

109<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

# S. 1359

To amend the Internal Revenue Code of 1986 to increase retirement savings and security, to facilitate the provision of guaranteed retirement income for life, and to make the retirement plan rules simpler and more equitable, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

JUNE 30, 2005

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

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## A BILL

To amend the Internal Revenue Code of 1986 to increase retirement savings and security, to facilitate the provision of guaranteed retirement income for life, and to make the retirement plan rules simpler and more equitable, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Retirement Savings  
5 and Security Act of 2005”.

1 **TITLE I—INCREASING RETIRE-**  
 2 **MENT SAVINGS AND SECUR-**  
 3 **RITY**

4 **SEC. 101. INCREASING PARTICIPATION THROUGH AUTO-**  
 5 **MATIC CONTRIBUTION ARRANGEMENTS.**

6 (a) IN GENERAL.—Section 401(k) of the Internal  
 7 Revenue Code of 1986 (relating to cash or deferred ar-  
 8 rangement) is amended by adding at the end the following  
 9 new paragraph:

10 “(13) NONDISCRIMINATION REQUIREMENTS  
 11 FOR AUTOMATIC CONTRIBUTION TRUSTS.—

12 “(A) IN GENERAL.—A cash or deferred ar-  
 13 rangement shall be treated as meeting the re-  
 14 quirements of paragraph (3)(A)(ii) if such ar-  
 15 rangement constitutes an automatic contribu-  
 16 tion trust.

17 “(B) AUTOMATIC CONTRIBUTION TRUST.—

18 “(i) IN GENERAL.—For purposes of  
 19 this paragraph, the term ‘automatic con-  
 20 tribution trust’ means an arrangement—

21 “(I) except as provided in clause  
 22 (ii), under which each employee eligi-  
 23 ble to participate in the arrangement  
 24 is treated in a consistent manner as  
 25 having elected to have the employer

1 make elective contributions in an  
2 amount not less than the applicable  
3 percentage of the employee's com-  
4 pensation, and

5 “(II) which meets the require-  
6 ments of subparagraphs (C), (D), and  
7 (E).

8 “(ii) EXCEPTIONS.—

9 “(I) EXISTING EMPLOYEES.—  
10 Clause (i) shall not apply to any em-  
11 ployee who was eligible to participate  
12 in the arrangement (or a predecessor  
13 arrangement) immediately before the  
14 first date on which the arrangement is  
15 an automatic contribution trust.

16 “(II) ELECTION OUT.—Each em-  
17 ployee eligible to participate in the ar-  
18 rangement may elect not to have con-  
19 tributions made under clause (i) or to  
20 have elective contributions made at a  
21 specified level, and such clause shall  
22 cease to apply to compensation paid  
23 on or after the effective date of the  
24 election.

1 “(iii) APPLICABLE PERCENTAGE.—

2 For purposes of this subparagraph—

3 “(I) IN GENERAL.—Except as  
4 provided in this clause, the applicable  
5 percentage with respect to any em-  
6 ployee is 3 percent.

7 “(II) INCREASE IN PERCENT-  
8 AGE.—In the case of the second plan  
9 year beginning after the first date the  
10 election under clause (i)(I) is in effect  
11 with respect to the employee and each  
12 subsequent plan year, the applicable  
13 percentage with respect to the em-  
14 ployee shall be equal to the sum of the  
15 applicable percentage for the employee  
16 as of the close of the preceding plan  
17 year plus 1 percentage point. Under  
18 rules prescribed by the Secretary, the  
19 employer sponsoring the plan (or the  
20 plan administrator on behalf of the  
21 employer) may elect to provide that  
22 each such increase shall occur after  
23 each annual increase in an employee’s  
24 compensation occurring during each

1 of the plan years to which this sub-  
2 clause applies.

