that these actions involved "investment decisions" will almost always depend on the claimant's oral testimony concerning his state of mind years ago. As this Court said with respect to similar "state of mind" proof in *Blue Chip*:

> "Plaintiff's proof would not be that he purchased or sold stock, a fact which would be capable of documentary verification in most situations, but instead that he decided *not* to purchase or sell stock. Plaintiff's entire testimony could be dependent upon uncorroborated oral evidence of his

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[20] *See* 561 F.2d at 1227, App. 212a.

claim, and still be sufficient to go to the jury. The jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant. The very real risk in permitting those in respondent's position to sue under Rule 10b-5 is that the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove that he ever consulted a prospectus of the issuer, that he paid any attention to it, or that the representations contained in it damaged him." 421 U.S. at 746 (footnote omitted).

2. Extension of private rights of action would destroy the balance Congress struck in ERISA between remedying past inequities as to some workers and reduction of future benefits to others

ERISA was enacted after a thorough investigation and study of problems in the pension plan area.[21] Congress considered the extent to which it should provide retroactive relief to persons who had failed to meet harsh eligibility requirements in the past. It was mindful, however, that correction of inequities would involve charges to be borne by the plans, and therefore had to be balanced against the inequity of defeating the legitimate pension expectations of other workers. The compromises incorporated in ERISA now threaten to be vitiated by Rule 10b-5 suits which in effect

[21] As the Ninth Circuit stated in a recent opinion, "ERISA is the product of several years of legislative effort to improve the American pension system . . . a complex piece of legislation which addresses itself to many problems." *Connolly* v. *PBGC*, No. 76-2777, slip op. at 5 (May 4, 1978).

seek the very retroactive relief that Congress determined should not be granted.

The balancing of competing equities which Congress fashioned is illustrated by the exceptions Congress provided to the general rule that all service with the participating employer, whether before or after the enactment of ERISA, must be credited for vesting purposes. For example, service prior to January 1, 1970 need not be counted unless an employee has at least three years of service after December 31, 1970.[22] A plan may also disregard service before the effective date of ERISA if such service would otherwise have been disregarded under the rules of the plan with regard to breaks in service.[23]

These exceptions were deliberately enacted "[t]o keep the operation of the minimum vesting requirement reasonable and to avoid imposing undue burdens on plans. . . ." [24] With respect to workers such as Mr. Daniel, Congress' determination to balance the competing interests involved is set forth in unmistakable terms:

> "[I]t does not appear to be desirable to provide for retroactive vesting for employees who have already terminated their service with the employer, since this would create a substantial unexpected cost for the plan (thereby possibly jeop-

[22] ERISA § 203 (b) (1) (E); I.R.C. § 411 (a) (4) (E). The cited provisions do not permit disregard of service which the pre-ERISA plan terms required be counted.

[23] ERISA § 203 (b) (1) (F); I.R.C. § 411 (a) (4) (F).

[24] House Ways and Means Committee Report on H.R. 12855, H.R. Rep. No. 93-807, 93d Cong., 2d Sess. 20 (1974). *See also* House Ways and Means Committee Report on H.R. 12481, H.R. Rep. No. 93-779, 93d Cong., 2d Sess. 20 (1974); 120 Cong. Rec. 4297 (1974) (remarks of Mr. Ullman).

ardizing the size of benefits for employees still covered under the plan). . . ." [25]

Allowing private suits under Rule 10b-5 would thus upset the balance which Congress so carefully struck in ERISA. Furthermore, that balance in ERISA proceeds from Congress' understanding that the securities laws were inapplicable (*see* Teamsters International Petition at 33-41), an understanding which is now "part of the arch on which the new structure rests," *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 349 (1963). This is another sound policy reason why the Court should reject the lower court's extension of private rights of action.

3. Extension of private rights of action would require disclosure inconsistent with the type of disclosure which Congress, in passing ERISA, deemed appropriate

The ERISA disclosure requirements [26] are a direct response to testimony by one worker after another that he had been unaware of the provisions and rules of his plan. Even when plan documents and explanatory materials had been provided, they were generally in-

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[25] House Ways and Means Committee Report on H.R. 12481, H.R. Rep. No. 93-779, 93d Cong., 2d Sess. 56 (1974); House Ways and Means Committee Report on H.R. 12855, H.R. Rep. No. 93-807, 93d Cong., 2d Sess. 57 (1974). *See also* 120 Cong. Rec. 19199 (1974) (remarks of Mr. Ullman).

[26] ERISA sections 101 through 110 and 1031 through 1034 detail the disclosure and reporting required of pension plans. In some cases, this disclosure takes place directly to plan participants, in other cases, to the Department of Labor or the Treasury Department. For the most part, however, those reports made to government agencies rather than plan participants are themselves public information. ERISA § 106(a). Lengthy disclosure and reporting regulations have been promulgated by the Labor Department. *See* 29 C.F.R. § 2520.102-1 *et seq.* and § 2520.103-1 *et seq.*

comprehensible to plan participants. As one worker testified:

> "You see, all of these pensions are done up by corporation lawyers and against people, say working people with a high school education, and as everybody knows, there's no competition." [27]

Another worker said:

> "Senator, I have here books on the pension plan that ain't worth a quarter because I can't understand it. I don't know anything about it, and I defy any trustee of our plan to explain this to me. . . ." [28]

Congress therefore required that the document summarizing and describing the plan "be written in a manner calculated to be understood by the average plan participant. . . ." ERISA § 102(a)(1). It would require an amazing feat of draftsmanship, however, to make disclosures which would comply with ERISA section 102(a)(1) and yet suffice to avoid Rule 10b-5 liability—particularly in the case of complex actuarial assumptions. As corporate counsel are well aware, assurance against liability under Rule 10b-5 requires disclosure of all information which might reasonably be deemed "material" in light of this Court's opinion in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976).[29] The complex and detailed disclosure that

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[27] *See* 120 Cong. Rec. 29934 (1974) (remarks of Sen. Williams).

[28] *See id.*

[29] There are no definitive guidelines in the antifraud area of the securities laws. Rule 10b-5 itself is written in broad, general terms. The SEC has not utilized rulemaking power to clarify its requirements, *cf. SEC* v. *Chenery Corp.*, 332 U.S. 194, 215 (1947) (Jackson, J., dissenting) (Holding Company Act), but has instead relied on case-by-case adjudication, where courts have interpreted the requirements of the rule

would be required under the decision below is the very type of disclosure that workers complained about,[30] and that Congress was determined to prevent in ERISA.

4. Affirmance of the decision below would threaten the stability and cause termination of many multiemployer plans

In the circumstances set forth above, administrators and employers are understandably concerned over their plans' potential liability. Indeed, the NCCMP has been advised that some employers and plan administrators, concerned over the implications of the decision below, have already declined to approve new bene-

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"flexibly," *e.g., Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973), "broadly," *e.g., Garner* v. *Pearson*, 374 F. Supp. 591, 595 (M.D. Fla. 1974), and "liberally," *e.g., Fox* v. *Kane-Miller Corp.*, 398 F. Supp. 609, 637 (D. Md. 1975), *aff'd*, 542 F.2d 915 (4th Cir. 1976). The establishment of definitive guidelines is contrary to the policy of the SEC. In responding to a request from Senators Williams and Javits as to what disclosure the SEC believed is required of pension plans under the lower court's decision, the Chairman of the SEC responded, *inter alia*: "[T]he efficacy of the antifraud provisions would be sacrificed if hard and fast rules were laid down as to what those provisions required. . . ." Memorandum submitted under cover letter of December 7, 1977 to Honorable Harrison A. Williams, Chairman, Committee on Human Resources, United States Senate, by Harold M. Williams, Chairman, SEC.

[30] Even the more sophisticated investor in the traditional securities markets may find such disclosure too complex or lengthy to understand. However, there are analysts and investment counselors to whom such documents are understandable and meaningful. One who purchases securities on a broker's recommendation or on the advice of an investment analyst may well have benefited from such disclosure. There are no parties analogous to analysts and investment counselors in the pension plan context.

fits or increases in existing benefits.[31] Furthermore, concerns about potential liability and additional costs and regulation brought about by the applicability of the securities law [32] are likely to result in a significant curtailment in the provision of pension benefits,[33] which neither ERISA nor any other federal law requires employers to provide.

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[31] In one case currently being litigated, a contributing employer contends that the plan's alleged failure to make the disclosures required by the decision below vitiates his obligations under the collective bargaining agreement and entitles him to a refund of all contributions previously made. *Western Washington Laborers-Employers Health & Security Trust Fund* v. *Universal Utility Contractors, Inc.*, Civ. No. C77-710M (W.D. Wash).

[32] There is no basis for the finding of the court below that interests in pension plans are "securities" for antifraud purposes but are not subject to the registration provisions of the securities laws. It is axiomatic that the registration provisions are applicable to all securities absent a statutory exemption. At the most, the legislative and administrative history discussed by the Seventh Circuit, 561 F.2d at 1237-1241, App. 258a-59a suggests an exemption from the registration provisions only for the "securities" of pension plans whose funds are maintained by a bank or in a separate account by an insurance company. The assets of multiemployer plans—such as the members of the NCCMP—are generally *not* managed by banks or insurance companies, with the result that their "securities" would be subject to the full panoply of registration requirements of the securities laws.

[33] According to a Pension Benefit Guaranty Corporation ("PBGC") study, "Analysis of Single Employer Defined Benefit Plan Terminations, 1976," PBGC Publication No. 505, approximately ten percent of the plans covered by Title IV of ERISA (relating to plan termination insurance and contingent employer liability) terminated in the two calendar years following its enactment. *Id.* at 2. Of those plans terminating in 1976, 20 percent cited ERISA as the reason for termination, and another 15 percent cited ERISA as one of several

The Department of Labor Study discussed above, *supra* p. 19, concluded that the potential exposure of pension plans under the lower court's holding may approach $40 billion.[34] This Court recognized recently in *City of Los Angeles* v. *Manhart*, 46 U.S.L.W. 4347, 4352 (U.S. 1978), that significant changes in rules governing pension plans which create major unforeseen contingencies should not lightly be adopted:

> "Nor can we ignore the potential impact which changes in rules affecting insurance and pension plans may have on the economy. Fifty million Americans participate in retirement plans other than Social Security. The assets held in trust for these employees are vast and growing—more than $400 billion were reserved for retirement benefits at the end of 1977 and reserves are increasing by almost $50 billion a year. These plans, like other forms of insurance, depend on the accumulation of large sums to cover contingencies. The amounts set aside are determined by a painstaking assessment of the insurer's likely liability. Risks that the insurer forsees will be included in the calculation of liability, and the rates or contributions charged will reflect that calculation. The occurrence of major unforeseen contingencies, however, jeopardizes the insurer's solvency and,

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reasons. *Id.* The House Small Business Committee recently surveyed the plans that notified the PBGC between June, 1976 and April, 1977 of an intent to terminate. Of those responding, 87.3 percent indicated that ERISA had some effect on the decision. *See* Pension Rep. (BNA) R-11 et seq. (Oct. 24, 1977).

[34] DOL Study at I-4. The assumptions of this study were based on an "element of conservatism." *Id.* at A-14. An actuarial study prepared by Martin E. Segal Co. for the NCCMP indicates that agregate damages may be nearer to $100 billion.

ultimately, the insureds' benefits. Drastic changes in the legal rules governing pension and insurance funds, like other unforeseen events, can have this effect." (Footnote omitted.)

The NCCMP fears that the adverse effects of the holding below will be especially significant for multiemployer plans. The plan termination and contingent employer liability provisions of ERISA presently allow employers contributing to multiemployer plans to withdraw from participation more easily than those contributing to single-employer plans. An employer's withdrawal from a single-employer plan normally results in plan termination, imposing substantial ERISA-related liability on the employer. In contrast, an employer's withdrawal from a multiemployer plan (by "bargaining out"—*i.e.*, not agreeing in the next collective bargaining agreement to continue contributions to the plan), will generally not cause a plan termination,[35] and the employer may well escape all liabil-

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[35] In most cases, ERISA does not even require such withdrawal to be reported. When a "substantial employer" (an employer accounting for 10 percent or more of the plan's contributions over two consecutive years out of the three years preceding withdrawal (ERISA § 4001(a)(2)) withdraws from a plan, the plan administrator must notify the PBGC. ERISA § 4063(a)(1). (It is not yet clear whether the simultaneous or concerted withdrawal of two or more employers, accounting for 10 percent or more of the plan's contributions only in the aggregate, constitutes the "withdrawal of a substantial employer.") The withdrawing employer must post a bond or pay an amount into escrow as surety against contingent liability in a later plan termination, but if no termination occurs in the five years following withdrawal, the withdrawing employer has no ultimate liability. ERISA § 4063(c)(2). If the withdrawal causes a "reportable event" under ERISA § 4043(b), the administrator must report such event to the PBGC. ERISA § 4043(a).

ity under ERISA.[36] Indeed, the termination of a multiemployer plan will generally impose no ERISA liability on contributing employers where the benefits of multiemployer plan participants are not insured under Title IV of ERISA.[37]

The ease with which employers may withdraw from multiemployer plans is of particular significance in considering the impact of extending Rule 10b-5 rights of action, given the unique role of these plans and the difficulties which have beset their creation and maintenance. Economic conditions in those industries which have multiemployer plans were generally not favorable to their formation. While workers have managed to secure the creation of such plans through collective bargaining, those plans have had to be carefully nurtured.[38] The plans are still attempting to adjust to the complex regulatory environment created by ERISA.

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[36] A termination in the five years following withdrawal will generally impose liability, but such liability will decrease to zero over this five-year period.

[37] PBGC Opinion No. 75-9 states: "Under Sec. 4082(c) of the Act, the Corporation generally does not pay benefits of multiemployer plan participants guaranteed under Title IV; and thus there is no employer liability with respect to multiemployer plans which terminate prior to January 1, 1978." (ERISA has since been amended so that the date when PBGC insurance becomes mandatory for multiemployer plans is now July 1, 1979.) ERISA allows the PBGC to provide insurance under certain conditions prior to the date when such insurance is mandatory. ERISA §§ 4082(c)(2), (3) and (4).

[38] A recent study by the PBGC found that "approximately one-eighth of all multiemployer plans, covering one-fifth of participants in such plans, are experiencing significant financial hardship which may result in plan termination." "Potential Multiemployer Plan Liabilities Under Title IV of ERISA," reproduced in Pens. Plan Guide (CCH) ¶ 23,036 (1977).

The added burden of compliance with the securities laws, never contemplated, may well be too much for their fragile underpinnings. Thus, extension of securities regulation to pension funds would threaten the very existence of multiemployer plans—the only vehicle that exists in many industries for providing pension and welfare benefits to workers and their dependents.

CONCLUSION

For the foregoing reasons, the NCCMP urges that the Court reverse the judgment of the court below.

Respectfully submitted,

PAUL S. BERGER
MELVIN SPAETH
ROBERT H. WINTER
K. PETER SCHMIDT
HADRIAN R. KATZ
1229 19th Street, N.W.
Washington, D.C. 20036
(202) 872-6784

Of Counsel:
ARNOLD & PORTER
1229 19th Street, N.W.
Washington, D.C. 20036
GERALD M. FEDER
1201 Connecticut Ave., N.W.
Washington, D.C.

Dated: May 22, 1978

Mr. GEORGINE. I was hoping that you would be out voting when I came to this section, Senator.

Senator MATSUNAGA. You may continue.

Mr. GEORGINE. Another important feature of S. 209 is that dealing with preemption. S. 209 is now proposing to limit the preemption provisions of ERISA in the case of community property laws and State health insurance laws.

For plans such as many of the regional and national plans affiliated with the coordinating committee, a break in the law of uniformity established by absolute Federal preemption is likely to have serious consequences.

If multiemployer plans were compelled to comply with State health laws, such plans would have to meet the highest standards among the States imposing such law in order not to discriminate against any of its members. Moreover, it is almost certain that our plans would be placed in the untenable position of including a plan provision which is mandated by one State and prohibited by a different State.

The administrative expense alone involved with compliance would make such a task almost insurmountable.

Congress was mindful of such problems when passing ERISA and we believe these provisions also pose a serious threat to our multiemployer plans. We urge you to strengthen rather than weaken the preemption provisions of ERISA.

Another significant feature of S. 209 is the provision which would create a single agency to administer ERISA. The coordinating committee has long supported the principle of one agency. As long ago as April 1975, in my testimony at the oversight hearings held by the House Subcommittee on Labor Standards, I expressed concern about the problems of dual administration and called for a single agency to be given jurisdiction over this important and complex area.

Despite the administration's ERISA reorganization plan number four, which attempted to lessen the severity of dual jurisdiction problems, our plans are still plagued with jurisdictional problems. We view the reorganization plan as only an interim measure. Of particular concern is the fact that the plan never established formerly a mechanism to insure that all collective bargained issues be reviewed by the Labor Department. We hope that the record will be open long enough for the coordinating committee to submit further comments on this subject after the administration has submitted its report on the reorganization.

Mr. Chairman, we believe there are many important provisions in S. 209 which are necessary to help multiemployer plans continue to provide retirement security to their participants. We appreciate your efforts, and those of your colleagues, in this area.

We of the National Coordinating Committee for Multi-Employer Plans, will do our best to provide whatever assistance and data you need in our mutual efforts to improve ERISA.

Mr. Chairman, we would also like to emphasize that, although we have a genuine interest in the provisions of this bill, we feel that S. 1076, the termination insurance bill, is of vital importance to the very existence of multiemployer plans, and unless the termination insurance bill is passed by May 1, 1980, the multiemployer plans would be subject to the current law.

Without overstating the case, this would probably spell the end to multiemployer plans. We therefore urge Congress not to take any action which would delay passage of that bill.

Thank you very much.

Senator MATSUNAGA. Thank you very much, Mr. Georgine.

I had hope that you would have been enlightened by now and change your views on the State health insurance plan preemption issue. I appreciated the withdrawal of serious objections when the exemption only of Hawaii's health plan was raised in the Labor and Human Resources Committee.

That committee as you know, extended the provision to States other than Hawaii.

Assuming that the exemption is restricted to medical insurance programs similar to Hawaii's or that the exemption applies only to Hawaii, what would your position then be?

Mr. GEORGINE. Well, Senator, normally we feel that preemption is a very important issue and that there should be uniformity.

In the case of Hawaii, however, we felt at the time that an exemption was certainly not extraordinary and that we would be willing to go along with it, and we have not changed since then.

Senator MATSUNAGA. Thank you very much.

I understand the Senate will hold another vote before 5 o'clock and we have quite a few witnesses remaining. Should we have additional questions we will submit them to you in writing. We would like now to proceed with the other witnesses, some of whom have come from Hawaii, 5,000 miles away. We would not want to detain them another night just to testify tomorrow.

Mr. GEORGINE. That would be unfortunate. Of course, I would go to Hawaii and take their place for them.

Senator MATSUNAGA. I keep telling my colleagues that if they have not been to Hawaii, they had better get there soon before it is too late. From what the press makes of them, once they have been to Hawaii they will at least know what Heaven looks like, when they go the other way. [Laughter.]

Again, thank you very much.

Mr. GEORGINE. Thank you, Senator.

The prepared statement of Mr. Georgine follows. Oral testimony is continued on p. 318.]

National Coordinating Committee for Multiemployer Plans

SUITE 603 • 815 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20006 • (202) 347-1461

TESTIMONY OF ROBERT A. GEORGINE,

CHAIRMAN

NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

BEFORE

THE FINANCE SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE ON

PRIVATE PENSION PLAN AND EMPLOYEE FRINGE BENEFITS

December 4, 1979

I appreciate this opportunity to testify at this hearing on a number of amendments to ERISA addressed by S.209.

I am testifying before you today as Chairman of the National Coordinating Committee for Multiemployer Plans. The Coordinating Committee is a nonprofit organization whose sole purpose is to represent the interests of the eight million people who are participants in negotiated multiemployer pension and welfare plans. These plans provide benefits for workers in such industries as building and construction, maritime, the needle trades and retail and service trades. Our affiliates include over 100 international unions, national pension and welfare funds and local Taft-Hartley trusts. Together, they represent the great majority of participants in multiemployer plans. Because of the frequent job changes in these industries a multiemployer plan, that is, one which provides an employee with credit for service with a number of participating employers, is often the only way to ensure that these employees will get a pension. Indeed, such multiemployer plans provide a measure of portability on a voluntary basis which does not exist in other plans.

Multiemployer plans have special characteristics not fully recognized under the present law.

Frankly, we believe that participants in multiemployer plans and those who sponsor them through collective bargaining are at a crossroads. The challenges to their continued existence come from many directions.

In some instances, the industries in which they exist are dying, on a national or regional basis. In addition, in industries such as construction, the level of employment resulting in contributions to the plans has still not recovered from the recession of the mid 1970's. Furthermore, increasing numbers of employers are going non-union and taking with them the work which would otherwise produce income to these funds. Finally, ERISA has the potential for inflicting the stroke which breaks the backs of our plans instead of helping them to flourish. The impact of these trends and their potential result will be far reaching and adverse to the aging members of our population who will be deprived of any pension coverage.

Congress has already recognized that the termination insurance program as set forth in Title IV simply will not function for multiemployer plans. We appreciate the opportunity to work with the PBGC and ultimately with you in developing a new program which will provide for the needs of participants in plans which are financially troubled while not overburdening remaining plans to the point where they in turn must terminate.

We also appreciate the opportunity we have had to testify before you previously about our needs and are pleased to see that S.209 includes many of the provisions which we feel are necessary if our plans are to flourish, such as provisions to facilitate our reciprocity agreements, a more flexible definition of multiemployer plans, provisions to impose a statutory duty on employers to make contributions to collectively bargained plans and several other provisions, some of which I will discuss in greater detail at this time.

One of the most important features of S.209 is section 154 which would confirm the Supreme Court's decision in the Daniel case and would clarify, once and for all, the fact that a participant in a typical pension plan is not purchasing a security when he or she goes to work. However, also emerging in this bill is an unnecessary anti-fraud like provision which embodies most of the pitfalls inherent in the anti-fraud standards of the securities laws.

At the outset, I note for the record that those of us who are willing to accept responsibility for the establishment and implementation of these plans are forced to make a terrible choice. We must either acquiesce in punitive legislation or risk having our testimony misunderstood by some and clearly distorted by others.

Mr. Chairman, we have recently been asked whether we think that union officers and corporate personnel managers should be able to get away with fraud. That's like asking: "When did you stop beating your wife?"

In the first place, the record does not exist that such wholesale fraud is occurring -- and, if it does exist, no one has shared the documentation with me or my staff.

In the second place, if such wholesale fraud does exist, remedies also already exist under current law to deal with such fraud. They should not be replaced by federal legislation which will give rise to securities type anti-fraud litigation. As the Supreme Court has stated, such litigation presents a significant "danger of vexatiousness different in degree and in kind than that which accompanies litigation in general." Again quoting the Supreme Court, this kind of litigation would confront courts and juries with "many rather hazy issues of historical fact, the proof of which [would] depend almost entirely on oral testimony." The nature of this proof, the Supreme Court indicated, might subject defendants to a kind of legalized blackmail, forcing settlements even in groundless cases.

Such dangers are equally apparent in this legislation.

Thirdly, Mr. Chairman, the vague standard in this bill is in total conflict with the other disclosure standards of ERISA, which require plans to disclose specified information to participants in a specified manner.

As observed by the Chairman of the Senate Labor and Human Resources Committee,

> "Congress carefully set out in ERISA the rules it intended to govern disclosure to participants so that case-by-case judgments would not be required and the uncertainties that accompany a case-by-case standard could not be present."

The case-by-case approach inherent in S.209 will provide a gold mine for the legal profession, but not much else.

ERISA is designed to impose certain obligations on plan sponsors and other fiduciaries toward participants in their plans and their beneficiaries.

There is no question in my mind that ERISA already prohibits plan sponsors and fiduciaries from perpetrating a fraud on those persons ERISA is designed to protect--participants and their beneficiaries.

But S.209 throws a net out over every "person," including many who have no reason to believe they are covered by ERISA.

These "persons" will have to be prepared to defend even baseless actions charging them with having knowingly misrepresented the plan as many as perhaps twenty and thirty years before the action commenced.

Of course, although this legislation appears to be aimed at those individual persons, it will be used as a device to dip into the perceived "deep pockets" of the unions or employers whom they represent.

Mr. Chairman, at least in the case of labor organizations, those "deep pockets" which will be emptied contain nothing more than the hard earned dues money of working men and women. They should not be available to be tapped by "speculators and their lawyers," as the Supreme Court has described the potential unscrupulous plaintiffs in fraud cases.

Many of our substantive arguments were made to the Supreme Court in the Daniel case, and I ask that our *amicus* brief in that case be included in the record. (2)

Another specific fault with S.209 is that it attempts but fails to protect plan sponsors against fraud actions predicated on such plan documents as summary annual reports.

SARs were issued by plans long before ERISA was enacted because they were useful documents. Then, with the enactment of ERISA, SARs were required to become more formal and to include specified information. Of course, ERISA did not preclude plans from including additional information and many do--to the advantage of plan participants.

Under the anti-fraud provisions of S.209, the propriety of those SARs will be tested in fraud litigation. Plans will be forced to either restrict the SAR to limited information or to begin producing securities type prospectuses, which no plan participant will understand.

Mr. Chairman, there are other specific problems. But, tinkering with Section 515 of ERISA will not remedy the chief problem. I hope you will appreciate the importance of not including <u>any</u> such provision in this bill.

I urge you to recognize that these plans were established in industries where benefits would not otherwise have been available. Their continued existence is in jeopardy as a result of increased burdens from the economy, additional costs and employer and trustee anxieties, resulting from ERISA. This additional burden, whose harmful potential cannot even be measured, could further undermine the continued existence of these plans.

Another important feature of S.209 is that dealing with preemption. You are now proposing to limit the preemption provisions of ERISA in the case of community property laws and state health insurance laws. For plans such as many of the regional and national plans affiliated with the Coordinating Committee, a break in the wall of uniformity established by absolute federal preemption is likely to have serious consequences.

If multiemployer plans were compelled to comply with state health laws, such plans would have to meet the highest standard among the states imposing such law in order not to discriminate against any of its members. Moreover, it is almost certain that our plans would be placed in the untenable position of including a plan provision which is mandated by one state and prohibited by a different state. The administrative expense alone involved with compliance would make such a task almost insurmountable. Congress was mindful of such problems when passing ERISA. We believe this provision poses a serious threat to the continued existence of multi-employers plans. We urge you to strengthen rather than weaken the preemption provisions of ERISA.

Another signifcant feature of S.209 is the provision which would create a single agency to administer ERISA. The Coordinating Committee has long supported the principal of one agency. As long ago as April 1975, in my testimony at the oversight hearings held by the House Subcommittee on Labor Standards, I expressed concern about the problems of dual administration and called for a single agency to be given jurisdiction over this important and complex area.

ERISA has been the law for five years now and the need for eliminating dual administration is even more apparent. Despite the best efforts of officials in both agencies, dual jurisdiction of the Department of Labor and the Internal Revenue Service has proved extremely frustrating, time consuming and cumbersome to plan administrators and other persons interested in the important job of insuring that the objectives of ERISA are carried out in practice.

From the day ERISA was signed into law, we have been following the developing administration of the Act with interest and concern. We have tried to insure that the administrative interpretations of ERISA would be consistent with the intent of Congress and based on a practical understanding of the requirements of multiemployer funds. In connection with this effort, we have filed numerous memoranda and letters with Labor and Treasury. In many cases, though certainly not always, the responsible administrative personnel at these departments have been cooperative and receptive to our suggestions. In general, however, even when they have agreed with us, they have not been in a position to take action with respect to our recommendations because of the necessity of coordinating with another agency with a possibly differing viewpoint. This is one serious problem resulting from the division of responsibility under ERISA.

In nearly all of our efforts, we have had two agencies and two sets of administrators to deal with. Each agency is necessarily concerned with the resolution of issues falling under the jurisdiction of the other. Coordinating has proven to be cumbersome and time consuming and has made it virtually impossible to get an answer -- much less a quick answer -- to many of the problems arising under ERISA.

The administration's ERISA Reorganization Plan No. 4 attempted to lessen the severity of the dual jurisdiction problem. However, we view it as only an interim measure. Our plans are still plagued with jurisdictional problems.

Of particular concern, is the fact that the Reorganization Plan never established formally a mechanism to ensure that all collectively bargained issues be reviewed by the Labor Department. We hope that the record will be open long enough for the Coordinating Committee to submit further comments on this subject after the administration has submitted its report on the reorganization.

As I have previously stated, we appreciate your inclusion of a number of helpful provisions in S.209. Specifically, we endorse the following:

PROHIBITED TRANSACTIONS

We support your effort to relieve the technical burdens created for many plans in their daily transactions by defining the term party-in-interest to exlude those persons who are highly unlikely to be in a position to influence the actions of a plan or of plan officials.

RECIPROCAL AGREEMENTS

One of the greatest benefits now being provided by multiemployer plans on a voluntary basis is the portability of benefits from one plan to another. One of these arrangements, called "money-follows-the-man," involves the transfer of contributions from wherever an employee may be working in his trade to his home pension plan, where all of his pension credits are accumulated. We are concerned that the minimum standards provisions of ERISA and the

Internal Revenue Code as well as the prohibited transactions provisions may be read to bar such arrangements. We appreciate, therefore, the inclusion of sections 121 and 144 to clarify this situation.

SUSPENSION OF BENEFITS BECAUSE OF REEMPLOYMENT

The vesting provisions of ERISA may require payment of benefits by a multiemployer plan to a person who, although he or she had reached retirement age, continues to be employed with the same employer, but in a different craft, or in the same craft and area, but in a different industry. The current provision may also be read to deprive a multiemployer plan of any practical means of enforcing a legitimate definition of retirement. Furthermore, the law may bar a plan from suspending benefits on account of self employment in the same trade, craft or industry in the broadly defined geographic area covered by the plan.

We endorse the provisions of S.209 providing for suspension on account of either employment or self employment in the same trade, craft or industry in the broadly defined geographic area covered by the plan. We also are heartened by the inclusion of provisions permitting suspension for a reasonable period of time so as to preclude use of the pension as a form of unemployment insurance and to allow for reasonable penalties for misrepresentation or withholding of material fact.

OBLIGATION OF EMPLOYER TO CONTRIBUTE

In an inexplicable rule, the Labor Department and IRS held over two years ago that the failure of a multi-employer plan to collect delinquent contributions on a timely and reasonable basis was a prohibited transaction in that it amounted to an extension of credit to the delinquent employer. However, in the same ruling, the agencies held that the employer's failure to contribute was not a prohibited transaction, even though, in effect, the employer was unilaterally extending credit to himself.

Employer contributions are the life-blood of multi-employer plans. It is in the interests of the participants, the sponsoring unions and those employers who meet their obligations to make it unlawful for an employer to fail to make his agreed-upon contributions.

While we agree with section 154 of S.209 in this respect, we disagree with section 153 which singles out this new right and bars the Secretary of Labor from enforcing it. While we would not make it mandatory for the Secretary to bring these collection actions, we would at least urge that the Secretary be permitted to do so. Furthermore, like the Fair Labor Standards Act, we would urge that a violation of section 154 should result not only in an order enforcing payments, but in an order providing for an equal amount as liquidated damages payable to the fund.

ADDITIONAL AMENDMENTS

We also applaud the inclusion of provisions (a) providing for the determination of participation on a plan year basis, (b) approving the Labor Department's elapsed time regulations, (c) authorizing multiemployer plans to refund mistaken contributions within six months after the plan administrator knows that the contribution was made by mistake of fact, (d) providing special lump sum distribution rules for multiemployer plans, (e) permitting funding to take account of future amendments, and (f) permitting the summation of different benefit accrual rates for different periods of employment in determining the accrued benefit to which a participant is entitled upon his separation from service.

SURVIVOR PROTECTION

Survivor protection has been expanded under this bill to a participant who is credited with at least 10 years of vesting and who dies before the annuity starting date. If the plan provides an annuity as the normal form of benefit it will be required to provide a survivor's annuity to the participant's spouse at the annuity starting date. The increased cost as a result of added survivor protection can theoretically be charged against the participant's pension. However, in multiemployer plans that cost is most likely to be absorbed by the plan because most plans find it impossible to successfully communicate the information necessary for the participant to make a choice.

An additional flaw in this provision is that requiring the survivor's annuity payment on the annuity starting date. Rather than once again increasing plan costs to keep track of the spouse, we suggest that the plan have the option of paying the actuarial equivalent of the survivor benefit at the time of death or a paid-up deferred annuity at that time. Before making final recommendations on this subject we need further cost data. Therefore, we hope that we will be permitted to make further comments at a subsequent time.

EXCLUSION OF NONCOVERED SERVICE

Collectively bargained multiemployer plans are generally funded on a basis of fixed amounts of contributions based on the work of employees covered under the collective bargaining agreement. So, for example, if a carpenter works 1500 hours during the year on work subject to the collective bargaining agreement, his employer will make the required cents per hour contributions, he will receive vesting credit for the year and will accrue a benefit based on the 1500 hours worth of contributory service.

Unfortunately, what is happening with more and more frequency is that the employee is performing work under a bargaining agreement and will, at the same time, be performing non-union work for which he is making no contributions to the plan.

Under the vesting regulations issued by the Labor Department, a carpenter can work under the contract for one year and then work on the non-union jobs of the same contractor for nine years, and receive 10 years of vesting credit. This is simply unfair to the employees who continue to work under the contract and to the employees who make contributions to the plan.

We urge an amendment which would permit multiemployer plans to disregard an employee's service for participation and vesting purposes if it is the same type of work for the same employer but not within the bargaining unit.

Mr. Chairman, I now turn my attention to a provision in the bill which we believe is not in the interests of participants in collectively bargained pension plans.

CREDIT FOR ESTABLISHMENT OF SMALL PLANS

Section 204 would provide a tax credit for small employers who establish or maintain qualified employer retirement plans. In the first place, it is not clear whether this provision is designed to apply to employers who contribute to multiemployer plans. If not, it will provide an incentive to the withdrawal of such employers from multiemployer plans to the disadvantage of the plan. If the provision does apply to contributions to multiemployer plans, it unfairly discriminates amongst signatories to the collective bargaining agreement and contributors to the plan solely on the basis of their size. For these reasons we cannot support section 204.

I would also like to mention a provision which previously appeared in related legislation but fail to appear in S.209.

AMENDMENTS TO CONFORM PLANS TO FINAL REGULATIONS

One would have thought that simple fairness dictates that a plan amendment designed to comply with final regulations will not be considered in violation of ERISA simply because it alters amendments adopted after ERISA was signed into law, but prior to the issuance to final regulations. Yet, the agencies have not been willing to issue such a ruling. In S.3017, a precursor to this bill, such a provision was included. However, it was dropped under S.209. We urge you to reconsider including it in this bill.

FIXING VESTED RIGHTS

We favor the addition of an amendment that would eliminate a dangerous ambiguity under the present statute with respect to an employee who terminates covered employment with vested rights long before his or her pension is to begin. An individual may leave a plan at age 40 with fully vested rights to a deferred pension. Twenty-five years later, when this employee is ready to draw down his pension, he may find that the plan has doubled or tripled its benefit plan for those who remained in covered employment but without any intention of applying the increase to those who terminated long before. Yet, under the terms of the present statute, it may be possible for such an employee, just before he's ready to receive benefits, to secure temporary employment under the coverage of the plan and then have an arguable case that he or she is automatically entitled to a doubling or tripling of the benefit that had been vested 25 years earlier. This opens the door to the worst form of adverse selection.

It must be recognized that multiemployer plans, different from single employer plans, have no control over the employment or reemployment of participants. The short period of employment that a person may need in order deliberate: to arrange a doubling or tripling of his benefits may, as a matter of fact, be given to him as a favor by a participating employer to whom it does not represent a significant individual cost. It is easy to imagine widespread development of collusive practices representing wholesale abuse of these pension funds, not consistent with their actuarial soundness. We do not believe that Congress intended such a result.

We suggest an amendment that would clarify the law to the effect that a separation from service for the purpose of establishing vested benefit accruals be defined by a plan as a one year break in service or some comparable cut off period that will serve to avoid what may otherwise become a widespread abuse of multiemployer plans by those who learn to manipulate technicalities.

CONCLUSION

Mr. Chairman, we believe there are many important provisions in S.209 which are necessary to help multiemployer plans to continue to provide retirement security to their participants. We appreciate your efforts and those of your colleagues in this area. We, of the National Coordinating Committee for Multiemployer Plans, will do our best to provide whatever assistance and data you need in our mutual efforts to improve ERISA.

Mr. Chairman, we would also like to emphasize that although we have genuine interest in the provisions of this bill, we feel that S.1076, the Termination Insurance Bill is of vital importance to the very existence of multiemployer plans. Unless the Termination Insurance Bill is passed by May 1, 1980, multiemployer plans will be subject to the current law. Without overstating the case, this would probably spell the end to multiemployer plans. We therefore, urge Congress not to take any action which would delay passage of that Bill.

Senator MATSUNAGA. Our next witness is Mr. Boris Auerbach from the ERISA Industry Committee.

Mr. Auerbach?

Mr. AUERBACH. Thank you, Senator.

STATEMENT OF BORIS AUERBACH, THE ERISA INDUSTRY COMMITTEE

Mr. AUERBACH. My name is Boris Auerbach, secretary of Federated Department Stores in Cincinnati—unfortunately, not Hawaii. I am vice president to the ERISA Industry Committee, ERIC. ERIC is an association of 100 major corporations concerned with employee benefit issues.

Generally we support, with some technical modifications, the provisions of sections 2 through 5 of S. 1089. They are intended to simplify compliance by employee benefit plans with various reporting and disclosure requirements under ERISA.

We do have serious reservations about section 6 of 1089 which would give civil enforcement authority to IRS.

We will supply the subcommittee with a more detailed statement for the record, including our comments on 1089 as well as on certain important issues not in legislation, pending before the subcommittee.

For example, we will provide comments in our detailed statement on current problems facing plans maintained outside the United States primarily for the benefit of nonresident aliens.

We will also supplement our comments on S. 209 with a more detailed statement for the record. I would like to make a few general comments on S. 209.

Although, with modifications, we can support certain provisions of 209, we believe certain proposals would significantly expand existing ERISA provisions and standards. We continue to oppose provisions which would greatly expand ERISA standards and requirements at this time.

Many of these provisions will add new layers of regulation in the private retirement system which can only serve to add new burdens and costs on plan sponsors already seriously concerned with higher compliance cost.

We are deeply concerned that these provisions would inhibit the continued improvement of existing plans, a matter of great importance, not only to plan sponsors, but to plan participants.

Moreover, we believe that major substantive amendments of ERISA should be deferred until a comprehensive assessment of retirement issues is completed by the President's Commission on Pension Policy.

Finally we note that some of the provisions of the bill are designed to foster the continued improvement of existing plans and the growth of the private system. ERIC supports these provisions and perhaps they should be more appropriately be the subject of a separate bill which could be enacted expeditiously.

Among the provisions of S. 209, which we could support with certain modifications, are the provisions on reporting and disclosure. More specifically we support the proposed elimination of the summary annual report as contained in section 113. We note that section 3 of S. 1089 would also abolish the requirement for furnishing the report. The summary annual report contains journal information previously disclosed to participants in a form which we find employees do not find useful. Its preparation and distribution is costly.

Accordingly, we would support the elimination of the summary annual report. We would prefer section 113 of S. 209.

We also generally support section 102 of S. 209 which would amend ERISA section 3 to authorize the Secretary of Labor to issue regs exempting severance pay and supplemental pay arrangements from the ERISA definition of the pension plans.

We do believe employers should be encouraged to provide voluntary income supplements from general corporate assets to employees in a variety of situations which are beneficial to employees. However, the language of section 102 should be modified to authorize the Secretary of Labor to exclude these arrangements from the scope of the ERISA definition of welfare plans as well. This modification would provide the Department of Labor with greater flexibility to develop regulations with appropriate safeguards to exempt such payroll practices from all of the ERISA reporting, disclosure and fiduciary provisions.

With regard to alimony and support payments, we believe that section 128 could well eliminate a source of current major concern facing employers throughout the country. This section, creating exception to section 2060 of ERISA, would permit garnishments of pension benefits pursuant to a judgment, decree, or order relating to child support, alimony payments, or marital property rights pursuant to a State domestic relations law.

We support it to the extent that it would except from antialienation provisions compliance by plan sponsors with State court decrees pursuant to marital disillusion proceedings ordering plans to pay benefits in pay status to nonemployee spouses.

However, to make the exception workable and to eliminate its substantial administrative burden on sponsors and participants alike, the section should be amended to deal with the problem of benefits not currently in pay status.

With regard to elapsed time, we support the adoption of a provision similar to section 129 of S. 209 authorizing the Secretary of Labor to prescribe by regulation methods for measuring service for purposes of the sections of the act based on measurement of the elapsed time of an employee's service.

Codification of present DOL regulations would remove any remaining doubt that ERISA permits this widely utilized elapsed time method of crediting service.

With regard to misrepresentation, we do have great difficulty with section 154. In summary, we oppose the inclusion of proposed section 515 into ERISA for the following reasons:

One, the immediate and pressing need for such a provision is unclear.

Two, whatever gap and protection under ERISA may exist for some employees between the commencement of employment and plan participation is met by the protection of State common law fraud theories.

Three, once an employee is a participant, ERISA not only provides remedies for breeches of fiduciary duty, but also, through disclosure, furnishes adequate protection for the participant.

In addition, we are concerned that section 515, if enacted, would become a standard cause of action included in virtually every ERISA claim as a device to inhibit the availability of summary judgments or dismissals on motion in clearly nonmeritorious cases.

We submit that section 515 would result in substantially increased litigation costs to large employers, would contribute significantly to the already congested Federal dockets, and would provide a very real disincentive to small employers to establish plans.

As a result of the unanimous decision of the Supreme Court in the *Daniels* case, there is a serious question as to the need or desirability of section 154. We believe that the detailed provisions of ERISA through existing remedial language, provides a broad and comprehensive tool to handle abuses.

It should be noted that the fact situation that gave rise to *Daniels* would easily have been taken care of by the break in service rules of ERISA.

The rules in this area and on funding, eligibility, vesting and fiduciary matters not only provide adequate protection to participants, but also give guidance to fiduciaries and others who must work with the plan. Thus providing a new remedy for an employee could take years in the courts at a great cost to all parties, in lieu of specific, easily understood requirements, including plain procedures.

We think, therefore, this new remedy would be a disservice to both employees and employers.

Turning to preemption, section 155(1) adds language to 514(b)(2)(b) clarifying that State laws which regulate the content of group insurance provisions under ERISA are preempted by ERISA. We generally support this desirable step in the direction of strengthening the preemption provisions.

We do not support 155(2) which would create an exemption to ERISA's broad preemption of certain State laws which require an employer to directly or indirectly provide health care benefits or services to employees and their dependents.

We submit that this proposal would narrow the scope of ERISA preemption and open the door to multiple and potentially conflicting State laws that ERISA was intended to exempt.

We believe that the legislative history clearly indicates that preemption provisions are intended to eliminate the thread of conflicting or inconsistent State and local regulation of benefit plans and to avoid opening the door to multiple and potentially conflicting State laws.

We submit that State laws such as those that would be permitted under 155(2) is what Congress had in mind when it enacted 514.

With regard to the Employee Benefits Commission, we strongly urge the deferral of that proposal at this time. The proposal certainly should be deferred until there has been a reasonable opportunity to assess the operation of the administration's Reorganization Plan No. 4 and until the administration's recommendations on the reorganization plan are submitted to Congress next year.

The principal multiple jurisdiction problems arose immediately after the passage of ERISA and in large part were associated with the creation of new offices within the Labor and Treasury Departments and the implementation of entirely new legislation. We believe these problems have been largely resolved and the multiple jurisdiction matter is not now of major concern.

While efforts to streamline ERISA enforcement and to achieve a centralized policy on retirement goals are laudable, the creation of a new agency at this time is something we do not want to face up to.

With regard to joint and survivor provisions, we strongly object to these proposals which would, in effect, require the providing of life insurance for all who are more than 50 percent vested.

We think that going down this path would again start us up with all the problems of amending plans and everything that goes with it.

In connection with profit-sharing plans, we find that the proposal is totally unnecessary since under most of the plans that I am familiar with, participants are completely vested, or their beneficiaries are completly vested, in the event of death.

We very much appreciate the opportunity to appear before you, Senator.

Senator MATSUNAGA. Thank you very much, Mr. Auerbach. We certainly appreciate the concise manner in which you presented your case and your more detailed statements will appear in the record.

Mr. AUERBACH. Thank you.

[The material referred to follows. Oral testimony continues on p. 356.]

STATEMENT OF THE ERISA INDUSTRY COMMITTEE (ERIC)

BEFORE THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND

EMPLOYEE FRINGE BENEFITS

SENATE COMMITTEE ON FINANCE

ON THE ERISA SIMPLIFICATION ACT (S. 1089) AND

THE ERISA IMPROVEMENTS ACT OF 1979 (S. 209)

DECEMBER 4, 1979

My name is Boris Auerbach, Secretary, Federated Department Stores, Cincinnati, Ohio. I am Vice President of The ERISA Industry Committee ("ERIC"). I am accompanied by George J. Pantos and Jerry L. Oppenheimer, counsel to ERIC. ERIC is an association of 100 major corporations concerned with employee benefits issues.

Generally, ERIC supports, with some technical modifications the provisions of sections 2 through 5 of "The ERISA Simplification Act" (S. 1089). They are intended to simplify compliance by employee benefit plans with various reporting and disclosure requirements under ERISA. However, we have serious reservations about section 6 of S. 1089, which would give civil enforcement authority to the Internal Revenue Service. We will supply the Subcommittee with a more detailed statement for the record which will include comments on S. 1089 as well as on certain important issues not in legislation pending before this Subcommittee, which we believe should be given serious consideration if legislation is to be enacted. For example, we shall provide comments in our more detailed statement on current problems facing plans maintained outside the United States primarily for the benefit of non-resident aliens.

Today, I wish to offer some comments on certain provisions in "The ERISA Improvements Act of 1979" (S. 209). We will also supplement our comments on S. 209 with a more detailed statement for the record. Before doing so, however, I would like to offer some general observations on S. 209.

Although with modifications, we can support certain provisions of S. 209, we believe several proposals in S. 209 would significantly expand existing ERISA provisions and standards. We continue to oppose provisions which would greatly expand ERISA standards and requirements at this time. Many of these provisions will tend to add new layers of regulation on the private retirement system which can only serve to add new burdens and costs on plan sponsors already seriously concerned with higher compliance costs. This can only serve to fuel inflation and to frustrate ERISA's objective of fostering and encouraging the establishment and maintenance of private plans. We are deeply concerned that these provisions would inhibit the continued improvement of existing plans - a matter of great importance to plan sponsors and plan participants.

Moreover, while we believe it is appropriate for the Congress to continue its study of these and other retirement issues, and we commend this Subcommittee for doing so, we believe that major substantive amendments of ERISA should be deferred until a rationale, comprehensive assessment of retirement issues is completed by the President's Commission on Pension Policy.

Finally, we note that some of the provisions of the bill are designed to foster the continued improvement of existing plans and the growth of the private pension system generally. ERIC supports these provisions and suggests that they would more appropriately be the subject of a separate bill which could be enacted expeditiously.

The following comments are intended to highlight in summary fashion some of our principal concerns with certain specific provisions in S. 209.

Among the provisions of S. 209 which we can support, with certain modifications, are the following:

<u>Reporting and Disclosure</u>

- ERIC generally supports simplification of reporting and disclosure requirements. More specifically, ERIC supports the proposed elimination of the Summary Annual Report as contained in Section 113. We note that Section 3 of S. 1089 would also abolish the requirement that employers furnish participants with a Summary Annual Report. The required Summary Annual Report contains general information previously disclosed to participants in a form which employees do not find useful. Its preparation and distribution is costly for plan sponsors. Accordingly, ERIC supports the elimination of the Summary Annual Report, but would prefer Section 113 of S. 209 to Section 3 of S. 1089.

Severance Pay and Supplemental Pay

ERIC generally supports Section 102 of S. 209 which would amend ERISA Section 3 to authorize the Secretary of Labor to issue regulations exempting severance pay and supplemental pay arrangements from the ERISA definition of a pension plan. We believe employers should be encouraged to provide voluntary income supplements from general corporate assets to employees in a variety of situations which are beneficial to employees. However, the language of Section 102 should be modified to authorize the Secretary of Labor to exclude severance and supplemental pay arrangements from the scope of the ERISA definition of a welfare plan as well. The suggested modification would provide DOL with greater flexibility to develop regulations--with appropriate safeguards--to exempt such payroll practices from all of ERISA's reporting, disclosure and fiduciary provisions.

Alimony and Support Payments

Section 128 could well eliminate a source of current major concern facing employers throughout the country. This section would create an exception to Section 206(d) of ERISA and would permit garnishments of pension benefits pursuant to a judgment, decree or order "relating to child support, alimony payments, or marital property rights pursuant to a State domestic relations law." We commend the bill's authors for suggesting this exception in a manner which would have no effect on ERISA's preemption provisions.

Thus, ERIC supports Section 128 to the extent that it would except from the anti-alienation provisions compliance by plan sponsors with state court decrees pursuant to marital dissolution proceedings ordering plans to pay benefits in pay status to non-employee spouses. However, to make the exception workable and to eliminate a substantial administrative burden on plan sponsors and participants, Section 128 should be amended to deal with the problem of benefits not currently in pay status.

Elapsed Time

We support the adoption of a provision similar to Section 129 of S. 209 authorizing the Secretary of Labor to prescribe by regulation one or more systems of measuring service for purposes of Sections 202, 203 and 204, which are based upon measurement of the elapsed time of an employee's service. Codification of present Department of Labor regulations would remove any remaining doubt that ERISA permits the widely-utilized elapsed time method of crediting service.

* * * * *

We are seriously concerned with the following provisions of S. 209:

Misrepresentation; ERISA and Securities Laws

Section 154 adds new section 515 to Title I of ERISA which would prohibit certain forms of misrepresentation in connection with employee benefit plans. In summary, ERIC opposes the inclusion of proposed Section 515 into ERISA for the following reasons: 1) The immediate and pressing need for such a provision is unclear; 2) Whatever gap in protection under ERISA may exist for some employees between commencement of employment and plan participation is met by the protection of state common law fraud theories; and 3) Once an employee is a participant, ERISA provides not only remedies for breaches of fiduciary duty but also through disclosure furnishes adequate protection for the participant.

In addition to the unnecessary nature of this proposal, ERIC members are greatly concerned that Section 515, if enacted, would become a standard cause of action included in virtually every ERISA claim as a device to inhibit the availability of summary judgments or dismissals on motion in clearly nonmeritorious cases. ERIC submits that Section 515 would: (1) result in substantially increased litigation costs to large employers; (2) contribute significantly to the already congested dockets of the Federal courts; and (3) provide a very real disincentive to small employers to establish and maintain pension plans.

As a result of the unanimous decision of the Supreme Court in the Daniel case, there is a serious question as to the need or desirability of Section 154. We believe that the detailed provisions of ERISA through existing remedial language provide a broad and comprehensive tool to handle abuses.

Moreover, it should be noted that the fact situation which gave rise to the Daniel litigation would have been easily taken care of by the break-in service rules of ERISA. The specific

ERISA rules in this area and on funding, eligibility, vesting and fiduciary matters, not only provide adequate protection to participants, but also give guidance to fiduciaries and others who must work with the plan. Thus, providing a new remedy for an aggrieved employee--which could take years in the courts at a great cost to all parties in lieu of specific, easily understood requirements, including claims procedures--does a disservice to employees and employers alike.

Preemption

Section 155(1) adds language to ERISA Section 514(b)(2)(B) clarifying that state laws which regulate the content of group insurance provisions under plans covered by ERISA are preempted by ERISA. Generally, ERIC supports the provision as a desirable step in the direction of strengthening ERISA preemption provisions.

However, ERIC does not support Section 155(2) which would create an exception to ERISA's broad preemption of certain state laws which require an employer to directly or indirectly provide health care benefits or services to employees and their dependents. We submit that this proposal would narrow the scope of ERISA preemption and open the door to multiple and potentially conflicting state laws that ERISA was intended to exempt.

The ERISA legislative history clearly indicates that ERISA's preemption provisions are intended to eliminate the threat of conflicting or inconsistent state and local regulation of employee benefit plans and to avoid opening the door to multiple and potentially conflicting state laws. We submit that state laws such as those that would be permitted under Section 155(2) is what Congress had in mind when it enacted Section 514.

Accordingly, ERIC suggests that Section 155(2) would significantly weaken ERISA's preemption provisions and strongly urges that the provision be deleted from the bill.

Employee Benefits Commission

ERIC strongly urges deferral of the proposal to consolidate in a new Employee Benefits Commission all responsibility for administering ERISA Titles I and IV and certain sections of the Internal Revenue Code. The proposal should be deferred until there has been a reasonable opportunity to assess the operation of the Administration's Reorganization Plan No. 4 and until the Administration's recommendations on the reorganization plan are submitted to Congress next year.

The principal multiple jurisdiction problems arose immediately after passage of ERISA and, in large part, were associated with the creation of new offices within the Labor and Treasury Departments and the implementation of entirely new legislation. These problems have been largely resolved, and the multiple jurisdiction matter is not now of major concern. While efforts to streamline ERISA enforcement and to achieve a centralized policy on retirement goals are laudable, the creation of a new agency at this time could have the opposite effect of resurrecting many of the start-up and transfer of responsibility problems which were the source of many of the complaints which generated this proposal.

Joint and Survivor Provisions

ERIC strongly objects to the proposal to amend significantly, in effect, ERISA's vesting rules and to require retirement plans which provide annuity options to provide, in effect, life insurance for all who are more than fifty percent vested. This proposal would increase plan costs, might lead to reduced benefits, would conflict with existing life insurance programs and would affect funding requirements.

With regard to pension plans, the proposed additional joint and survivor protection is mainly a substitute for existing death benefit coverage. Death benefits are far more common in employee benefit programs than retirement benefits, and for sound technical and conceptual reasons the general practice is to use pension plans to provide retirement benefits and group life insurance plans to provide death benefits. Federal encouragement of new death benefits in a retirement plan along the lines of Section 127 will generally not create a net increase in death benefits, but only a jostling of existing death benefit arrangements, which will be adjusted to make room for a new, more complex mandated benefit which must be described and made available to plan participants.

With regard to profit-sharing plans, this proposal will not result in new death benefits since profit-sharing plans already widely provide full vesting at death. What the proposal does is to require that the death benefit be paid to the spouse, whether that is what the participant wants--or even what the spouse wants.

We appreciate the opportunity to appear.

Supplementary Statement

of

The ERISA Industry Committee (ERIC)

INTRODUCTION

The ERISA Industry Committee (ERIC) is an association of 100 major employers concerned with employee benefit issues. Its members include half of the nation's fifty largest industrial companies and represent a cross-section of the nation's largest retailers, utilities, banks and insurers.

ERIC believes that major substantive amendments of ERISA should be deferred. Many of the provisions before the Subcommittee would unwisely and unnecessarily expand ERISA, require amendments of plan documents, and otherwise add new burdens and costs for plans and their sponsors. This could only lead to additional plan terminations, serve to fuel inflation, and frustrate the objective of fostering and encouraging the establishment and maintenance of private plans.

Other provisions before the Subcommittee are designed to make technical improvements to simplify ERISA and reduce administrative costs. With appropriate modifications, ERIC would support the expeditious enactment of a bill restricted to these kinds of improvements.

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On April 3, 1979, ERIC presented testimony to the Subcommittee on sections 201-05 of S. 209 and other tax issues. ERIC's position with regard to the matters considered in that testimony is unchanged. Those matters are not treated again in this statement.

On February 7, 1979, ERIC testified before the Senate Committee on Labor and Human Resources (the "Labor Committee") on S. 209 and supplemented that testimony with comments filed on March 23, 1979. On November 7, 1979, ERIC presented testimony to the Labor Committee on S. 1089, and, on December 4, 1979, ERIC again testified before the Subcommittee on S. 209 and S. 1089.

This statement supplements ERIC's prior testimony. For convenience, it generally follows the order of S. 209 as described in the Labor Committee's November, 1979, Summary and Analysis of Consideration (hereinafter the "Committee Print"), and, unless otherwise indicated, parenthetical references in headings are to sections of S. 209. The matters discussed herein are not necessarily considered in the order of importance to ERIC.

For the sake of brevity, the statement is summary and does not deal with every provision of the bills before the Subcommittee. ERIC would welcome the opportunity to amplify this statement through additional submissions, to confer with members of the Subcommittee and staff, and generally to make the experience of ERIC's members and counsel available to the Subcommittee.

I. Severance Pay and Supplemental Pay Arrangements (§ 102)

Severance pay, supplemental pay, and similar payroll practices are beneficial to employees, and employers should be encouraged to provide discretionary income supplements from general corporate assets in a variety of situations. Thus, ERIC generally supports section 102(5). However, the Secretary of Labor's authority should be expanded to cover all ERISA requirements, including those applicable to welfare plans. Rather than amending ERISA's definitions, a provision permitting the Secretary to exempt such arrangements by regulation should be included in ERISA section 4(b).

II. Reporting and Disclosure (§§ 111-16 of S. 209 and §§ 1-5 of S. 1089)

ERIC generally supports simplification of reporting and disclosure requirements and, accordingly, generally supports the thrust of these proposals.

A. Benefit Statements. The approach regarding benefit statements in section 111 of S. 209 is more appropriate than that of the regulations proposed by the Labor Department on February 9, 1979. ERIC hopes, however, that the final regulations will eliminate the need for legislation.

B. Pension Plan Reports. ERIC endorses section 112 of S. 209 which would permit greater flexibility in simplifying pension plan reporting requirements.

C. Summary Annual Reports. ERIC also supports section 113 of S. 209 and section 3 of S. 1089 which would eliminate the summary annual report. It is not useful to participants, and its preparation and distribution is costly. ERIC prefers section 113 of S. 209 to section 3 of S. 1089 for the reasons stated in its November 7, 1979, testimony before the Labor Committee.

D. Master Trusts. In order to facilitate more efficient administration of plans without reducing ERISA protections, ERIC suggests that ERISA section 103 should be amended to reverse the Labor Department requirement that plans of related employers which invest through a single master trust allocate on Forms 5500 assets of the master trust to each individual plan. *See*, *e.g.*, 1978 Instructions for Form 5500, item 13, p. 5; 29 CFR § 2520.103-5(c)(2)(ii).

The required allocation is contrary to generally accepted accounting principles, misleading to plan participants, expensive and unnecessary. Each participating plan should be able to report its undivided interest in the master trust, accompanied by the trust's full financial statement, as is permitted for common or collective trusts which commingle the assets of plans of unrelated employers. *See*, *e.g.*, Instructions, *supra*; 29 CFR §§ 2520.103-3, -5, and -9. Section 3202 of H.R. 6053 would accomplish this result.

III. Employee Transfers (§ 121)

This proposal would facilitate reciprocity arrangements between multiemployer plans. The Committee Print noted at 20 that proposed Treasury regulations would significantly inhibit long established practices connected with the transfer of pension rights attributable to employees not covered by multi-employer plans but moving from company to company within an affiliated group. The Committee Print further noted that an amendment to ameliorate the disruptive effect of such regulations was not proposed because the regulations were not then final. Final regulations have been issued without curing the problem, and ERIC strongly urges the Subcommittee to deal with the problem so that such practices may continue.

IV. Workers' Compensation Offsets (§ 126)

ERIC strongly opposes prohibiting the reduction of pension benefits by the amount of workers' compensation awards. Plans have been designed with the knowledge that such offsets have been permitted. There is no reason now to permit very costly duplication of benefits or to require costly amendments to those plans which prohibit such duplication.

The Service, in regulations issued before ERISA and republished thereafter, has long permitted pension benefits to be reduced by amounts which the beneficiary receives under state workers' compensation laws or other state or federal disability programs. See, Treasury Regulation section 1.411(a)-4(a); Rev. Rul. 68-243, 1968-1 C.B. 157. See also, Rev. Rul. 78-178, 1978-1 C.B. 117; 4 Larson, Workmen's Compensation Law §§ 97.00, 97.51. Recent litigation, relying on the prohibitions on forfeitures of vested benefits in ERISA section 203 and Code section 411, has brought this practice into question.

The Labor Committee viewed pensions as deferred compensation and workers' compensation awards as compensation for disability. Committee Print at 26. That Committee apparently would permit payments from disability plans to be offset by workers' compensation but prohibit offsets to accelerated or augmented payments from pension plans. ERIC questions these premises. Many plans accelerate vesting and payment of pension benefits on disability, and payments from such plans are excludable from income under Code section 105 as amounts received for personal injuries or sickness. See, Wood v. U.S., 590 F.2d 321 (9th Cir. 1979); Masterson v. U.S., No. 78C2438 (N.D. Ill. Oct. 31, 1979). Thus, pension benefits and workers' compensation have the same purposes. Furthermore, dollars derived from benefits are fungible, and there should be no difference whether such amounts are paid from a separate plan or from the employer's retirement plan.

Regardless of the philosophical distinctions, if pension benefit offsets for workers' compensation, Social Security, or similar disability programs are not permitted, a disabled worker may receive far greater income, much of it tax-free, than he did while working. Indeed, in a typical case a disabled employee with 30 years of service could receive, from workers' compensation, Social Security, and his pension, more than 150% of his prior take home pay. See, "Compensation

Systems Available to Disabled Persons in the United States", Report of the Research Subcommittee of the Disability Insurance Committee of the Health Insurance Association of America, Dec., 1979. Obviously, this frustrates the purpose of both disability and pension programs and can only lead to abuse.

For this reason, in 1965, Congress enacted 42 U.S.C. § 424a, which provides that Social Security disability benefits must be offset by workers' compensation benefits to the extent that the combined Social Security and workers' compensation benefits exceed 80% of the employee's previous average monthly earnings.

Accordingly, ERIC opposes the proposal to prohibit the offset of workers' compensation benefits from pension benefits. Instead, the bill should be amended to permit specifically the continued reduction of pension and disability benefits for amounts received by a disabled employee from workers' compensation or similar disability programs. However, after such payments are in pay status, they should not be reduced because of increases in Social Security disability benefits.

V. <u>Joint and Survivor Provisions</u> (§ 127)

ERIC supports provisions permitting plans to provide optional benefits in a form other than a qualified joint and survivor annuity, simplifying the required notice to participants, and effectively exempting defined contribution plans from the joint and survivor requirements. However, ERIC strongly objects to provisions which, in effect, amend significantly ERISA's vesting rules and which require retirement plans which provide annuity options to pay benefits to survivors of participants who are more than fifty percent vested at death. This would require virtually all defined benefit plans to bear the burden of costly plan amendments, would increase plan costs, might lead to reduced benefits, would conflict with existing life insurance programs, and would affect funding requirements.

More specifically, ERIC supports the recognition that plan participants and beneficiaries are not necessarily served by requiring all plans which have annuity options to provide joint and survivor annuities as the normal form of benefit. Experience, both before and after ERISA, has shown that, for personal, tax planning, or other reasons, employees overwhelmingly elect benefit payments in forms other than joint and survivor annuities. Thus, defined benefit plans should be explicitly permitted to offer, as the normal form of benefit, annuity payments other than joint and survivor annuities, such as guaranteed term annuities, single life annuities, or other installment payments.

ERIC also supports eliminating repeated notices or computations of joint and survivor benefits if the summary plan description incorporates an explanation of the benefit and the participant's attention is directed to it. This would greatly simplify compliance and reduce administrative costs.

In addition, ERIC supports the proposal's implied exception from the joint and survivor provisions for plans, principally defined contribution plans, which vest a participant's accrued benefits at death, but the proposal should be strengthened by exempting them explicitly and entirely from ERISA section 203 and Code section 401(a)(11). There is no reason to subject these plans to the administrative burdens of the joint and survivor provisions.

ERIC strongly opposes the proposed expansion of the pre-retirement survivor annuity requirement. Defined benefit plans are designed to pay retirement benefits and traditionally forfeit even vested benefits on death. See, e.g., ERISA section 203(a)(3)(A) and Code section 411(a)(3)(A). A plan's funding assumptions contemplate participant mortality. A requirement that benefits be paid to the survivor of every participant who achieves a certain level of vesting would occasion a major change in a plan's purpose and funding assumptions.

Furthermore, the benefit of the provision to employees would be far outweighed by the administrative burdens to the plan. As a practical matter, the amount of benefit accrued at the point of early death of a participant would be small, and the reduction for a survivor annuity would, in many cases, make any benefit miniscule. Moreover, payment would be deferred until the participant would have reached early retirement age. Thus, in many cases, the survivor would receive no benefit for many years after the participant's death. The recordkeeping necessary to account for small benefits and the identities and locations of survivors who may move and/or remarry during the period between a participant's death and his early retirement date would be significant and completely out of proportion with the amount of benefits eventually paid to a survivor.

The new requirement would also be difficult to explain to spouses, who would not comprehend why they must wait for benefits occasioned by a participant's death, particularly when their immediate needs may be great. A 35 year old widow would take little comfort from a retirement annuity to be paid 20 or more years in the future, particularly if she has children to support. The disillusionment would be even greater if she knew that employer provided life insurance was curtailed to affect the added cost of the federally mandated program.

ERIC members are concerned about their employees' dependents and believe that survivor protection is most effectively and efficiently provided through group term life insurance or other death benefit programs, not by mandating a redesign of pension programs. Death benefits are the most common type of employee benefit, and for sound technical and conceptual reasons the general practice is to use pension plans to provide retirement benefits and group life insurance plans to provide death benefits. Pension plan resources are more appropriately allocated to benefits other than death benefits, such as larger retirement benefits, more liberal provisions for earlier retirement, more liberal vesting, and post-retirement increases to compensate for inflation. Thus, ERIC strongly objects to expanding pre-retirement survivor benefits.

VI. Court Orders for Alimony and Support (S 128)

ERIC supports the provision which clarifies, without weakening ERISA's preemption provisions, that plans should comply with state court domestic relations decrees relating to child support, alimony, or settlement of marital rights which order benefits paid to a participant's former spouse. However, to eliminate a substantial administrative burden on plans and participants, problems presented by benefits not currently in pay status should also be resolved.

The following example illustrates problems presented to plans by benefits not in pay status: John and Mary Doe, both age 25, reside in California; in 1975, John became an employee of Widget Corp., sponsor of a final average salary pension plan with ten-year cliff vesting; in 1980, John and Mary are divorced, and Widget's plan administrator receives an order establishing Mary's community property interest in any benefits ultimately payable to John attributable to employment during the marriage; in 1985, Mary moves to Michigan and remarries but fails to notify the plan administrator; in 2015, John receives benefits from Widget's plan.

First, it would be impossible for a court in 1980 to establish intelligently or equitably the amount or percentage of benefits payable to Mary in the year 2015 because there is no current benefit established and the amount of John's benefit depends on future employment and salary. Second, Widget's plan administrator would be in the untenable position of trying to comply with an order directing payment to an individual who had moved and changed her name and address thirty years before benefits became payable. Similar problems could arise with older divorcees who work beyond normal retirement age, participants who die before retirement age, etc. Section 3309 of H.R. 6053 would deal with these problems.

VII. Elapsed Time (§ 129)

ERIC supports codifying present Labor Department regulations to remove any doubt that ERISA permits the widely-utilized elapsed time method of crediting service. However, ERIC opposes the "aggregate test" proposed in the second sentence of section 129. Who are "disadvantaged employees"? How would determinations under an "aggregate test" be made in the absence of the very hourly computations and records which the elapsed time method is designed to eliminate? The present regulations contain adequate safeguards to assure that employees whose service is measured in terms of elapsed time are not disadvantaged by the use of this method.

VIII. Funding of Future Benefits (§ 131)

ERIC strongly opposes requiring that after 1980 a plan's funding method take into account provisions of a plan which are not yet effective. The proposal is directly contrary to recently proposed Treasury regulation section 1.412(c)(3)-1 defining the term "reasonable funding method" which prohibits taking into account any provision of a plan which is not effective. The legislative proposal could significantly alter customary collective bargaining practices, would accelerate the cost of funding plans (and thus contribute to inflation), would result in significant and unnecessary additional complexity, and could, therefore, result in additional plan terminations.

The Committee Print at 31-32 describes the provision as if it related solely to multiemployer plans. However, neither that description nor the provision is so limited. Many single employer plans are collectively bargained, and benefits typically are phased in over several years. The commencement date of increased benefits is frequently as important as (or more important than) the amount of the increase. The proposal would negate any advantage of deferring increased benefits to future years and would therefore make bargaining more difficult.

Furthermore, the proposal would engender controversy and further complexity. Thus, the proposal would require regulations to establish "appropriate" adjustments to funding standard accounts in the event a provision never became effective. This would add further complexity to funding standard accounts. Finally, we note that the proposal would deem any provision "adopted but contingent on a future event" as not effective prior to the occurrence of the event. This provision, although necessary, would be difficult to apply. More specifically, it would exempt contingent provisions from immediate funding requirements, but what contingencies are contemplated? Future benefit increases customarily might be made contingent on some event, even though it was virtually certain that the event would occur. Thus, administering the proposal could be difficult.

IX. Impact of Inflation on Retirement Benefits (S 152)

ERIC strongly opposes any authorization of a Labor Department study of mandatory cost-of-living adjustments to private plan benefits. The effects of inflation cannot be isolated from a consideration of related issues, such as a standard of "adequate" retirement income, the role of Social Security and other government programs, their relationship to private pension plans, the mechanisms for funding future benefits, and the effect of indexed benefits on inflation, capital formation, and economic growth.

The 1979 Advisory Council on Social Security has studied the retirement income goals for Social Security and private plans and the impact of inflation. It expressed particular concern about "the updating of [private] pension benefits to take account of inflation after retirement", but concluded that:

> While it is theoretically simple for private pension plans to adjust their benefits for inflation, there is no way in which private pensions can fund benefits that are indexed against an inflation rate of an indefinite amount. . . . Moreover, even providing protection against a definite and limited inflation rate is very expensive. Reports of the 1979 Advisory Council on Social Security at 198-200 (Dec. 7, 1979).

The Advisory Council referred its findings to the President's Commission on Pension Policy, which is charged with recommending a national retirement policy and which is studying the respective roles of Social Security, private plans, and savings in providing adequate benefits and their effects on private capital formation and economic growth. It has held hearings on the Adequacy of Retirement Income in an Inflationary Era.

In addition, Congress in 1977 created a National Commission on Social Security which will file its report on January 11, 1980, on the adequacy of retirement income provided by public and private plans, including the need for, and financial impact of, an inflation index for the elderly.

Accordingly, any additional Labor Department study would duplicate the work of these bodies, would be completed significantly after their reports have been made, and would unnecessarily dissipate resources.

X. <u>Misrepresentation</u> (§ 154)

ERIC strongly opposes the proposed misrepresentation provisions. They would largely duplicate more specific ERISA provisions, would inhibit communications regarding plans, and may very well stimulate vexatious and costly litigation. The proposal is neither needed nor desirable.

The detailed provisions of ERISA, including existing remedies, provide a broad and comprehensive deterent to abuse.

Even the Committee Print at 41-43 recognizes that participants are protected by ERISA.*/

Nonetheless, ERIC is concerned that the proposal is broadly drawn, and the Committee Print at 42 indicates that it is "intended to be interpreted in a relatively broad fashion". Even the Labor Department has experienced difficulties in establishing standards for clearly expressing complex plan information in language which is reasonably "accurate and comprehensive", yet "calculated to be understood by the average participant", as required by ERISA section 102.**/ If the proposal were adopted, employers might attempt to protect themselves by rigidly restricting employees from answering questions regarding plan provisions. Employee communications could be significantly inhibited, and ERISA's policy of fostering development of concise and simple explanations could be frustrated.

The new provisions apparently would apply principally if a new employee who is not a participant was not given proper plan documents and requested specific information from a plan offi-

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*/ The Committe Print also indicates that ERISA's specific provisions would take precedence over the new misrepresentation provisions, although this is not clear in section 154 itself.

**/ For example, the requirement that plans distribute summary plan descriptions was deferred repeatedly. See, e.g., 40 Fed. Reg. 14268 (March 15, 1977). In addition, regulations proposed on July 29, 1976, would have required summary annual reports "which could not be readily understood by many participants and beneficiaries" and were withdrawn and reproposed on August 25, 1978, and finally again modified and adopted on April 3, 1979. 44 Fed. Reg. 19400-01 (April 3, 1979).

cial who knowingly or negligently provided false information. Most employers routinely furnish summary plan descriptions to new permanent employees. If these documents sufficiently inform participants, they should also be sufficient for new employees. Furthermore, such employees may be protected by state common law. Thus, ERIC questions the justification for the proposal.

Moreover, despite the Committee Print's note at 44 that attorneys fees could be awarded in the case of clearly spurious litigation, counts of misrepresentation would be included in many suits and would generally foreclose the possibility of summary judgment because of the factual nature of the allegations. Unnecessary and protracted litigation would almost certainly result, exacerbating the existing congestion in federal court dockets and providing another very real disincentive to small employers to establish and maintain pension plans.

XI. Preemption (§ 155)

ERIC generally supports clarifying that ERISA preempts state laws which regulate the content of group insurance policies sold to plans. ERIC strongly opposes permitting states to impose non-uniform requirements on welfare plans covered by ERISA. These proposals would be unduly burdensome for multistate employers and contrary to ERISA's well-conceived preemption policy.

Proposed new ERISA section 514(b)(5) would permit the proliferation of potentially conflicting or non-uniform state health care statutes. It may be impossible to comply with the laws of neighboring states where employees work in one state and reside in another. The problems would be exacerbated if the employer were headquartered in a third state and contracted with an insurer in a fourth state, each of which had different requirements. Some employers would have to contend with the laws of all fifty states.

The Committee Print at 48 recognized that compliance with varying state health care requirements will result in increased administrative costs and, at least in some cases, a lowering of overall benefits in plans which now exceed the minimum benefits states may require. The possible value to employees does not outweigh these burdens. Finally, the administration of any such state laws would be difficult, if not impossible, because reporting and disclosure, fiduciary standards, and enforcement provisions would continue to be preempted by ERISA.

The proposal also would allow states to require conversion or continuation rights under group health plans. The Committee Print at 46-47 distinguishes such provisions from the preempted imposition of particular insurance coverages by describing them as not unduly disruptive of ERISA's general policy of preemption. ERIC disagrees.

There are now more than a dozen non-uniform state health conversion or continuation laws. The variations will confuse employees (and perhaps plan administrators) and create needless administrative expense and, possibly, litigation. Insurance companies would have to assure that policies meet all of the various (and possibly conflicting) state provisions. Conversion and continuation privileges are expensive, and employers and employees often may wish to use "benefit" dollars for different types of employee benefits.

Accordingly, ERISA should clearly preempt any state insurance law which mandates the inclusion of any specific provision related to welfare or health plan benefits, whether during or after employment, and whether or not provided through insurance.

XII. Deductions for Contributions to Foreign Retirement Plans

ERIC urges that the Code treatment of retirement plans maintained for nonresident aliens be conformed to the existing ERISA exemption. Deductions for contributions to plans maintained by United States persons for nonresident aliens should not depend on whether the plans meet ERISA standards. Plans "maintained outside the United States primarily for the benefit of persons substantially all of whom are nonresident aliens" are exempt by section 4(b)(4) of ERISA from all requirements of Title I of ERISA.

The Service currently requires that Forms 5500 be filed with regard to foreign plans if a deduction is claimed for contributions to them, and has taken the position in private letter ruling 7904042 that U.S. employers may deduct contributions to a foreign plan only if the plan is a fully qualified plan, *i.e.*, it complies with all of the amendments to the Code made by ERISA, or if the very limited exceptions in Code section 404(a)(4) or (5) or ERISA section 1022(j) apply. In addition, in view of private letter ruling 7904042, it is likely that the Service will literally apply the Code to the end that the income from trusts which are a part of nonqualified foreign plans could be taxed to the employer under Code section 679.

The ERISA Conference Report suggests that the Code was not amended to exempt foreign plans because "such plans would have no need to seek tax deferral qualification". H.R. Rep. 93-1280, 93d Cong., 2d Sess. 291 (1974). This analysis is, at best, incomplete; it ignores the deduction and taxation of income problems and the fact that foreign plans often cannot comply with the ERISA requirements.

Obviously, when Title II of ERISA added the ERISA requirements to the Code, the requirements of section 404(a) became much more extensive, exacerbating the problems associated with imposing U.S. standards on foreign plans maintained for nonresident aliens. For example, in Canada, the employee must be given the option to elect a joint and survivor annuity; under Code section 401(a)(11), as added by ERISA, the employee must be given the joint and survivor annuity unless he elects otherwise. Thus, it is impossible to comply with both laws. As a further example, technical advice memorandum 7839005 deals with the practice in Germany of funding plans through reserve accounts, rather than trusts, which are uniquely a concept of English common law, unrecognized in Germany and many other countries. Similarly, Jamaican authorities have objected to plans which incorporate provisions required by ERISA. Problems have also arisen under the laws of other countries which conflict with ERISA.

ERIC strongly urges the adoption of a provision similar to section 4705 of H.R. 6053 to assure that contributions to foreign plans maintained primarily for the benefit of nonresident aliens are deductible and that the income from such plans is not taxed to U.S. employers.

XIII. Lump Sum Distributions

Code section 402(e)(4)(H) should be amended to clarify that participation in predecessor plans or other plans of related employers can be counted toward the eligibility requirement for lump sum distributions, provided that the employee's years of service under those plans are taken into account in computing his benefit under the plan making the distribution. Regulations proposed in 1975 have yet to be finalized. Private letter rulings hold that an employee must have been a participant in the plan making the distribution for five taxable years; participation in a plan which was merged into the plan making the distribution or in a related plan is not sufficient.

Similarly, determining the fraction of a distribution which is capital gain and the fraction which is ordinary income under Code section 402(a)(2) depends on the number of calendar years of "active participation" of an employee before Jnauary 1, 1974. It is also unclear whether "tacking" is permitted for purposes of this calculation. Section 4701 of H.R. 6053 would properly resolve these issues.

XIV. Actuarial Assumptions

Rev. Rul. 79-90, 1979-11 I.R.B. 8, requires that the actuarial assumptions used to determine optional benefits be explicitly stated or referenced in plan documents. Possibly more important, an as yet unpublished rule would make a change in the assumptions stated in the plan documents subject to the anti-cutback rule in Code section 411(d)(6).

Defined benefit plans promise a participant a benefit expressed in a certain form, generally an annuity. This "normal" benefit must, under the Service's regulations, be "determinable" throughout a participant's employment.

To meet the individual needs of participants, plans frequently provide participants an election to receive benefits in other forms, such as lump sum distributions, single or joint life annuities, or guaranteed annuities. The amount of any optional form of benefit is determined by applying actuarial assumptions to the "normal" form of benefit accrued for any participant under the plan.

If the actuarial assumptions used are not reflective of current interest or mortality factors, the optional benefit may be worth significantly more or less than the normal form of benefit. Thus, for example, a participant may find that he could elect a lump sum distribution rather than the normal form of benefit provided by a plan and, if the plan used obsolete actuarial assumptions, purchase a more generous annuity from an insurance company. On the other hand, he may find that he receives significantly less in the form of the lump sum distribution than a similarly situated participant who elects the normal annuity.

Plans are funded on the assumption that all participants will elect the normal form of benefit or a benefit which is economically and actuarially equivalent to the normal form. The use of obsolete actuarial assumptions results in funding discrepancies and causes disparity in treatment among participants.

Accordingly, plans have always been allowed the flexibility to adjust actuarial assumptions as the applicable interest rates or mortality experience change. Many large plans use mortality and interest assumptions which are specifically tailored to reflect the plan's own experience, rather than that of specific banks, insurance companies, or the general population. (Mortality assumptions can vary with the sexual or age composition of a particular employer's work force.) Such practices should be encouraged rather than discouraged.

Enrolled actuaries are entrusted under ERISA with the responsibility of certifying a plan's funding requirements and determining the actuarial assumptions used for purposes of determining contributions. Section 4306 of H.R. 6035 would reverse Rev. Rul. 79-90 and entrust the same actuaries with certifying appropriate actuarial assumptions for use in determining optional forms of benefit.

XV. Employee Benefits Commission (Title IV)

ERIC strongly urges deferral of the proposal to consolidate in a new Employee Benefits Commission responsibility for administering ERISA Titles I and IV and various unspecified sections of the Code. The proposal should be deferred at least until there has been a reasonable opportunity to assess the operation of the Administration's Reorganization Plan No. 4.

The principal multiple jurisdiction problems arose immediately after passage of ERISA and, in large part, were associated with the creation of new offices within the Labor and Treasury Departments and the implementation of entirely new legislation. These problems have been largely resolved, and the multiple jurisdiction matter is not now of major concern. Efforts to streamline ERISA enforcement are laudable, but the creation of a new agency at this time would have the opposite effect of resurrecting many of the start-up and transfer of responsibility problems which were the source of many of the complaints which generated this proposal.*/

XVI. Civil Enforcement by Treasury (§ 6 of S. 1089)

ERIC has serious reservations about authorizing the Secretary of the Treasury to bring civil actions to enforce

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*/ An Employee Benefits Commission has been seriously urged (post-ERISA) at least since May 1978. See, S. 3017. Yet, its proponents are unable to designate the Code provisions the Commission would administer. This is but one of the many practical difficulties and resulting uncertainties which would be engendered by the proposal and which its proponents gloss over by deferring to the Executive Branch.

compliance by a plan or a trust with the requirements of the Code. It would represent a fundamental and very important enlargement of the Internal Revenue Service's enforcement authority. The Service has structured its audit and enforcement procedures to settle or litigate matters in specialized tax proceedings. It has neither the staff nor the expertise to engage in civil enforcement litigation.

This proposal would duplicate in the Service authority presently vested by ERISA in the Labor Department. We see no advantage to such duplication. The purpose of the proposal is far from clear. It is importantly related to fundamental questions of ERISA enforcement and to Reorganization Plan No. 4. Until there is more experience with the Reorganization Plan, further legislation regarding the administration of ERISA is premature.

In addition, the essential thrust of the proposal is unclear. To take an extreme example, if a taxpayer adopted a plan with very limited coverage which was not intended to be tax qualified, could the Service through civil litigation require costly amendments necessary to obtain the unwanted tax qualified status? We would think not, but the example, although extreme, suggests the uncertainty presented by the proposal and the difficulty of refining it.

Senator MATSUNAGA. Our next panel of witnesses consists of Mr. William J. Chadwick and Mr. Robert Midkiff, who I believe traveled the longest distance to be with us today, from that heavenly place called Hawaii.