3 “(III) MAXIMUM PERCENTAGE.—

4 The applicable percentage with re-  
5 spect to any employee for any plan  
6 year shall not exceed 10 percent.

7 “(C) MATCHING OR NONELECTIVE CON-  
8 TRIBUTIONS.—

9 “(i) IN GENERAL.—The requirements  
10 of this subparagraph are met if, under the  
11 arrangement, the employer—

12 “(I) makes matching contribu-  
13 tions on behalf of each employee who  
14 is not a highly compensated employee  
15 in an amount equal to 50 percent of  
16 the elective contributions of the em-  
17 ployee to the extent such elective con-  
18 tributions do not exceed 6 percent of  
19 compensation, or

20 “(II) is required, without regard  
21 to whether the employee makes an  
22 elective contribution or employee con-  
23 tribution, to make a contribution to a  
24 defined contribution plan on behalf of  
25 each employee who is not a highly

1            compensated employee and who is eli-  
2            gible to participate in the arrange-  
3            ment in an amount equal to at least  
4            2 percent of the employee's compensa-  
5            tion.

6            The rules of clauses (ii) and (iii) of para-  
7            graph (12)(B) shall apply for purposes of  
8            subclause (I). The rules of clause (ii) of  
9            paragraph (12)(E) shall apply for purposes  
10          of subclauses (I) and (II).

11          “(ii) OTHER PLANS.—An arrange-  
12          ment shall be treated as meeting the re-  
13          quirements under clause (i) if any other  
14          plan maintained by the employer meets  
15          such requirements with respect to employ-  
16          ees eligible under the arrangement.

17          “(D) VESTING.—The requirements of this  
18          subparagraph are met if an employee who has  
19          completed at least 2 years of service (within the  
20          meaning of section 411(a)) has a nonforfeitable  
21          right to 100 percent of the employee's accrued  
22          benefit derived from employer contributions  
23          taken into account in determining whether the  
24          requirements of subparagraph (C) are met.

25          “(E) NOTICE REQUIREMENTS.—

1           “(i) IN GENERAL.—The requirements  
2 of this subparagraph are met if the re-  
3 quirements of clauses (ii) and (iii) are met.

4           “(ii) REASONABLE PERIOD TO MAKE  
5 ELECTION.—The requirements of this  
6 clause are met if each employee to whom  
7 subparagraph (B)(i) applies—

8                   “(I) receives a notice explaining  
9 the employee’s right under the ar-  
10 rangement to elect not to have elective  
11 contributions made on the employee’s  
12 behalf and how contributions made  
13 under the arrangement will be in-  
14 vested in the absence of any invest-  
15 ment election by the employee, and

16                   “(II) has a reasonable period of  
17 time after receipt of such notice and  
18 before the first elective contribution is  
19 made to make either such election.

20           “(iii) ANNUAL NOTICE OF RIGHTS  
21 AND OBLIGATIONS.—The requirements of  
22 this clause are met if each employee eligi-  
23 ble to participate in the arrangement is  
24 given notice of the employee’s rights and  
25 obligations under the arrangement within a

1           reasonable period before any year (or, if  
2           the increase in the applicable percentage  
3           occurs after an annual increase in an em-  
4           ployee’s compensation, before such in-  
5           crease).

6           The requirements of clauses (i) and (ii) of para-  
7           graph (12)(D) shall be met with respect to the  
8           notices described in clauses (ii) and (iii) of this  
9           subparagraph.”.

10       (b) MATCHING CONTRIBUTIONS.—Section 401(m) of  
11 the Internal Revenue Code of 1986 (relating to non-  
12 discrimination test for matching contributions and em-  
13 ployee contributions) is amended by redesignating para-  
14 graph (12) as paragraph (13) and by inserting after para-  
15 graph (11) the following new paragraph:

16           “(12) ALTERNATIVE METHOD FOR AUTOMATIC  
17       CONTRIBUTION TRUSTS.—

18           “(A) IN GENERAL.—A defined contribution  
19       plan shall be treated as meeting the require-  
20       ments of paragraph (2) with respect to match-  
21       ing contributions if the plan—

22           “(i) meets the contribution require-  
23       ments of subparagraphs (B)(i) and (C) of  
24       subsection (k)(13),



1           “(ii) meets the vesting and notice re-  
 2           quirements of subparagraphs (D) and (E)  
 3           of subsection (k)(13), and

4           “(iii) meets the requirements of  
 5           clauses (ii) and (iii) of paragraph (11)(B).

6           “(B) MATCHING CONTRIBUTIONS.—An an-  
 7           nuity contract under section 403(b) shall be  
 8           treated as meeting the requirements of para-  
 9           graph (2) with respect to matching contribu-  
 10          tions if such contract meets requirements simi-  
 11          lar to the requirements under subparagraph  
 12          (A).”.

13          (c) EXCLUSION FROM DEFINITION OF TOP-HEAVY  
 14          PLANS.—

15           (1) ELECTIVE CONTRIBUTION RULE.—Clause  
 16           (i) of section 416(g)(4)(H) of the Internal Revenue  
 17           Code of 1986 is amended by inserting “or  
 18           401(k)(13)” after “section 401(k)(12)”.

19           (2) MATCHING CONTRIBUTION RULE.—Clause  
 20           (ii) of section 416(g)(4)(H) of such Code is amended  
 21           by inserting “or 401(m)(12)” after “section  
 22           401(m)(11)”.

23          (d) DEFINITION OF COMPENSATION.—

24           (1) BASE PAY OR RATE OF PAY.—The Sec-  
 25           retary of the Treasury shall, by no later than De-

1 cember 31, 2006, modify Treasury Regulation sec-  
2 tion 1.414(s)–1(d)(3) to facilitate the use of the safe  
3 harbors in sections 401(k)(12), 401(k)(13),  
4 401(m)(11), and 401(m)(12) of the Internal Rev-  
5 enue Code of 1986, and in Treasury Regulation sec-  
6 tion 1.401(a)(4)–3(b), by plans that use base pay or  
7 rate of pay in determining contributions or benefits.  
8 Such facilitation shall include increased flexibility in  
9 satisfying section 414(s) of such Code in any case  
10 where the amount of overtime compensation payable  
11 in a year can vary significantly.

12 (2) APPLICATION OF REQUIREMENTS TO SEPA-  
13 RATE PAYROLL PERIODS.—Not later than December  
14 31, 2005, the Secretary of the Treasury shall issue  
15 rules under subparagraphs (B)(i) and (C)(i) of sec-  
16 tion 401(k)(13) of such Code and under clause (i)  
17 of section 401(m)(12)(A) of such Code that, effec-  
18 tive for plan years beginning after December 31,  
19 2005, permit such requirements to be applied sepa-  
20 rately to separate payroll periods based on rules  
21 similar to the rules described in Treasury Regulation  
22 sections 1.401(k)–3(c)(5)(ii) and 1.401(m)–3(d)(4).

23 (e) SECTION 403(b) CONTRACTS.—Paragraph (11) of  
24 section 401(m) of such Code is amended by adding at the  
25 end the following:

1           “(C) SECTION 403(b) CONTRACTS.—An  
2 annuity contract under section 403(b) shall be  
3 treated as meeting the requirements of para-  
4 graph (2) with respect to matching contribu-  
5 tions if such contract meets requirements simi-  
6 lar to the requirements under subparagraph  
7 (A).”.

8 (f) INVESTMENTS AND PREEMPTION.—

9           (1) CONTROL DEEMED TO HAVE BEEN EXER-  
10 CISED WITH RESPECT TO AMOUNT OF AUTOMATIC  
11 CONTRIBUTIONS.—Section 404(c) of the Employee  
12 Retirement Income Security Act of 1974 (29 U.S.C.  
13 1104(c)) is amended by adding at the end the fol-  
14 lowing new paragraphs:

15           “(4) AUTOMATIC CONTRIBUTION ARRANGE-  
16 MENT.—

17           “(A) IN GENERAL.—A participant or bene-  
18 ficiary in an individual account plan shall, for  
19 purposes of paragraph (1), be treated as exer-  
20 cising control over the assets in the account  
21 with respect to the contributions made under an  
22 automatic contribution arrangement.