We would be happy to hear from you.

STATEMENT OF WILLIAM J. CHADWICK, ESQ., PAUL, HASTINGS, JANOFSKY & WALKER

Mr. CHADWICK. Thank you, Mr. Chairman.

My name is Bill Chadwick. I am with the Los Angeles law firm of Paul, Hastings, Janofsky & Walker. On my right is Bob Midkiff, who is the president of the American Trust Co. of Hawaii.

My firm represents both the American Trust Co. of Hawaii and all of the profit-sharing plans in Hawaii who currently own one parcel of employer real property, or real property leased back to the company establishing a plan.

I also represent numerous plans in California in the same situation.

What we would like to do, in the time allotted to us this afternoon, is have Mr. Midkiff talk about the economics of these arrangements and the benefits of the plans and of the participants and beneficiaries of the plans, and then I would like to precisely state for the record what the existing rules are and what the Department of Labor's existing procedures are with respect to dealing with employer real property transactions.

Senator MATSUNAGA. Please proceed.

Mr. MIDKIFF. Thank you, Mr. Chairman.

I have submitted some prepared testimony which is rather detailed. I will just concentrate, if I may, on the section relating to economics at this point.

Senator MATSUNAGA. Please proceed.

STATEMENT OF ROBERT MIDKIFF, AMERICAN TRUST CO. OF HAWAII, INC.

Mr. MIDKIFF. We are a custodial trust company. We do not offer an investment service, but we do keep a time-weighted rate of return on all of our clients' retirement plans. We have over 1,500 retirement plans.

The economics of investment in employer real property far outweighs that of other forms of equity investment. Since 1952, I have assisted in the conception of over 1,000 profit-sharing plans in the State of Hawaii and I would just like to cover two of these to make my points.

We are trustees of a profit-sharing plan of a very substantial garment manufacturing firm with 116 employees. The fund is currently valued at $2.5 million and the assets are 80 percent invested in six parcels of real property, two of them employer real property.

The corporate objective of the family stockholders of this company is to provide an amount of at least $100,000 as retirement distributions from the profit-sharing plan to each of the seamstresses at normal retirement age. On December 31, 1977, the account balances of each seamstress who had worked there since 1963, when the plan was started, was $40,000.

Last year, with rental income and market value appreciation based on annual reappraisal by a qualified member of the Appraisal Institute, the value of these accounts rose to $50,000 or a 24-percent gain from investment and appreciation. This $10,000 growth in the profit-sharing plan exceeded their take-home pay last year.

The land under the plan of another garment manufacturing company is owned by the profit-sharing plan. The building itself is owned by the company. The annual return to the employees in this plan, based on rental income and reappraisal, has exceeded 12 percent per year since purchase.

Out of 160 employees in this plan, 150 voluntarily contribute 6 percent of their pay in order to benefit from the 12 percent net tax-free return to their voluntarily contribution account.

As may be expected, the morale of these employees is extremely high. Productivity is tremendous, and company profits climb each year.

We did apply to the Department of Labor for an exemption for the profit-sharing plan's retention of this property. The Department instructed us to withdraw it and reapply some time in 1984.

At this point we are uncertain whether the plan will continue to own the property after 1984 or whether the Department of Labor will force the plan to divest itself of the property. This uncertainty has prevented the company from enlarging the building and increasing the value of the plan's assets and the property.

One more example. In another situation, the employees of a small, commercial printing plant were able to finance the purchase of their company prior to ERISA through the profit sharing plan. This plan brought the company's building through a mortgage note to the plan.

The company pays 12 percent per year as lease rent to the plan and this rent, together with company profit-sharing contributions and employee contributions is amortizing the loans to purchase the company. There are 25 employee stockholders who share in profits as well as the benefits from real estate investment in their own company building.

Thank you, Mr. Chairman.

Mr. CHADWICK. Mr. Chairman, I have a summary of my comments and a detailed statement, both of which I would like inserted into the record.

Because of the statements made by the Department of Labor earlier this afternoon, I would like to deviate from my prepared remarks and explain for the record exactly how the prohibited transaction rules apply to employer real property transactions and how the Department of Labor has exercised its authority to consider administrative exemptions from the prohibitions and to interpret the statute in the context of advisory opinions.

Senator MATSUNAGA. Without objection, your prepared statement will appear in the record, and you may proceed.

Mr. CHADWICK. The rules are rather complex, but to simplify them a bit, let me start by saying that section 407 of ERISA provides that no employee pension benefit plan, whether a defined benefit plan or defined contribution plan, such as a profit-sharing plan, can acquire or hold any employer real property and employer real property is real property owned by the plan and leased to the employer maintaining the plan.

No plan can acquire or hold any employer real property other than qualifying employer real property.

With respect to defined benefit plans, those plans may acquire and hold qualifying employer real property, provided that the fair market value of the employer real property does not exceed 10 percent to the fair market value of the plan's assets.

With respect to defined contribution plans, technically referred to as eligible individual account plans, those plans are not subject to the 10-percent limitation. However, they can still only hold qualifying employer real property.

Qualifying employer real property is a term of art. It is a statutorily defined term. It means a substantial number of geographically dispersed parcels of employer real property provided that those parcels are suitable or adaptable without excessive cost for more than one use.

The Labor Department has interpreted that definition as precluding a profit-sharing plan from acquiring or holding one parcel of employer real property because, according to the Department of Labor, by definition, one parcel of employer real property does not satisfy what is commonly referred to as the plurality requirement or the multiple parcel requirement.

With that as a background, I would like to focus on two fact situations: One, the situation in which prior to ERISA, or more specifically, prior to July 1, 1974, a plan acquired a parcel of real property and leased it to the employer, maintaining the plan.

In that case, the acquisition and holding of that real property, or the continued leasing of that real property to the employer maintaining the plan, may be permissible until June 30, 1984, under a transitional rule contained in section 414(c)(2) of ERISA.

However, if you go to the Labor Department and ask them whether a transaction is, in fact, covered by that transitional rule, the Labor Department will tell you that they will not rule on that issue because such a determination is inherently factual in nature.

That leaves counsel in the position of also not being able to rule for the same reason. The Labor Department has said it is factual. How can counsel go back to the client and give a legal opinion that the holding would be permissible until June 30, 1984?

Therefore, clients have applied for exemptions from the applicable prohibitions pursuant to the Labor Department's administrative exemption procedure.

What the Labor Department tells you is, since the transitional rule may be available, it is premature to grant, or consider, an exemption and therefore the applicant should withdraw the exemption request. However, again, the Labor Department will not tell you whether, in fact, the transaction is covered by the transitional rule.

This puts the client in an impossible situation. The client has to either dispose of the property immediately or decide that it will assume the risk that the transaction is covered by the transitional rule and therefore, hold on to the property and reapply for an exemption some time in late 1983.

Of course, at that time, there is certainly no assurance that the Department will favorably dispose of the applicant's exemption request. In the interim if the client has to finance an improvement on the property, a bank will not lend on the property if it feels that the property may have to be disposed of prematurely. So the property just sits there.

The second situation, let's assume that a plan does not have any employer real property but that it would like to acquire real property and lease it back to the employer. The acquisition would be prohibited in the absence of an exemption.

Now, if the property is available on the market, the plan may decide that it will apply for an exemption without acquiring the property first, but just apply for an exemption for a proposed transaction.

However, there are no guidelines, so you cannot structure the transaction, and there is certainly no assurance that the property will be available on the market by the time the Labor Department gets around to considering and disposing of the exemption request.

Certainly, the exemption process has been speeded up quite a bit recently, but it still takes approximately 6 months at best, and it is still a very expensive, very time-consuming process from the standpoint of the client.

My final comment is that S. 1958 is more restrictive than the existing statutory conditions. It is more protective of the interests of participants and beneficiaries and of plans. We strongly support it, because it does permit plans to hold a single parcel of real property and lease it to the employer provided conditions are met which safeguard the interests of participants and beneficiaries.

By the Labor Department's own admission, the conditions contained in your bill, S. 1958, are the same conditions that the Labor Department imposes when it gets around to dealing with exemption requests.

Thank you.

Senator MATSUNAGA. Thank you very much.

Because of the time limitation, I will dispense with the questions, should subcommittee members have questions we will submit them to you in writing.

[The prepared statements of Messrs. Chadwick and Medkiff follow:]

TESTIMONY OF WILLIAM J. CHADWICK, ESQ., PAUL, HASTINGS, JANOFSKY & WALKER, LOS ANGELES, CALIF.

My name is William J. Chadwick. I am with the Los Angeles California law firm of Paul, Hastings, Janofsky & Walker. Prior to rejoining Paul, Hastings, Janofsky & Walker in March of 1977, I was involved in the administration and enforcement of the Employee Retirement Income Security Act of 1974 (ERISA) on behalf of both the Department of Labor, as the Administrator of Pension and Welfare Benefit Programs, and the Department of the Treasury, as an Attorney-Advisor for Tax Policy in the Office of the Tax Legislative Council.

My testimony this afternoon is in support of S. 1958, a bill to amend ERISA for the purpose of facilitating the investment by certain employee pension benefit plans in qualifying employer real property. S. 1958 would amend the prohibited transaction restrictions contained in section 407 of ERISA to permit eligible individual account plans to invest in qualifying employer real property provided certain conditions are satisfied. The conditions are designed to protect the interests of such plans and of their participants and beneficiaries and to protect the rights of such participants and beneficiaries.

S. 1958 is both necessary and appropriate for a number of reasons. First, the restrictions contained in section 407 of ERISA prohibit eligible individual account plans from acquiring and holding a single parcel of employer real property. Second, although section 408(a) vests the Secretary of Labor with authority to grant administrative exemptions from the applicable restrictions, the Department of Labor will not consider an exemption application if the employer real property transaction is arguably within the scope of section 414(c)(2), the transitional provision relating to employer real property leases. However, the Department of Labor will not issue an advisory opinion with respect to whether a particular employer real property lease is covered by the section 414(c)(2) transitional provision. Third, the administrative exemption process is both expensive and time-consuming. In addition, in the absence of guidance from the Department of Labor, it is difficult to structure employer real property transactions to guarantee an administrative exemption. Fourth, the conditions contained in S. 1958 parallel the conditions contained in the limited number of administrative exemptions that the Department of Labor has proposed and granted. Fifth, the conditions contained in S. 1958 insure that employer real property transactions which satisfy the conditions are in the interest of eligible individual account plans and of their participants and beneficiaries and protective of the rights of such participants and beneficiaries.

I. SECTION 407 PROHIBITS AN ELIGIBLE INDIVIDUAL ACCOUNT PLAN FROM HOLDING A SINGLE PARCEL OF EMPLOYER REAL PROPERTY

Section 407(a) of ERISA provides that an employee pension benefit plan may not acquire or hold any employer real property which is not qualifying employer real property. The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan.

With respect to qualifying employer real property, a defined benefit plan may not acquire any qualifying employer security or qualifying employer real property, if immediately after such acquisition the aggregate fair market value of employer securities and employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan. It is important to note that the 10 percent limitation relates to aggregate employer securities and employer real property held by the plan.

Section 407(b) of ERISA provides that the 10 percent limitation shall not apply to any acquisition or holding of qualifying employer real property by an eligible individual account plan. The term "qualifying employer real property" means parcels of employer real property: (1) if a substantial number of the parcels are disbursed geographically; (2) if each parcel of real property and the improvements thereon are suitable for more than one use; (3) even if all such real property is leased to one lessee; and (4) if the acquisition and retention of such property complies with the provisions contained in Part 4 of Title I of ERISA other than the diversification rules contained in section 404 of ERISA and the otherwise applicable prohibited transaction restrictions contained in section 406 of ERISA. According to the Department of Labor, the definition of the term "qualifying employer real property" precludes an eligible individual account plan from acquiring and holding a single parcel of employer real property. A single parcel of employer real property does not satisfy the plurality requirement.

II. DEPARTMENT OF LABOR WILL NOT CONSIDER AN EXEMPTION APPLICATION IF TRANSITIONAL RELIEF MAY BE AVAILABLE

Section 408(a) of ERISA vests the Secretary of Labor with the authority to grant administrative exemptions from the applicable prohibitions. Section 414(c)(2) of ERISA contains a transitional provision, until June 30, 1984, for a lease of property, including employer real property, involving an employee pension benefit plan, including an eligible individual account plan, and a party in interest, including the employer maintaining the plan, provided certain conditions are satisfied.

Prior to the effective date of the prohibited transaction restrictions contained in sections 406 and 407 of ERISA (i.e., January 1, 1975) numerous employee pension benefit plans acquired and held employer real property. In most cases, the acquisition in holding arguably satisfies the conditions contained in section 414(c)(2) of ERISA. In order to continue holding employer real property after June 30, 1984, some of these plans have applied for administrative exemptions from the applicable prohibitions. However, the Department of Labor has decided, as a matter of policy, that it will not consider an exemption request if the underlying transaction is arguably within the scope of the transitional provision contained in section 414(c)(2) of ERISA. Thus, exemption applicants are required to withdraw their applications.

In addition, the Department of Labor will not render an advisory opinion that the underlying transaction is covered by the transitional provision. As a result, the exemption applicant is faced with a difficult choice. The applicant can cause the plan to dispose of the employer real property immediately or the applicant can assume the risk that the underlying transaction is covered by the transitional provision and shortly before the expiration of transitional relief reapply for an administrative exemption.

III. ADMINISTRATIVE EXEMPTION PROCESS IS EXPENSIVE AND TIME CONSUMING

With respect to employer real property transactions that do not satisfy the conditions contained in section 414(c)(2), the Department of Labor will consider exemption applications. However, the exemption process is expensive and time consuming. In addition, since the Department of Labor has not published substantive exemption guidelines, it is difficult or impossible to determine whether a particular employer real property transaction will be disposed of favorably by the Department of Labor. The plan must participate in structuring a proposed transaction without knowing whether the conditions it deemed necessary and appropriate will be acceptable to the Department of Labor and then wait for the Department of Labor to render a decision. Of course, in some cases, there is no certainty that the property will still be available when the exemption request is disposed of by the Department of Labor.

IV. S. 1958 CONTAINS CONDITIONS LIKE THE CONDITIONS IMPOSED BY THE DEPARTMENT OF LABOR

S. 1958 would eliminate these problems by amending the definition of the term "qualifying employer real property" to permit eligible individual account plans to acquire and hold a single parcel of employer real property. In effect, the proposed amendment to section 407(d)(4) of ERISA is a statutory administrative exemption from the prohibited transaction restrictions. The conditions contained in the proposed amendment closely parallel the conditions the Department of Labor has imposed in the administrative exemptions it has granted.

Without discussing each of the conditions contained in the proposed amendment, it is important to note a few of the conditions. First, the acquisition cost of the employer real property cannot exceed 50 percent of plan assets. While this restriction is appropriate, it is also more restrictive than the current statutory condition applicable to plans holding multiple parcels of employer real property. Second, the return to the plan pursuant to the lease of the employer real property to the employer maintaining the plan, must be at least as favorable to the plan as the annual rate of return on such property would be if such property was leased to an unrelated party. This condition is also more restrictive than the conditions applicable to plans holding multiple parcels of employer real property. Third, in most cases, lease rentals must be personally guaranteed by a party in interest with respect to the plan. Fourth, in the event of default, in addition to the party in interest guarantee, the plan may lease the property to another party or dispose of the property. Fifth, the entire arrangement includes the involvement of an independent fiduciary.

V. S. 1958 CONTAINS CONDITIONS DESIGNED TO PROTECT THE RIGHTS OF PLANS AND PARTICIPANTS

The conditions contained in the proposed amendment to section 407(d)(4) of ERISA are more restrictive than the existing restrictions contained in the statute. The only difference is that the proposed amendment would permit eligible individual account plans to acquire and hold a single parcel of employer real property. However, the applicable conditions more than compensate for any perceived increase in risk to the plan.

I would like to thank the Committee for the opportunity to testify this afternoon. I'll be pleased to answer any questions with respect to S. 1958. Thank you.

STATEMENT SUBMITTED BY ROBERT R. MIDKIFF, PRESIDENT, AMERICAN TRUST CO. OF HAWAII, INC.

SUMMARY

I. Employer real property investments have out-performed other equity investments.

II. The ERISA conference bill in requiring investment in several parcels and in requiring geographical-diversity, denied investment in employer real property for small profit sharing plans.

III. S. 1958 provides careful safeguards for investing in employer real property.

This statement is submitted in support of Senate Bill 1958 amending the Employee Retirement Income Security Act of 1974 for the purpose of facilitating the investment by employee profit sharing plans in qualifying employer real property. This statement is submitted on behalf of five profit sharing clients of American Trust Company of Hawaii, Inc.

Since 1952, I have assisted in the conception and birth of over 1,000 profit sharing plans in the State of Hawaii. In the years prior to ERISA, many of our clients invested in a single piece of real property, leasing it back to the employer to the great benefit of the plan members. At the time of the passage of ERISA, five of out retirement plan trusts owned employer real property with a lease-back to the company. Four of these trusts own a single piece of employer real property. One of the trusts own two parcels of employer real property: One on the island of Oahu and one on the neighboring island of Kauai.

Under Section 408 of ERISA, each of these trusts will have to dispose of these parcels of employer real property within ten years.

I would like to describe several successful profit sharing plans with employer real property. We are trustees of the profit sharing plan of a very substantial garment manufacturing firm with 116 employees. The fund is currently valued at $2.5 million, and the assets are 80 percent invested in six parcels of real property, two of them employer real property.

A corporate objective of the family stockholders of this company is to provide an amount of at least $100,000 as retirement distribution from the profit sharing plan to each of the seamstresses at normal retirement age. On December 31, 1977, the account balance of any seamstress who had worked there since 1963, when the plan was started, was $40,000. Last year, with rental income and market value appreciation, based on annual reappraisal by a qualified member of the appraisal institute, the value of these accounts rose to $50,000, for a 24 percent gain. This $10,000 growth in the profit sharing plan exceed their take-home pay last year.

The land under the plan of another garment manufacturing company is owned by the profit sharing plan. The building itself is owned by the company. The annual return to employees in this plan, based on rental income and reappraisal, has exceeded 12 percent per year since purchase. Out of 160 employees in this plan, 150 voluntarily contribute 6 percent of their pay in order to benefit from the 12 percent net tax-free return to their voluntary contribution account. As may be expected, the morale of these employees is extremely high, productivity is tremendous, and company profits climb each year.

We have applied to the Department of Labor for an exemption for the profit sharing plan's retention of the property. The Department has instructed us to withdraw the application and re-submit it immediately before the 10 year grace period expires in 1984.

At this point we was uncertain whether the plan will continue to own the property after 1984 or whether the Department of Labor will force the plan to divest itself of the property. This uncertainty has prevented the company from enlarging the building and increasing the value of the plan's assets in the property.

In another situation, the employees of a small commercial printing plant were able to finance the purchase of their company prior to ERISA, through the profit sharing plan. This plan bought the company's building through a mortgage note on the building. The company pays 12 percent per year as lease rent to the plan, and this rent, together with company profit sharing contributions and voluntary employee contributions, is amortizing the loans to purchase the company. There are 25 employee stockholders who share in profits as well as the benefits from real estate investment in their own company building.

In the deliberations leading to the passage of ERISA, single employer plan investment in one piece of property was inadevertently prohibited. When this bill first passed the House, there were no prohibited transactions. The prohibited transaction provisions (borrowed from private foundation legislation) were added by the Senate Human Resources Committee. ERISA was amended on the Senate floor to permit profit sharing plans to invest in employer real property as well as employer stock but without a defintion of employer real property.

In the conference committee, without any futher hearings, employer real property was defined as parcels (plural) of property, geographically diversified and adapted for multiple use. This language was suggested to the conference committee by the attorney for the Southland Stores Corporation in order to meet the requirements for the 7-11 Store profit sharing plan which owned multipurpose buildings in 40 states. The conference committee action inadvertantly required all existing small company profit sharing plans to divest themselves of their employer real property within ten years and has prevented and new plan from beginning to invest in employer real property by acquiring a single piece of property.

Since the passage of ERISA, real estate investments have provided a higher return with less risk than almost all forms of equity investment. The ability of employees to take pride in the land or building owned by their profit sharing plan will be restored by the passage of S. 1958. The safeguards which have been required in the several exemption approvals of the Department of Labor are provided for in the bill. Each proposed employer real property investment will have to be very carefully reviewed to meet the investment safeguards of the bill.

It deserves your favorable consideration.

Respectfully submitted.

Senator MATSUNAGA. Our last panel of witnesses consists of the following: Dr. Darold Morgan, president, Annuity Board of the Southern Baptist Convention; Dr. Charles Cowsert, executive secretary, Board of Annuities and Relief, Presbyterian Church in the United States; Rev. Gordon Smith, treasurer, the Ministers and Missionaries, Benefit Board of the American Baptist Church; Mr. Leo Landes, representative, Joint Retirement Board of the United Synagogue of America; Dr. John Ordway, executive vice president, United Church of Christ Pensions Board; and Mr. Gary Nash, secretary, Church Alliance for Clarification of ERISA.

Senator Talmadge, the sponsor of S. 1090, 1091, and 1092 is not able to be here this afternoon because of a conflict in his schedule. He has asked me, however, to express his strong support for these bills and his appreciation to the representatives of the church groups today for your participation in this hearing.

Senator Talmadge has requested that I submit his statement in support of his bills for the record.

Without objection, Senator Talmadge's statement will appear in the record.

[The statement of Senator Talmadge follows. Oral testimony continues on p. 374.]

STATEMENT OF HON. HERMAN E. TALMADGE, U.S. SENATOR

Mr. Chairman, I am pleased that your Subcommittee has scheduled this hearing on my bills, S. 1090, S. 1091, and S. 1092.

I strongly support this legislation, and I am hopeful that the Finance Committee and the Senate will act favorably on these measures in the near future. I am delighted that representatives of the Church Alliance for Clarification of ERISA have this opportunity to present their views in support of S. 1090, S. 1091, and S. 1092 to this Subcommittee. I would like to thank Dr. Darold Morgan, President of the Annuity Board of the Southern Baptist Convention, Dr. Charles Cowsert, Executive Secretary of the Board of Annuities and Relief, Presbyterian Church in the United States, Reverend Gordon Smith, Treasurer, The Ministers and Missionaries Benefit Board of the American Baptist Churches, Mr. Leo Landes, Representative of the Joint Retirement Board of United Synagogue of America, Dr. John Ordway, Executive Vice President, United Church of Christ Pensions Board, Mr. Gary Nash, Secretary of the Church Alliance for Clarification of ERISA, Mr. Dick Kelly, United States Catholic Conference, Mr. Walter Donnelly, Treasurer of the Church Pension Fund of the Episcopal Church, Mr. John McCracken, Counsel, The Church Pension Fund of the Episcopal Church, Mr. Pat Persons, Counsel to the Ministers and Missionaries Benefit Board of the American Baptist Churches, and Dr. Charles V. Bergstrom, Executive Director, Office for Governmental Affairs, Luthern Council in the U.S.A. for participating in these hearings.

The Church Alliance for Clarification of ERISA consists of the chief executive officers of the pension programs of nearly all of our large church denominations, Protestant, Jewish, and Catholic, some twenty-seven in number. A list of these churches is attached. The Church Alliance was formed because of the growing concern of the churches as to the effect of certain provisions of the Employee Retirement Income Security Act of 1974 on their pension and welfare benefit programs. These bills, S. 1090, 1091, and 1092 were introduced by my colleagues, Senators Bentsen and Boren, and myself to respond to those concerns. Identical bills have been introduced in the House of Representatives by Congressmen Conable and Corman. A number of the members of both Houses have indicated that they support our bills and would like to be identified as cosponsors.

The plans of our churches were among the first in this country to provide retirement and welfare benefits for employees. Several of these plans date back to the 1700's. The retirement plans of the Church Alliance have been in existence in their present form on an average of at least forty years. Most provide retirement benefits in the form of fully-vested and fully-funded annuities. They are professionally managed and have been operated responsibly, and have provided benefits to the ministers and lay employees of the churches, including the agencies carrying out their religious missions, for a long period of time.

In drafting the Employee Retirement Income Security Act of 1974, which is called ERISA, Congress recognized that there were serious Constitutional objections to subjecting the churches, through their plans, to the examination of books and records and possible levy on church property to satisfy plan liabilities. As a consequence, "church plans" were excluded from the purview of ERISA. However, the exclusionary language was drafted in terms of hierarchical churches and did not give consideration to the special problems of religious organizations that are operated on a congregational basis. Equally important, at the last moment in the drafting process, it was decided that the church plan exemption would not apply if church agencies were retained in church plans. A transitional rule does permit church plans in existence at the time of ERISA to cover church agencies until December 31, 1982. Finally, ERISA extended to certain exempt organizations, but not to churches or their agencies, relief from the limitations on contributions to Section 403(b) annuity programs.

S. 1090 and 1091 are companion bills dealing with the definition of church plan in Title I of ERISA and the Internal Revenue Code, respectively. These would clarify the definition of church plan and permit such a plan to cover agencies carrying out the religious missions of the church. S. 1092 is a revenue bill which would extend to our churches and agencies the special relief provisions now applicable to educational organizations, hospitals, and home health service agencies for contributions to Section 403(b) annuity programs, which are widely utilized in church plans.

A church plan is presently defined as a plan established and maintained for its employees by a church or by a convention or association of churches.[1] The definition further provides that until December 31, 1982, the plan may cover the employees of a church agency, but not after that date if it is to be considered a church plan. Even where this transitional rule applies, a church plan has been precluded from including the employees of agencies if the plan was not maintained for those agencies on January 1, 1974.

The churches of this country are faced with the dilemma of subjecting their pension and welfare benefit plans to the provisions of ERISA if they wish to retain their agencies in these plans after 1982. It is unreasonable of us to expect a church to waive its Constitutional privileges by continuing to cover agency employees after that date. Therefore, by 1983 the churches must choose between two alternatives. They may establish a separate plan meeting ERISA standards for the employees of their agencies, or they may abandon the coverage of agency employees. Either choice will be a costly and painful experience. It is impossible at this time to predict what alternative the churches will choose, but the costs of undoing years of experience and establishing and maintaining two separate plans may be too much for the churches and agencies to bear. In this case, agencies whose employees are now covered by the church plan will be forced to abandon their retirement and welfare programs or, in the alternative, seek coverage from non-church sources, which may prove to be too expensive or too burdensome to undertake, particualrly in the case of small agencies. To those of us who are sponsoring these bills, this result seems unfair and inconsistent with the principles of ERISA which were to foster retirement and welfare benefit coverage.

Church agencies are such eleemosynary institutions as schools, colleges, missions, convents, hospitals, orphanges, summer camps, drug abuse centers, inner city agencies, nursing and retirement homes, and day care centers. They are considered by the churches as one means by which they fulfill their missions. They are also considered as part of the churches. Many are very small and rely on contributions to meet operating expenses. If they are forced out of church plans in 1983, they may

[1] Section (3)(33), Title I, ERISA; Section 414(e), IRC.

be unable to incur the increased costs of providing alternatives. Many, we fear, will cease to provide retirement and welfare benefit coverage. The Comptroller General and The Pension Benefit Guaranty Corporation have studied the impact of ERISA on small retirement plans. These studies indicate that a significant number of small plans have terminated since 1974. Of these, a large number have cited ERISA as a major factor. My colleagues and I do not want ERISA to be the cause of the termination of retirement and welfare benefit programs for church agencies.

S. 1090 and 1091 will permit a church plan to continue to provide retirement and welfare benefits for agency employees, including the employees of agencies coming into existence after January 1, 1974, without sacrificing its church plan exemption. This concept of one plan for both church and agency employees is critical for a further reason. It allows ministers and lay employees to move from church to agency and back without gaps in plan coverage and with coverage by one retirement system. These two bills also make a number of technical corrections in the church plan definition, mainly to take into account the structural differences between our congregational denominations and our hiearchical denominations.

S. 1092 provides the same measure of limited relief to the ministers and lay employees of our churches, which is already accorded employees of educational organizations, hospitals, and home health service agencies. A great many church plans provide retirement benefits in the form of annuity arrangements described in Section 403(b) of the Internal Revenue Code. These are classified as defined contribution plans for purposes of the limitations on contributions found in Section 415(c)(1), enacted by ERISA. This limitation is the lesser of $25,000, adjusted by increases in the cost of living, or 25 percent of an employee's compensation. The 25 percent limitation curbs all but minimal contributions to the plans of poorly paid employees. Thus, there is virtually no way of making larger than normal or "catch-up" contributions to compensate for those years when contributions were small because of low salaries. We recognized this problem in 1974 by providing in Section 415(c)(4) a series of elections to override the 25 percent limitation under limited circumstances. However, we extended these elections only to the employees of educational institutions, hospitals, and home health service agencies.

The starting salary of a minister is only from $5,000 to $10,000 a year. It may increase to $15,000 or $20,000 at the time of retirement but rarely over that figure. A typical pension of a minister is only from $2,000 to $3,000 a year. Lay employees generally receive less than these amounts. Section 415(c)(4) grants employees of other exempt organizations, who expect to be poorly paid throughout their careers, the opportunity to have catch-up contributions made to their plans late in their careers. Then, their children will be educated, and their personal expenses may decline. They will be in a better position than they were earlier in life to afford larger plan contributions and to make up for the years when contributions were necessarily small. Ministers and lay employees need the same elections that the employees of other institutions have to raise their retirement incomes to an acceptable level.

The Section 415(c)(1) limitation is out of line with the generous limitations for defined benefit plans. Under Section 415(b), annual retirement benefits may be as great as the lesser of $75,000, adjusted by increases in the cost of living, or 100 percent of the employee's average compensation for his high three years. We also provided in 1974 that these limitations need not be considered if the annual benefit does not exceed $10,000, which is also indexed by cost of living increases.

S. 1092 would extend the elections of Section 415(c)(4) to our ministers and lay employees. It also provides that the elections need not be considered if a contribution does not exceed $10,000. This $10,000 amount is indexed, as are several other figures in Section 415, and is comparable to the $10,000 amount for defined benefit plans. These limitations are all subject to the limitation of the exclusion allowance in Section 403(b)(2).

S. 1092 also makes an amendment to the exclusion allowance formula in Section 403(b)(2). One factor in computing the exclusion allowance is an employee's years of service with his present employer. Many ministers and lay employees change jobs within their denominations quite frequently. Since only service with the present employer is considered in computing the exclusion allowance and since most employees in congregational churches are technically employees of their immediate employer and not the church itself, frequent changes of position penalize the employee by diminishing the exclusion allowance. S. 1092 would amend Section 403(b)(2) so that all years of service by a minister or lay employee for employers within the denomination would be considered as years of service for one employer.

Mr. Chairman, my remarks in the Congressional Record accompanying the introduction of these bills explain them in more depth than I have here. I am, therefore, appending these remarks to this statement.

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

An alliance of the chief executive officers of the pension programs of the following church denominations and other organizations:

Union of American Hebrew Congregations
United Presbyterian Church in The U.S.A.
Church of God
Presbyterian Church in the United States
Reorganized Church of Jesus Christ of Latter Day Saints
Unitarian Universalist Association of Congregations in North America
African Methodist Episcopal Church
The Lutheran Church-Missouri Synod
Catholic Mutual Relief Society
United Methodist Church
United Synagogue of America
Southern Baptist Convention
Presbyterian Church in America
General Conference of Seventh-day Adventists
United Church of Christ
Church of God in North America
Episcopal Church
The Christian Church (Disciples of Christ)
The Wesleyan Church
Church of the Brethren
The American Lutheran Church
Christian Reformed Church in North America
Lutheran Church in America
Church of the Nazarene
American Baptist Churches
Mennonite Churches
A.M.E. Zion Church

The PRESIDING OFFICER. Without objection, it is so ordered.

By Mr. TALMADGE (for himself, Mr. BENTSEN, and Mr. BOREN):

S. 1090. A bill to amend the Employee Retirement Income Security Act of 1974 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan; to the Committee on Finance and the Committee on Labor and Human Resources, jointly, by unanimous consent.

S. 1091. A bill to amend the Internal Revenue Code of 1954 to permit a church plan to continue after 1982 to provide benefits for employees of organizations controlled by or associated with the church and to make certain clarifying amendments to the definition of church plan; to the Committee on Finance.

S. 1092. A bill to amend section 403(b) of the Internal Revenue Code of 1954 with respect to computation of the exclusion allowance for ministers and lay employees of the church, and to amend sections 403(b)(2)(B), 415(c)(4), 415(d)(1), and 415(d)(2) and to add a new section 415(c)(8) to extend the special elections for section 403(b) annuity contracts to employees of churches, conventions, or associations of churches, and their agencies and to permit a de minimis contribution amount in lieu of such elections; to the Committee on Finance.

LEGISLATION REGARDING CHURCH PENSION PLANS AND RELATED REFORM OF ERISA

● Mr. TALMADGE. Mr. President, with my colleagues Senators BENTSEN and BOREN, I am reintroducing legislation to amend the definition of "church plan" found at section 414(e) of the Internal Revenue Code and section 3(33) of the Employee Retirement Income Security Act of 1974, which I introduced in the 95th Congress. All of the major church denominations in this country—Protestant, Catholic, and Jewish—are of one accord in this matter. They need and desire relief.

When we enacted ERISA in 1974, we set 1982 as the date beyond which a church plan could no longer provide retirement and welfare benefits for employees of church agencies. We also forbade the church plans to provide any new agency coverage after 1974. Moreover, as I will explain later, the church plan definition is so narrow that it almost completely fails to consider the way our church plans have for decades operated. At this moment our churches are justifiably concerned that their plans do not meet the church plan requirements and are, therefore, subject to ERISA. In 1974, we did not recognize the unique character and needs of our church plans.

The church plans in this country have historically covered both ministers and lay employees of churches and church agencies. These plans are some of the oldest retirement plans in the country. Several date back to the 1700's. The average age of a church plan is at least 40 years. To comply with ERISA by 1982, the churches must divide their plans into two so that one will cover church employees and the other, agency employees. It is no small task to break up a plan that has been in existence for decades, even centuries.

The estimated legal, actuarial, and accounting costs of the initial division of church plans and the additional continuing costs of maintaining two separate plans are so significant that reduced retirement and other benefits may result unless they can be assimilated. To offset these additional costs, the churches are confronted with a very large, and possibly not absorbable, economic burden, merely to provide pre-ERISA level of benefits. There is no imposition by ERISA of such moment on the plans of other organizations.

Church agencies are essential to the churches' mission. They are for the sick and needy and disseminate religious instruction. They are, in fact, part of the churches. As a practical matter, it is doubtful that the agency plans would survive subjection to ERISA. There is an essential difference between the plans of business and the plans of church institutions. If a business incurs increased plan maintenance costs, it merely passes these on to the consumer. The incomes of most church agencies, on the other hand, are dependent solely upon tithes and other offerings. There is virtually no way for them to compensate for the additional costs of complying with ERISA. The churches fear that many of the agencies would abandon their plans. We are concerned today that the requirements of ERISA has made the maintenance of plans so expensive and demanding even for businesses which have the capacity to absorb additional costs. The impact of ERISA on church agencies would be many times as serious as that on businesses.

Ministers and lay employees have a unique need to be covered by one plan. Employment is extremely fluid within our denominations. A minister will frequently move from church to agency, or wherever his services are most needed. If he cannot be covered by one plan, gaps in coverage may occur because the agency may not have a plan or may have a waiting period before participation. If the church plan definition is allowed to remain, ministers and lay employees will not be able to pursue their missions nearly as freely as they have in the past. It is inescapable that the way our churches have functioned will be directly affected.

As I mentioned earlier, the church plan definition is so narrowly drawn that it does not in many ways even approximate the way church plans are organized or operated. For example, this definition can be interpreted to require a minister or lay employee of a church to be a current employee. Many ministers serve their faith outside the denominational structure—as chaplains in prisons, hospitals, universities, and elsewhere. Evangelist ministers are usually self-employed and have no employer. There is no valid reason for denying these persons the benefits of retirement and welfare coverage.

This type of problem is less apt to occur in a hierarchical denomination because a minister may continue to be considered an employee even though he is serving outside the church structure.

Most church plans of congregational denominations are administered by a pension board. This is usually an organization separately incorporated from, but controlled by, the denomination. Under the church plan definition, there is a question whether the plan is established by a church, as it must be, or by a pension board. This requirement also points up the inapplicability of the church plan definition to congregational churches. In this type of church, the denomination has little, if any, control over the local churches. Some differences in plan provisions occur, because the denomination cannot enforce uniformity, and the question whether the plan is maintained by the denomination or by the local churches is raised.

The inability of a congregational denomination to control its agencies makes it difficult to see how the church agency plan could meet the requirements of ERISA. In a corporate structure lines of authority are clear. One plan covering the employees of a parent and its subsidiaries can easily meet the requirements of law because of the control executed by the parent. As I have stated, a congregational denomination cannot force the agencies to observe the requirements of ERISA. Accordingly, there is little hope that a plan established by a congregational church for its agencies could comply with ERISA.

Mr. President, these and other problems over the church plan definition under present law confront the churches today. They are worried that their plans do not now meet the church plan requirements and concerned over the impending restructuring of their plans. It is time we remove the churches from this statutory cloud. If we have enacted a statute that may require the church plans to come under ERISA, file reports, be subject to the examination of books and records and possible foreclosure of church property to satisfy plan liabilities, it must be changed because we have clearly created an excessive Government entanglement with religion.

Under the provisions of our proposals, effective as of January 1, 1974, a church plan shall be able to continue to cover the employees of church-associated organizations. There will be no need to separate the employees of church agencies from the church plan. Our legislations retains the definition of church plan as a plan established and maintained for its employees by a church or by a convention or association of churchs exempt from tax under section 501. However, to accommodate the differences in beliefs, structures, and practices among our religious denominations, all employees are deemed to be employed by the denomination. The term employee is also redefined to include: First, a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry; second, an employee of an organization which is exempt from tax and which is controlled by or associated with the church; and third, certain former employees who participated in the church plan before separation from service.

Under our legislation an organization is "associated" with a church if it shares common religious bonds and convictions with that church. Thus, by including an ordained minister as an employee without the requirement of an actual employment relationship, the church plan may continue to cover a minister who serves outside of the denominational structure, provided the service is in the exercise of his ministry. Accordingly, a minister serving as a prison chaplain or teaching religious studies at a university or an evangelist minister by who no employer would be entitled to participate in the church plan.

Under our legislation a church plan will not have to remove from its rolls an employee who has left the denominational group but may retain his accrued benefit or account for the eventual payment of benefits under the plan. There is no real reason why a church plan should be forced to pay a former employee his accrued benefit in cash and, thus, destroy his retirement benefits. Some denominations continue to accept plan contributions for disabled employees and, temporarily, for employees who have separated from service. A minister or lay employee may reach a point in his career where he wants time to decide whether he will spend the rest of his life in the service of the church. During this period the denomination may permit the individual to continue to be covered by the church plan even though he is separated from service. Under the our legislation a church plan may continue to receive contributions for an individual who is a participant in the church plan at the time of his separation from service but only for a period of 5 years. A time limit is not placed upon employees who separated from service because of disability.

A plan or program funded or administered through a pension board, whether a civil law corporation or otherwise, will be considered a church plan, provided the principal purpose or function of the pension board is the administration or funding of a plan or program for the provision of retirement or welfare benefits for the employees of a church. The pension board must also be controlled by or associated with a church exempt from tax under section 501. No church plan administered or funded by a pension board would be disqualified merely because it is separately incorporated or merely because of variations in the plan provisions among the local employers.

Our legistration also corrects a very harsh position taken by the Treasury Department in its proposed regulations defining church plans. These proposed regulations provide that once a church plan fails to meet the requirements of church plan it can never thereafter be a church plan. This rule requires perpetual disqualification of church plan status for the smallest violation of rules that are not now clearly understood and that will take years to resolve.

Our proposals provide a mechanism whereunder a church plan will be disqualified as such only after it receives appropriate notice that it has violated the church plan requirements and does not within a certain period of time correct its default. The term "correction" as used in the legislation is not intended necessarily to require a church plan to undo the default completely or to put itself and other parties in precisely the same position they would have been in had the default never occurred. The degree of correction required should depend upon the equities of the situation.

For example, a possible violation of the church plan requirements would be the coverage of an impermissible number of individuals who are not defined as employees. A complete correction of this type of default would require the plan to refund to these individuals all contributions made on their behalf. Such a correction may cause the distributions to be included in the incomes of innocent persons and, hence, work a hardship on them.

In this type of situation, the default should be considered corrected if the church plan were permitted to retain the accrued benefits or accounts of these individuals for the eventual payment of benefits upon their death or retirement. But the plan should accept no further contributions with respect to them.

Mr. President, with my distinguished colleagues Senators BENTSEN and BOREN, I today reintroduce legislation to amend several provisions of the Internal Revenue Code that inequitably prevent the satisfactory accumulation of retirement benefits for the majority of clergymen and lay employees of church denominations in this country. This legislation is a large step in the direction of assuring our ministers and lay employees of an adequate retirement allowance.

It is well known that clergymen and lay employees are not well compensated. The beginning salary for a minister may be from $8,000 to $10,000 a year. Prior to retirement his salary may have increased to $15,000 or $20,000. Lay employees generally receive less compensation than ministers. Moreover, the retirement incomes of ministers and lay employees from church retirement plans are very small, being on the order of from $2,000 to $3,000 a year.

Most of our church denominations provide for the retirement of their ministers and lay employees in the form of annuities governed by section 403(b) of the code. The amount that can be contributed for the purchase of such an annuity, without income tax consequences to the employee, is limited by the "exclusion allowance" of section 403(b)(2). The amount of the exclusion allowance for any year is the excess of (1) 20 percent of the employee's includable compensation for the year times the employee's years of service with his or her employer over (2) the aggregate tax-sheltered contributions made by the employer for the employee in prior years. The exclusion allowance is designed to permit larger than usual retirement annuity contributions to be made late in the employee's career to compensate for the years when contributions may not have been possible. These are called catchup contributions. The opportunity for making catchup contributions is extremely important to poorly paid persons such as ministers and lay employees. A minister who is paid $7,500 a year at the beginning of his career will need all of his income for many years to support his family and educate his children. During these years, because of the minister's low level of salary, pension contributions made on his behalf by his church will be minimal. However, when he reaches 50 years or so, his living expenses will tend to decrease. Then he or his employer may be in a position to make significant catchup contributions to his retirement annuity.

However, two provisions of the code inequitably prevent the making of catchup contributions in the case of many ministers and lay employees. In 1974 when we enacted section 415(c)(1) of the code, we placed a limitation on the amounts that can be contributed to a defined contribution plan, such as a 403(b) annuity arrangement. This limitation, which operates independently of the exclusion allowance, is the lesser of $25,000 (adjusted by increases in the cost of living) or 25 percent of the participant's compensation. In imposing this limitation, we recognized that it would have a serious effect on the ability to make catchup contributions and provided in section 415(c)(4) certain elections that a participant could make in order to override the 25-percent ceiling. However, these elections are available only to employees of educational organizations, hospitals, and home health service agencies. Obviously, we were not then aware of the extensive use of section 403(b) annuities by our churches.

The second problem area is the provision in section 403(b)(2) which limits the "years-of-service" factor of the exclusion allowance to years of service with the employee's current employer. In computing the exclusion allowance for any year, the employee is not given credit for any years of service with prior employers. It is common in many denominations for a minister or lay employee to move from one church to another within the denomination or among various agencies of the denomination during the course of their careers. Under current law each church or denominational agency for which the minister or lay employee works is treated as a separate employer for purposes of the years-of-service factor. The minister or lay employee is accordingly not given credit for all of his or her services with the denomination in the computation of the exclusion allowance. For an employee who has changed jobs frequently, as do the ministers and lay employees of many denominations, this rule severely reduces the exclusion allowance and the ability to make catchup contributions.

Mr. President, our legislation would correct the first inequity by extending the right to make the elections in section 415(c)(4) to employees of churches and their agencies. We believe that these persons should have the right to make the same elections as employees of educational organizations, hospitals, and home health service agencies. Our legislation also provides a de minimis amount of $10,000 which may be contributed, subject to the exclusion allowance, without the necessity of making the section 415(c)(4) elections. This de minimis amount is parallel to the de minimis amount provided for defined benefit plans in section 415(b)(4) of the code. The term "agency" of a church is also defined in our legislation as an exempt organization which is either controlled by or associated with a church or a convention or association of churches. We further provide that an organization is "associated" with a church or a convention or association of churches if it shares common religious bonds and convictions with that church.

Our legislation also would treat the service of a minister or lay employee with any church or church agency of a religious denomination as the service with a single employer for purposes of computing the exclusion allowance. All the years of service of a minister or lay employee for churches or agencies of the denomination would be aggregated in determining the exclusion allowance for taxable years beginning after 1977. It would make no difference whether the years of service being aggregated occurred before 1978 or after 1977. Our legislation will enable contributions to be made by and on behalf of ministers and lay employees in order to provide them with retirement benefits based upon the years of service with the denomination, rather than with the current employer.

Mr. President, I have received numerous letters from officials of various denominations endorsing the legislative proposals I am making today regarding church pension plans and related reform of ERISA. I ask unanimous consent that they be printed at this point in the RECORD.

There being no objection, the letters were ordered to be printed in the RECORD, as follows:

THE RABBINICAL PENSION BOARD,
New York, N.Y., May 3, 1979.

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The Union of American Hebrew Congregations was incorporated in 1873 by an act of the Ohio Legislature for the purpose of . . .

"To encourage and aid the organization and development of Jewish Congregations.

To promote Jewish education and to enrich and intensify Jewish life.

To maintain the Hebrew Union College-Jewish Institute of Religion."

Some 35 years ago, the Union of American Hebrew Congregations and the Central Conference of American Rabbis organized the Rabbinical Pension Board for the purpose of administering pensions and other group insurance plans for the benefit of rabbis, religious educators, congregational administrators and other synagogue professionals who are engaged in work on behalf of the Reform Jewish Movement within the United States.

The Rabbinical Pension Board, through its two parent bodies, represents some eight hundred Reform Jewish congregations and some eleven hundred participating rabbis and other congregational professionals. The Rabbinical Pension Board is managed by a Board of Trustees elected by the Board of the Union of American Hebrew Congregations and the Central Conference of American Rabbis.

Mr. Robert L. Adler of Chicago, the chairman of the Rabbinical Pension Board, and I, share a great concern about the facts of the Employee Retirement Income Security Act of 1974 ("ERISA") on our retirement annuity and welfare benefit program. We are particularly concerned about the "intrusion of the Internal Revenue Service into the affairs of church groups and their agencies by presuming to define what is and what is not an integral part of these religious groups" and we are supporting "legislation to amend Section 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA) and Section 414(e) of the Internal Revenue Code of 1974 (Code) relating to the definition of 'church plan' so that agencies such as ours are recognized as part of a church or convention of churches and are entitled to participate in such a church plan."

We appreciate your introducing and co-sponsoring with Senator Lloyd Bentsen last year legislation designed to clarify and define the church plan and to allow denominational workers to have greater retirement annuity benefits.

Companion legislation has been reintroduced this legislative session in the House of Representatives by Representative Barber B. Conable, Jr. of New York as H.R. 1576, 1577 and 1578.

Senator Talmadge, members of over twenty-five religious denominations share a mutual concern about the effects of ERISA on traditional church pension programs. These concerns have been expressed individually and through the Church Alliance for Clarification of ERISA.

Your introducing and co-sponsoring the legislation supported by the Church Alliance for Clarification of ERISA, of which we are a member, during this session of the Congress will be most appreciated.

We feel that it is most important that this be accomplished as speedily as possible.

Sincerely,

THEODORE K. BROIDO,
Secretary, Rabbinical Pension Board.

JOINT RETIREMENT BOARD
OF RABBINICAL ASSEMBLY,
New York, N.Y., April 27, 1979.

Senator HERMAN TALMADGE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: I wish to thank you for having introduced legislation in the 95th session of Congress sponsored by the Church Alliance for Clarification of ERISA and showing your interest in helping the millions of participants in Church and Synagogue sponsored pension plans.

I would very much appreciate it and would deem it an honor if you could find time to introduce and sponsor similar legislation in the 96th session of Congress.

If there is any way we can be of help, please do not hesitate to let us know.

Sincerely,

LEO. J. LANDES.

WORKERS BENEFIT PLANS,
St. Louis, Mo., April 30, 1979.

Hon. HERMAN E. TALMADGE,
U.S. Senate
Washington, D.C.

DEAR SENATOR TALMADGE: First, I want to express on behalf of our church body my deep appreciation to you for the interest and efforts you demonstrated on behalf of the church pension programs by introducing legislation in the last session of Congress which would have benefited the many workers presently enrolled in the various denominational pension programs.

If the present definition of "church plan" as same is contained in the Employee Retirement Income Security Act of 1974 ("ERISA") is not changed as was outlined in the legislation you introduced into the Senate last year, the pension program of The Lutheran Church-Missouri Synod will have to be divided into two programs, one for ministers who are serving church agencies and another for those ministers serving what the present definitions call "church". This splitting up of our programs is going to be a costly procedure and can only be borne out of the program monies, which means out of the pension monies available to our already underpaid church workers. Our church body certainly does not look favorably upon the fact that the Internal Revenue Service is attempting to define what is and what is not "church" and how the mission of the church is to be carried out.

Senator Talmadge, The Lutheran Church-Missouri Synod pension programs are not the only church pension programs facing a problem over the effects of ERISA. All major denominations are involved as evidenced by the formation of the Church Alliance for Clarification of ERISA. Your assistance is needed and we certainly hope you will again introduce and co-sponsor legislation to clarify the church plan definition of ERISA and also allow church workers to have greater retirement benefits.

Your continued interest and support in this matter is greatly appreciated.

Sincerely yours,

EARL E. HAAKE,
Administrator.

PRESBYTERIAN CHURCH IN AMERICA,
Columbus, Ga., April 27, 1979.

Senator HERMAN TALMADGE
Washington, D.C.

DEAR MR. TALMADGE: The Presbyterian Church in America has expressed its support of the various bills being suggested to exempt the church pension funds from the provisions of ERISA.

Whatever you can do to help us would be greatly appreciated.

Yours truly,

DAN M. MOORE,
Business Administrator.

THE BOARD OF PENSIONS,
Philadelphia, Pa., April 18, 1979.

Hon. HERMAN E. TALMADGE,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR: On behalf of the Board of Pensions of the United Presbyterian Church in the U.S.A., may I express to you our sincere appreciation for your introduction and co-sponsorship last year of legislation designed to clarify the ERISA definition of a "church plan." From the standpoint of this Board and similar units of other religious denominations, such clarifying legislation is essential to remove the present uncertainty concerning the intent of this definition.

Absent the needed clarification, church plans will be unable to serve all employees of churches and church agencies without becoming subject to the administrative requirements of ERISA. The expenses that would result from meeting these administrative requirements would necessarily result in a reduction of the pension benefits that would otherwise be payable to plan beneficiaries. Because of the low salaries paid to church workers, their pensions are already small—they can ill afford to be reduced.

We believe that the legislation you sponsored last year would correct important defects of ERISA. Therefore, we urge you to reintroduce and co-sponsor similar legislation in the present session of Congress. In so doing you will be helping to assure that church pension plans will be able to maintain their service to church workers and their families on an efficient, cost-effective basis.

Very truly yours,

ARTHUR W. BROWN,
President, Board of Pensions.

BOARD OF PENSIONS,
LUTHERAN CHURCH IN AMERICA,
Minneapolis, Minn., April 18, 1979.

SENATOR HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: Last year you introduced and co-sponsored legislation with Senator Lloyd Bentsen designed to clarify the church plan definition of the Employee Retirement Income Security Act of 1974 (ERISA) and to allow denominational workers to have greater retirement annuity benefits. Clergy and lay members of the Board of Pensions of the Lutheran Church in America appreciate your efforts and only regret that the legislation failed to be enacted.

Companion legislation has now been reintroduced in this legislative session in the House by Representative Barber B. Conable, Jr. of New York as HR 1576, 1577 and 1578.

You have already received a summary statement of some of the problems related to ERISA and church plans that require legislative attention. An additional copy of that summary prepared by the 26 denominational members of the Church Alliance for Clarification of ERISA is enclosed for your review.

We are deeply concerned about the effects of ERISA on our denomination's retirement annuity benefit programs. Your introducing and co-sponsoring the legislation supported by the Church Alliance for Clarification of ERISA in this session will be appreciated.

Such support will be considerable help to us and other church pension plans in utilizing as much of available resources as possible for the benefit of our many retired ministers and church lay workers.

Sincerely,

MANFRED HOLCK, Jr.,
Comptroller.

PENSION FUND OF
THE CHRISTIAN CHURCH,
Indianapolis, Ind., April 12, 1979.

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: Every religious communion that has been around long has a church pension plan. One needn't wonder why for long, when they understand the nature and commitment of the ministry and others who serve the Church, plus the desire of the Church to be true to its teachings in social and economic practices. This, I am confident, is true for all groups, be they Catholic, Protestant, or Hebrew.

By and large these institutions are served by devoted persons who make sacrifices—rarely own property—live on limited income—and serve wherever they are called.

Early in our history, the need arose for the provisions for them in case of their age or disability or their survivors in time of death. Consequently, Church pension plans are older than the life insurance industry in the United States.

Because the communion I serve is one of the younger communions, our Board began its operation in 1895 and has operated under a charter here in Indiana since then.

Because of certain things included and also omitted in the Employee Retirement and Income Security Act of 1974 (ERISA), this denomination, along with most other denominations, has become increasingly aware of the effect that is occurring upon our church pension plan and benefit programs.

The effect is a strange one. As a matter of fact, in regard to vesting and funding, our plans exceed the requirements expected under ERISA. However, in regard to reporting requirements in relationship to the units serving the Church in its various benevolent, missionary and educational enterprises, the law as now written would separate us from almost a century of service to such institutions by 1982. In addition to that, there are other injustices placed upon ministers and church employees who are not accorded the same retroactive computation advantages for their employers to build up their pensions in their final years that are accorded employees of other institutions.

This concern was registered and expressed by a resolution passed in the last General Assembly of the Christian Church (Disciples of Christ) meeting in Kansas City, Missouri in October, 1977.

We are grateful to you and Senator Bentsen, as well as Representative Conable, of New York, for introducing legislation in the last session that would have corrected many of these ills. We are calling upon many of our concerned senators and representatives to join you in this session to see that this matter does have the legislative correction so sorely needed. Along with representatives of some twenty-five or thirty other denominations participating in the Church Alliance for Clarification of ERISA, we have been attempting to express a mutual concern, since we have no regular Church organization of this broad base—Catholic, Protestant and Jewish, in order to make such a presentation to those who can correct this situation by legislation.

Your introduction and co-sponsoring of the legislation needed in this session is most appreciated.

Cordially yours,

WILLIAM MARTIN SMITH.

THE AMERICAN LUTHERAN CHURCH,
Minneapolis, Minn., April 18, 1979.

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The American Lutheran Church (ALC) has been established as a "union of congregations to which the Gospel of reconciliation has been given," the specific purposes to be "the proclamation and propagation of the christian faith, and the quickening and sanctification of the members of its congregations through the use of the means of Grace."

A copy of the stated purpose, chapter 3 of the Constitution of The ALC, is enclosed with this letter for your information. Please note that Section 3.26 specifically recognizes the establishment and maintenance of the work of the Board of Pensions by The ALC.

Many people of our 2.4 million member church body are deeply concerned about the seeming intrusion of the Internal Revenue Service into the affairs of church groups and their agencies, by presuming to define what is and what is not an integral part of these religious groups' mission and supporting "legislation to amend Section 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA) and Section 414(e) of the Internal Revenue Code of 1974 (Code) relating to the definition of 'church plan' so that church related agencies are recognized as part of a church or convention of churches and entitled to participate in a church plan." We share a great concern about the effects of the Employee Retirement Income Security Act of 1974 ("ERISA") on our denomination's retirement annuity and welfare benefit programs.

We appreciate your introducing and co-sponsoring legislation with Senator Lloyd Bentsen last year designed to clarify the church plan definition of ERISA and to allow denominational workers to have greater retirement annuity benefits.

Companion legislation has been introduced this legislative session in the House by Representative Barber B. Conable, Jr. of New York as H.R. 1576, 1577 and 1578.

Enclosed is a summary of some of the problems related to ERISA and matters requiring legislative attention.

Senator Talmadge, members of our twenty-five religious denominations share a mutual concern about the effects of ERISA on traditional church pension programs. These concerns have been expressed individually and through the Church Alliance for Clarification of ERISA. Our Pension Board is an active participant.

Your introducing and co-sponsoring the legislation supported by the Church Alliance for Clarification of ERISA this session would be most appreciated.

Sincerely,

HENRY F. TREPTOW,
Executive Secretary.

REORGANIZED
CHURCH OF JESUS CHRIST
OF LATTER DAY SAINTS,
April 27, 1979.

Re: Church Plans
Hon. HERMAN E TALMADGE,
U.S. Senate, Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The Reorganized Church of Jesus Christ of Latter Day Saints was organized in accordance with the laws of New York on June 6, 1830 as a religious organization. Since the early days of the Church, ministers and other denominational workers have been provided for prior to and upon retirement.

As Presiding Bishop and Chief Financial Officer of the Reorganized Church of Jesus Christ of Latter Day Saints, I have a concern about the effects of the Employee Retirement Income Security Act of 1979 (ERISA) on our denomination's retirement annuity and welfare benefit programs. We are also concerned about the Internal Revenue Service's attempt to define what is and what is not a part of our denomination's mission.

We appreciate your introducing and co-sponsoring legislation with Senator Lloyd Benteen last year designed to clarify the church plan definition of ERISA and to allow denominational workers to have greater retirement annuity benefits. Comparable legislation has been reintroduced this session by Representative Barber B. Conable, Jr. of New York as HB 1576, 1577, and 1578 which we support.

Your introduction and co-sponsoring the legislation is supported by the Reorganized Church of Jesus Christ of Latter Day Saints and is most appreciated.

Sincerely,

F. E. HANSEN,
Presiding Bishop.

THE PENSION BOARDS,
UNITED CHURCH OF CHRIST,
April 17, 1979.

Re: Employee Retirement Income Security Act of 1974 and church plans
Hon. HERMAN E. TALMADGE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The Pension Boards of the United Church of Christ include three pension corporations and a common investment corporation that had been individually or jointly serving the ministry and the employees of the United Church of Christ since 1914.

The United Church of Christ is a denomination formed out of the merger of the Congregational Christian Church and the Evangelical and Reformed Church. Both of these denominations date back to colonial times, the Congregational Christian Church growing out of the church of the Pilgrims, while the Evangelical and Reformed Church grew out of the colonial settlers coming from Germany and other parts of middle Europe.

Over the years that the Pension Boards have served the ministers and employees of the United Church of Christ, their record has been outstanding in providing benefits for those participants who are covered under the program. The Pension Boards have been ahead of their time in facing up to the responsibility of providing retirement income for their employees and have maintained standards that, in most areas, were ahead of those required by the Employee Retirement Income Security Act of 1974, long before that Act was even contemplated by the Congress. When that Act was ultimately passed by the Congress, one of the first actions by the Pension Boards was to review that Act and assure that we met the standards of vesting and non-discrimination established by the Act, even though, as a church plan, we were probably not covered by the Act during the current years.

Notwithstanding our general compliance with the intent of the Act, many of the Act's provisions would be a substantial detriment to the Pension Boards, and a dissipation of the funds of the Pension Boards for administrative detail that will neither serve the participants, nor the Government. In addition, the Pension Boards carry on a substantial relief function of the Church which cannot be accommodated within the strict provisions of ERISA. For these reasons, and others we greatly appreciated your introducing and co-sponsoring during the last session of the Congress, legislation intended to clarify the exemption of churches from the provisions of ERISA and to provide for the coverage of church agencies and ministers, wherever carrying out their ministry, within the church plan.

As you are aware, Senator Talmadge, the major religious denominations have a substantial concern over the effects of ERISA, and have joined together to form the Church Alliance for the Clarification of ERISA. The legislation desired by the Church Alliance for the Clarification of ERISA, which you introduced in the Senate last year, and which was introduced in the House last year by Representative Barber B. Conable, Jr. of New York, has been reintroduced in the House by Barber Conable in this legislative session. We sincerely hope that you will introduce and co-sponsor that legislation in the Senate during this session. Copies of the legislation have been forwarded to you by Mr. Darold H. Morgan, President of the Annuity Board of the Southern Baptist Convention.

Thank you for your consideration in this matter.

Sincerely,

JOHN D. ORDWAY,
Executive Vice President.

THE PENSION DEPARTMENT OF
THE A.M.E. CHURCH,
Nashville, Tenn., April 17, 1979.

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: I am writing you in reference to bill H.R. 1576 as it relates to Church Pension Plans and ERISA. We appreciate your efforts heretofore in meeting with church representatives to get a clear understanding of difficulties imposed on the church by the government. Your effort on our behalf has been deeply appreciated and we continue to ask your support in the passage of bill H.R. 1576 in this Congress.

Yours sincerely,

J. M. GRANBERRY, Jr.,
Secretary-Treasurer.

ANNUITY BOARD OF THE
SOUTHERN BAPTIST CONVENTION,
Dallas, Tex., April 4, 1979.

Re: Church Plans
Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The Southern Baptist Convention was incorporated in 1845 by an act of the Georgia legislature for "the purpose of eliciting, combining, and directing the energies of the Baptist Denomination of Christians for the propagation of the gospel."

In 1918, what is now the Annuity Board of the Southern Baptist Convention was chartered to provide relief, support benefits and annuities for ministers of the gospel and other denominational workers within the of the Southern Baptist Convention. Our Annuity Board is managed by a Board of Trustees elected annually by action of the Southern Baptist Convention.

Dr. Jimmy Allen, the President of the Southern Baptist Convention (the present pastor of the First Baptist Church of San Antonio), Dr. Porter Routh, the Executive Secretary of the Executive Committee of the Southern Baptist Convention headquarters in Nashville, Tennessee, and I share a great concern about the effects of the Employee Retirement Income Security Act of 1974 ("ERISA") on our denomination's retirement annuity and welfare benefit programs.

The messengers to the 1978 annual session of the Southern Baptist Convention adopted resolutions (copies enclosed) protesting "the intrusion of the Internal Revenue Service into the affairs of church groups and their agencies, by presuming to define what is and what is not an integral part of these religious groups' mission" and supporting "legislation to amend Section 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA) and Section 414(e) of the Internal Revenue Code of 1974 (Code) relating to the definition of 'church plan' so that church related agencies are recognized as part of a church or convention of churches and entitled to participate in a church plan."

We appreciate your introducing and co-sponsoring legislation with Senator Lloyd Bentsen last year designed to clarify the church plan definition of ERISA and to allow denominational workers to have greater retirement annuity benefits.

Companion legislation has been reintroduced this legislative session in the House by Representative Barber B Conable, Jr of New York as HR 1576, 1577 and 1578. Enclosed as exhibits to this letter are texts of remarks made last year when similar legislation was first introduced. Also enclosed is a summary of some of the problems related to ERISA and matters requiring legislative attention.

Senator Talmadge, members of over twenty-five religious denominations share a mutual concern about the effects of ERISA on traditional church pension programs. These concerns have been expressed individually and through the Church Alliance for Clarification of ERISA.

Your introducing and co-sponsoring the legislation supported by the Church Alliance for Clarification of ERISA this session would be most appreciated.

Sincerely

DAROLD H. MORGAN,
President, Annuity Board of the Southern Baptist Convention.

CHRISTIAN REFORMED CHURCH IN
N.A. MINISTERS' PENSION FUND,
April 25, 1979.

Re Church Plans
Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The Christian Reformed Church was determined to be exempt from Federal Income Tax under section 501 (c) (3) on October 7, 1971 as a non-profit corporation organized for the purpose of propagation of the Christian gospel.

As of January 1, 1970, the Christian Reformed Synod appointed a Ministers' Pension Committee to administer for Synod a pension plan for retired and disabled ministers or their widows.

Our Christian Reformed Church Ministers' Pension Committee is responsible to the Christian Reformed Synod. It is greatly concerned about the effects of the Employee Retirement Income Security Act of 1974 (ERISA) on our denomination's benefit programs. The Christian Reformed Church Ministers' Pension Committee asked me as Administrator of the Ministers' Pension Plan to register our protest against a possible intrusion of the Internal Revenue Service into the affairs of church groups and their agencies, by presuming to define what is and what is not an integral part of these religious groups' mission and supporting "legislation to amend Section 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA) and Section 414(e) of the Internal Revenue Code of 1974 (Code) relating to the definition of 'church plan' so that church related agencies are recognized as part of a church or convention of churches and entitled to participate in a church plan."

We sincerely appreciate your introducing and co-sponsoring legislation with Senator Lloyd Bentsen last year designed to clarify the church plan definition of ERISA and to allow denominational workers to have greater retirement benefits.

We are pleased that companion legislation has been reintroduced this legislative session in the House by Representative Barber B. Conable, Jr of New York as HR 1576, 1577 and 1578. Our church envisions problems related to ERISA particularly in the administrative details required.

Senator Talmadge, members of over twenty-five religious denominations share a mutual concern about the effects of ERISA on traditional church pension programs. These concerns have been expressed individually and through the Church Alliance for Clarification of ERISA.

Your introducing and co-sponsoring the legislation supported by the Church Alliance for Clarification of ERISA this session would be most appreciated.

Sincerely,

GARRETT C. VAN DE RIET,
Administrator.

THE MINISTERS AND MISSIONARIES BENEFIT BOARD OF THE AMERICAN BAPTIST CHURCHES,
New York, N.Y., April 23, 1979.

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The American Baptist Churches Ministers and Missionaries Benefit Board serves ministers, missionaries and lay employees of churches and institutions related to the American Baptist Churches. Our denomination is composed of approximately 6,000 churches with 1½ million members. The Ministers and Missionaries Benefit Board provides a variety of benefits for the protection of over 9,000 active and retired members, including surviving spouses and dependent children. These benefits include the ABC Retirement Plan, The Annuity Supplement, the Death Benefit Plan, The American Baptist Medical Plan and a wide variety of non-contractual supplementary benefits funded by the Board's endowment.

We were most appreciative of your leadership in introducing and co-sponsoring legislation with Senator Bentsen last year which, if enacted, would clarify the implication of ERISA for the American Baptist Churches. Present ERISA legislation and the proposed regulations issued by the Internal Revenue Service creates serious problems for us. Unless clarified by legislation, the proposed regulations could result in reduced benefits for our members. Your remarks in introducing this legislation last year, as published in the Congressional Record, indicated an understanding of these problems.

We are writing to encourage you to re-introduce this legislation in the Senate as a companion to H.R. 1576, 1577 and 1578 introduced in the House by Representative Barber B. Conable, Jr. of New York with whom we have been working.

We join with the members of the Church Alliance for the Clarification of ERISA, which represents every major religious group in the United States, in expressing our appreciation for assisting us in this effort.

Sincerely yours,

DEAN R. WRIGHT,
Executive Director.

THE CHURCH PENSION FUND,
April 27, 1979.

Re: Church Plans

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: In 1914, The Church Pension Fund was created by The General Convention of The Episcopal Church to provide pension benefits for aged and disabled ministers of the Episcopal Church. Our Board is managed by a Board of Trustees elected triennially by action of the General Convention.

We share the concern of all denominational pension boards about the intrusion of the Internal Revenue Service into the affairs of church groups and their agencies, by presuming to define what is and what is not an integral part of these religious groups' mission. We completely supported the introduction in the last legislative session of legislation to amend Section 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA) and Section 414(e) of the Internal Revenue Code of 1974 (Code) relating to the definition of 'church plan' so that church related agencies are recognised as part of a church or convention of churches and entitled to participate in a church plan.

We greatly appreciated your introducing and co-sponsoring legislation with Senator Lloyd Bentsen last year designed to clarify the church plan definition of ERISA and to allow denominational workers to have greater retirement annuity benefits.

Companion legislation has been reintroduced this legislative session in the House by Representative Barber B. Conable, Jr. of New York as HR 1576, 1577 and 1578. Members of over twenty-five religious denominations have expressed their concerns about the effects of ERISA on traditional church pension programs through the Church Alliance for Clarification of ERISA.

On behalf of the Trustees of The Church Pension Fund and the active and retired ministers of the Episcopal Church, I most earnestly appeal for your continued support of all clergy and all religious organizations by re-introducting and co-sponsoring in this session the legislation supported by the Church Alliance for Clarification of ERISA.

Sincerely,

ROBERT A. ROBINSON,
President.

UNITARIAN UNIVERSALIST ASSOCIATION,
Boston, Mass., April 30, 1979.

Re Church Plans

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: Last year the Universalist Association (UUA) joined the Church Alliance for Clarification of ERISA because of its concern about the many questions raised of the impact of ERISA on church pension plans, such as the one maintained by the UUA.

Your support of the clarifying legislation last year was greatly appreciated; and the dicision by you to reintroduce the legislation this year would also be much appreciated.

I am scheduled to meet with the Pension Plan Study Committee that was appointed by the UUA Board of Trustees at its January 26, 1979 meeting on May 24, 1979. If you have decided to re-file the legislation prior to that date, please let me know so that I can inform the Committee members of our favorable action.

Thank you for your consideration of these matters.

Very truly yours,

WILLIAM B. DUFFY, Jr.,
General Counsel.

GENERAL CONFERENCE OF SEVENTH-DAY ADVENTISTS,
Washington, D.C., April 18, 1979.

Subject: Church Retirement Plans

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The Seventh-day Adventist Church was one of the first religious or business organizations to initiate a private pension plan for the benefit of its employees. Our retirement plan was started in 1911 and has been a continuous operation since then. As of December 31, 1978 approximately 36,000 clergy and lay employees of our church and agencies were covered by this plan and 8,800 were receiving retirement benefits. During 1978 benefit payments amounted to just over $36 million.

Our retirement plan is a "promise to pay" type plan and would technically be classified as an "unfunded" type retirement plan since we do not keep individual accounts for covered employees and no attempt has been made to fund the liabilities on an accrual basis. The cost of the yearly benefits is considered a current operating expense of the Church. However, a reserve equivalent to three years benefit expense is kept on hand at all times. Our Church feels that it is just as much obligated to pay retirement benefits as to pay the salaries of active employees. The entire assets of the Church are back of the retirement plan and its has always lived up to its obligations in this regard.

The Seventh-day Adventist Church, along with over twenty-five other religious denominations, has a major concern about the effects that the Employee Retirement Income Security Act 1974 (ERISA) would have on the operation of our retirement plan. We have been an active member of the Church Alliance for the Clarification of ERISA and fully support the efforts of this association to effect needed changes in the Act. For one thing, the funding requirements would be a major problem for us if we have to comply with ERISA requirements. They would place an oppressive burden on the Church as large sums of money would have to be taken from the funding of other church ministries and used instead to fund the past service liabilities for the retirement benefits of employees of church agencies

The possibility of having to separate the employees of the so-called church agencies from our retirement plan is another of our major concerns.

Our Church has always considered its agencies as directly involved in the total ministry and outreach of the Church. In our theology and philosophy of church operations our institutions have from their inception been integral parts of the Church, direct instruments in the carrying out of its divine commission. Those who serve in these institutions of the Church, whether in the fields of publishing, health, education, or any other, have dedicated their lives to the Church's mission. To separate these workers from the Church plan will create a problem of portability as there is considerable movement of employees from one type of organization to another.

The efforts of the Internal Revenue Service to define what constitutes a church and what does not in our opinion is a violation of the principle of separation of church and state, but has characterized our nation from its beginning. If the church can be trusted to administer pension benefits for its ministers and other employees who in the opinion of government are working directly for the church, it would seem that the church could also be trusted to provide retirement benefits for employees of its agencies without being regulated by the government.

Our Church plan is presently being revised to comply with nearly all of the standards of ERISA regarding eligibility and benefits. In addition it provides many additional benefits that are not mandated by ERISA, such as an annual cost of living increase. Coming under the jurisdiction of ERISA will not really benefit our employees, but instead the excessive administration and reporting burdens would no doubt result in a reduction in the pension benefits of our employees.

We appreciated very much your introducing and co-sponsoring legislation with Senator Lloyd Bentsen last year designed to clarify the church plan definition of ERISA and to bring about other needed corrections in this Act. Your introducing and co-sponsoring similar legislation in this session of Congress will be greatly appreciated.

Sincerely,

K. H. EMMERSON,
Treasurer.

GENERAL BOARD OF PENSIONS OF THE UNITED METHODIST CHURCH,
Evanston, Ill., May 1, 1979.

Senator HERMAN E. TALMADGE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR TALMADGE: The general United Methodist denomination is a volunitary religious movement and connectional network of millions of persons, known as "members," and literally tens of thousands of units, variously designated as local churches, charges, conferences, boards, commissions, councils, and agencies. These many units operate in religious service and mission throughout the United States of America and numerous foreign countries. They are related and brought together in worship and service through local Church, Charge, District, Annual, Jurisdictional (regional), and the General Conference in a connectional manner which is fundamentally characteristic of the denomination in its entirety. To assist in its work, the denomination known as the United Methodist Church, through an "Administrative Order," has created certain organizations at a denominational level to assist all other units in performing certain specialized tasks. One such General Agency is the General Board of Pensions of the United Methodist Church. In writing to you in support of legislation proposed by the Church Alliance for Clarification of ERISA, the General Board of Pensions of the United Methodist Church is acting within its specific and delegated authority, on behalf of all persons and organizations which comprise the denomination known as the United Methodist Church.

A fundamental tenet of the United Methodist doctrine is that the "wholeness of the gospel is manifest in the totality of the Church." From its earliest days, United Methodists have been active in the support of many institutions, of education, health care, and in other areas, and millions of persons have benefited from these efforts over the years. The legislation which we now support, in our opinion, will aid our denomination and other religious denominations in continuing such work (much of which is of such special benefit to individual persons in this country).

We would not presume to suggest that, because the United Methodist denomination is identified as a "church," it is therefore "above the law," "outside the law," or entitled to "special treatment by the law". Nevertheless, the fact remains that churches, even more than non-profit organizations in general, by their very nature, organization, and function are unique. I daresay that no two religious denominations are organized or function in exactly the same manner. Efforts, by legislatures or other bodies, to lump all "churches" together for identical treatment, particularly when legislation has been drafted initially to deal primarily with the commercial or business world, pose very serious and, we presume, generally unintended difficulties for such church groups. We respectfully submit that the Congress has a clear and justifiable interest in seeing that legislation passed by it presents no unnecessary handicap to bona fide religious denominations for the work of their denominations in the areas affected by such laws. If, because of the unique structure and operation of the various individual churches, specific legislation is required in order to minimize or eliminate such undue restrictions on churches, then we feel that specific legislation should receive the prompt and careful attention of all members of the Congress.

In the interest of time, we shall mention only two (of the many) instances in which the proposed legislative changes would be of special significance with respect to the United Methodist denomination. "The itinerant system is the accepted method of The United Methodist Church by which ministers are appointed by the bishops to fields of labor." As presently provided, the law would require the General Board of Pensions of the United Methodist Church to switch its ordained clergy in and out of differing pension plans each time such ministers changed appointments from local churches into what are known as "special appointments," in such areas as the chaplaincy, church-related and other educational institutions, and other areas of work. Such a requirement—to move a person in and out of a "church plan"—is unduly burdensome and provides no benefit for the individual involved. The proposed legislation would permit the inclusion of ordained ministries in a single pension plan regardless of where those ministers are serving at any given point in time.

Along the same line, the present definition of a "church plan" is too restrictive. The present definition simply will not accommodate the needs of the United Methodist denomination in its efforts to provide pensions for its ordained clergy and lay employees of churches and church-related institutions. The United Methodist Church has licensed clergy, two levels of ordination, a separate Diaconal ministry classification, and lay employees in various degrees of relationship to the various units of the church. To require a multitude of different pension plans, each having to be tailored for the specific status of each such group is again unduly burdensome and provides no benefits for the individuals concerned. The legislation proposed, by broadening the definition of a "church plan" would permit the General Board of the General Board of the United Methodist Church to consolidate the number of different pension plans it must administer, thus providing a multitude of benefits for the plan participants.

For these, and other similar reasons, we urge your support of the legislation proposed and submitted under the Church Alliance for Clarification of ERISA.

Yours sincerely,

James M. Walton-Myers.

Board of Pensions of the
Church of God,
Anderson, Ind., April 17, 1979

Re Church Plans.
Senator Herman E. Talmadge,
Senate Office Building,
Washington, D.C.

Dear Senator Talmadge: Thank you for introducing in last year's Senate the legislation supported by the Church Alliance for Clarification of ERISA. Since the Senate did not have time to act on this legislation, it is our hope and prayer that you will reintroduce the legislation this year.

The Church of God Pension Plan came into existence in 1949. We are a small church in comparison to many large denominations, yet our heritage dates back 100 years. We have approximately 4,000 ministers and congregations. Our ministers have never earned large salaries, and retirement benefits for them will be minimal in comparison to many persons who have worked for industry and who have gone on pension.

If our church plan is required to abide by all the demands of ERISA after 1982, we will have to lower our retirees' retirement income even more for there is no way we can take on added work-loads without increasing the operational costs to run our plan.

Since our plan is only 30 years old, and a voluntary plan, many of our ministers have a very small accumulation in their retirement fund. Our hope is that Government regulations will permit churches like educational institutions to make retro-active (tax-sheltered) contributions to a minister's retirement account for years of service when he was not a member of the voluntary pension program sponsored by his denomination.

If the Senate does not permit Church Agencies to remain a part of our Church Pension Plan, our office will find it necessary to run two pension programs. Operational costs will nearly double and our low income church employees and ministers will again be made to suffer.

From the foregoing information, you can readily see the frustrations we face as Church Pension Plans. Our ministers and church employees, even though academically qualified and often highly trained have been underpaid during their working days because they found themselves in service oriented positions, and they will also find themselves short-changed in retirement.

Our Communion and I'm sure all churches affiliated with the Alliance for Clarification of ERISA will be most appreciative for any help you give us in the Legislature pertaining to these matters.

Sincerely yours,

Harold A. Conrad,
Executive Secretary.

Catholic Mutual
Relief Society of America,
Omaha, Nebr., May 3, 1979.

Re: Church Plan
Senator Herman E. Talmadge,
Russell Senate Office Building,
Washington, D.C.

Dear Senator Talmadge: The Catholic Mutual Relief Society is a nonprofit, charitable, religious and benevolent association organized in 1889 by an ecclesiastical body of members of the hierarchy of the Roman Catholic Church in North America for the purpose of protecting and preserving properties of such Church and to further aid and assist the Members of the Hierarchy and Religious in the discharge of their Canonical Duties. The management of this Society is vested in a Board of Trustees, all of whom must be Archbishops or Bishops of the Roman Catholic Church. Currently there are twenty-one Bishops and Archbishops acting as Trustees of the Society.

Through its many members, the Society has learned of the concern of church groups and their agencies for their continued operation in the face of increasing interference by the Internal Revenue Service. As a service to our members, we have helped support the Church Alliance For The Clarification of ERISA in its attempts to amend ERISA to at least recognize the present state of church retirement plans for churches and their agencies.

We thank you for your co-sponsorship of the legislation with Senator Bentsen in the last session of Congress attempting to clarify the church plan definition contained in ERISA and allowing greater retirement annuity benefits to those people working within the denominations. While ours is a Roman Catholic organization, our association with the Church Alliance has made us aware of the many problems caused by ERISA to our brothers in the Protestant and Jewish organizations.

You are aware of the many problems created by ERISA which the Church Alliance has addressed. Your continued support and co-sponsorship of legislation proposed by the Church Alliance For The Clarification of ERISA is very much appreciated. We would respectfully urge you to reintroduce the Church Alliance legislation in this session of Congress.

Sincerely,

Thomas J. Hanrahan,
Executive Vice President.

Mr. ROBERT C. BYRD. Mr. President, I ask unanimous consent that a bill introduced by Mr. Talmadge, for himself and others, relating to ERISA, be jointly referred to the Committee on Finance and the Committee on Labor and Human Resources.

The PRESIDING OFFICER. Without objection, it is so ordered.

Senator MATSUNAGA. We would be happy to hear from you. You may proceed as you wish.

STATEMENT OF DAROLD MORGAN, PRESIDENT, ANNUITY BOARD, SOUTHERN BAPTIST CONVENTION

Mr. MORGAN. Mr. Chairman, I am Darold Morgan, the president of the annuity board of the Southern Baptist Convention, which is the Church Pension Board of our Denomination. I am also chairman of the Church Alliance for Clarification of ERISA, which is an extraordinary interdenominational effort which represents practically all the major denominations of our land.

We have with us today people that will introduce themselves and we will do our best to keep within the time limits. When you have ministers and lawyers on the panel, it is going to press us to honor that, but we are going to do our very best.

I am astonished, myself, at the fact that I think this is the broadest denominational cooperation almost of religion in America, because we have strong representation from our Jewish friends, our Roman Catholics, all of the major Protestant groups, the Seventh Day Adventists, the Mormons, the Unitarians Universalists, the list is quite long and I will not read it for you, but it is interesting to point out that representing more than 50 million church members, of whom many of these denominations have passed their resolutions in support of this area, we have common agreement in this very interesting experiment and a very deep concern on behalf of all our church pension groups.

Since I am addressing the Honorable Senator from Hawaii I am almost tempted to digress from my notes and go into one of our very delightful accounts out in Honolulu, the Hawaiian Baptist Academy, which is owned by our Baptist churches in Hawaii, and the very thing that we are talking to, will make it very difficult for us and our annuity board of the Southern Baptist Convention to continue to serve an agency like that.

Our concern for clarification speaks for something that I think relates to every single State and all the denominations in our land.

I certainly want to express an appreciation and I know the minutes will reflect this, to Senator Talmadge who is sponsoring the legislation as well as Senator Bentsen, my own Senator from Texas and Senator Boren from Oklahoma. These all have cosponsored this legislation, S. 1090, 1091, and 1092 and we appreciate very much the opportunity to testify at this hearing.

Some of our panel and others will be submitting supplementary statements.

When ERISA was passed, Congress exempted church plans from the purview of ERISA, but at the last moment, a moratorium was placed on the inclusion of agency plans and that is why I mentioned that fine school out in Hawaii, in the church plan. By 1983, a church plan may not include employees of church agencies if the church plan is to maintain its exemption. There are many, many technical problems that need legislative correction and clarification and I am going to ask Dr. Ordway to introduce himself and speak to some of these issues.

STATEMENT OF JOHN ORDWAY, EXECUTIVE VICE PRESIDENT, UNITED CHURCH OF CHRIST PENSIONS BOARD

Mr. ORDWAY. Thank you. Good afternoon, Senator Matsunaga.

My name is John Ordway. I am executive vice president of the pension boards of the United Church of Christ.

The United Church of Christ is a major Protestant denomination having approximately 5,500 churches and approximately 2 million members.

The church was formed in 1957 as a result of the merger of the Congregational of Christian Churches and the Evangelical and Reformed Church. The church traces its beginnings back to the Pilgrims of Plymouth Rock. Incidentally, I believe that in Hawaii our church is the strongest denomination.

I did prepare a complete statement on the three bills and the various points of the three bills and would ask that they be included in the record. In this testimony, I will only discuss the concerns that churches have about the elimination of so-called church agencies from church plans and some of the reasons why the Senate bills 1090 and 1091, removing that distinction should be adopted.

A church, as an entity, is very different from the traditional corporate entity. The traditional corporations normally has a limited number of departments each with a large number of employees numbering in the thousands and a centralized form of management which establishes a standardized employee work schedule and environment.

The church on the other hand is made up mostly of small work units, some of which might be agencies under ERISA and others may be classified as churches by ERISA. But all of which are a part of the church as far as our own determination is concerned.

They usually involve 1 to 5 employees and seldom number over 100 employees. These units generally involve thousands of locations each with its own locally developed employee work schedule and environment. There is a tremendous amount of employee mobility within the system, the average pastor moving every 3 to 5 years between churches and what may be considered church agencies.

Yet, few pastors leave the system, the average pastor retiring with over 35 years of service, all in the pursuit of his ministry, usually within a single denomination, although very often including service in what might be determined to be an agency of the church.

The present provisions of ERISA would seem to require that any employment with a church agency be eliminated from coverage if the plan is to continue as a church plan. Such a result is undesirable.

Further, ERISA seems to require a determination as to what type of entity can properly be termed a part of the church by the courts or at an administrative level, which would be in violation of the first amendment rights granted to religious organizations. Our courts have held that ecclesiastical bodies alone have the competence to make determinations relating to matters of church policy, doctrine, or religious programs, and that it is beyond the authority of any branch of civil government to do so.

Over the years, within our form of operation, our churches have struggled to develop pension systems which will function effectively in their unique environment. Most have very broad coverage, good vesting rights, complete portability between units, sound funding schedules, and full disclosure of operating activities.

The imposition of the current ERISA requirements on the churches, in order to provide benefits to employees or organizations determined under ERISA to be agencies, would result in an unnecessary and expensive breaking up and restructuring of their pension systems. Most of these systems would immediately become more complex and expensive to operate if they came under ERISA and most would determine that the complexity and cost could not be justified for the number of the so-called agency employees involved.

These systems will likely become a multiplicity of plans involving hundreds or thousands of independently developed arrangements for small groups of participants in local units. Participation, vesting, portability, funding, minimum benefits, past service benefit improvements, communications, legal and actuarial requirements will all change drastically.

The impact will probably mean that employees of what are determined to be church agencies will not be covered at all. These results are clearly inconsistent with the intent of Congress in 1974 when ERISA was enacted.

The legislation in Senate bills 1090 and 1091 is designed to avoid these unnecessary complications.

I particularly would like to respond to some of the statements that Mr. Halperin made, but with the time limitations we have and the people who need to testify here, I will make no comment on that at this point. Examples of some of the problems we have encountered, and will encounter in the future, will be discussed by the Reverend Dr. Cowsert, and by Mr. Landes.

Dr. Cowsert?

STATEMENT OF DR. CHARLES C. COWSERT, EXECUTIVE SECRETARY, BOARD OF ANNUITIES AND RELIEF, PRESBYTERIAN CHURCH IN THE UNITED STATES

Mr. COWSERT. Mr. Senator, I am Charles C. Cowsert, executive secretary of the pension board of the Presbyterian Church in the United States with headquarters in Atlanta, Ga. I wish to convey today felicitations and gratitude of many Georgia church people to our able and effective Senator Talmadge who, along with Senator Bentsen and Senator Boren and others, not only has manifested a great awareness of the problems created for church plans by ERISA, but also has initiated appropriate corrective legislation.

Mr. Chairman, my denomination is the second largest Presbyterian body in America, has its roots in the mainstream of American Presbyterianism, and as early as the 1700's our people initiated a "fund for pious uses" to care for the elderly and disabled retired ministers and their dependents.

It was out of this benevolent concern that grew the current well-conceived and well-administered church pension plans which the Presbyterian Church, through the Board of Annuities and Relief, operates today.

There are two of these church pension plans. One is for ordained ministers who may be pastors of local churches or agency employees of the denomination. The other is for lay employees who may serve in local churches or in agencies of denominations. Both of these pension plans are defined benefit plans including spouse death benefits as well as annuity benefits. Each is fully funded with no unfunded preservice liabilities. Both provide immediate vesting of member dues with 100-percent vesting privileges after 5 years.

Contractual benefits have always been met; and since 1964, the board has granted up to 127 percent compounded cost-of-living increases.

Our investments are professionally managed under the highest fiduciary standards.

Now, Mr. Chairman, the problems in administration of our funds both for the administrator and the trustees began with the introduction of ERISA legislation in 1974. The uncertainties created for our plans have caused us tremendous problems.

One question is whether or not I, as an administrator of a church pension plan, may enroll the employees of an agency that was created after January 1, 1974, or the employees of an agency that was then in existence but not enrolled in our plan at that time.

As a director of our program, I take the position that I may not enroll those employees. I have disallowed the enrollment of employees on the staff of an orphan's home in Alabama. I have disallowed the enrollment of the staff of a church kindergarten in Missouri.

But I understand that some other directors do enroll such people on the grounds that this law applies not necessarily to the local agency that was created, or that was not enrolled in 1974, but applies, rather, to the denominational pension plan itself. So which interpretation is correct? This is in doubt.

Then, of course, there is the question of what is a church agency and what is not a church agency, and who shall determine it, whether it is the government or the church. This is deep water we are treading here, of course, as you well know.

Then, of course, there persists that question about the corporation, whether or not a corporation that is separate from the church but controlled by it may administer an ERISA-exempt plan.

These types of uncertainties make competent and desirable trustees very nervous about their fiduciary responsibilities, and hard to get. I believe that the bills we are talking about today will correct these uncertainties and help us out in that direction.

But, Mr. Chairman, it is not the uncertainties as much as the certainties that really bother us about this ERISA. For one thing, the law states clearly—and there is no confusion about this—that by December 31, 1982, I am going to have to take out of our plan all the employees of agencies. Now, I personally have been in our plan for 37 years, 17 years as minister of a local church and 20 years as an administrative director of one of our denominational activities as an agency. And for 37 years I have never had it come out of our plan. But under this law, there is no doubt about it. As an agency employee I will have to be taken out and put in another plan of some kind.

The only thing I see to do is to create two more plans, which would mean four plans, and already reference has been made to the unusual and unnecesssary expenses involved in this. You are familiar with the actuarial expenses, the legal expenses and all of this, and it really imposes a burden upon our people for whom we have provided and for whom we have promised to provide in the future.

Another question is that of a minister not currently employed by a church. We have people on study leave. We have people serving as evangelists and various types of jobs who are not in a local church and under ERISA, as presently drawn, these people must be excluded, as I understand it, or we must come under the terms.

Mr. Chairman, our people are upset about this law because out of their free will offerings they thought they were making provision for their ministers and their employees in their retirement. Up to now we have done a good job, and our people know that we have, and what we seek is not to avoid the requirements and the standards that ERISA involves. What we seek is a clarification of the definition that will enable us to continue to serve them.

Thank you sir.

Senator MATSUNAGA. Thank you very much, Dr. Cowsert.

Mr. Smith?

STATEMENT OF REV. GORDON SMITH, TREASURER, THE MINISTERS AND MISSIONARIES BENEFIT BOARD OF THE AMERICAN BAPTIST CHURCH

Mr. SMITH. Yes.

I am Gordon Smith, Mr. Chairman, the treasurer of the American Baptist Church's ministers and missionaries benefit board.

We have 9,000 active and retired ministers whom we serve in our denomination, along with their dependent children and surviving spouses.

To provide for the better maintenance of the ministry. These are the words of the charter under which our board operates. To do this, we provide a variety of benefits for our American Baptist ministers wherever they are engaged in the exercise of their ministry, whether that be in churches, colleges, seminaries, social service agencies, or overseas missionaries or as chaplains or as evangelists.

We also provide coverage during periods of transition such as temporary unemployment or during times of disability. Under the present ERISA statute, it is possible that we could lose our church exemption if we continue this protection for these members.

S. 1090 and 1091 makes it clear that we can continue to meet our chartered responsibility in providing protection for these members and still maintain our church plan status under ERISA.

A second problem relates to catchup provisions for 403(b) annuities. Many of us spend our entire working life within our denomination serving different churches, different boards, different church organizations. The formula for computing the exclusional allowance for a 403(b) annuity defines years of service as years working for a current employer.

I have worked in our denomination for 27 years as a minister. I have had four employers. I am with my fourth one now in my fourth year.

The exclusion allowance, therefore, is determined on the basis of 4 years rather than 27 years, the time of service in my denomination.

My family responsibilities at this time in life are less. The contribution toward my annuity could be greater and, assuming that I make it, Mr. Chairman, would result in greater income in retirement.

Now, this is true virtually of all of the members who are in my age group. S. 1092 is designed to correct this. It also extends special elections provided in section 415 for employees of educational organizations, hospitals, and home health care service agencies to include members of plans represented in the church alliance.

We, therefore, respectively urge favorable consideration and the ultimate passage of these bills, first to provide needed relief for church employees, lay and professional, and second to protect the important and unique function of church plans.

STATEMENT OF LEO LANDES, REPRESENTATIVE, JOINT RETIREMENT BOARD OF UNITED SYNAGOGUE OF AMERICA

Mr. LANDES. I am Leo Landes. I represent the joint retirement board of the United Synagogue of America, which is housed in New York. The board sponsors one of the smaller programs allied with the Church Alliance for Clarification of ERISA.

The board program has altogether approximately 1,500 participants employed by almost 800 different employers, each of whom is controlled by a separate board, and each board is very jealous of its independence.

We have an average, therefore, of less than two employees for each employer.

Approximately 75 percent of our employees, or participants, are clergymen. We offer a group 403(b) annuity which is fully funded and insured with a large national commercial insurance carrier.

Our program is 100 percent vested immediately. We are proud of the fact that the annuity is completely portable. A participant may move from synagogue to synagogue, to any other 501(c)(3) employer and our movement, carry the group annuity with him, without a new load, without any additional charges, and without any lapse in coverage or protection.

Of the 1,500 participants, less than 100 are made up of nonclergy who are employed by an employer, which is not a synagogue. Most of these employers are small educational institutions dealing with religious instructions for school-aged children.

Asking the independent trustees of each individual synagogue to comply with the fiduciary and reporting and other requirements of ERISA would jeopardize the continued participation of these synagogues in the program.

Similarly, it would be unfair to ask the 1,400 other participants in the program to pay the increased costs that would have to be incurred if we were forced to comply with ERISA for the sake of the less than 100 participants.

The result would be the way the present law reads that these 100 participants would no longer be able to participate in the group program offered by the Joint Retirement Board. Each of these 100 participants would be forced to obtain an individual contract. The load on this individual contract would generally be at least five times the load, or the expenses, connected with our group program. The benefits would be far less. Our valued portability would be severely limited.

We are sure that Congress did not intend, when ERISA was contemplated, to have this result and urge relief.

Thank you.

Senator MATSUNAGA. Thank you.

Who is next?

Mr. NASH. Senator, I am.

STATEMENT OF GARY NASH, SECRETARY AND GENERAL COUNSEL, CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

Mr. NASH. I am Gary Nash, secretary and general counsel of the annuity board of the Southern Baptist Convention in Dallas. I also voluntarily serve as the Secretary of the Church Alliance for Clarification of ERISA.

Dr. Cowsert and Mr. Landes and Reverend Smith before me have discussed specific examples of the impact of the law on church plans, employees being denied coverage in church plans because of the ERISA moratorium on church agency in church plans; the need for clarification in the ERISA church plan definition so that church plans will not have to be fragmented, or terminated, and so that existing participants will not be forced out of church plans; the inequitable impact of the law on various denominational employees, depending on the form of church organizational structure; the problem of ministers performing their ministry outside the formal denominational structure; and the tax modifications appropriate for section 403(b).

In light of Mr. Halperin's comments, it should be kept in mind that 403(b) annuities are the means used by the churches of providing benefits to ministers and lay employees with no motive of discriminating in favor of highly paid employees.

S. 1090 and 1091 define a church plan to include a plan established and maintained by a church pension board. These bills establish a retroactive corrections period and a procedure to restore church plan status for denominational plans which fail to meet the requirements for church plan status.

S. 1092 is purely a revenue measure. It amends section 403(b) and 415. With respect to the computation of the exclusion allowance for ministers and lay employees of a church, or a convention or association of churches, or an agency of a church.

To extend the special elections for 403(b) annuities which are presently available to employees of schools, hospitals and home health service organizations to employees of churches, conventions or associations of churches and their agencies and to permit a de minimis contribution amount in lieu of such elections.

We request that our testimony and prepared statements, in their entirety, be made a part of the record. We would like to respond to Mr. Halperin's comments in writing by supplemental submission.

Many of the representatives of other denominations are present to respond to questions if you have them at this time, and I would like to introduce them, if that is permissible.

Senator MATSUNAGA. Without objection, the statements will appear in the record. However as you will note there are five lights on the clock, which mean that I have 5 minutes left to rush over to the Senate floor to vote. I will now have to declare a recess until 2:30 o'clock tomorrow afternoon when other witnesses will testify.

Mr. NASH. This will conclude our remarks, then.

Senator MATSUNAGA. That is correct.

[The material referred to follows:]

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

November 27, 1979

Mr. Michael Stern, Staff Director
Committee on Finance
Room 2227, Dirksen Senate Office Building
Washington, D. C. 20510

Re: Senate Finance Subcommittee on Private Pension Plans and Employee Fringe Benefit Hearings on S.1090, S.1091, and S.1092, relating to church plans

Dear Mr. Stern:

Enclosed is a statement for filing by witnesses scheduled to testify as a panel on the above referenced bills. Dr. Darold Morgan, Dr. Charles Cowsert, Rev. Gordon Smith, Mr. Leo Landes, Dr. John Ordway, and Mr. Gary Nash will testify as a panel.

The summary of principal points included in the statement of panel members is as follows:

I Background of church pension programs in this country
II The impact of ERISA on Church Plans - Basic issues
III Examples of ERISA problem areas for church plans
IV Legislative recommendations
V Conclusions

The panel members may submit additional and supplemental materials and statements describing the impact of the present laws on their church plans and the need for amendment and clarification of the law.

Enclosed in a separate mailing container are 100 copies of this written statement.

Very truly yours,

Gary S. Nash

Gary S. Nash

GSN:fw

Enclosure

THE NEED FOR CLARIFICATION IN THE ERISA CHURCH PLAN DEFINITION

This statement will discuss briefly the background of church pension programs in this country, the impact of ERISA on church plans, the need for clarification in the law with respect to church plans, and specific recommendations for legislative action.

BACKGROUND OF CHURCH PENSION PROGRAMS IN THIS COUNTRY

Churches have traditionally felt a sense of responsibility for making provision for their aged and disabled workers and their families. Church pension programs have developed as a ministry of churches.

The first pension programs in the United States were set up by churches in the early 1700s (before there was an Internal Revenue Code or an income tax) to provide benefits to ministers and other church employees. As early as 1717 the Presbyterian Church established a "Fund for Pious Uses." One of the first functions of this fund was to provide a grant to the widow of a deceased minister. In 1784 the Methodist Church established "The Preachers' Fund" to make provision "first, for the worn-out preachers and then for the widows and children of those that are dead." Church relief ministry became a denomination-wide concern because ministers passed from one presbytery to another or from one synod, diocese, conference, district or state to another. The denominational boards of relief that were developed became the denominational pension boards of today which still operate relief, welfare and assistance programs in addition to the pension programs which they operate. As churches grew and their ministries increased, church boards, commissions, and agencies were created to carry out the ministries and missions supported by tithes and offerings of members of local churches.

The nature of church work now may require ministers and lay workers to serve not only in local churches, but also to serve in church agencies. Additionally, many ministers in pursuit of their ministry, serve as chaplains in church and non-church related organizations, as evangelists, as church fund raisers, as employees of social service or religious organizations and as employees of social service agencies or religious organizations sponsored by other denominations or faiths. The denominational pension boards have served the unique needs of the ministers and lay workers within their respective denominations. Generally no church pension board program is identical to that of another denomination's since church denominations are organized differently, and a program serving the needs of a hierarchically organized denomination might not meet the needs of one serving a congregationally organized denomination.

Many congregationally organized churches and denominations have developed individual account plans which provide annuity type benefits to participants throughout their denominational careers. Although many of these programs were developed prior to the existence of the Internal Revenue Code, many of these programs have been treated as Code section 403(b) annuities for tax purposes. For years many of these plans have been fully funded and participants have enjoyed immediate vesting. ERISA has established standards that many exempt church plans meet or are striving to achieve.

THE IMPACT OF ERISA ON CHURCH PLANS--BASIC ISSUES

The Employee Retirement Income Security Act of 1974 (ERISA) has exempted church plans from major portions of coverage under the Act. However, because of the way church plan is defined in ERISA, the church plan exemption is not available to many traditional church plans. By threatening to fragment denominational pension plans, ERISA is having an adverse impact on organized religion and it threatens to undermine the way churches have functioned successfully and responsibly for years.

Under the present definition found in Title I of ERISA at section 3(33) and in Title II of ERISA under what is now known as Internal Revenue Code section 414(e) a church plan is defined so as to prohibit a church plan from covering employees of church agencies after 1982. Furthermore, the law may be interpreted to require that a church plan may not cover employees of new church agencies coming into the plan after 1974.

The legislatively mandated splitting of church retirement programs into fragments by 1982 contrasts sharply with fundamental principles of separation of church and state. By carving out certain church ministries and functions, the government has taken upon itself the role of defining and limiting church ministries through the ERISA church plan definition. ERISA's splitting up of churches through their pension programs fails to recognize the uniqueness of organized religious denominations today and the vital role that denominational pension programs play.

Under ERISA, existing church plans must by 1982 undo many years of responsible experiance and create two or more plans, one covering church employees and one covering agency employees. Since churches and agencies are generally dependent upon the voluntary tithes and offerings of church members, the costs of reorganizing a church plan and maintaining different plans may significantly reduce plan benefits or require an unnecessary additional economic burden on churches to provide the same level of benefits to participants in order to comply with ERISA's rigid administrative and government reporting requirements. If churches and church agencies are faced with additional costs of complying with ERISA, many of these organizatiions may have no alternative but to abandon their retirement programs or to cut down on their ministries so as to pay the increased ERISA costs which afford no real economic benefit.

SPECIFIC EXAMPLES OF ERISA PROBLEM AREAS FOR CHURCH PLANS

The following paragraphs describe some specific examples of ERISA problem areas for church plans. The list of examples below is by no means exhaustive but rather is merely representative of some of the problem areas facing church plans. Comments to proposed "church plan" regulations enclosed with this statement describe in more detail some of the "church plan" problem areas.

As noted by attorney Pat Persons in "ERISA and the Churches", copy enclosed, the application of ERISA to retirement and other benefit plans established by religious denominations would raise questions of church-state relations under the First Amendment of the U.S. Constitution. The possibility of such a church-state confrontation was recognized by Congress, as evidenced by the statement in the Senate report explaining why church plans were not made subject to the plan termination insurance requirements of ERISA. This report states:

> "The committee is concerned that the examination of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities."

Although this statement was made with reference to the plan termination insurance provisions, it seems clear that the same reasoning underlay the exemption accorded to church plans under other parts of ERISA.

By exempting church plans from ERISA, Congress was endeavoring to adhere to the long-established principle of separation of church and state as expressed in the First Amendment. Decisions of the Supreme Court in recent years have held that where a statute calls for governmental action that raises a question under the religion clauses of the First Amendment, in order to be constitutional "the statute must not foster an excessive government entanglement with religion." Church Alliance members believe that an excessive entanglement would result if ERISA were applied to church plans. It is therefore important to take effective steps to prevent this situation from arising.

The statutory ban on new agencies participating in church plans in ERISA section 3(33)(B) and (C) has already resulted in many employees of church denominations being denied pension plan coverage. Other denominations have allowed new agencies to join existing retirement programs by taking the position that the denomination's existing program was "established and maintained" for all church affiliates prior to 1974 regardless of whether the new agencies' employees were participating in the plan. Neither position is satisfactory since one leaves employees without pension benefits and the other jeopardizes the "church plan" status of the program.

In its proposed regulations the Treasury Department took the position that if a church plan should ever, at any time or for whatever reason, fail to meet the requirements of a church plan it can never thereafter regain its exempt status under ERISA. This position is unnecessarily harsh because a failure to meet the requirements of a church plan may result from insignificant violations of rules that are not now clearly defined and will take years to resolve. S. 3172 would give a church plan which has violated the applicable rules an opportunity to correct the violation and thereby retain its exemption from ERISA. Such a provision seems essential to the orderly functioning of church plans.

Church plans are exempt from the reporting and disclosure requirements of Title I of ERISA, but the IRS has a requirement that all churches having plans must file Form 5500. For congregationally organized denominations, this requirement can mean that thousands of local churches could each be required to file a Form 5500, even if they each have only one plan participant in the plan.

The problems involved in fragmenting church plans by 1982 promises to be a difficult and expensive administrative nightmare. No regulations on how church plans are to accomplish this task have been proposed. The problem of portability of benefits from an ERISA qualified plan to an exempt church plan has not been addressed. Ministers and lay persons desiring to move about within the denominational structure may find that ERISA regulations would require them to endure gaps in retirement coverage.

Under the existing statute, it is possible that a church plan might lose its exemption under ERISA if it covers a minister who is not an employee of a church (or until December 31, 1982, an employee of a church agency). However, numerous ministers pursue their ministries from time to time by serving outside the formal denominational structure. Examples would be ministers employed as chaplains in hospitals, prisons or colleges, or teaching religious studies in an educational institution, or serving as self-employed evangelists. It is important to such ministers, and to the denomination, that their membership in Church Pension Board's benefit plans be maintained during such period of service as a minister outside the denomination. The proposed bill would make clear that this can be done without jeopardizing the exempt status of the plans under ERISA.

A similar question exists under present law with respect to the coverage of congregational ministers or lay employees who are not currently employed because they are disabled or in transition from one job to another.

ERISA contains extensive rules regarding the investment of assets of employee benefit plans, and the purposes for which such assets may be disbursed. These rules, which in some cases are quite rigid, are appropriate for the typical employee benefit plans with which ERISA is concerned. In such typical plans, contributions are made to a fund by the employer, or the employees, or both, for the purpose of providing benefits that are specified in the plan. ERISA provides that the assets of such plans shall be used for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plans. However, since most church pension boards were established for broader purposes than the exclusive purpose rule of ERISA, the Federal government might be placed in the position of determining the extent to which a church pension board's endowment and other funds could be used for the board's general and religious purposes, as distinguished from benefit plan purposes.

By failing to recognize church pension boards in ERISA section 403 requiring the establishment of a trust or the issuance of insurance contracts "issued by an insurance company qualified to do business in a State," ERISA fails to deal with the question of whether a church pension board will be allowed to continue to fund or administer annuity programs of church agencies without operating under a "church plan" exemption.

There are no statutory exemptions in ERISA section 408 for church pension boards--they are not needed as long as the "church plan" exemption applies. Statutory exemptions from the ERISA section 406 prohibited transactions provisions, such as those applicable to banks and insurance companies in section 408(b)(4), (5), (6), and (8), would probably not apply to a church pension board operating without the "church plan" exemption. These sections appear to be important enough for the insurance industry and others to seek even greater exemptions just so they can carry on business as usual. If the technical application of section 406 is to apply to church pension boards without similar exemptions, traditional church pension boards, if they continue to perform their traditional roles in denominational pension programs beyond 1982, may be faced with unusually large legal expenses to avoid technical violation of the law.

The problem that is of the greatest concern to a number of the denominations is the so-called church agency problem. As previously mentioned, under present law a church plan cannot retain its ERISA exemption after December 31, 1982 if it continues to cover employees of church agencies. Examples of church agencies would be any of the following organizations which is affiliated with a church or a convention or association of churches: a hospital, a school or college, a nursing home, a retirement home, a drug-abuse center, or a children's home or camp.

The Church Alliance has taken the position that because of the close relationship that exists between churches and their affiliated agencies, it is essential that the employees of the agencies be eligible for coverage under the benefit plans of the church. If this is not permitted, the agencies will have only two alternatives; that is, either to establish ERISA plans for their employees or to terminate their plans on December 31, 1982. Because of the expense and red-tape connected with establishing ERISA plans, it is feared that many agencies will choose to terminate their plans, thus depriving their employees of benefits which they are now receiving as members of the church plan. Also, it is believed that if agency employees are not allowed to participate in church plans, the mobility of church employees within the denomination will be greatly restricted. S.1090 and S.1092 would permit the continued coverage of agency employees in church plans after December 31, 1982.

It is not an overstatement to say that if S.1090 and S.1092 are not enacted, the consequences for all religious denominations will be very serious. The type of regulation mandated by ERISA is simply not appropriate for an organization with a religious history and purpose such as the pension boards of religious denominations.

LEGISLATIVE RECOMMENDATIONS

Members acting on behalf of the pension programs of over twenty-five religious denominations in the United States have formed the Church Alliance For Clarification of ERISA (the "Church Alliance"). The Church Alliance members support the amendment of the ERISA "church plan" definition so as to recognize traditional church plans which cover employees of churches and church agencies. In addition, the Church Alliance members support the removal of a number of technical defects in the law which do not recognize the differences in the denominational structures of various churches. Church Alliance members are concerned that many churches' plan participants will not have pension benefits provided for them if they are forced out of church plans by ERISA requirements.

Bills to clarify the church plan definition supported by the Church Alliance members have been introduced by Senator Herman E. Talmadge of Georgia and Senator Lloyd Bentsen of Texas (S.1090 and S.1092), by Congressman Barber B. Conable, Jr. of New York (H.R.1576 and H.R.1578). Bills introduced by the same legislators amend section 403(b) of the Internal Revenue Code (S.1092 and H.R.1577).

Enclosed as a part of this statement are brief summaries of the specifications for the legislation supported by the members of the Church Alliance For Clarification of ERISA. The introductory statements (Congressional Record, page S54444 and following) concerning S.1090, S.1091, and S.1092 made by Senator Talmadge explain the bills and give some examples of problems the bills are intended to relieve.

Additionally, letters of comments on proposed "church plan" regulations to the Commissioner of Internal Revenue are enclosed as a part of this statement.

An article "ERISA and the Churches" is enclosed as a part of this statement. The texts of the bills referred to in that article (delivered May 23, 1978) are virtually the same as S.1090, S.1091 and S.1092.

It should be pointed out that S.1090 and S.1092 are intended to have the following effect with respect to the following:

By including ordained ministers within the definition of employee without requiring an employment relationship, the bill permits a church plan to continue to cover a minister who serves in the exercise of his ministry outside of the denominational structure. The words "in the exercise of his ministry" are to be given their plain meaning, and the restrictions placed upon these words in the regulations under such provisions of the Code as sections 3121 and 1402 are not to be employed. Thus, a chaplain in the Armed Forces of the United States or a chaplain in a prison or a hospital, operated by the United States, a State, Territory, or possession of the United States, or the District of Columbia, or a foreign government, or a political subdivision of any of the foregoing, would be performing services in the exercise of his ministry. A minister who teaches religious studies in a university that is not church related could also receive coverage. An evangelistic minister who has no employer would also be permitted to participate in the church plan.

It should also be pointed out that these bills consider the denominational pension boards to be arms of churches carrying out the religious function of compensating denominational workers.

CONCLUSION

The members of the Church Alliance For Clarification of ERISA support S.1090, S.1091, and S.1092. The members acting on behalf of the pension programs of the following denominations are as follows: Mr. Robert Adler (Union of American Hebrew Congregations), Mr. Arthur W. Brown (United Presbyterian Church in the U.S.A.), Mr. Gary W. Brunson (Mennonite Churches), Mr. Harold A. Conrad (Church of God), Dr. Charles C. Cowsert (Presbyterian Church in the United States), Mr. Ray C. Dodds (Reorganized Church of Jesus Christ of Latter Day Saints), Mr. William B. Duffy, Jr. (Unitarian Universalist Association of Congregations in North America), Rev. James M. Granberry, Jr. (African Methodist Episcopal Church), Mr. Earl E. Haake (The Lutheran Church-Missouri Synod), Mr. Thomas J. Hanrahan (Catholic Mutual Relief Society), Mr. Gerald K. Hornung (United Methodist Church), Mr. Leo Landes (United Synagogue of America), Dr. Darold H. Morgan (Southern Baptist Convention), Dr. Dan M. Moore (Presbyterian Church in America), Mr. W. L. Murrill (General Conference of Seventh-day Adventists), Dr. John D. Ordway (United Church of Christ), Mr. Darrell Prichard (Church of God in North America), Dr. Robert A. Robinson (Episcopal Church), Dr. William Martin Smith (The Christian Church - Disciples of Christ), Mr. John Storey (The Wesleyan Church), Mr. Joel K. Thompson (Church of the Brethren), Rev. Henry F. Treptow (The American Lutheran Church), Mr. Garrett C. Van de Riet (Christian Reformed Church in North America), Dr. Jewett L. Walker (A.M.E. Zion Church), Dr. L. Edwin Wang (Lutheran Church in America), Rev. Dean Wessels (Church of the Nazarene) and Dr. Dean R. Wright (American Baptist Churches).

APPENDIX

Letters of comments on proposed "church plan" regulations to Commissioner of Internal Revenue:

- dated May 1977 from Darold H. Morgan, Chairman of Church Alliance For Clarification of ERISA
- dated November 18, 1977 from Gary S. Nash, General Counsel of Annuity Board of the Southern Baptist Convention
- dated October 7, 1977 from John D. Ordway, Executive Vice President of The Pension Boards of the United Church of Christ
- dated November 23, 1977 from John P. Persons, attorney for The Ministers and Missionaries Benefit Board of the American Baptist Churches

"ERISA AND THE CHURCHES" prepared by John P. Persons, Attorney-at-Law, Patterson, Belknap, Webb & Tyler, for meeting of Board of Managers of The Ministers and Missionaries Benefit Board of American Baptist Churches, May 23, 1978.

Summary of Specifications for Legislation Supported by Church Alliance For Clarification of ERISA H.R.1577 and S.1092 (96th Congress)

Summary of Specifications for Legislation Supported by Church Alliance For Clarification of ERISA H.R.1576, S.1091, H.R.1578, and S.1090 (9th Congress)

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

SECRETARY:
Mr. Gary S. Nash
Suite 311, 511 North Akard
Dallas, Texas 75201
(214) 747-6155

COUNSEL:
Williams, Myers & Quiggle
Suite [illegible], Brawner Building
888 Seventeenth Street N.W.
Washington, D.C. 20006
(202) [illegible]

May 20, 1977

Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, N. W.
Washington, D. C. 20224

Attention: CC:LR:T

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

This letter is written pursuant to the notice published in the Federal Register dated April 8, 1977, inviting comments on the definition of "church plan" as defined in Section 414(e), IRC. These comments are submitted by the Church Alliance for Clarification of ERISA, an alliance of church pension program chief executive officers acting on behalf of the pension programs of the denominations listed on the left side of this page. We believe the regulations to have been exceptionally well drafted. We have but three comments.

First. All of the churches comprising the Church Alliance permit an exceptional degree of freedom in the clergy and lay personnel to pursue their ministry and careers according to their own consciences. A minister will not necessarily upon ordination continue without interruption until retirement to serve his church in this precise capacity. He may for a time during his career accept a post, for example, at a drug rehabilitation center or child abuse agency. Nonetheless, the church plan may continue to cover the minister or former lay employee for the reason that the plan of his new employer may require a period of employment before eligibility to participate or may have no plan at all.

Ministers and lay employees are not munificently compensated. Nor can they look forward to retirement benefits that are munificient. A gap in pension coverage works real hardship on such persons.

Section 414(e) does not require that the employees of the church be current employees. We assume that the proposed regulations do not intend to require coverage solely of present employees in order to meet the church plan requirements. There would seem to be no compelling social or other policy for imposing such a condition. The underlying principle behind ERISA is to promote, rather than to discourage, coverage and portability.

Therefore, for purposes of clarification, we propose the addition of the following language in Proposed Regs. §1.414(e)-1(a):

> "There is no requirement in section 414(e) or this section that the employees of a church or convention or association of churches be current employees. Therefore, a church plan will not fail to meet the requirements of section 414(e) or this section merely because it provides coverage for ministers and former lay employees of a church or convention or association of churches, and, additionally, for plans described in the special rule of paragraph (d), the agencies of such church (or convention or association of churches)."

Second. In Proposed Regs. §1.414(e)-1(a), it is stated:

> "If at any time during its existence a plan is not a church plan because of a failure to meet the requirements set forth in this section, it cannot thereafter become a church plan."

There is no support for this position in the legislative history of ERISA that we can find.

When the final church plan regulations are promulgated, it will be almost three years since the enactment of ERISA. It is quite possible that a church in some minor way could have during this period failed to qualify as a church plan in spite of all good faith efforts at complying with the bare words of the statute. A rule that irrevocably denies exemption for acts or failures to act during a period when no regulations were issued is severe.

Practically no two church plans are alike in design or operation. Yet Congress has attempted in Section 414(e) to embrace the design and operation of the multitude of church plans in this country. This problem of squeezing within the definition of church plan should not be made more intolerable than it is now by a rule that once a church plan fails to qualify, it may never do so. Even with regulations, many areas are unclear and will remain so for years.

Organizations described in Section 501(c) are granted exemption from the income tax under Section 501(a). A Section 501(c)(3) organization failing to meet, say, the "exclusively" test in one year may, by changing its organization or operational characteristics, be a 501(c)(3) organization in another year. There is no more indication in Section 414(e) than in Sections 501(a) or 501(c)(3) that Congress intended that failure to meet the requirements of these sections be perpetual.

Section 410(d) grants churches an irrevocable election to elect to come within certain provisions of ERISA. There is no practical danger that a church plan might deliberately fail to meet the requirements of church plan in order to avoid the irrevocability of this election. The reason is that coming within these ERISA provisions offers no conceivable advantage to a church plan.

Therefore, we would suggest that the above-quoted language be omitted in its entirety.

Third. Under Section 414(e), a plan must be established and maintained for its employees by a church or convention or association of churches. Under Proposed Regs. §1.414(e)-1(e), a church includes a religious order or religious organization if such order or organization (1) is an integral part of the church and (2) is engaged in carrying out the functions of the church, whether as a civil law corporation or otherwise.

Most church plans are administered by or funded through a pension board. It is believed that at the very least these pension boards carry out the functions of the church and are, therefore, included as part of the church. It might be helpful, however, if the Regulations give pension boards that administer or fund church plans as an example of an organization that is engaged in carrying out the functions of a church.

If you find any of the foregoing suggestions unacceptable, we request that a public hearing be held on the proposed regulations under Section 414(e), IRC. At such time a number of the members and spokesmen of the Church Alliance will request the opportunity to testify.

Respectfully submitted,

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

By Darold H. Morgan
Darold H. Morgan, President
Annuity Board of the
Southern Baptist Convention
511 North Akard Building
Dallas, Texas 75201

ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION • 511 NORTH AKARD BUILDING • DALLAS, TEXAS 75201 (214) 747-9…

GARY S. NASH
General Counsel

November 18, 1977

Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, N. W.
Washington, D. C. 20224

Attention: CC:LR:T

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

This letter is written pursuant to the notice published in the Federal Register dated April 8, 1977, inviting comments on the definition of "church plan" as defined in Section 414(e), IRC, and pursuant to the notice published in the Federal Register dated September 7, ~~1977,~~ inviting comments to be delivered at a public hearing held October 6, 1977 in Washington, D. C.

I testified at the public hearing on October 6, 1977. I am enclosing with this letter a copy of my prepared testimony delivered at that hearing.

I have noted an article which appeared in the November 7, 1977 issue number 162 of the BNA Pension Reporter on page A-7 concerning the comments of Henry Rose, Pension Benefit Guaranty Corporation General Counsel, concerning the proposed "church plan" regulations. The article indicates that Rose has expressed objection to the general rule established in the proposed regulations which would provide that if at any time a plan fails to meet the requirements for being a church plan, then it can never thereafter become a church plan. Under this very harsh interpretation made in the proposed regulation, the PBGC may find itself excessively entangled in church affairs should it enforce the liability requirements of ERISA Section 4062 against an employer participating in a church plan, which inadvertently failed to meet the criteria of the proposed regulations. I would urge you to reconsider this aspect of the proposed regulations.

The proposed regulations concerning "church plans" have evoked considerable interest from the major denominations in the United States. Should you pursue Mr. Rose's apparent suggestion to define the term "church" in the regulations, I would respectfully request to comment on the proposed definition prior to its becoming adopted as a final regulation.

Respectfully submitted,

Gary S. Nash

Gary S. Nash, General Counsel

Annuity Board of the
Southern Baptist Convention

GSN:nt

Enclosure

ORAL COMMENTS TO THE INTERNAL REVENUE SERVICE BY GARY S. NASH ON THE PROPOSED REGULATIONS RELATING TO CHURCH PLANS ON OCTOBER 6, 1977

INTRODUCTION

I AM GARY S. NASH, IN HOUSE GENERAL COUNSEL OF ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION, 511 NORTH AKARD, DALLAS, TEXAS 75201. ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION IS A TEXAS NON-PROFIT CORPORATION, INCORPORATED IN 1918 TO PROVIDE FOR THE RELIEF, SUPPORT, BENEFITS AND ANNUITIES OF MINISTERS AND LAY EMPLOYEES OF BAPTIST ORGANIZATIONS OF THE SOUTHERN BAPTIST CONVENTION. ATTENDING THIS HEARING WITH ME TODAY IS DR. DAROLD MORGAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION.

MY COMMENTS ON YOUR PROPOSED CHURCH PLAN REGULATIONS WILL PROVIDE YOU WITH BACKGROUND INFORMATION ABOUT THE ANNUITY BOARD, INFORMATION ABOUT "CHURCH PLAN" DEFINITION PROBLEM AREAS DURING THE TRANSITIONAL PERIOD AND AFTER DECEMBER 31, 1982 AND I WILL CONCLUDE WITH SPECIFIC RECOMMENDATIONS CONCERNING THE REGULATIONS.

CONSTITUTIONAL OBJECTION TO JURISDICTION

AT THE OUTSET, I STATE MY CONSTITUTIONAL OBJECTIONS, BASED ON THE FIRST AMENDMENT FREE EXERCISE AND ESTABLISHMENT CLAUSES, TO THE JURISDICTION OF GOVERNMENTAL BODIES TO PASS LAWS AND REGULATIONS RESPECTING CHURCH AFFAIRS AND THE MANNER AND POLITY THE VARIOUS DENOMINATIONS HAVE SELECTED TO DISCHARGE THEIR RELIGIOUS MISSION.

BACKGROUND

UNLIKE HIERARCHICAL DENOMINATIONS OR QUASI HIERARCHICAL DENOMINATIONS, THE SOUTHERN BAPTIST CONVENTION USES A CONGREGATIONAL STRUCTURE EMPLOYING A MULTITUDE OF CIVIL LAW CORPORATIONS TO CARRY OUT FUNCTIONS

OF WORSHIP, PREACHING, EDUCATING, HEALING AND OTHER RELIGIOUS MISSIONS AND MINISTRIES.

CONGREGATIONAL BAPTIST CHURCHES ARE AUTONOMOUS CHURCHES AND ARE NOT SUB-PARTS OF A CHURCH. SOUTHERN BAPTIST CHURCHES BAND TOGETHER THROUGH LOCAL ASSOCIATIONS, STATE CONVENTIONS AND THE SOUTHERN BAPTIST CONVENTION TO PERFORM MINISTRIES WHICH MIGHT MORE EFFECTIVELY OR EFFICIENTLY BE CARRIED OUT THROUGH THE USE OF POOLED FUNDS VOLUNTARILY GIVEN TO LOCAL CHURCHES BY INDIVIDUAL CHURCH MEMBERS. THROUGH THE VOLUNTARY DONATIONS OF SOUTHERN BAPTIST CHURCHES TO THE CO-OPERATIVE PROGRAM, MONIES ARE DISTRIBUTED TO SOUTHERN BAPTIST CONVENTION ORGANIZATIONS AND STATE BAPTIST CONVENTIONS, AND STATE CONVENTION ORGANIZATIONS TO CARRY OUT MINISTRIES WHICH SMALL INDIVIDUAL CHURCHES ALONE MIGHT NOT OTHERWISE BE CAPABLE OF CARRYING OUT.

STATE BAPTIST CONVENTIONS ESTABLISH ADDITIONAL BAPTIST ORGANIZATIONS SUCH AS HOSPITALS, UNIVERSITIES, LOCAL MISSIONS AND CHAPLAINCY PROGRAMS AND ALSO CONTRIBUTE TO THE ANNUITY BOARD ON BEHALF OF MINISTERS, AMOUNTS EQUALLING SPECIFIED AMOUNTS CONTRIBUTED ON BEHALF OF MINISTERS BY LOCAL CHURCHES.

UNLIKE HIERARCHICAL CHURCHES SUCH AS THE ROMAN CATHOLIC CHURCH OR THE CHURCH OF JESUS CHRIST OF LATTER DAY SAINTS, AND UNLIKE QUASI HIERARCHICAL CHURCHES SUCH AS THE UNITED PRESBYTERIAN CHURCH IN THE USA, WHERE THERE ARE CLEAR LINES OF RESPONSIBILITY, CONTROL AND AUTHORITY, CONGREGATIONAL BAPTIST CHURCHES ARE WITHOUT CLEAR LINES OF CONTROL FROM THE STATE BAPTIST CONVENTIONS AND FROM THE SOUTHERN BAPTIST CONVENTION. RATHER, CHURCH MEMBERS OF LOCAL CHURCHES ELECTED AS TRUSTEES ON BOARDS OF DENOMINATIONAL ORGANIZATIONS CONTROL THE POLICIES OF THE VARIOUS DENOMINATIONAL ORGANIZATIONS.

NO CHURCH OR OTHER DENOMINATIONAL ORGANIZATION IS REQUIRED TO PARTICIPATE IN ANY OF THE RETIREMENT ANNUITY OR WELFARE BENEFIT PROGRAMS PROVIDED THROUGH THE ANNUITY BOARD OF THE SOUTHERN BAPTIST CONVENTION. PARTICIPATION IS STRICTLY VOLUNTARY.

HOWEVER, THE ANNUITY BOARD HAS BEEN ABLE TO SERVE THE UNIQUE REQUIREMENTS OF THE SOUTHERN BAPTIST CONVENTION AFFILIATED CHURCHES AND DENOMINATIONAL ORGANIZATIONS ESTABLISHED TO CARRY OUT THE FUNCTIONS AND MINISTRIES OF CHURCHES.

SOUTHERN BAPTIST MINISTERS AND LAY EMPLOYEES ARE HIGHLY MOBILE, CHANGING FROM CHURCH TO CHURCH, FROM CHURCH TO OTHER DENOMINATIONAL ORGANIZATION, FROM DENOMINATIONAL ORGANIZATION TO DENOMINATIONAL ORGANIZATION AND VICE VERSA.

THE ANNUITY BOARD HAS DIFFERENT INVESTMENT POOLS TO FUND RETIREMENT ANNUITY AND RELIEF BENEFITS, DEPENDING ON THE NATURE AND THE PART OR PARTS OF THE PROGRAM IN WHICH A DENOMINATIONAL EMPLOYEE MAY BE PARTICIPATING.

ONE PART OF THE ANNUITY BOARD PROGRAM IS MAINLY FOR MINISTERS, AND IT RECEIVES CONTRIBUTIONS FROM THE MINISTER'S CHURCH AND MATCHING CONTRIBUTIONS FROM THE STATE CONVENTION WHERE THE CHURCH IS LOCATED. ANOTHER PART OF THE PROGRAM IS SIMILAR TO A THRIFT PLAN OR MONEY ACCUMULATION PLAN AND BOTH MINISTERS AND OTHER DENOMINATIONAL EMPLOYEES PARTICIPATE IN THIS PART IF THEY SO DESIRE.

A THIRD PART OF THE PROGRAM PROVIDES FOR A VARIABLE ANNUITY BENEFIT AS A SUPPLEMENT TO PARTICIPATION IN ONE OF THE OTHER PHASES OF THE PROGRAM. THIS VARIABLE PART OF THE PROGRAM IS OPEN TO ANY DENOMINATIONAL EMPLOYEE WHO IS ALSO PARTICIPATING IN SOME OTHER PHASE OF THE PROGRAM.

THERE ARE NO ORGANIZATIONS PARTICIPATING IN ANNUITY BOARD PROGRAMS WHICH ARE OTHER THAN CODE SECTION 501(c)(3) ORGANIZATIONS. THE ANNUITY BOARD HAS NO PLANS MAINTAINED PRIMARILY FOR EMPLOYEES EMPLOYED IN CONNECTION WITH UNRELATED TRADES OR BUSINESSES.

PROBLEM AREAS

THERE IS A GREAT DEAL OF CONCERN OVER WHAT THE INTERNAL REVENUE SERVICE AND THE DEPARTMENT OF LABOR ARE GOING TO DECIDE ARE "AGENCIES" WHICH CANNOT PARTICIPATE IN CHURCH PLANS AFTER DECEMBER 31, 1982. WE ARE CONCERNED ALSO AS TO WHETHER CHURCH PENSION BOARDS WILL BE ABLE TO CONTINUE TO SERVE THESE AGENCIES AFTER 1982, SINCE THE SEVERAL ERISA DRAFTING COMMITTEES WERE APPARENTLY UNAWARE OF THE EXISTENCE OF CHURCH PENSION BOARDS.

BAPTIST SCHOOLS AND HOSPITALS HAVE PARTICIPATED IN ANNUITY BOARD PROGRAMS NOT ONLY BECAUSE OF THE QUALITIES OF THE PROGRAMS BUT ALSO BECAUSE OF THE INHERENT DENOMINATIONAL TIES.

THE GOVERNMENT-MANDATED DIVISION OF AGENCIES FROM CHURCHES IN CONTEXT OF CHURCH PLANS IS VIEWED WITH ALARM NOT ONLY BECAUSE OF THE INVOLUNTARY BREAKING OF RELIGIOUS TIES, BUT ALSO BECAUSE OF THE INCREASED ADMINISTRATIVE COSTS FOR BOTH THE EXEMPT CHURCH PLAN AND THE NEW NON-EXEMPT AGENCY PLANS.

WE FEEL THAT DURING THE TRANSITION PERIOD, OUR JOINT FUNDED DENOMINATIONAL ANNUITY PROGAM IS ENTITLED TO BE TREATED AS A CHURCH PLAN.

RECOMMENDATIONS

THE REGULATIONS SHOULD RECOGNIZE AS CHURCH PLANS JOINT FUNDED DENOMINATIONAL ANNUITY PROGRAMS ESTABLISHED AND MAINTAINED THROUGH CHURCH PENSION BOARDS.

WE CONCUR WITH THE OTHER DENOMINATIONAL PENSION BOARDS REPRESENTED THROUGH THE CHURCH ALLIANCE FOR CLARIFICATION OF ERISA IN ALL POINTS PRESENTED IN THE LETTER OF COMMENTS TO THE COMMISSIONER, DATED MAY 20, 1977, CONCERNING THE PROPOSED CHURCH PLAN REGULATIONS. IN THIS EXTREMELY COMPLEX AND SPECIALIZED AREA OF "CHURCH PLANS" IN THE ERISA CONTEXT, IT CERTAINLY APPEARS HARSH AND UNFAIR TO IMPOSE AN INCURABLE AND PERPETUAL BANISHMENT FROM "CHURCH PLAN" STATUS FOR A DENOMINATION PLAN WHICH, IN SPITE OF GOOD FAITH EFFORTS AT COMPLYING WITH THE STATUTORY CHURCH PLAN DEFINITION, FAILED TO MEET IT. WE THEREFORE STRONGLY URGE THAT THE FOLLOWING LANGUAGE FROM SECTION 1.414(E)-1(A) BE DELETED IN ITS ENTIRETY:

> "IF AT ANY TIME DURING ITS EXISTENCE A PLAN IS NOT A CHURCH PLAN BECAUSE OF A FAILURE TO MEET THE REQUIREMENTS SET FORTH IN THIS SECTION, IT CANNOT THEREAFTER BECOME A CHURCH PLAN."

WE URGE THAT A DENOMINATIONAL PENSION BOARD WHICH FUNDS OR ADMINISTERS CHURCH PLANS BE GIVEN AS AN EXAMPLE OF AN ORGANIZATION THAT IS ENGAGED IN CARRYING OUT THE FUNCTIONS OF A CHURCH. CHURCH PENSION BOARDS ARE INTEGRAL IN THAT THEY PERFORM VITAL AND NECESSARY FUNCTIONS FOR THE EXISTENCE OF THE CHURCHES.

<u>CONCLUSION</u>

THE VARIETY OF ORGANIZATIONAL STRUCTURES OF THE VARIOUS RELIGIOUS DENOMINATIONS PRESENT IN THE UNITED STATES APPEAR TO POSE A VERY DIFFICULT PROBLEM FOR REGULATIONS TO DEAL WITH IN THE "CHURCH PLAN" CONTEXT SINCE "CHURCH" HAS SO MANY DIFFERENT MEANINGS AND CONNOTATIONS, NOT ONLY IN THE TAX LAWS BUT ALSO FROM ONE DENOMINATION TO ANOTHER. YOU WILL FIND THAT DENOMINATIONAL PENSION PROGRAMS HAVE GENERALLY

A GREATER DEGREE OF CONTROL IN THE PLAN MEMBER THAN OTHER PLANS OF PROFIT MAKING ORGANIZATIONS. YOU WILL ALSO FIND THAT DENOMINATIONAL PENSION PROGRAMS MAY HAVE A GREAT DEAL OF DIFFICULTY FITTING INTO A GOVERNMENT DEFINED AND ENFORCED UNIFORMITY FOR EXEMPT CHURCH PLAN STATUS. FOR THAT REASON I URGE THAT THE REGULATIONS YOU ADOPT BE AS FLEXIBLE AS REASONABLY POSSIBLE UNDER THE LAW.

THANK YOU.

The Pension Boards UNITED CHURCH OF CHRIST

JOHN D. ORDWAY
Executive Vice President

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October 7, 1977

Director, Legislation and Regulation Branch
Office of Chief Counsel
1111 Constitution Avenue, N.W.
Washington D. C. 20224

Re: Proposed regulations defining the term "Church Plan".

Dear Sir:

At the conclusion of the hearing on the proposed regulations to define the term "Church Plan", it was indicated that any further written comment concerning the subjects discussed would be welcome.

During the hearing presentation, two individuals suggested that the regulations, when issued, include a church pension board as an example of the type of entity that would be considered to be within the definition of Church or an Association or Convention of Churches. In each case, Ms. Kahn asked the individual how one would distinguish a pension board from the other agencies of the church.

A pension board is clearly distinguishable from other types of agencies of the church. A pension board is carrying out the internal administration of the church necessary for the church as a whole to function. Other agencies dealing with the public as a whole or some segment of the public are pursuing their ministry by the provision of some charity or service for the people of the community. There is a distinct difference between the two.

Ultimately all of the work of the church is intended to benefit the community and there has been considerable discussion over which functions are deemed to be functions of a church and which functions, when carried out by a separate entity of a church, are such that the entity is considered an agency not exempt from the Employee Retirement Income Security Act of 1974. The questions related to such functions as health care, education, care for the aged or disabled, etc.; when such functions are carried out by the church through the provisions of service to the public, and whether or not such functions are functions of a "church" are not required to be answered to differentiate between a pension board and an agency of the church. Congress has established a difference between "churches" and such "agencies", at least for the purposes of ERISA. Accordingly, I only deal with the carrying out of the functions of a church in the more traditional sense.

In that sense, the direct functions of a church are carried out in the local community in some building usually built and paid for by a congregation who also employs a minister and others to carry out or supervise the specific functions performed within that church and to the congregation and community. This would include Sunday services in a christian church, baptism, marriage, funerals, communion, counselling, and a myriad of other items. There would normally be a Sunday School for children, a choir, a youth group, as well as an adult group, a women's group, a men's group, and a wide variety of committees dealing with specific needs and concerns in religious and spiritual matters, of the congregation, of the community, and throughout the world.

Because these concerns are common to virtually all churches, and within a specific denomination, have a common religious interpretation as a basis for dealing with such concerns, regional and national bodies are established to assist in the efficient implementation of those concerns. In a hierarchical church the national bodies would commonly be looked at as the "Church" carrying out the functions of the church through the local congregations which are normally owned or controlled by that national body. In a congregationally structured church, the general public would still view the national bodies as the "church". However, in this type structure, the national or regional bodies do not control the local congregations, and in most cases do not directly carry out the commonly thought of functions of the church. However, their role is essential to the functions of those local congregations and they are an integral part of the church as a whole.

These functions include such things as the publication of hymnals, church school materials, support of new congregations, assistance in the placement of ministers, supervision and coordination of missionary activities, coordination and assistance in the activities of local congregation in their individual ministries, financial aid for the building or extension of church facilities, and on through virtually every element of the operation of a local church, not to mention national leadership of the denomination.

One could say that such elements could be provided by some other source but such an answer does not recognize the circumstances of the church. When a church of a particular denomination wants a hymnal, they need one which reflects the theological thinking of that denomination, not a publication that some secular organization would compile, and it certainly is not practical to say that each local congregation should publish their own.

Similarly, when a congregation wants to build a new church or an extension to its existing structure, it could be said that they could borrow money from some local lending facility. Again, that solution is not possible

Director, Legislation and Regulation Branch October 7, 1977

in a great number of situations. While a church structure may cost substantial amounts to build, its value in the market place is usually limited to its use as a church. A bank attempting to foreclose on a church building has two basic problems. First, the building is unsaleable unless there happens to be another congregation in the area that needs a building. Accordingly, the value of the property is often limited to the value of the land. Second, the bank incurs a substantial public relations detriment when their foreclosure becomes public knowledge. As a practical matter, normal mortgage financing does not adequately meet the needs of a church.

Another circumstance with which national and regional bodies must deal is the employment and maintenance of the ministers of the denomination. A church cannot, as a practical matter, go to an employment agency to locate a minister. A church looking for a new minister necessarily wants a minister that adheres to the principles of that denomination. This normally requires knowledge of those ministers within the denomination who are either presently unemployed or who are seeking, or willing to consider, a change from their present employment. A national body relating to this concern meets the needs of both the local congregation and the minister who must fulfill his calling in a variety of settings over the period of his working career. The maintenance of that minister over his career and beyond his working years is the continuing concern of the local church and the church as a whole as it is only through an effective ministry that the primary functions of the church can be effectively pursued. This includes current income and housing, but also includes provision for health care, disability income, survivor benefits, and retirement income for the minister and his dependents.

Again, it could be said that such benefits could be obtained from other sources, but such a position again does not recognize the facts of a ministry within a church. While ministers commonly will devote an entire career within a single denomination, their ministry will move within the denomination from church to church to agency, and back to another church. The great majority of churches will have, at most, three full time employees, and a large number will have only one, the minister. Other services of the church (teaching, clerical, choir director, etc.) will be obtained from persons within the congregation on a part time basis either as unpaid volunteers or for minimal compensation.

Under such circumstances, the costs of obtaining individual benefit packages for the employed individuals is prohibitive in cost as group coverages would not be available, impractical for the participants because of the necessity of changing coverages with each change in the minister's employment, and impossible for those most in need who incur health or other problems making them uninsurable with the organization selected by their next employer for the provision of such benefits. Further, it should be noted that separate pension benefits provided by each individual entity employing the minister, even if in full compliance with ERISA, could well result in the minister receiving no benefit whatsoever. The minister will commonly work in a particular entity for less than ten years, as he or she will usually want to change the setting in which his or her ministry is performed. This may simply be a desire to move between an urban or rural setting or to a larger or smaller church, but may well include a wish to impact on a particular social concern such as drug abuse, prison rehabilitation, mental health, etc. Termination of service at any entity with less than ten years service could result in forfeiture of the accrued benefit if the individual were in a plan covered by ERISA. This is not true of any church pension system of which I am aware, where service is consistently viewed as service to the denomination as a whole. These benefits are the benefits provided through the pension boards of the various churches for the ministers and lay employees of such churches. In addition, many pension boards, including the Pension Boards of the United Church of Christ, administer other funds which provide additional financial help to the ministers and his or her dependents when special financial needs arise. This would include such things as assistance with medical or hospitalization costs not covered by a health insurance plan, needed funds during periods of temporary unemployment, education assistance to the children of deceased ministers, monthly aid to ministers or spouses of deceased ministers whose income during working years was insufficient to generate even a moderate pension benefit, recognizing that there continues to be a large number of ministers still living who retired before social security even became available to ministers.

These functions of a pension board are a necessary function of a national church body, whether carried out in a hierarchical church structure where the national body is represented in a single head and operates a pension board, or in a congregational church structure where the national body is a group of individual entities each charged with a particular area of the church's concern (be it internal administration, or national or world wide pursuit of its ministry), one of which is the maintenance of the ministry through the administration of programs for their health, welfare, retirement, and relief through a pension board. The pension boards, as such, are an integral part of the church and, as such, are a necessary part of carrying out the functions of the church so as to be considered a part of the church.

Accordingly, I submit that a pension board could properly be used as an example of the type of entity that is a church, or an association or convention of churches, and could properly be distinguished from church "agencies" that perform other services to or for the community or for individuals who are not a part of the church structure engaged directly or indirectly in carrying out the functions of a "church".

Sincerely,

JDO/dek

BCC: James W. Quiggle
Gary S. Nash
John Redmond

PATTERSON, BELKNAP, WEBB & TYLER
30 ROCKEFELLER PLAZA
NEW YORK, N. Y. 10020

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LEGAL SERVICES
ANNUITY BOARD, SBC

November 23, 1977

Commissioner of Internal Revenue
1111 Constitution Avenue
Washington, D.C. 20224

Attention: CC:LR:T (LR-193-74)

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

By letter dated October 14, 1977, our client, The Ministers and Missionaries Benefit Board of American Baptist Churches, advised you of its desire to submit additional information and comments for your consideration in connection with the final regulations under section 414(e) of the Internal Revenue Code, relating to the exemption of church plans from ERISA. We are enclosing a letter signed by the Reverend Dean R. Wright, Executive Director of The Ministers and Missionaries Benefit Board of American Baptist Churches, providing such additional information and comments.

On pages 24 and 25, Rev. Wright points out that the large majority of church pension plans, including the one administered by The Ministers and Missionaries Benefit Board, are not "qualified plans" under section 401(a) of the Internal Revenue Code. Instead, they provide pension benefits for ministers and lay employees in the form of annuities under section 403(b) of the Internal Revenue Code. Accordingly, these "section 403(b) plans" do not, in general, come within the provisions of Title II of ERISA, which pertains primarily to "qualified" plans. It is our understanding, however, that a section 403(b) plan may constitute an employee pension benefit plan for purposes of Title I of ERISA, and also, perhaps under certain circumstances, for purposes of Title IV of ERISA.

The definition of a "church plan" is the same for purposes of all three titles of ERISA. As discussed more fully in Rev. Wright's letter, this may help to explain the comments made by several church pension boards at the hearing on October 6, 1977 with respect to the coverage of "former employees" under a section 403(b) church plan.

The American Baptist denomination is grateful for the opportunity it has been given to submit additional comments for consideration. We shall be happy to provide any further information which might be of assistance.

Sincerely yours,

John P. Persons

John P. Persons

Enclosure

THE MINISTERS AND MISSIONARIES BENEFIT BOARD
of the
AMERICAN BAPTIST CHURCHES
475 Riverside Drive, New York, New York 10027

November 23, 1977

Commissioner of Internal Revenue
1111 Constitution Avenue
Washington, D.C. 20224

Attention: CC:LR:T (LR-193-74)

Re: Proposed Regulations Under Section 414(e), IRC, Defining "Church Plan"

Dear Sir:

The purpose of this letter is to provide the Treasury Department and the Internal Revenue Service with additional information and comments which we believe will be helpful in the preparation of final regulations under section 414(e) of the Internal Revenue Code, relating to "church plans."

This letter will focus primarily upon two important considerations that we believe have not been adequately stressed in the comments heretofore submitted. These are (1) the origins, structure and role of a "church pension board" such as our organization, and (2) the principles of U.S. constitutional law which underlie the exemption granted by Congress to "church plans" in ERISA, and which should be adhered to in promulgating final regulations under section

414(e) in order to avoid unconstitutional entanglements between government and religion that the Congress did not intend.

In the light of the factual and legal background provided by the foregoing considerations, we shall, in conclusion, restate briefly the specific comments we have previously made with respect to the proposed regulations and explain why they are important to the American Baptist denomination.

1. The Origins, Structure and Role of a Church Pension Board

Many "church plans" are administered or funded by pension boards, separate corporate entities that are associated with and controlled by the churches and other religious bodies of the denomination. Because of the differences in beliefs, structures and practices among the various religious denominations, there are wide variations in their pension boards and the plans administered by these boards. At the same time, however, there are many points of similarity.

Virtually all of these pension boards were established and in operation many years prior to the enactment of ERISA. It seems reasonable to assume, therefore, that when Congress exempted "church plans" from the requirements of ERISA, it intended to include within the exemption -- especially during the transitional period that ends on December 31, 1982 -- the plans administered by these church pension boards as they existed on January 1, 1974. It may therefore be helpful for the Service and the Treasury Department to know how the pension board of the American Baptist denomination came into being, what its organizational structure is, from what sources its funds have been derived, and what programs it carries on for the benefit of the ordained ministers, missionaries and lay employees of the denomination.

The Ministers and Missionaries Benefit Board of American Baptist Churches (the "Board") is one of four separately incorporated national organizations established by the American Baptist denomination to carry out its work. The denomination consists of approximately 6,000 local churches, and numerous other affiliated religious and charitable organizations, throughout the United States. These churches and affiliated organizations make up the institutional structure of the denomination. There are approximately 1,500,000 individual members of the local churches of the denomination. Consistent with Baptist congregational beliefs, each of the local churches is separate, independent and autonomous.

The principal coordinating and directing entity of the denomination is American Baptist Churches in the U.S.A.

("ABC"). ABC was formed as an unincorporated association in 1907 and was incorporated by a special act of the New York legislature in 1910. Its present name was adopted in 1972 when the denomination completed a major revision of its organizational structure. Prior to 1972 ABC was known first as the Northern Baptist Convention, and later as the American Baptist Convention.

At the first annual meeting of the then Northern Baptist Convention in 1908, a commission of seven was appointed to consider the needs of aged and disabled ministers and their widows and orphaned children. At that time, the dire economic straits of superannuated Baptist ministers and missionaries was a cause of great concern to the denomination. Because of the low salary levels that prevailed it was impossible for most individual ministers and missionaries to set aside, out of current compensation, a sufficient amount to provide for their cost of living after retirement or disability, or to provide for their widows and dependent children in the event of their death prior to retirement. The commission was instructed to address itself to this problem, which was one that could not be solved at the local level but only on a denomination-wide basis through the combined efforts of the autonomous local churches and other church bodies.

Because the commission was without funds, little was accomplished until May, 1911 when an anonymous layman of the denomination offered to contribute $50,000 towards a fund for the relief of superannuated and disabled ministers and missionaries, on condition that by December 25, 1911 an additional $200,000 be obtained from other sources for the same purpose. In August 1911 the Ministers and Missionaries Benefit Board was organized in unincorporated form and a financial campaign was undertaken to raise the additional $200,000. Through the help of many generous members of the denomination, including Mr. John D. Rockefeller, Sr.,[1/] the goal of $200,000 was met by the December 25 deadline. By this action, the denomination took the first step toward providing an adequate retirement income to the ministers and missionaries (and their families) who carry on the denomination's work.

The question then arose as to whether this function could best be carried on by having the Ministers and

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1/ In 1917 another denomination-wide fund raising campaign was launched, and by 1919 a total of $2,000,000 had been raised through contributions to the Board. Taking note of this progress, Mr. John D. Rockefeller, Sr. then made a matching gift of $2,000,000, bringing the Board's endowment fund to $4,000,000. Mr. Rockefeller's interest in the work of the Board continued during the 1920's, and ultimately he contributed a total of $6,900,000 to the Board's endowment. The enclosed Annual Report of the Board for 1976 contains a complete list of gifts and legacies (of $1,000 or more) that have been made to the Board for its corporate purposes.

Missionaries Benefit Board continue as an unincorporated branch of the Northern Baptist Convention itself, or whether a new entity should be established which would be legally separate from the Convention, but subject to its overall direction and control. After careful consideration, the decision was made by the denomination to follow the latter course. This decision led to the incorporation of the Ministers and Missionaries Benefit Board, in 1913, by a special act of the New York legislature.

From the start priority was given to the development of a pension plan for Baptist ministers and missionaries. This plan was initially called the Retiring Pension Fund, and it was administered by the Ministers and Missionaries Benefit Board pursuant to the Board's mandate as set forth in its original Act of Incorporation: "to administer its funds for the benefit of worthy Baptist ministers and Baptist missionaries, their wives or widows, and their dependent children...." Dues were set at 6 percent of compensation, but since it was recognized that many ministers would be unable to pay even this small amount, the Board provided, from its endowment, a subsidy ranging from 65 to 75 percent. In effect the member's annual dues to the Retiring Pension Fund amounted to approximately 1.8 percent of compensation.

During the 1930's and 1940's efforts were made to enroll ministers and missionaries of the denomination in the Retiring Pension Fund. Increased membership required greater reserves, over and above the dues received from members, and a total of $4,000,000 was placed in the Retiring Pension Fund for this purpose. Of this $4,000,000, $1,800,000 was provided through a denomination-wide fund raising campaign for American Baptist missions, and the balance was provided by the endowment fund. After the Retiring Pension Fund was firmly established, steps were taken periodically to increase the dues in order to improve the level of retirement benefits.

In the 1950's the Board was confronted with the question of how to distribute, equitably, increasingly available resources to meet growing retirement needs. After a thorough study, the Board in 1965 established a variable annuity program to replace the Retiring Pension Fund, which had provided only fixed annunities. The new variable annuity program, called the American Baptist Churches ("ABC") Retirement Plan, provides for the issuance of annuities pursuant to Section 403(b) of the Code. Virtually all members of the Retiring Pension Fund have transferred to the ABC Retirement Plan. Also in 1965 the ABC Retirement Plan was opened to lay employees of the churches and other affiliated organizations of the denomination pursuant to an amendment of the Board's charter. This was done in recognition of the fact that the denomination has a responsibility to provide for the retirement of its lay employees as well as for its ministers and missionaries.

Since the early 1960's the Board has sought to accomplish its mission 2/ of providing for the welfare and maintenance of ministers, missionaries, and lay employees who serve the denomination by providing additional benefit programs such as: (1) The Annuity Supplement, which provides a means whereby participants can increase their retirement income through the purchase of supplemental variable annuities under salary reduction arrangements; (2) The M & M Death Benefit Plan, which provides group term life insurance protection for active members prior to retirement;

2/ The purposes of the Board as now set forth in its Act of Incorporation are as follows:

Sec. 2. The objects of the corporation shall be to administer its funds for the benefit of ministers and missionaries who have served the Baptist denomination, their spouses or surviving spouses and their dependent children, and to attain these objects either directly or through the medium of related organizations; to cooperate with such organizations in securing, so far as practicable, uniformity in the methods for the extension of such aid; to promote interest in the better maintenance of the ministry; also, to receive and administer funds to provide benefits to other persons who as employees have served the Baptist denomination, and to their spouses or surviving spouses and their dependent children; and to adopt such measures to these ends as may be recommended by American Baptist Churches in the U.S.A.

and (3) The ABC Medical Plan, which provides medical and hospital benefits to participants and their dependents, both before and after retirement. The Board also provides grants and emergency assistance to needy American Baptist ministers and missionaries and their families. In addition, it maintains a program of salary support for ministers who work for Baptist employers that are unable to pay compensation that the Board considers adequate.[3/]

Income from the Board's general fund (as distinguished from funds that are allocable to the various benefit plans or otherwise legally restricted) is presently used to meet all of the administrative expenses of the retirement, death benefit and medical plans. Income from the general fund is also used to provide supplementary benefits, such as: (1) emergency assistance to active and retired ministers and their families experiencing financial hardship, (2) supplemental grants to retired ministers and missionaries and their surviving spouses who are in serious financial need, (3) grants to augment low annuity payments, (4) medicare premiums for retired participants who are over age 65, and (5) support for orphaned children.

3/ A more complete summary of the history of the Board and its programs is set forth in the enclosed excerpt from the Annual Report of the Board for 1971, which was the Board's 60th anniversary year. Also enclosed is a copy of the Annual Report for the year 1976.

Although the Board is separately incorporated and has been determined by the Service to be exempt from federal income tax under Section 501(c)(3) of the Code, it is an integral part of the American Baptist denomination and of American Baptist Churches in the U.S.A. In carrying out its corporate functions, the Board is subject to the supervision and control of the American Baptist denomination, as exercised through the ABC and its affiliated societies and agencies. The Board's Act of Incorporation provides that in carrying out its purposes, the Board shall "adopt such measures to these ends as may be recommended by American Baptist Churches in the U.S.A." The Board is supervised by a board of directors (called "managers") varying between twelve and eighteen in number. At least nine of the managers of the Board are elected by the ABC, and an additional three of the managers are elected by the boards of directors of three other denominational bodies which are supervised and controlled by the ABC. The Board is required to submit an annual report to the ABC, and the ABC has the power to instruct the Board with regard to its general policies. The By-Laws and regulations adopted by the Board with respect to its organization, the management and disposition of its assets, the duties and powers of its officers and the management of its affairs are subject to confirmation by the ABC. The time and place of the meetings of the Board may be determined by the ABC.

In view of the foregoing, we believe and strenuously maintain, that the Board is included within the term "church" as described in § 1.414(e)-1(e) of the proposed regulations -- namely, a "religious organization [that] (1) is an integral part of a church, and (2) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise." We believe that one of the essential functions of a church -- whether organized along congregational or hierarchal lines -- is to provide (during active employment and after retirement) for the welfare of the persons who carry on its work, and without whom the church could not function. At the hearing on October 6, 1977 we requested that this conclusion be made explicit in the regulations, and we were surprised and disturbed when this suggestion was questioned by at least one of the government representatives present at the hearings. We hope that the information presented above will help to clarify this issue, and that the final regulations will specifically recognize a church pension board as an organization that carries out the functions of a church.

Moreover, returning to a point mentioned earlier in this letter, we believe that Congress intended that the plans being administered for the American Baptist denomination by our pension board on January 1, 1974 (and also the plans then existing of other denominations) be included within the exemption accorded "church plans" at least until January 1, 1983, and thereafter if the plans do not cover church-related "agencies". Understandably, Congress did not have detailed information as to the coverage provided under all church plans in existence on January 1, 1974, and it therefore enacted specific coverage limitations with respect to only two situations. First, it provided that employees of unrelated businesses operated by churches may be covered by an exempt church plan so long as the plan is not <u>primarily</u> for their benefit. Second, it provided that employees of church-related "agencies" may be covered by an exempt church plan until 1983 but not thereafter. Otherwise, the definition of an exempt church plan was set forth in more general terms, and the details as to other questions that would inevitably arise were left to be filled in by regulations and administrative rulings. We believe that Congress intended these questions to be resolved in such a way as to avoid the risk of unconstitutional interference by the federal government in the programs that have been established by churches for the purpose of providing retirement and welfare benefits to the persons through whom the churches carry out their religious mission.

2. <u>Constitutional Principles that Should Be Adhered to in the Formulation of the Final Regulations</u>

The only explanation in the Congressional committee reports regarding the reasons for the exemption of church plans under ERISA appears in the following extract from the Senate report explaining why church plans were not made subject to the plan termination insurance requirements of ERISA:

> "At the option of an exempt church (or of a convention or association of churches), plans covering its employees may be included in the insurance coverage. The committee is concerned that the examinations of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities. However, if the church itself has determined to consent to such examinations, to the premium tax payments, and to the contingent employer liabilities, then it may elect to have the insurance program apply to its plan or plans. . . ."4/

Although this statement was made with reference to the plan termination insurance provisions, it seems clear that the same reasoning underlay the exemption accorded to church plans from the provisions of Titles I and II of ERISA.

By exempting church plans from ERISA, Congress was endeavoring to adhere to the long established principle of separation of church and state as expressed in the First Amendment: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise

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4/ Sen. Rep. 93-383, 93rd Cong., 2d Sess., 1974-3 C.B. Supp. 160.

thereof . . . ." As observed by Mr. Justice Black of the United States Supreme Court thirty years ago, this language in the First Amendment "was intended to erect 'a wall of separation between church and state.'"5/

In more recent decisions the Supreme Court has applied a three-part test in determining the constitutionality of statutes calling for governmental action raising a question under the religion clauses of the First Amendment. The third part of this test, which is directly relevant to the present discussion, requires that "the statute must not foster an excessive government entanglement with religion."6/

As Mr. Justice Blackmun stated in a case under the religion clauses decided only last year:

> "The importance of avoiding persistent and potentially frictional contact between governmental and religious authorities is such that it has been held to justify the extension, rather than the withholding, of certain benefits to religious organizations. The Court upheld the exemption of such organizations from property taxation partly on this ground. Walz v. Tax Commission, 397 U.S. 664, 674-675, 90 S. Ct. 1409, 1414-1415, 25 L.Ed.2d 697 (1970)."7/

Mr. Justice Harlan, in a separate opinion in the Walz case, supra, warned of the constitutional problems that

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5/ Everson v. Board of Education, 330 U.S. 1, 16 (1947).

6/ Lemon v. Kurtzman, 403 U.S. 602, 613 (1971).

7/ Roemer v. Board of Public Works of Maryland, 426 U.S. 736, 748 at n. 15 (1976).

are raised by governmental programs "whose very nature is apt to entangle the state in details of administration" of church functions.[8/] In Lemon v. Kurtzman, supra, the Supreme Court held unconstitutional a state statute supplementing the salaries of teachers in Catholic parochial schools because the statute created a "relationship pregnant with dangers of excessive government direction of church schools and hence of churches."[9/]

If ERISA were applied to the plans that churches have established for the welfare of their ministers and lay personnel, it would be difficult to imagine a situation that would be more "pregnant with dangers of excessive government direction" or more likely "to entangle the state in details of administration" of a vital church function.

If subject to ERISA, church plans would be required to file detailed and extensive annual reports with the Federal government -- a requirement which the churches believe would erode their rights under the First Amendment. Non-compliance with the reporting requirements could lead to governmental enforcement actions, and even criminal prosecution, against the church officials who administer the church plans. In order to enforce ERISA's requirements, the

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8/ 397 U.S. 665, 695.

9/ 403 U.S. 602, 621.

Secretary of Labor could require the submission of reports, books and records, and could enter upon church property for the purpose of inspecting books and records and questioning church officials concerning any and all aspects of the church plans under their administration. Powers such as these were held in Caulfield v. Hirsch,[10/] and Catholic Bishop of Chicago v. N.L.R.B.[11/] to preclude the application of the National Labor Relations Act (NLRA) to Catholic parochial schools. In Caulfield the court stated:

> "The entangling relationships which can arise under the NLRA appear in a wide variety of ways. Because they may result in numerous conflicts and confrontations between the NLRB and the church schools, they are, in my mind, excessive and, therefore, not permissible within the meaning of the first amendment."[12/]

Under ERISA, moreover, the reach of governmental regulation may go to the very heart of the conduct of a church's religious mission through its pension board. Fiduciaries of ERISA plans are subject to the fiduciary responsibility provisions set forth in Part 4 of Title I. We fully subscribe to the objectives underlying these fiduciary responsibility provisions. However, because of the differences in purposes, programs and sources of funds of church pension

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10/ Caulfied v. Hirsch, 95 LRRM 3164 (E.D. Pa. 1977).

11/ Catholic Bishop of Chicago v. N.L.R.B., 559 F.2d 1112 (7th Cir. 1977).

12/ 95 LRRM 3164, 3179.

boards and the intimate involvement of such boards in the conduct of their church's religious functions, we believe that the application of Part 4, Title 1 to church pension boards would give rise to serious conflicts between such boards and the federal government concerning the investment of their funds and the purposes for which such funds could be expended.

For example, as we have previously explained, our pension board is generally responsible for the maintenance of the ministers, missionaries and lay personnel of the denomination, and their families. Substantial sums have been donated to the Board as endowment funds to enable it to carry out this general corporate purpose. Other funds have been paid to the Board as "premiums" for contractual benefits under the retirement, disability, medical and death benefit programs. The ABC Retirement Plan is a variable annuity plan under which a separate account is maintained for each participant, whose annuity benefits under the Plan are based upon the value of this account. However, in order to protect retired participants from a severe drop in income should investment experience be adverse, the Board has obligated itself to use its endowment funds to supplement the variable annuity benefits to the extent necessary to maintain retirement income at specified minimum levels. Thus, the minimum levels of income are "guaranteed" by the

Board's endowment funds, which the Board also uses for many other purposes not related to the employee benefit plans -- such as emergency assistance, salary maintenance for ministers, grants-in-aid to persons with inadequate incomes, and counselling of ministers in regard to retirement and other matters. If ERISA applied to the Board's plans, the federal government would be placed in the position of determining the extent to which the Board's endowment funds could be used for the board's general corporate purposes (as distinguished from employee benefit plan purposes). This, we believe, would give rise to an unconstitutional regulation by the government as to the use of moneys donated to the Board for its religious purposes. Other conflicts and confrontations[13/] could arise under the fiduciary responsibility provisions because of the fact that our Board -- like many other church pension boards -- is not merely a "pension" fund but has broad religious purposes as well.

Another area that involves a high potential for governmental entanglement in the affairs of churches is

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13/ For example, the endowment funds of our Board are sometimes loaned to American Baptist organizations that need financing for projects that are within the scope of the Board's general corporate purposes. If ERISA applied to our church plans and the endowment funds were held to constitute plan assets, the Board would be prohibited from making such loans because of the provisions of section 406. Such application of ERISA's prohibited transaction rules would seem clearly to interfere with the conduct of church functions in violation of the First Amendment.

Title IV of ERISA, regarding plan termination insurance. Church plans subject to Title IV would be required to pay the plan termination insurance premiums therein provided -- a burden of questionable constitutionality if imposed upon churches without their consent. Church plans covered by Title IV would also be subject to examination of books and records, and the church employer could be subject to contingent liabilities potentially leading to governmental liens and foreclosures upon church assets to satisfy such liabilities. These are some of the "entanglements" that led Congress to exempt church plans from the provisions of Title IV.

Meeting the plan participation requirements of Title I could also impose a burden upon some churches in violation of their constitutional rights. Our Board makes a strenuous effort to encourage all American Baptist local churches to cover under our benefit plans all of their employees, both ordained and lay. However, we have no power to compel a church to do this, and some churches simply do not have the financial resources to do so. In such situations a church may decide, as a matter of pricrities, that it will cover its minister from tho time he is first employed by the church, but it will not cover its lay employees (sexton, secretary, etc.) until they have been employed for a number of years. Such an arrangement might violate the ERISA participation standards, so that the church might be forced to terminate the coverage of its minister because it is not financially able to provide coverage for all of its employees. We question whether the government can burden in this manner the freedom of a church to employ its minister on such terms as it deems appropriate in the management of its own internal affairs.

In summary, we believe that serious constitutional questions will be raised if section 414(e), defining "church plans", is interpreted too narrowly, thereby causing the disqualification of church plans for reasons that were not clearly contemplated by Congress.

3. Summary of Comments Regarding the Proposed Regulations

In the light of the preceding discussion, we believe that certain modifications should be made in the proposed regulations in order to enable "church plans" to continue to function effectively in meeting their responsibilities to their respective denominations, while at the same time preserving their exempt status under ERISA. The changes that we suggest are as follows:

a. Coverage of ministers and lay employees not currently employed by a Baptist employer

As previously stated, the American Baptist denomination has charged our Board with the responsibility of providing for the welfare of ministers, missionaries and lay employees who have served the American Baptist denomination. The large majority of ministers carry out their ministry by serving as employees of local churches and other constituent bodies of the denomination. However, there is no authority within the American Baptist denomination that can direct a minister to serve in one capacity or another. Ministers are free to pursue their ministries as their consciences dictate.

In this connection, it may be noted that rulings issued by the Internal Revenue Service under Section 107 of the Internal Revenue Code, relating to parsonage allowances, recognize that a minister can serve his denomination without being employed by a member church. Thus, the Service has held that a minister's services are in the exercise of his ministry, and therefore the minister can exclude a bona fide parsonage allowance, if he is a traveling evangelist,[14] a university chaplain,[15] or a civilian chaplain or other employee of the United States, a state or a political subdivision.[16]

Many American Baptist ministers carry on their ministry in a capacity other than as an employee of a Baptist

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14/ Rev. Rul. 64-326, 1964-2 C.B.37.

15/ Special Ruling, Sept. 1, 1955, CCH 1954 Code Tr. Binder ¶37,361.

16/ Rev. Rul. 72-462, 1972-2 C.B. 76; Treas Reg. §1.107-1(a).

church or agency. American Baptist ministers can, and frequently do, pursue their ministry in the capacity of a chaplain in a prison, a university, or a hospital. American Baptist ministers may be self-employed, serving the denomination as evangelists or fund raisers for local churches. American Baptist ministers frequently serve for a part of their career in a church or agency of another denomination, or in an interdenominational organization. In addition, American Baptist ministers may be temporarily unemployed from time to time, while moving from one position to another within the denomination, or while disabled.

In all of these situations, our Board has a responsibility under our Act of Incorporation to make coverage available to an American Baptist minister under our benefit plans, even though the minister is not currently employed by a Baptist church or organization. During such a period, the minister's closest link to the denomination may be through his or her membership in our benefit plans, and it is not uncommon for these plans to be the only coverage available to the minister and his family. It is especially important, therefore, that we be able to cover ministers in these situations without losing our exemption under ERISA as a church plan.17/

17/ Similar considerations give rise to a need to continue coverage with respect to certain career lay employees while they are not currently employed by a Baptist employer, such as a lay employee who is on temporary leave of absence while performing services for an ecumenical organization, or a lay employee who is temporarily unemployed while moving from one position to another.

We submit that section 414(e) does not preclude such coverage by a church plan. Although Congress has expressly imposed limitations upon the coverage of employees of an unrelated trade or business of a church, and also (beginning in 1983) upon the coverage of church "agencies", it has not provided that a church plan shall cover <u>exclusively</u> persons who are current employees of a church. Accordingly, so long as a church plan is established <u>primarily</u> for church employees, there would appear to be no valid reason to disqualify the plan under section 414(e) merely because the plan <u>incidentally</u> covers some ministers and former lay employees whom the denomination has determined it has a responsibility to cover even though they are not currently employed by a church or agency of the denomination. In this regard, it is significant that section 414(e) permits a church plan to cover persons employed in an unrelated trade or business of a church, so long as this is not the primary purpose of the plan. It would be anomalous to permit such coverage of employees of unrelated businesses -- who have no connection with the religious functions of a church -- while prohibiting incidental coverage of American Baptist ministers who are pursuing their ministry outside the denominational structure as chaplains or evangelists, or in the employ of an ecumenical organization.

Moreover, a requirement that our church plan terminate coverage of an American Baptist minister when he accepts religious employment outside the denomination would be a strong deterrent to a minister's engaging in these types of activities. It seems highly doubtful that Congress intended section 414(e) to require such a result.

It is relevant to emphasize at this point that the American Baptist Churches Retirement Plan is not a "qualified" plan under section 401, et seq. of the Internal Revenue Code. It is instead a tax deferred annuity plan under which annuity contracts are purchased for American Baptist ministers and lay employees by their employers pursuant to section 403(b) of the Code. Thus, the requirements that the ABC Retirement Plan would have to meet if it were a "qualified" plan are not applicable. There is no requirement under section 403(b) that Baptist ministers and lay employees be <u>current</u> employees of a Baptist church or organization. Instead, section 403(b) merely requires that the annuity contract be purchased by an employer which is a section 501(c)(3) organization. Accordingly, a Baptist minister who is currently working for an ecumenical organization, or as a chaplain in a hospital, can obtain the tax benefits of section 403(b) if his section 501(c)(3) employer purchases an annuity contract for him under the ABC Retirement Plan. 18/

18/ A minister working as a self-employed evangelist apparently cannot qualify for the tax treatment provided by section 403(b) because he is not an "employee." However, such a minister may wish to obtain coverage under the ABC Retirement Plan on a non-tax-deferred basis. It would seem that we should be able to make such coverage available without having the plan lose its status as a "church plan."

Since the ABC Retirement Plan is not subject to the criteria that apply to "qualified" plans under the Internal Revenue Code, our primary concern is in maintaining the status of the ABC Retirement Plan as an exempt church plan under Titles I and IV of ERISA. Since the same definition of "church plan" applies for purposes of Titles I and IV of ERISA[19/] and section 414(e), it is extremely important that the regulations under section 414(e) not impose upon section 403(b) church plans limitations that properly should be applied only to "qualified" plans. A requirement that a "church plan" cover only persons who are currently employed by the church would have this result and would, we submit, therefore be unwarranted.

b. The need for a standard of substantial compliance in determining whether a section 403(b) church plan qualifies under section 414(e)

For many of the reasons discussed above, we urge that the Internal Revenue Service, the Labor Department and the Pension Benefit Guaranty Corporation adopt a standard of "substantial compliance" in determining whether a section 403(b) plan, such as the ABC Retirement Plan, qualifies as a "church plan" for purposes of section 414(e) of the Internal Revenue Code and Titles I and IV of ERISA.

It is our understanding that the large majority of denominational pension plans are section 403(b) plans funded

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19/ ERISA Section 3(33).

the Federal government cannot "prefer one religion over another."[20/]

These considerations appear to be relevant to the provision in § 1.414(e)-1(a) of the proposed regulations that if at any time during its existence a plan is not a church plan because of a failure to meet the requirements of the regulations, it cannot thereafter become a church plan. This provision is likely to lead to the very types of entanglements and confrontations between government and religion which the church plan exemption in ERISA was intended to avoid. An innocent mistake in the operation of a section 403(b) church plan (such as the participation of a single employer or employee later determined to be ineligible) could have the effect of permanently subjecting the plan to the regulatory provisions of Titles I and IV of ERISA. Such a situation is distinguishable from a case in which a church plan voluntarily elects to become subject to ERISA, thereby waiving its Constitutional immunities under the First Amendment. We therefore urge that this provision be deleted from the final regulations.

c. The Inclusion of Church Pension Boards Within the term "Church"

We have previously set forth the factual basis for the inclusion of our Board within the term "church" as

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20/ 330 U.S. 1, 15 (1947).

through annuity contracts issued by church pension boards. Because of the requirements of section 403(b), benefits under these plans (including the ABC Retirement Plan) are fully vested and fully funded with respect to all participants.

Having been established by a broad spectrum of different religious denominations to serve their own particular religious needs, there is no uniformity in the provisions of these section 403(b) plans, or the coverages provided thereunder. It seems appropriate, therefore, for the responsible governmental agencies to take these historical differences into account in formulating regulations defining "church plans". If this is not done, some denominational plans may find themselves retroactively denied "church plan" status on the basis of regulations adopted several years after the enactment of ERISA, while other denominational plans will be more fortunate and have their "church plan" status approved because their denominational structures happen to fit within the regulations. It seems highly unlikely that Congress intended to favor some section 403(b) church plans and penalize others merely because of historical differences in denominational structures, practices and beliefs. Moreover, such a position would appear to raise serious questions under the First Amendment because, as Justice Black stated in Everson v. Board of Education, described in § 1.414(e)-1(e) of the proposed regulations, and we have requested that this conclusion be made explicit in the final regulations by the addition of an appropriate example. We should also like to point out that this Board has approximately 70 employees, all of whom are covered by the ABC Retirement Plan and our other employee benefit plans. If this Board is not determined to be included within the term "church" for purposes of the "church plan" definition in ERISA, then a question will be raised as to whether this Board will be required to terminate the coverage of its own employees under the existing plans before January 1, 1983 in order to preserve the church plan status of these plans after that date. Such a requirement would seem to be difficult to justify on any basis, and we submit that it is not consistent with purposes underlying the "church plan" exemption in ERISA.

We respectfully request that the suggestions set forth in this letter be adopted in the final regulations. We shall be happy to provide the Service with any further information which would be helpful in the formulation of the final regulations.

Sincerely yours,

Dean R. Wright
Dean R. Wright
Executive Director

ERISA AND THE CHURCHES

It seems safe to say that very few Federal statutes in recent memory have attracted as much attention, or have given rise to as much debate, as the Employee Retirement Income Security Act of 1974, familiarly known as ERISA.

When ERISA was signed into law on September 2, 1974, President Ford called it the most important piece of social legislation since the enactment of the Social Security Act in 1934. The purpose of ERISA was nothing less thah to reform the private pension system in the United States. The need for such reform in certain areas had been well documented. A leading authority in the field of pensions, Dr. Dan Magill of the University of Pennsylvania, summarized the regulatory situation prior to ERISA as follows:

> "Despite the fact that pension plans in the private sector of the economy were holding out the promise of retirement and other benefits to almost half of the nonagricultural work force..., and had accumulated an estimated 175 billion of assets to meet benefit promises, they were subject to only peripheral regulation prior to 1974."

There were, of course, a number of state and Federal laws that dealt with various aspects of the private pension system. However, "there was no single law or body of law designed to regulate the totality of the private pension institution."

Such laws as then existed proved ineffective in some cases in preventing abuses such as the siphoning-off of plan assets through transactions tainted by conflicts-of-interest, self-dealing, imprudent investment practices and other breaches of fiduciary duty. In addition, even in cases where abuses of these kinds did not exist, workers were sometimes denied benefits, which they rightfully expected to receive, because of unreasonable pension plan requirements regarding the vesting of benefits, or because of the failure of some employers to make adequate contributions to their plans in order to fund the benefits on a sound actuarial basis. Although only a relatively small portion of the total number of employees covered by private pension plans were affected by such abuses and inequities, Congress properly decided to put an end to them by the enactment of ERISA.

However, ERISA did not limit itself to these major areas that were in need of reform. Instead, ERISA went on with a seemingly endless stream of incredibly detailed and complex rules regulating virtually every aspect of every type of employee benefit plan. To insure that these rules would be faithfully observed, Congress gave extensive enforcement powers to the Internal Revenue Service and the Department of Labor--and also created a new Federal agency--the Pension Benefit Guarantee Corporation--to assure the payment of retirement benefits in those situations where pension plans are terminated before adequate contributions have been made to provide the benefits promised in the plans. Congress also gave to each participant in an employee benefit plan covered by ERISA the private right to sue in the Federal courts in order to enforce the provisions of the law. Finally, having created such a comprehensive system of Federal regulation, Congress declared that ERISA would supersede and preempt all state laws applicable to the covered employee benefit plans.

In view of the powerful forces that led to the enactment of ERISA, it is highly significant that Congress allowed one--and only one-segment of the private pension community to be exempted from the tidal wave of regulation brought on by ERISA. The single exception which Congress allowed was for church plans. "Government plans" were also exempted, but they are, of course, public and not private plans. As to church plans, Congress provided that they would be covered by ERISA only if they voluntarily elected to be covered.

Unfortunately, in writing the definition of an exempt church plan, Congress took a more restrictive view than the churches would have liked. What Congress attempted to do was to divide the myriad institutions through which religious denominations carry on their work into two baskets. It put into Basket One those institutions which it referred to as "churches or conventions or associations of churches," and it put into Basket Two those institutions which it referred to as "agencies of a church or a convention or association of churches." Congress provided that until December 31, 1982 a church plan could cover employees of institutions in both of these baskets. However, after December 31, 1982 a church plan could cover only employees of institutions in Basket One. In other words, after December 31, 1982 an exempt church plan could cover only employees of churches or conventions or associations of churches, but it could not cover employees of so-called church agencies.

It was recognized almost immediately after ERISA was enacted that the different treatment accorded churches and church agencies would give rise to difficult problems that would ultimately have to be met. However, the 1982 deadline was then eight years away and no immediate action was required. The sitution changed abruptly on April 8, 1977. On that date the Internal Revenue Service issued proposed regulations implementing and interpreting the statutory language defining an exempt church plan. After studying these regulations the churches realized that they had a problem which required immediate action if they wished to preserve the immunity of their employee benefit plans from Federal regulation under ERISA.

Accordingly, a coalition of 25 religious denominations was formed to decide upon and carry out a program of action to deal with these crucial problems. This coalition adopted the name Church Alliance for Clarification of ERISA. The Ministers and Missionaries Benefit Board is a member of the Church Alliance and has participated actively in its work over the past year.

The Church Alliance decided that its first order of business should be to present to the Treasury Department and the Internal Revenue Service written objections regarding certain portions of the proposed regulations. These objections were filed on May 20, 1977, and in October 1977 representatives of the Church Alliance appeared at a hearing on the proposed regulations in Washington, D. C. before a panel of officials from the Treasury Department, IRS, Department of Labor and PBGC. A statement on behalf of American Baptist Churches was presented by its General Secretary, Robert C. Campbell.

It was evident from the comments made by the government representatives at the hearing that they had very little knowledge or understanding of church pension plans and the important differences that exist between these plans and the pension plans of business corporations and other organizations in the private sector. It therefore appeared that an urgent need existed to educate the government representatives concerning church pension plans. In November 1977, Dean R. Wright, Executive Director of The Ministers and Missionaries Benefit Board of American Baptist Churches, filed with the IRS and other governmental agencies involved a letter of some 29 pages describing the origins, structure and method of operation of The Ministers and Missionaries Benefit Board, and also pointing out the important constitutional considerations which motivated Congress to exempt church plans from ERISA. The efforts of the Church Alliance in heading off the issuance of regulations which could have been very harmful to church plans appear to have met with some success because no final regulations have as yet been issued.

The Church Alliance next turned its attention to the preparation and promotion in the Congress of four bills to correct what the churches perceive to be defects in the treatment of church plans and their participants under present law. Two of these bills, which are noncontroversial, would amend the Internal Revenue Code to provide more equitable tax treatment for ministers and other participants in church retirement programs who need to make greater contributions during the latter stages of their careers in order to provide a more adequate level of income after retirement. While these two bills are important, they do not deal with questions that are crucial to the churches. The third and fourth bills do deal with such crucial questions.

The purpose of these bills--H.R.* 12172 and H.R.* 12312--is to revise the church plan definition in ERISA so as to enable church pension organizations, such as The Ministers and Missionaries Benefit Board, to continue to serve the needs of their denominations by providing retirement, insurance, medical and other benefits to the ministers and lay employees of the denomination without becoming subject to ERISA. These bills were introduced in the House of Representatives during April by Rep. Barber Conable of New York. Senator Herman Talmadge of Georgia, and Senator Lloyd Bentsen of Texas, have agreed to co-sponsor the bills in the Senate.

At this point it seems appropriate to explain some of the reasons why American Baptist Churches and other religious denominations consider these bills to be so important. From the standpoint of The Ministers and Missionaries Benefit Board, these reasons are as follows:

1. The application of ERISA to retirement and other benefit plans established by religious denominations would raise questions of church-state relations under the First Amendment of the U.S. Constitution. The possibility

* now HR 1576 and 1578

of such a church-state confrontation was recognized by Congress, as evidenced by the statement in the Senate report explaining why church plans were not made subject to the plan termination insurance requirements of ERISA. This report states:

> "The committee is concerned that the examination of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities."

Although this statement was made with reference to the plan termination insurance provisions, it seems clear that the same reasoning underlay the exemption accorded to church plans under other parts of ERISA.

By exempting church plans from ERISA, Congress was endeavoring to adhere to the long-established principle of separation of church and state as expressed in the First Amendment. Decisions of the Supreme Court in recent years have held that where a statute calls for governmental action that raises a question under the religion clauses of the First Amendment, in order to be constitutional "the statute must not foster an excessive government entanglement with religion." We and the other Church Alliance members believe than an excessive entanglement would result if ERISA were applied to church plans. It is therefore important to take effective steps to prevent this situation from arising.

2. ERISA contains extensive rules regarding the investment of assets of employee benefit plans, and the purposes for which such assets may be disbursed. These rules, which in some cases are quite rigid, are appropriate for the typical employee benefit plans with which ERISA is concerned. In such typical plans, contributions are made to a fund by the employer, or the employees, or both, for the purpose of providing benefits that are specified in the plan. ERISA provides that the assets of such plans shall be used for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plans.

The Ministers and Missionaries Benefit Board does, of course, administer several employee benefit plans. However, unlike the typical situation to which ERISA applies, that is not the exclusive purpose for which the Board was established. Instead, the Board has a much broader mandate which requires it to administer its funds for the benefit of the ministers, missionaries and lay employees of the denomination, and also to promote the better maintenance of the ministry. In carrying out these charter responsibilities, the Board is frequently called upon to expend its funds for the benefit of persons who are not members of its benefit plans.

Moreover, a number of the Board's programs fall outside the context of its benefit plans, such as salary maintenance for ministers, emergency assistance, grants-in-aid to persons with inadequate income and counseling of ministers in regard to retirement and other matters. The funds needed to carry on these programs are provided by the Board's endowment, which has been derived from contributions and bequests made to the Board by many generous donors since the Board was founded in 1911. The endowment also "guarantees" the minimum levels of retirement income that are specified in the Guarantees and Obligations adopted by the Board in connection with the ABC Retirement Plan.

If ERISA applied to the Board's benefit plans, the Federal government would be placed in the position of determining the extent to which the Board's endowment funds could be used for the Board's general corporate and religious purposes, as distinguished from benefit plan purposes. It is not believed that this is a proper function of government, or that Congress intended such a result. Accordingly, it is important that the statute be amended to make clear that The Ministers and Missionaries Benefit Board, and similar boards of the other denominations, may continue to operate as they have in the past without being subject to ERISA requirements that were designed for a different type of organization having no religious purposes.

Also, if ERISA applied to the ABC Retirement Plan, it is quite possible that substantial premiums ($13,000 in 1978) would be payable to the PBGC each year under the plan termination insurance program. Since the ABC Retirement Plan is fully funded, it is difficult to see how the participants in the Retirement Plan would benefit from such premium payments, which constitute, in effect, a tax levied by the Federal government on private pension plans.

3. Meeting the participation standards of ERISA could impose a burden upon some churches. The Ministers and Missionaries Benefit Board, of course, makes a strenuous effort to encourage all American Baptist local churches to cover all of their employees, both ordained and lay, under the Board's benefit plans. However, the Board has no power to compel a church to do this, and some churches may lack the financial resources to do so. In such a situation a local church may decide, as a matter of priority, that it will cover its minister from the time he or she is first employed by the church, but it will not cover its lay employees until they have been employed for a number of years and thereby attained a "career" status. Such an arrangement might violate the ERISA participation standards, forcing the church to terminate the coverage of its minister because it is not financially able to provide coverage for all of its employees. It seems questionable whether the government should interfere in this manner with the freedom of a church to employ its minister and lay employees on such terms as it deems appropriate in the management of its own internal affairs.

4. Under the existing statute, it is possible that a church plan might lose its exemption under ERISA if it covers a minister who is not an employee of a church (or until December 31, 1982, an employee of a church agency). However, numerous Baptist ministers pursue their ministries from time to time by serving outside the formal denominational structure. Examples would be Baptist ministers employed as chaplains in hospitals, prisons or colleges, or teaching religious studies in an educational institution, or serving as self-employed evangelists. It is important to such ministers, and to the denomination, that their membership in the Board's benefit plans be maintained during

such period of service as a minister outside the denomination. The proposed bills would make clear that this can be done without jeopardizing the exempt status of the plans under ERISA.

A similar question exists under present law with respect to the coverage of Baptist ministers or lay employees who are not currently employed because they are disabled or in transition from one job to another. The proposed bills would eliminate this question and allow such coverage.

5. The present statute fails to recognize the fact that the American Baptist employee benefit plans, as well as most church plans of congregational denominations, have historically been administered by a corporate entity that is separate from, but controlled by, the denomination. The statute is not clear as to whether such a plan may qualify as an exempt church plan under ERISA. This question would be resolved by the proposed bills.

6. In its proposed regulations the Treasury Department took the position that if a church plan should ever, at any time or for whatever reason, fail to meet the requirements of a church plan it can never thereafter regain its exempt status under ERISA. This position is unnecessarily harsh because a failure to meet the requirements of a church plan may result from insignificant violations of rules that are not now clearly defined and will take years to resolve. The proposed bills would give a church plan which has violated the applicable rules an opportunity to correct the violation and thereby retain its exemption from ERISA. Such a provision seems essential to the orderly functioning of church plans.

7. The problem that is of the greatest concern to a number of the denominations is the so-called church agency problem. As previously mentioned, under present law a church plan cannot retain its ERISA exemption after December 31, 1982 if it continues to cover employees of church agencies. Examples of church agencies would be any of the following organizations which is affiliated with a church or a convention or association of churches: a hospital, a school or college, a nursing home, a retirement home, a drug-abuse center, or a children's home or camp.

The Church Alliance has taken the position that because of the close relationship that exists between churches and their affiliated agencies, it is essential that the employees of the agencies be eligible for coverage under the benfit plans of the church. If this is not permitted, the agencies will have only two alternatives; that is, either to establish ERISA plans for their employees or to terminate their plans on December 31, 1982. Because of the expense and redtape connected with establishing ERISA plans, it is feared that many agencies will choose to terminate their plans, thus depriving their employees of benefits which they are now receiving as members of the church plan. Also, it is believed that if agency employees are not allowed to participate in church plans, the mobility of church employees within the denomination will be greatly restricted. The proposed bills would permit the continued coverage of agency employees in church plans after December 31, 1982.

These are some of the problems that have led the members of the Church Alliance to attach so much importance to the enactment of the proposed bills.

It is not an overstatement to say that if the bills are not enacted, the consequences for all religious denominations will be very serious. The type of regulation mandated by ERISA is simply not appropriate for an organization with a religious history and purpose such as The Ministers and Missionaries Benefit Board and the pension boards of the other religious denominations.

It is important to emphasize that the desire of the Board, and the other members of the Church Alliance, to be exempt from ERISA is not based upon a view that the employees of churches and their agencies should be denied the protections of ERISA. In the case of the plans of The Ministers and Missionaries Benefit Board, most of these protections are already provided. The ABC Retirement Plan is fully funded, and members' benefits thereunder are fully vested at all times. The Board's investments are professionally managed in accordance with the highest fiduciary standards applicable to organizations of its type under New York law. The reports of the Board's operations, as audited by its independent certified public accountants, are regularly provided to the governing bodies of the denomination and are freely available to other interested persons. To the extent possible, the Board has encouraged all American Baptist churches and employing organizations to provide participation under the Board's benefit plans for all of their employees, both ordained and lay. And the Board has made a consistent effort to communicate the provisions of its benefit plans to all participants.

Accordingly, it would seem that there is little that ERISA would add to this picture, except increased administrative costs and unwarranted governmental involvement in the administration of an essential church function. It is therefore hoped that when called upon to do so, the members of the Board will help to communicate to the denomination-at-large, and to the Congress, the importance of the legislation that is being sought by the Board and the Church Alliance for Clarification of ERISA.

Prepared by John P. Persons, Attorney-at-Law, Patterson, Belknap, Webb & Tyler, for meeting of Board of Managers of The Ministers and Missionaries Benefit Board of American Baptist Churches, May 23, 1978.

7/78

CHURCH ALLIANCE FOR CLARIFICATION OF ERISA

January 18, 1980

The Honorable Lloyd Bentsen
Chairman, Subcommittee on Private
Pension Plans and Employee
Fringe Benefits
240 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Bentsen:

The members of the Church Alliance for Clarification of ERISA appreciated the opportunity to testify in support of S. 1090, 1091, and 1092 at the hearings before the Subcommittee on Private Pension Plans and Employee Fringe Benefits on December 4, 1979. Because of the short period of time allotted us at the hearings and of our inability to answer the Treasury's testimony, we would like to supplement the record by this letter on behalf of one of our bills, S. 1092.

S. 1092 has two major objectives. One is to permit the ministers and lay employees of our churches and agencies to make the same series of elections in Section 415(c)(4) of the Internal Revenue Code that are now available to employees of educational institutions, hospitals, and home health service agencies. Contributions to such defined contribution plans as Section 403(b) annuity arrangements are limited by Section 415(c)(1) to the lesser of $25,000 (adjusted by increases in the cost of living) or 25 percent of the participant's compensation. This provision was designed by Congress to curb massive contributions to defined contribution plans by the wealthy. However, since the maximum contribution is the lesser of the two amounts, this limitation has a devastating effect on the amounts that can be contributed to the pensions of persons who are poorly compensated. The elections of Section 415(c)(4) override the 25 percent limitation and permit larger than normal, or "catch-up", contributions under circumstances that are important to us.

Another main objective of S. 1092 is to amend the exclusion allowance formula of Section 403(b)(2) so that all years of service by a minister or lay employee for a denomination are considered years of service for one employer. The amount that can be contributed without tax incidence to a Section 403(b) annuity is limited by the exclusion allowance formula in Section 403(b)(2) as well as by the limitation of Section 415(c)(1). The amount of the contribution that is excluded from the employee's income is equal to the excess of 20 percent of includable compensation times number of years of service over the amounts contributed in prior years that have been excludable from gross income. The term, "years of service", has been interpreted to mean years of service with the participant's present employer. The ministers and lay employees in many of our denominations change jobs every three to five years. In the congregational denomination, the technical employer is the immediate employer, the local church or church agency, not the denomination. Yet ministers and lay employees consider that all of their service is for one employer, the denomination. When years of service is limited to service for the present employer, credit for past service for other employers in the denomination is denied, and the exclusion allowance is severely restricted. Significant catch-up contributions then cannot be made to a participant's annuity in order to make up for the years in which contributions were necessarily small.

One other objective of S. 1092 is to permit a de minimis contribution of $10,000 to be made without consideration of either the 25 percent limitation or the elections. Like other limiting figures in Section 415, this amount is adjusted by increases in the cost of living. This de minimis amount is parallel to the $10,000 de minimis amount in Section 415(b)(4) with respect to the limitation on contributions to defined benefit plans.

By far the majority of our churches employ Section 403(b) annuity arrangements as the method of providing retirement benefits for ministers and lay employees. These annuities meet the needs of the churches precisely and have been used long prior to the introduction of Section 403(b) into the Code many years ago. Retirement benefits under these annuities are completely portable. Because of the continual movement of ministers and lay employees within the churches, the portability of benefits is essential. There is no way a loosely organized congregational church can administer a retirement plan, even a defined contribution plan, that is qualified under Section 401(a). This type of denomination has no control over local church units and would not be able to police and enforce the intricacies of Section 401(a). A defined benefit qualified plan is not practical. Many churches and agencies do not have the affluence to guarantee a minister or lay employee a pension of a fixed amount. There would inevitably result unfunded past service liabilities which would make the minister or lay employee an unattractive applicant to his next employer.

In the fall of 1977, the Church Alliance collected statistics with regard to the compensation and retirement incomes of ministers and lay employees and brought them to the attention of the late Dr. Laurence N. Woodworth, then Assistant Secretary for Tax Policy of the Treasury Department. Excerpts from a letter to Dr. Woodworth dated September 12, 1977, are attached as Exhibit A. The statistics reveal that the ministers and lay employees of our churches are not paid munificent salaries or retirement incomes by any standard. Recent figures do indicate some, but not great, progress in this respect.* However, the provisions of S. 1092 are specifically designed to increase the retirement incomes of those ministers and lay employees who are now retiring and whose compensation and annuity contributions in the 1970's and earlier years were pathetically small.

The circumstances for the need to make catch-up contributions should be explained. A minister will begin his career at a salary of approximately $5,000 to $10,000 a year. During the first years of the minister's career, contributions may be a function of salary and, hence, very small. It may also be that the minister will be employed by a new or struggling church that cannot afford any plan contributions. Under the Code, the minister may take a reduction in salary to permit his employer to purchase supplemental annuity benefits. However, the minister's already woefully inadequate cash compensation will not for many years permit this course of action. He will need every penny he earns to feed and clothe his family and educate his children. It is not until the minister has been working for 25 or 30 years that his compensation will increase to the point where some amount may go to the purchase of additional annuity benefits. Several years prior to retirement age, when his personal living expenses may have declined, he may be in a position to use part of his salary to supplement his retirement income. In some instances a minister's salary may still not be adequate to bring retirement benefits up to an acceptable level, congregations will collect funds as a "love offering" for the minister and contribute them to the minister's retirement annuity. In either of these instances the effort at enhancing the retirement benefits to any worthwhile extent may be stifled by the 25 percent limitation of Section 415(c)(1), which requires that the contribution be no more than 25 percent of compensation, and by the limitation of years of service to service with the present employer under Section 403(b)(2). An example of the mathematical operation of these limitations is given by The American Baptist Churches and attached as Exhibit B.

These circumstances are precisely the same circumstances that persuaded Congress in 1974 to introduce the Section 415(c)(4) elections in the case of teachers and employees of hospitals and health care institutions. The Joint Conference Report (No. 93-1280, 93d Cong, 2d Sess.) states, at page 345:

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* For example, The Christian Church reports that in 1978 the average annual compensation of ministers was $13,388, which is a cash salary of $11,157 plus parsonage allowance. In 1976, the average annual compensation was $11,336, representing a cash salary of $9,858 plus parsonage.

"However, under present law, certain categories of employees covered under section 403(b), such as teachers, typically have a pattern of low contributions in the early stages of their careers, with relatively high 'catch-up' contributions made late in their careers. (Often section 403(b) plans operate on a salary-reduction basis.) In order to make allowance, for this problem the conference substitute provides teachers, hospital employees, and employees of home health care institutions (which are tax-exempt and which the Secretary of Health, Education and Welfare has classified as a home health agency for purposes of medicare) with a choice of three alternative rules which permit a significant amount of 'catch-up'. The individual may elect the alternative he wishes to use (in a time and manner to be prescribed in regulations) and the election, once made, is to be irrevocable."

At the hearings on December 4, 1979, the Treasury Department testified in opposition to that portion of S. 1092 that would extend the elections of Section 415(c)(4) to ministers and lay employees and establish a de minimis amount of $10,000 adjusted by increases in the cost of living. Apparently, the Treasury has no objection to the amendment of Section 403(b)(2) so that all years of service by a minister and lay employee for a denomination may be considered as years of service for one employer. We have had difficulty understanding the Treasury's position. It seems to have been based upon a general dissatisfaction with Section 403(b) and to an opposition in principle to the extension of the elections of Section 415(c)(4) to other classes of employees, possibly because they are complicated of administration. The Treasury said, however, that it would not object to a provision permitting contributions of a maximum of $7,500, which would take the place of both the 25 percent limitation of Section 415(c)(1) and the exclusion allowance formula of Section 403(b)(2). This figure would not be adjusted by increases in the cost of living.

The churches consider the Treasury's argument in opposition to S. 1092 as weak, untenable, and, in a sense, irrelevant. Section 403(b) is not at issue. Nor is there any indication that the elections under Section 415(c)(4), now available only to employees of educational institutions, hospitals, and home health service agencies, will be repealed. We have demonstrated that ministers and lay employees have the same, if not greater, need for the elections of Section 415(c)(4) as teachers. We are not asking for special treatment. We are simply asking for the same treatment that others in the same category have already received. We believe that a provision for a de minimis amount will, by and large, solve the Treasury's problem that the elections are complicated of administration. Most contributions would fall into the de minimis category, and neither the elections nor the exclusion allowance would have to be considered.

It is absolutely necessary that the de minimis amount be adjusted by increases in the cost of living. We all know the factor inflation is playing in our lives. It is quite likely that in several years the effect of the de minimis amount will be two-thirds of what it is now. In a few years more, the effect of the de minimis amount may be one-half, and so on. If inflation continues, Congress will have to increase the de minimis amount. However, the churches are not organized to bring to the attention of Congress the need to update the law. From our viewpoint, it is preferable that the law be updated automatically.

The ability to contribute no more than $7,500 does not satisfy the needs of the churches. It is true that most contributions will be under $7,500. However, contributions of more than $7,500, all generated by an absolute need for them, have not been uncommon. One denomination states that 99 contributions of over $7,500 were made during the past ten years. The average contribution in excess of $7,500 was $10,384. A great many of these were made prior to 1974 when the only limiting factor was the exclusion allowance of Section 403(b)(2). Another denomination cites four instances in which contributions exceeding $7,500 were made. In all of these instances, the minister or lay employee was approaching retirement age, and it was found necessary that an extraordinary amount be contributed in order to bring his retirement benefits up to an acceptable level.

Another denomination describes five instances in which contributions of over $7,500 have been made. All were made prior to 1974. Since that date this church has kept its members informed of the Code's limitations on contributions, and no large contributions have been made. It can only be surmised how many ministers and lay employees of this denomination have had the need of making catch-up contributions since 1974 but could not satisfy it because of the Code's limitations. Two of these instances are described by this church, as follows, in a letter to the Church Alliance:

> "The third and fourth cases are later along and involve local church pastors in similar circumstances. They had served, for a long period, the congregations from which they were retiring, through the establishment of each church and the building of church buildings. They came up to their seventies with contractual pensions of less than $1,200 a year. In both instances, occurring in the late 1960's, contributions for annuities were made through the church of some $15,000 for one and $20,000 for the other for the purchase of such annuities. I really do not know what these ministers, or their widows, would have done without such assistance. Though this was

done a dozen years ago in less inflationary times, it would be restricted now. Unfortunately, we are now creating additional Ministerial Relief for the Church as a whole, because the law imposes the 20/25% limit upon current salary for building such contractual benefits, as you know."

This letter concludes:

"As I told you previously, in 1975, we notified fourteen such individuals, congregations or units of the Church that the contributions for additional benefits under the Church Pension Plan would have to be restricted. These employers were trying to 'catch up' in the few remaining years of service with oversights of the past and run away inflation in the present. These folk will have to go into retirement with less pension than their churches and church employers would have otherwise provided."

One denomination informs us of a minister with thirty-five years of service who was to retire on an annuity of $210 a month. His church received contributions from members and provided a gift of well over $7,500 because his retirement benefits were not adequate. Another minister of this denomination has served approximately forty years and is scheduled to retire in a few years on benefits of $500 a month. A layman in his church writes:

"We will continue to contribute the maximum the law will permit in the next 4 years, but it will not make up for years of low salary and contributions. We will have to secure gifts from the congregation to supplement it. There is no other way."

Another denomination writes:

"We are distressed to hear that the Treasury Department apparently has expressed opposition to the inclusion, under Section 415(c)(4), of the employees of churches. We are also distressed to learn that the Treasury wants to impose a limit of $7,500 upon contributions to Section 403(b) annuities. We would view the inclusion of church employees as the correction of an obvious oversight on the part of the drafters of this legislation rather than as an extension or even a liberalization of the present laws. Employees of churches, no less than employees of educational organizations, hospitals, and home health service agencies, tend to be dedicated career individuals who find service to humanity a reward which partially offsets the fact that they earn lower pay than they could otherwise do so in the commercial world. Therefore, in our opinion there is every justification for the inclusion of church employees with the employees of these other organizations because all face similar problems with a tradition of lower than normal pension benefits.

"Our Board has consistently interpreted Section 415(c)(4) as not permitting clergy persons and lay employees to contribute sums to their pension accounts, as any form of 'make up' contribution, over and above the limitation of 25 percent of compensation. Because we have not permitted such payments, our files do not adequately reflect the number of inquiries or requests we have received. Only within the last month, I responded to one such individual advising that this person could not make any such contributions. In this inflationary age, we fully anticipate that there will be an ever-increasing number of instances in which ministers, approaching their retirement, see the need for paying more into a retirement fund than they are permitted to do so on an annual basis under current or proposed law. In many such instances, a spouse will have returned to work after children have left the home and the income of the couple in the years before retirement will be substantial enough to permit such additional contributions if in fact the law would allow them."

We have made inquiries of only a few of our denominations, but the examples we have been given show that a demand to contribute more than $7,500 to an annuity exists. If this limit on contributions is imposed, some pensioners will suffer, just as many have suffered since 1974 under the 25 percent of compensation limitation. While it is true that most contributions at present should be under $7,500, the churches require the flexibility to cope with the recurring case of the unfortunate retiree. For this reason, the churches are opposed to any rigid limit on contributions such as the limit advocated by the Treasury.

Respectfully,

CHURCH ALLIANCE FOR
CLARIFICATION OF ERISA

By: Darold H. Morgan

Darold H. Morgan, President
Annuity Board of the
Southern Baptist Convention
511 North Akard Building
Dallas, Texas 75201

EXHIBIT A

EXCERPTS FROM A LETTER FROM THE CHURCH ALLIANCE FOR CLARIFICATION OF ERISA TO DR. LAURENCE N. WOODWORTH DATED SEPTEMBER 12, 1977, CONCERNING THE SALARIES AND RETIREMENT INCOMES OF MINISTERS AND LAY EMPLOYEES

"We have made analyses of the average incomes and anticipated retirement benefits of clergy and lay employees of four of our denominations having Section 403(b) plans. The Board of Pensions of the United Methodist Church conducted a study of a representative minister from one of its conferences. Over the last 40 years this minister will have earned $215,130, broken down into ten-year increments, as follows

Year	Total Salary	Average Yearly Salary
1 - 10	$20,166	$2,017
10 - 20	38,454	3,845
20 - 30	59,569	5,957
30 - 40	96,941	9,694

"When this minister retires at age 65, his annual joint and survivor annuity amount will be $2,472, representing 19.02 percent of the minister's final salary. If this minister had been able to contribute 20 percent of his salary during the past 20 years, his pension would be $5,196 annually, or 40 percent of final earnings. Section 415(c)(1), of course, prevents any retroactive funding of this minister's pension.

"The Pension Fund of The Christian Church (Disciples of Christ) in a Compensation Study of ministers and lay employees, attached hereto as Schedule B, found that the 1976 average compensation base (including parsonage allowance) for all The Christian Church ministers was $11,336, which is the equivalent of an annual cash salary of $9,858 plus parsonage allowance. The average compensation base for ministers in 1971 was $8,075 representing a cash salary of $7,000 plus parsonage. According to other information from The Christian Church, the average pension provided for 157 persons (lay and ordained) retiring at an average age of 65.6 in 1976 was $2,264.81 per year.

"Schedule C is a list compiled by the Retirement Plan sponsored by the Jewish Theological Seminary of America, The Rabbinical Assembly, and The United Synagogue of America. It shows benefits currently being received from this plan by retired rabbis, cantors, educators, and administrators. The average monthly retirement income is approximately $225. One reason for these modest retirement benefits is that the plan was instituted a relatively short time ago, in 1946. A further study of the salaries of every tenth rabbi, cantor, educator and administrator covered by the Retirement Plan shows an average salary of $20,715.

"The Pension Board of the United Church of Christ selected at random a number of ministers and lay employees who retired during 1976. These records reveal the following information with respect to the pension records of the years of coverage:

First Full Year's Salary	Last Full Year's Salary	Years Contributed to Plan	Average Salary	Monthly Retirement Benefits
Minister				
A 3,000 (1948)	5,870 (1973)	25 7/12	4,096	70.33
B 1,650 (1942)	13,295 (1975)	34	5,534	332.27
C 1,610 (1943)	7,200 (1975)	33 1/3	5,492	308.46
D 1,656 (1938)	13,824 (1975)	34 1/3	5,817	236.40
E 4,600 (1959)	11,085 (1975)	17 1/3	7,538	148.36
Lay Employee				
A 2,050 (1946)	15,428 (1976)	31	6,997	210.64
B 4,000 (1957)	12,000 (1976)	20	7,351	153.78
C 8,820 (1964)	15,905 (1975)	12	10,565	131.95
D 3,300 (1962)	8,528 (1976)	15	6,006	93.76

"Also enclosed is a copy of the 1973 Clergy Support Study published by the National Council of Churches of Christ in the U.S.A."

EXHIBIT B

MATHEMATICAL OPERATION OF THE LIMITATIONS OF SECTIONS 403(b)(2) AND 415(c)(4) PROVIDED BY THE AMERICAN BAPTIST CHURCHES

The combined effect of the two limitations upon an American Baptist minister who moves to a new church late in his career is illustrated by the following example:

Assume that Minister M graduated from theological seminary in 1941 (at age 23), served in the Armed Forces for four years, and was called to American Baptist Church A to serve as its minister beginning January 1, 1945. M remained in this position for 10 years, during which period he received taxable compensation of $3,600 a year.* The church paid no contributions for annuity premiums or other retirement benefits for M.

On January 1, 1955 M left Church A and was called to American Baptist Church B, where he served as minister for 10 years. While at Church B, M received taxable compensation of $4,000 a year for his first 5

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* According to the Board's records, during the year 1950 the average cash compensation of ordained ministers of the American Baptist denomination was $3,165. This figure had increased to $4,768 by 1960, to $6,876 by 1969 and to approximately $10,300 by 1976.

years and $6,000 a year for his last 5 years. Church B also paid annuity premiums for M of $500 a year for the first 5 years and $800 a year for the last 5 years, or a total of $6,500 for 10 years, which premiums were excluded from M's gross income under Section 403(b).

On January 1, 1965 M left Church B and was called to American Baptist Church C where he served as minister for 5 years. While at Church C he received taxable compensation of $7,000 a year. Church C also paid annuity premiums for M of $980 a year, or a total of $4,900 for 5 years, which were excluded from M's gross income under Section 403(b).

On January 1, 1970 M left Church C and commenced serving as the minister of American Baptist Church D, which offered to pay him total compensation of $11,000, or $3,020 more than the total compensation ($7,000 plus $980) he was receiving at Church C. In view of the fact that only $11,400 had been contributed as premiums for M's retirement annuity during his 25 years of service with the American Baptist denomination, M would be willing to forego an increase in cash salary and, in lieu thereof, to have Church D apply the entire $3,020 increment to the payment of additional annuity premiums. However, under present law M is not permitted to count his years of service for Churches A, B and C in computing his exclusion allowance under Section 403(b), so he can exclude from gross income only $1,400 (20% of $7,000), assuming a continuation of his $7,000 cash salary. M could increase his exclusion allowance somewhat in 1970 by taking $9,170 in the form of cash salary and $1,830 in the form of annuity premium contributions, but he would be denied the opportunity to make any significant "catch-up" contributions. This would also be true in the subsequent years of M's employment with Church D, because the multiplier effect of his additional years of service with Church D will be wholly offset by the reduction for prior excluded contributions.

On the other hand, if M were permitted to count his service with Churches A, B and C, his exclusion allowance for 1970 under Section 403(b) would be $25,000, computed as follows:

20% of taxable compensation	$1,400
Multiplied by 26 years of service	26
	$36,400
Less: Prior excluded contributions	11,400
Exclusion allowance	$25,000

However, under Section 415 M would be limited to an exclusion of 25% of $7,000, or $1,750.

Accordingly, in order for M to be able to make any significant "catch-up" contributions during the last 5 years of his service to the American Baptist denomination, it would be necessary (1) to amend Section 403(b) to permit years of service with all American Baptist employers to be taken into account for purposes of that section, and (2) to amend Section 415 in the manner suggested in the Church Alliance's letter to Dr. Woodworth, or, at a minimum, to permit employees of churches and their agencies to make the special election under Section 415(c)(4).

SUMMARY OF THE STATEMENT OF JOHN D. ORDWAY, EXECUTIVE VICE-PRESIDENT OF THE PENSION BOARDS OF THE UNITED CHURCH OF CHRIST IN SUPPORT OF S.1090, S.1091, AND S.1092

The proposed legislation is desirable because:

1. It serves to eliminate the uncertainty which now exists as to the ability of a separate corporation affiliated with a church or association of churches to maintain a church plan and is in conformity with Congressional intent. (S.1090 and S.1091)

2. It eliminates the need to determine what organizations may be considered as parts of a church. Any such determination under present law would violate first amendment rights. (S.1090 and S.1091)

3. It removes the 1982 deadline under which employees of certain church organizations would no longer be eligible to participate in church plans. (S.1090 and S.1091)

4. It regards the service of a minister in the exercise of his ministry as an employee of a church or convention of churches, regardless of the source of his compensation. (S.1090 and S.1091)

5. It establishes a retroactive correction period to restore church plan status when an act of default occurs. (S.1090 and S.1091)

6. For purposes of the computation of the exclusion allowance under §403(b)(2) IRC, it treats "years of service" with all employers within a denomination as years of service with one employer. (S.1092)

7. It extends the special elections in §415(c)(4) IRC which are presently available to employees of selected 501(c)(3) corporations to employees of churches and associations of churches. (S.1092)

STATEMENT OF JOHN D. ORDWAY, EXECUTIVE VICE-PRESIDENT OF THE PENSION BOARDS, UNITED CHURCH OF CHRIST, DELIVERED ON DECEMBER 4th, 1979, BEFORE THE SENATE FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE BENEFITS WITH RESPECT TO S.1090, S.1091, AND S.1092

Mr. Chairman, and members of the Subcommittee, my name is John D. Ordway and I appear before you on behalf of the Pension Boards of the United Church of Christ, to speak in support of Senate bills S.1090, S.1091, and S.1092. In my capacity as Executive Vice-President of the United Church of Christ Pension Boards, I have grave concerns regarding the potentially adverse effect of the present law's provisions on the pensions of ministers and other employees of religious organizations. For reasons to which I shall address myself at a later point in my testimony, the bills which this committee is now considering would, to a very large extent, dispel my fears for the future, and enable religious organizations to provide retirement benefits to their dedicated workers in a fashion commensurate with the opportunities afforded those in other fields of endeavor. This is as it should be, because those laboring in the cause of religion share with all workers, the very same temporal needs, including the desire for dignity and security in later life.

Before considering the proposed legislation, however, I wish to inform this subcommittee as to the nature of the entities which I represent here today. The United Church of Christ is a major Protestant denomination consisting of approximately 5,500 churches, having a membership of close to 2,000.000. It was formed in 1957 through the union of the Congregational Christian Churches and Evangelical and Reformed Church, both of which denominations have had long and honored traditions in this country. Indeed, the Congregationalists trace their beginnings here to the coming of the Pilgrims at Plymouth Rock.

The Pension Boards of the United Church of Christ are four distinct corporate entities, two of which, the Annuity Fund for Ministers and the Board of Pensions and Relief of the Evangelical and Reformed Church, provide basic contractual retirement benefits, non-contractual supplementary relief benefits, insurance company underwritten health, disability income and life insurance benefits to ministers. The Retirement Fund for Lay Workers provides similar benefits for employees of local churches and other organizations of the United Church of Christ who are not recognized ministers of the United Church of Christ.

A fourth corporation, the United Church Board for Ministerial Assistance, was organized to afford financial relief and assistance to ministers who are in need. It is a religious charitable corporation in the pure sense of the term and obtains the funds which it disburses through contributions, bequests and earnings on endowments.

The contractual retirement benefits offered by the Pension Boards to ministers and lay workers take the form of tax-sheltered annuities in compliance with Section 403(b) of the

Internal Revenue Code. Contributions of a fixed percentage of a member's salary are made by the employer, such as a local church or other organization of the denomination. The funds are invested over the years and the earnings are accumulated in each member's account. At retirement age, the member enters upon an annuity which is funded with the accumulations in the account. Various forms of annuities are available at the option of the member, such as joint and survivor and ten year certain, which may be paid as either fixed benefit or variable benefit annuities.

Although our problems stem from the enactment of ERISA, our boards voluntarily undertook a review of our programs to assure that we were complying with the intent of standards established by the provisions of ERISA. I can say without equivocation that we have done all that we can do to meet ERISA's standards for participants, without restructuring our entire method of operation, as would be required if we were actually under its provisions.

The provisions of S.1090 and S.1091 are substantially identical and therefore, in my testimony, a reference to one or the other will include both. One of the key provisions contained in S.1090 is the definition of "church plan." By including within that definition a plan established by a convention or association of churches but maintained by a separate corporation associated or controlled by those churches, the proposed legislation eliminates a serious problem which is perhaps of singular significance to denominations which are organized along congregational lines, as is the United Church of Christ. Traditionally, in such denominations, the various programs, internal responsibilities, and ministries of the fellowship are carried out through separate corporations. It is surely beyond question that a legitimate, and indeed, necessary internal function of any denomination is the compensation of its workers and their care in their declining years. Thus, the Pension Boards of the United Church of Christ were established many years ago to fulfill this important responsibility. Under the law as presently written, it could be argued that a separate corporation providing retirement benefits for ministers and other church workers would not qualify as part of a church and therefore could not be considered as administering a plan meeting the definition of a "church plan." We do not believe that such an interpretation was within the intent of Congress in passing the present law and we urge that this area be clarified.

Equally important is the abandonment in the proposal contained in S.1090 of the concept of a "church agency." At best, the employees of church agencies, whatever that term might be ultimately construed to mean, were only assured of protection in a church plan until December 31, 1982. Moreover, church plans themselves would lose their status as such if they continued the employees of church agencies in their membership beyond that date. In excluding the employees of such agencies from membership in church plans, the present legislation, by implication, has estabblished the Internal Revenue Service or the Courts as the final arbiters with respect to an organization's status as part of a church. Any effort, it seems to me, to resolve what type of entity can properly be termed a part of a church in the Courts or at an administrative level, would be in violation of the First Amendment rights granted to religious organizations. Our Courts have held that ecclesiastical bodies alone have the competence to make determinations relating to matters of church polity, doctrine, or religious program and that is is beyond the authority of any branch of civil government to do so. The proposed legislation, by recognizing that employees of organizations exempt from tax and controlled by or associated with a church are eligible to participate in a church plan, precludes the possibility of any such violation of First Amendment rights and avoids the prospect of a multiplicity of lawsuits contesting the issue.

The proposed legislation also affords relief to those ministers and lay workers employed by church organizations which, under present law, may not be deemed to be within the protective mantle of a church plan commencing in 1983. Presently, the employees of such organizations will no longer be able to participate in church plans after 1982. Some have said that failure to cover employees of so-called "church agencies" would deny those employees basic protections, to which they should be entitled. One must question whether or not there is in fact a need for legislation to provide such basic protections. As I previously stated, we voluntarily modified our programs to comply with the intent of

ERISA shortly after the adoption of that law. In fact, our plans were established long before pension legislation made it useful for secular organizations to establish pension plans that were capable of abuse to the extent that the enactment of ERISA became necessary for the protection of employees. Our plans were not established as tax avoidance devices for highly compensated employees but because of the Church's basic concern for its employees, who were primarily low to moderately compensated individuals having no ownership or proprietary interest to protect or to divert to their personal use to avoid double taxation. Our plans have not been the source of the abuses you are trying to prevent. Accordingly, we must seriously question the appropriateness of our having to incur the substantial cost of compliance with ERISA in order to be able to continue to provide benefits to the employees of "church agencies" regardless of the constitutional problem in attempting to define how a church may appropriately carry out its work. As I have pointed out, the structures providing retirement benefits in the denomination which I represent were established long before the pension legislation embodied in ERISA was enacted. To restructure them now because of a need to comply with ERISA in order to be in a position to continue to offer benefits to the employees of church organizations not falling within the present definition of church plans would be far too costly and not warranted by the number of members within that category. An additional burden would then be placed on those members in that they would be compelled to seek coverage elsewhere, at a significant increase in cost, in which case, the most likely result would be the total discontinuance of plan benefits for those employees.

I applaud the proposed legislation's recognition that a minister can participate in a "church plan" so long as he is engaged in the exercise of his ministry, although not serving a local church. Ministers, regardless of their affiliations and source of compensation at any particular time, have a continuing need for pension benefits and a need to remain in the same pension plan. There can be no reasonable doubt that a minister engaged as a chaplain of a hospital or carrying out his ministry through a non-denominational agency is no less a clergyman fulfilling his ministry than is his brother in the pulpit of a church. The prospect of interrupting membership in a church plan as part of the price to be paid for the pursuit of a ministry in other than a traditional church setting might well serve to deter otherwise well-intentioned persons from service to segments of society such as drug addicts and alcoholics, the elderly or children, or from marriage and youth counseling posts.

S.1090 also serves the very important purpose of providing a mechanism to prevent the inadvertent loss of status as a church plan, which exists under present law. This is accomplished by granting a retroactive correction period following notice that the church plan is in default. In our denomination, it is possible to have individuals on our pension membership roles who are in the employ of organizations which have become disqualified as churches without our knowledge. The automatic loss of status without the opportunity to correct the default could be catastrophic for the plan and its membership. Conceivably, such loss could occur if the plan has but one unauthorized person within its membership. No fair minded person could countenance such a result.

I turn now to a consideration of S.1092 and its salutary provisions dealing with tax-sheltered annuities. The exclusion allowance for employees provided under Sections 403(b)(2) of the Internal Revenue Code is limited to an amount determined by multiplying 20% of the employee's includible compensation for the taxable year by the number of years of service with the employer, less all employer contributions toward the annuity excluded by the employee in prior taxable years. Ministers and, to a lesser degree, other church workers, are put at a severe disadvantage by limiting the years of service portion of the computation to service with a single employer. Obviously, such a limitation can only result in a reduction of the allowance. Historically, ministers move about frequently within a denomination, going from one church to another or to service on a national body of the denomination. In a church organized on hierarchical lines, such mobility would have no adverse effect, whereas in a congregationally organized denomination the consequences are disastrous, despite the fact that both the minister and the churches he serves regard all such service as within the denomination. The entitlement to the full exclusion allowance should not depend on the accident of church polity. To so limit the exclusion allowance as the present law does would, in many instances, make the section's benefits illusory. The amendment cures this defect by treating years of service with all employers within a denomination as years of service with one employer.

Finally, I should note that the benefits provided by §403(b) through tax-sheltered annuities are restricted to employees of organizations, described in §501(c)(3). Nevertheless, the special exclusion elections for 403(b) plans provided for in §415(c)(4) are limited to employees of educational organizations, hospitals, and home health service agencies. Employees of churches or their related organizations generally have lower incomes than the employees now having the special elections and therefore should have those same rights. Their needs are the same as those included in the benefit and, in many cases, more compelling. One would think that the present law manifests an oversight on the part of the draftsman in excluding a class of employees meeting the same criteria as was applied in establishing the group entitled to those special elections.

TESTIMONY BEFORE SENATE FINANCE COMMITTEE

SENATOR RUSSELL LONG, (D) LA., CHAIRMAN

DECEMBER 4, 1979

I am Charles C. Cowsert, Atlanta, Georgia, Executive Secretary of the Board of Annuities and Relief of the Presbyterian Church in the United States.

My Church of just under a million members has its roots in the mainstream of American Presbyterianism. It came into being during that period of "unpleasantness" associated with the 1860's and is the second largest Presbyterian body in America.

The Board of Annuities and Relief, a limited corporation under the laws of the Commonwealth of Kentucky, is separate from but controlled by the denomination. Article X of the Charter reads in part:

> "The powers of the above corporation are hereby limited, and the Board shall have under its management and control the Ministers' Annuity Fund, the Employees' Annuity Fund, the supervision of Ministerial Relief and such insurance services as the General Assembly (highest court of the denomination) may commit to it."

This Board is charged with administration of three service areas. Two of these, Pensions and Group Health Coverage, constitute non-profit, self-sustaining businesses. The third, Ministerial Relief, is strictly a benevolent enterprise based upon freewill offerings of church members.

The Board administers two pension plans -- a Ministers' Annuity Fund and an Employees' Annuity Fund:

1. The Ministers' Annuity Fund is a defined benefit plan which provides family protection such as disability annuities, death benefits and children's annuities, as well as retirement annuities for members and spouses. The Fund, initiated in 1940, is fully funded with no unfunded past service liabilities and offers 100% vesting privileges within five years. Dues are 12%on total compensation -- organization, 9%, and member, 3%. Investments are professionally managed under the strictest of fiduciary standards.

2. The Employees' Annuity Fund, established in 1942, is for lay employees of the Church. 12% dues in this Fund are directed primarily to age retirement annuities. After five years of membership a lay person may elect to transfer to the Ministers' Annuity Fund. This Fund also provides 100% vesting privileges after five years of participation. It was fully funded until January 1, 1978, at which time a minor liability was incurred in order to equalize periodic payments for both male and female members. Ample provision was made to overcome this slight liability.

The Board administers four group insurance plans, including both group life and health care coverage for approximately 7,000 active church employees and their dependents, as well as a major medical health program for about 2,500 retired persons and their dependent units, either as a supplement to Medicare or regular coverage for those under 65 and ineligible for Medicare.

The Board's Ministerial Relief Program provides income assistance and free health care coverage to eligible retired employees of the Church, many of whom labored for the most part prior to the initiation of the Church's Annuity Plans. This program, involving approximately one and a half million dollars annually, flows from the

Church's tithes and offerings.

ERISA'S IMPACT

Now, on behalf of the Board of Annuities and Relief, my denomination and the Alliance for the Clarification of ERISA, I speak in support of the proposed legislation S-1090, 1091 and 1092.

1. This legislation will remove much uncertainty that now adversely affects major decisions that trustees and administrative officers of church plans are required to make regularly. Because certain aspects of ERISA presently lend themselves to dual interpretations, different plan administrators make different applications.

a. The Church Plans I represent, and most Church Plans for that matter, are administered by a corporation that is a legal entity apart from the denomination but which is totally controlled by the denomination. There persists the question as to whether a pension plan thus administered can qualify as exempt from ERISA. Such unnecessary confusion frightens competent and experienced trustees and makes them wary of serving.

b. Then ERISA says that employees of agencies not a part of a church plan prior to January 1, 1974 may not be enrolled in an ERISA-exempt Church Plan. The Board of Annuities has applied this to employees of a local agency that existed, but did not enroll its employees in the denomination's plans before 1974 or an agency created after that date. Consequently, as a plan director, in order to avoid violation and to keep our ERISA-exempt status, I have disallowed pension participation of employees of local institutions or agencies organized after January 1, 1974, thus presently preventing such employees from accumulating pension credits. But I realize that other church plan administrators consider this restriction to apply only to the denominational plan -- whether it was in existence on that date.

c. Finally, there is the question of what is and what is not an agency of the Church and who shall have the authority to define a church agency -- the Church or the Government. I need not advise you, I am sure, that on this issue we are treading water that is very deep.

The Board supports the Talmadge-Bentsen Bills, because they will clear up much confusion that now prevails and will permit the Church Plans to operate without fear of violation or of suddenly becoming subject to ERISA.

2. But, Mr. Chairman, it is the certainties about ERISA, not the uncertainties, that give my Board the most concern.

a. The law states clearly that, unless a Church Plan comes under ERISA, December 31, 1982 is the deadline after which all employees of church agencies must be divorced from the Church Plans wishing to remain exempt from ERISA. There is no confusion here -- either we remove agency employees who may have been in our Plans for many years, or we bring the Plans under ERISA.

Since agency employees in the Presbyterian Church, U.S. are considered to be church employees, most of them move from local church employment to agency employment and frequently back again to local church service. It defies sound business principle to take such persons in and out of a pension system that heretofore has served them well. But, since they have no place else to turn for pension participation and since they are dependent upon this Board for pension provision in retirement, this Board will have no alternative but to create new Plans for these employees and make these Plans subject to ERISA. Thus, instead of administering two Pension Plans, both ERISA-exempt, the Board will administer four such Plans -- two under ERISA for agency employees and two ERISA-exempt for minister and lay persons employed by local churches. Such a useless increase in actuarial, accounting, legal and administrative expense can serve only one purpose, namely, to greatly reduce dollar benefits to plan beneficiaries whose pensions are already small, but nevertheless adequate, and at a time when inflation threatens to nullify their usefulness. While this denominational Board would try to provide participation privileges for such employees, it is likely that some agencies involved, aware of reduced benefits, would simply discontinue participation for their employees in such Plans. The Talmadge-Bentsen Bill would eliminate the needless removal of such agency employees and thus help to fulfill the original purpose of ERISA, namely, protection of pension benefits for retired and elderly people.

b. Under ERISA, as presently written, a Church Plan may lose its exempt status if it enrolls a minister not currently employed by a church. Yet, traditionally this Board has continued enrollment of clergy in good standing while they were on study leave, in transit between jobs, on independent duty apart from the Church, such as hospital chaplains, college professors, evangelists, and the like. Also, members enrolled in the Board's Plans frequently labor outside the denomination in ecumenical structures. Should continuation of this much needed coverage be allowed to deprive a Church Plan of its exempt status? The Talmadge-Bentsen legislation will correct this inequity.

In conclusion, Mr. Chairman, let me assure the Senate Finance Committee that the Church, a highly successful pioneer in the pension field, applauds congressional concern for the economic well-being of all Americans in retirement. But we beg of you not to penalize the Church Plans now nor force us to abandon at this time those for whom we are responsible. We are with you in the assurance of proper funding, vesting, accounting and reporting to annuitants. What we seek is a definition of a Church Plan that will allow us to continue to serve effectively all of our people while avoiding needless waste of resources and the reduction of employee benefits through increasing legal, actuarial and administrative costs. It is our conviction that Senate Bills 1090, 1091 and 1092 offer the appropriate corrections to ERISA and will provide the protection needed for a Church Plan. Thank you.

THE MINISTERS AND MISSIONARIES BENEFIT BOARD

of the

AMERICAN BAPTIST CHURCHES

475 Riverside Drive, New York, New York 10027

Senate Finance Committee
Hearings on S.1090, S.1091 and S.1092
December 4, 1979

Summary of Statement of Rev. Gordon E. Smith
on behalf of American Baptist Churches in the U.S.A.

A. S.1090 and S.1091: Definition of "Church Plan".

1. Excessive entanglement by the Government in the church may result if the ERISA definition of a "church plan" is not amended.

   a. The fiduciary standards of ERISA could result in the Government determining the use of the "endowment" fund of the American Baptist Ministers and Missionaries Benefit Board. This "endowment", created by gifts, is used to provide a variety of benefits to American Baptist church employees, active and retired.

   b. Many American Baptist churches and agencies could not meet the participation requirements of ERISA. Under our congregational structure, the denomination cannot compel independent churches and agencies to provide coverage. If ERISA were to apply to our plans, hundreds of our churches and agencies would be forced to terminate the coverage they now provide.

2. S.1090 and S.1091 provide a definition of "church plan" that will avoid excessive governmental entanglement.

   a. Allows coverage of ministers who are not serving within the formal denominational structure.

   b. Allows coverage of ministers and lay employees who are disabled or in transition from one job to another.

c. Allows coverage of employees of church agencies.

d. Makes it clear that a separately incorporated pension board may administer a church plan.

e. Provides for a "correction period" to enable a church plan to maintain its exemption in the event of a failure to meet the "church plan" definition.

3. American Baptist employees are already provided with most of the protections of ERISA: vesting and funding requirements are met; strong efforts are made to provide wide participation, and to communicate plan provisions to participants. This has been done without excessive governmental entanglement since long before the enactment of ERISA.

B. S.1092: Eliminates discrimination in "catch-up" contributions for church employees.

1. Provides that service with any church, agency or board of a denomination would be considered as service with a single employer in determining years of service under § 403(b). Eliminates current discrimination against ministers of congregational denominations as compared with ministers of hierarchical denominations.

2. Allows same elections to church employees as currently allowed under § 415 to employees of educational organizations, hospitals and home health service organizations. Provides for a $10,000 <u>de minimis</u> limitation under § 415.

Senate Finance Committee
Hearings on S. 1090, S. 1091 and S. 1092
December 4, 1979

Statement of Rev. Gordon E. Smith on behalf of American Baptist Churches in the U.S.A.

Our denomination, American Baptist Churches in the U.S.A., has very serious problems with the definition of a "church plan" as now set forth in ERISA and the Internal Revenue Code. These problems would be resolved by the enactment of S. 1090 and S. 1091. We welcome the opportunity to appear before you to explain the importance of these bills to our denomination.

Any suggestion that the employee benefit plans of our denomination might become subject to ERISA is very troubling to us. The right of churches under the First Amendment to carry on their religious activities without governmental regulation or interference is very fundamental, and we believe that this right would be seriously eroded if ERISA were applied to our benefit plans.

There are several areas in which the provisions of ERISA would seem to intrude upon the rights of churches under the First Amendment. One of these areas was expressly alluded to in 1973 by the Senate Finance Committee in its consideration of the pension plan termination insurance provisions of ERISA. In exempting church plans from these provisions the Committee stated that it was:

> "... concerned that the examination of books and records that may be required in any particular case as part of the careful and responsible administration of the insurance system might be regarded as an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities." Sen. Rep. No. 93-383, 93rd Cong., 1st Sess., 1974-3 C.B. Supp. 160.

We share the view expressed by the Senate Finance Committee in 1973 that the examination by the government of the books and records of churches is not appropriate. However, it is important to note that ERISA goes far beyond the mere examination of books and records. If ERISA were applicable to the benefit plans of our denomination, we are fearful that the Federal Government would be placed in the position of regulating the manner in which our denomination conducts one of its most vital church functions--the care and maintenance of the ministers, missionaries and lay employees who carry on the religious mission of American Baptists.

One of the principal ways in which this might occur is through the impact of the fiduciary responsibility provisions of ERISA upon the operations of the Ministers and Missionaries Benefit Board. This is the corporation--created in 1913--through which the American Baptist denomination administers to the needs of the people who carry on the denomination's work, and to their dependents. As part of its functions, the Ministers and Missionaries Benefit Board operates a number of employee benefit plans, including a retirement plan, a medical plan and a death benefit plan. In addition, however, the Ministers and Missionaries Benefit Board expends substantial sums each year in providing supplementary benefits such as: (1) emergency assistance to active and retired ministers and their families experiencing financial hardship, (2) supplemental grants to retired ministers and missionaries and their surviving spouses who are in serious financial need, (3) grants to augment low annuity payments, (4) supplemental medical benefits for retired participants who are over age 65, (5) support for orphaned children, and (6) the payment of all administrative expenses of the programs by which the Board provides benefits.

The funds needed to pay these supplementary benefits are provided from the Board's "endowment", which has been derived from contributions and bequests made to the Board by many generous donors since the Board was founded. The "endowment" also undergirds the minimum levels of retirement income that the Board has promised to provide under the American Baptist Churches Retirement Plan. Thus, unlike the typical pension or employee benefit fund, the Ministers and Missionaries Benefit Board has a responsibility under its charter to carry on a broad range of programs to meet the needs of the ministers, missionaries and lay employees of the denomination, whatever those needs might be from time to time. Some of the Board's programs are employee benefit plans, and others are purely donative in nature. Since all of these programs are supported to some extent by the Board' "endowment" funds, the application of ERISA to our benefit plans could lead to a situation in which the Government would determine the extent to which these funds could be used for the Board's general religious purposes, as distinguished from benefit plan purposes. The prospect of any such governmental involvement in our use of funds that have been contributed to us for our religious purposes would be very disturbing to us.

Meeting the participation standards of ERISA could also impose a burden upon some churches. The American Baptist denomination makes a strenuous effort to encourage all of its local churches to cover all of their employees, both ordained and lay, under the Board's benefit plans. However, the denomination has no power to compel a church to do this, and some churches may lack the financial resources to do so. In such a situation a local church may decide, as a matter of priority, that it will cover its minister from the time he or she is first employed by the church, but it will not cover its lay employees until they have been employed for a number of years and have thereby attained a "career" status. Such an arrangement might violate the ERISA participation standards, forcing the church to terminate the coverage of its minister because it is not financially able to provide coverage for all of its employees. Since in our congregational structure a church independently makes its arrangements with its minister and lay employees, the participation requirements of ERISA would present great difficulties for us if they applied to our retirement plan.

These are some of the reasons why we believe it is imperative that our benefit plans be able to qualify as "church plans" that are exempt from ERISA. However, as the definition of a "church plan" now reads, there are questions as to whether our plans can continue to qualify after 1982.

Under the existing statute, it is possible that a church plan might lose its exemption under ERISA if it covers a minister who is not an employee of a church (or until December 31, 1982, an employee of a church agency). However, numerous Baptist ministers pursue their ministries from time to time by serving outside the formal denominational structure. Examples would be Baptist ministers employed as chaplains in hospitals, prisons or colleges, or teaching religious studies in an educational institution, or serving as self-employed evangelists. It is important to such ministers, and to the denomination, that their membership in the denomination's benefit plans be maintained during such periods of service as a minister outside the denomination.

proposed bills would make clear that this can be done .thout jeopardizing the exempt status of the plans under ERISA.

A similar question exists under present law with respect to the coverage of Baptist ministers or lay employees who are not currently employed because they are disabled or in transition from one job to another. The proposed bills would eliminate this question and allow such coverage.

The present statute fails to recognize the fact that the American Baptist employee benefit plans, as well as most church plans of congregational denominations, have historically been administered by a corporate entity that is separate from, but controlled by, the denomination. The statute is not clear as to whether such a plan may qualify as an exempt church plan under ERISA. This question would be resolved by the proposed bills.

In its proposed regulations the Treasury Department took the position that if a church plan should ever, at any time or for whatever reason, fail to meet the requirements of a church plan it can never thereafter regain its exempt status under ERISA. This position is unnecessarily harsh because a failure to meet the requirements of a church plan may result from insignificant violations of rules that are not now clearly defined and will take years to resolve. The proposed bills would give a church plan which has violated the applicable rules an opportunity to correct the violation and thereby retain its exemption from ERISA.

Under present law a church plan cannot retain its ERISA exemption after December 31, 1982 if it continues to cover employees of church agencies. Examples of church agencies would be any of the following organizations which is affiliated with a church or a convention or association of churches: a hospital, a school or college, a nursing home, a retirement home, a drug-abuse center, or a children's home or camp.

Because of the close relationship that exists between our churches and our denominational agencies, we believe it is essential that employees of the agencies be eligible for coverage under the benefit plans of the denomination. If this is not permitted, our denomination would have no alternative but to terminate the participation of the agencies in our church plans, for the reasons explained earlier. In fact, because of the present law, we have been unable to admit any new American Baptist agencies into our church plans since January 1, 1974. For our denomination, the operation of one or more ERISA plans is not a viable alternative. Thus, the agencies now in our benefit plans would be forced either to establish ERISA plans for their employees or to terminate their coverage on December 31, 1982. Because of the expense of establishing and administering ERISA plans, it is feared that many agencies will choose to terminate their coverage, thus depriving their employees of benefits that they are now receiving as members of our church plans. Moreover, if agency employees are not permitted to participate in our church plans, the mobility of church employees within the denomination will be greatly restricted. The proposed bills would solve these problems and permit the continued coverage of agency employees in church plans after December 31, 1982.

I should like to emphasize that our desire to be exempt from ERISA is not based upon a view that the employees of our churches and agencies should be denied the protections of ERISA. Most of these protections are already provided under our plans. In accordance with section 403(b) of the Internal Revenue Code, the American Baptist Churches Retirement Plan is fully funded, and members' accrued benefits thereunder are fully vested at all times. The Board's investments are professionally managed in accordance with the highest fiduciary standards applicable to organizations of its type under New York law. The reports of the Board's operations, as audited by its independent certified public accountants, are regularly provided to the governing bodies of the denomination and are freely available to other interested persons. To the extent possible, the Board has encouraged all American Baptist churches and employing organizations to provide participation under the Board's benefit plans for all of their employees, both ordained and lay. And the Board has made a consistent effort to communicate the provisions of its benefit plans to all participants. Notwithstanding these considerations, we believe that the regulation mandated by ERISA is not appropriate for an organization with a religious history and purpose such as the Ministers and Missionaries Benefit Board. We therefore urge that S. 1090 and S. 1091 be enacted.

We also urge the enactment of S. 1092. This bill would liberalize the provisions of sections 403(b) and 415 of the Internal Revenue Code with respect to the making of "catch-up" contributions under church retirement programs that are funded through section 403(b) annuity contracts.

We became concerned about the need for such liberalization a number of years ago, when it became apparent to us that section 403(b) severely limits the "catch-up" contributions that can be made by a minister who has served several Baptist churches during his career. This is true of most American Baptist ministers. Under the wording of section 403(b), this problem would not exist if a minister remained with the same employer during his entire career, as would more likely be the case in a hierarchical denomination. Accordingly, in 1971 we asked the Internal Revenue Service to issue a ruling stating that, for purposes of section

403(b), service with any of our American Baptist churches, boards or agencies would be considered as service with one employer. However, the ruling issued by the IRS (copy attached) said that this could not be done. Thus, the present statute has the effect of discriminating against ministers in congregational denominations as compared with ministers in hierarchical denominations.

One of the objects of S. 1092 is to remedy this discriminatory effect of section 403(b) with respect to ministers in congregational denominations. However, this action alone would not permit any significant increase in catch-up contributions unless section 415 were also liberalized at the same time by making available to church employees the same "catch-up" elections that are already permitted in section 415 for employees of educational organizations, hospitals and home health service agencies. S. 1092 would accomplish this result.

The need for a liberalization of the limits on "catch-up" contributions is very great in the American Baptist denomination. Due to the low pay scale that has historically prevailed in the ministry, it is extremely difficult for ministers to make adequate provision for their retirement. Our experience has been that most ministers are not able to set aside any significant amounts under salary reduction arrangements that are allowed under section 403(b) until they have been working for at least 25 or 30 years. By this time, however, due to the existing limitations in sections 403(b) and 415, they are prevented from making any meaningful "catch-up" contributions during their later years. Accordingly, there is a real need for the relief that would be provided by S. 1092, and we respectfully urge its enactment.

Attachments:
IRS Ruling
Fact Sheet
Organizational Chart

Department of the Treasury

Internal Revenue Service
Washington, DC 20224

Date: NOV 30 1971

In reply refer to: [illegible]

The Ministers and Missionaries
Benefit Board of The American
Baptist Convention
c/o Mr. John P. Parsons
Patterson, Belknap & Webb
One Wall Street
New York, New York 10005

Gentlemen:

Your authorized representative, Mr. John P. Parsons, has requested a ruling on your behalf whether an individual may include those years of service with his present employer as well as other related employers in applying the limited exclusion from gross income provided by section 403(b) of the Internal Revenue Code.

You are an organization described in section 501(c)(3) of the Code which is exempt from taxation under section 501(a) of the Code. You make contributions on behalf of employees toward the purchase of an annuity of the type referred to in section 403(b) of the Code.

Customarily, a Baptist minister moves from one church to another during his career, and sometimes serves as a staff member of Baptist boards and societies.

Amounts contributed by his immediate employer for the purchase of an annuity for him are excludable from his gross income in the year contributed to the extent of an exclusion allowance, since the employer is exempt under section 501(c)(3) of the Code. In counting the number of "years of service", for purposes of computing an exclusion allowance, there shall be included one year for each full year during which the individual was a full-time employee of the organization purchasing the annuity. Section 1.403(b)-1(e) and (f) of the Income Tax Regulations. See also Rev. Rul. 69-629 C.B. 1969-2, 101.

Hence, we conclude that an individual may not include

The Ministers and Missionaries
Benefit Board of The American
Baptist Convention

years of service with an employer other than his present employer purchasing the annuity in computing the exclusion allowance.

Sincerely yours,

(Signed) I. Goodman

Chief, Pension Trust Branch

FACT SHEET

American Baptist Churches in the U.S.A.

Year of organization: 1907 (Incorporated in 1910 by Special Act of New York Legislature)

Number of cooperating churches: Approx. 6,000

Affiliated organizations: Approx. 200

Members of cooperating churches: Approx. 1,500,000

The Ministers and Missionaries Benefit Board of American Baptist Churches

Year of organization: 1911 (Incorporated in 1913 by Special Act of New York Legislature)

Principal purpose: To benefit ministers, missionaries and lay employees of the denomination through benefit plans and noncontractual benefit programs.

Statistical Summary of Individuals Participating in Benefit Plans (as of 3/31/79)

	Ministers and Missionaries	Lay Members	Total
Retirement Plan			
Premium-paying members	4,099	1,088	5,187
Average Compensation	$14,661*	$11,257	
Annuitants			
Retired	1,912	291	2,203
Disabled.	69	17	86
Widows and dependent children	1,098	61	1,159
The Annuity Supplement			
Premium-paying members	379	82	461
Annuitants	159	16	175
Medical Plans-family units covered			
Premium paid by employer, or member	3,489	1,231	4,720
Premium paid by Board for annuitants and grantees . .	2,691	279	2,970

Average compensation for full-time member, including housing.

1978 Payments for Benefit Plans

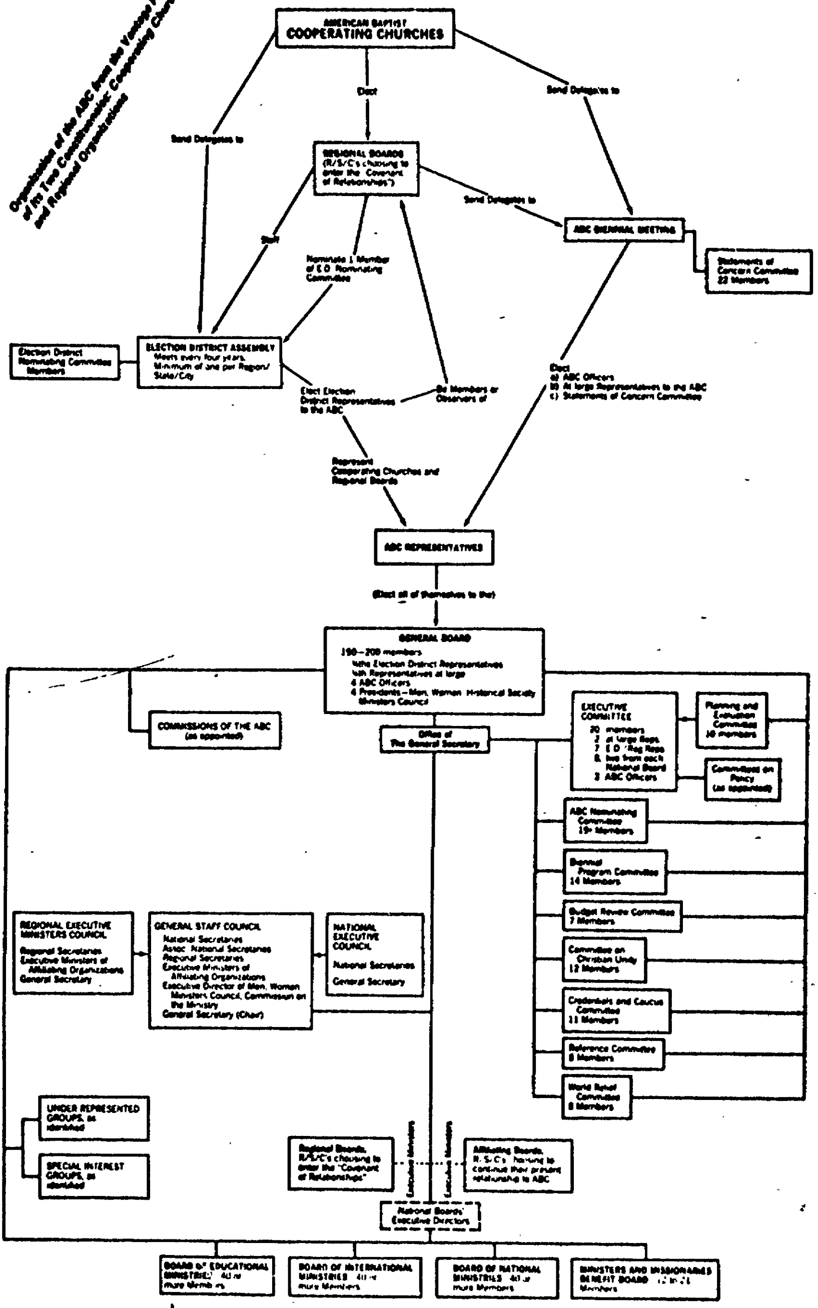
nnuities paid and death, disability and other benefits	$4,280,244
ledical protection for active and retired members and beneficiaries.	4,544,201
Total	$8,824,445

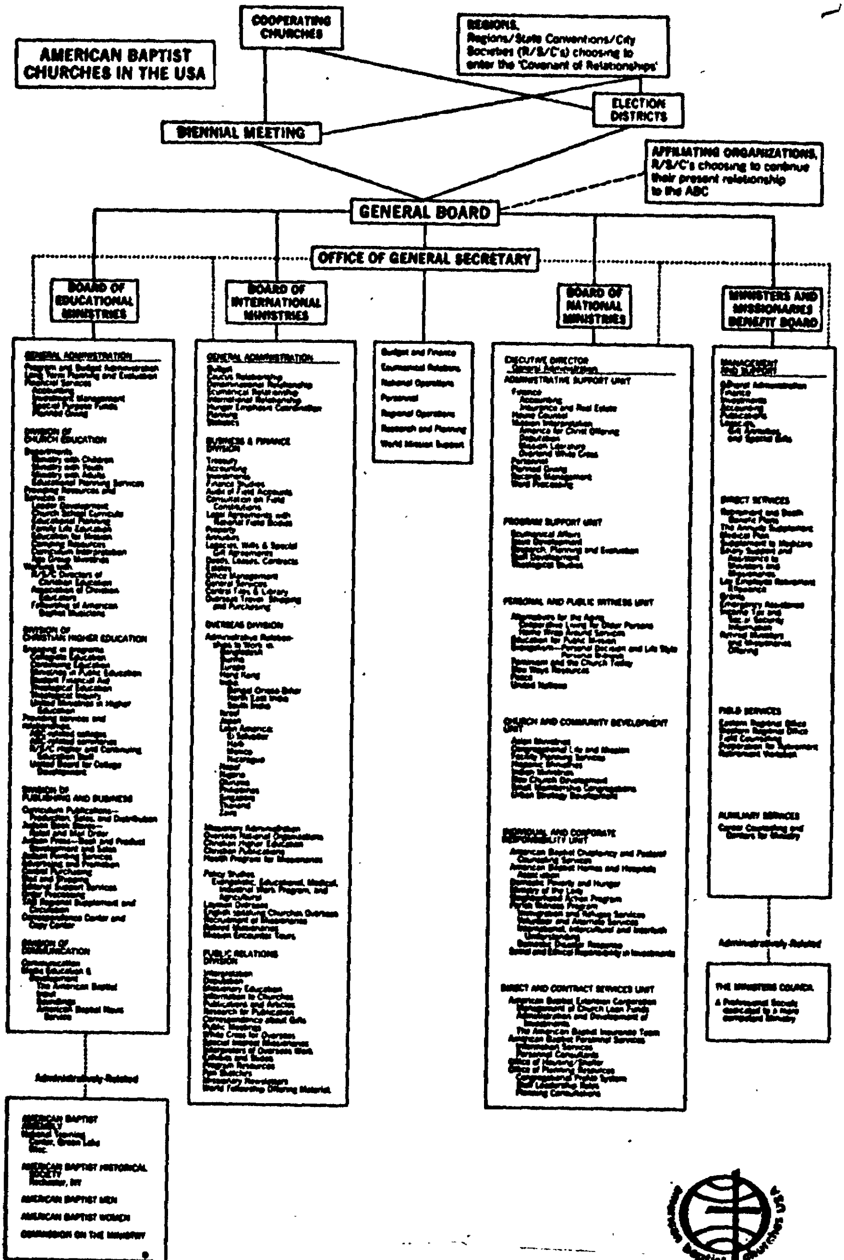
1978 Expenditures for Noncontractual Benefits

fts, special grants and supplementation o retirees	$1,237,496
ants and emergency assistance.	592,237
lary support for ministers	259,291
reer counseling for ministers.	154,511
Total	$2,243,535

AMERICAN BAPTIST CHURCHES IN THE USA

Organization of the ABC from the Vantage Point of its Two Constituencies: Cooperating Churches and Regional Organizations




AMERICAN BAPTIST CHURCHES IN THE USA
COOPERATING CHURCHES
REGIONS, Regions/State Conventions/City Societies (R/S/C's) choosing to enter the 'Covenant of Relationships'
ELECTION DISTRICTS
BIENNIAL MEETING
AFFILIATING ORGANIZATIONS, R/S/C's choosing to continue their present relationship to the ABC
GENERAL BOARD
OFFICE OF GENERAL SECRETARY
BOARD OF EDUCATIONAL MINISTRIES
BOARD OF INTERNATIONAL MINISTRIES
BOARD OF NATIONAL MINISTRIES
MINISTERS AND MISSIONARIES BENEFIT BOARD
Budget and Finance
Ecumenical Relations
National Operations
Personnel
Regional Operations
Research and Planning
World Mission Support
Administratively Related
AMERICAN BAPTIST MEN
AMERICAN BAPTIST WOMEN
Administratively Related
THE MINISTERS COUNCIL

Senator MATSUNAGA. Without objection, an opening statement of mine will be included in the record immediately following that of the Chairman. The subcommittee stands in recess.

[The opening statement of Senator Matsunaga appears at the appropriate place in the beginning of the hearing.]

Senator MATSUNAGA. The meeting now stands in recess until 2:30 p.m. tomorrow.

[Whereupon, at 5:10 p.m., the subcommittee recessed to reconvene on Wednesday, December 4, 1979, at 2:30 p.m.]

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