23           “(B) AUTOMATIC CONTRIBUTION AR-  
24 RANGEMENT DEFINED.—For purposes of this

1 paragraph, the term ‘automatic contribution ar-  
2 rangement’ means an arrangement—

3 “(i) which meets the requirements of  
4 subparagraph (C),

5 “(ii) under which a participant may  
6 elect to have the employer make payments  
7 as contributions under the plan on behalf  
8 of the participant, or to the participant di-  
9 rectly in cash,

10 “(iii) under which the participant is  
11 treated as having elected to have the em-  
12 ployer make such contributions in an  
13 amount equal to a specified percentage of  
14 compensation provided under the plan  
15 until the participant affirmatively elects  
16 not to have such contributions made (or  
17 affirmatively elects to have such contribu-  
18 tions made at a different percentage), and

19 “(iv) under which contributions de-  
20 scribed in clause (iii) are invested in ac-  
21 cordance with regulations prescribed by the  
22 Secretary which provide for the investment  
23 of the contributions in 1 or more invest-  
24 ment options which include a range of

1 asset classes, but only if the investment op-  
2 tions—

3 “(I) vary the emphasis and expo-  
4 sure among the asset classes as the  
5 participant approaches a target retire-  
6 ment date with the expectation that  
7 the participant will take distributions  
8 on or near such target retirement  
9 date, including model portfolios, life-  
10 cycle funds, retirement target date  
11 funds, managed accounts, and other  
12 similar investment options,

13 “(II) provide for a blend of cap-  
14 ital preservation and long-term appre-  
15 ciation through balanced portfolios or  
16 balanced funds, or

17 “(III) are otherwise approved in  
18 the regulations.

19 “(C) NOTICE REQUIREMENTS.—

20 “(i) TIME FOR NOTICE.—The admin-  
21 istrator of an individual account plan shall,  
22 within a reasonable period before each plan  
23 year and before the first contribution made  
24 on the participant’s behalf under subpara-  
25 graph (B), give to each participant to

1 whom an automatic contribution arrange-  
2 ment applies for such plan year notice of  
3 the participant's rights and obligations  
4 under the arrangement which—

5 “(I) is sufficiently accurate and  
6 comprehensive to apprise the partici-  
7 pant of such rights and obligations,  
8 and

9 “(II) is written in a manner cal-  
10 culated to be understood by the aver-  
11 age participant to whom the arrange-  
12 ment applies.

13 “(ii) FORM OF NOTICE; RESPONSE.—  
14 A notice shall not be treated as meeting  
15 the requirements of clause (i) with respect  
16 to a participant unless—

17 “(I) the notice includes a notice  
18 explaining the participant's right  
19 under the arrangement to elect not to  
20 have elective contributions made on  
21 the participant's behalf (or to elect to  
22 have such contributions made at a dif-  
23 ferent percentage),

24 “(II) the notice explains how con-  
25 tributions made under the arrange-

1                   ment will be invested in the absence of  
2                   any investment election by the partici-  
3                   pant or beneficiary, and

4                   “(III) the participant or bene-  
5                   ficiary has a reasonable period of time  
6                   after receipt of the notice described in  
7                   subclause (I) or (II) and before the  
8                   making of the first elective contribu-  
9                   tion to which the notice relates to  
10                  make either such election.

11                  “(5) CONTRIBUTIONS TO WHICH PARAGRAPH (4)  
12                  DOES NOT APPLY.—

13                  “(A) IN GENERAL.—A participant or bene-  
14                  ficiary in an individual account plan (including  
15                  a plan to which the requirements of this sub-  
16                  section do not otherwise apply) who does not  
17                  make an investment election with respect to  
18                  contributions described in subparagraph (B)  
19                  shall, for purposes of paragraph (1), be treated  
20                  as exercising control over the assets in the ac-  
21                  count with respect to such contributions.

22                  “(B) APPLICABLE CONTRIBUTIONS.—Contribu-  
23                  tions are described in this subparagraph if—

24                  “(i) the contributions are not described in  
25                  paragraph (4),

1           “(ii) the plan administrator satisfies rules  
2           similar to the rules of paragraph (4)(C), to the  
3           extent the rules relate to the explanation de-  
4           scribed in paragraph (4)(B)(ii)(II), and

5           “(iii) the contributions are invested pursu-  
6           ant to the regulations under paragraph  
7           (4)(B)(iv).”.

8           (2) PREEMPTION OF CONFLICTING STATE REG-  
9           ULATION.—Section 514 of such Act (29 U.S.C.  
10          1144(b)) is amended by adding at the end the fol-  
11         lowing new subsection:

12         “(e) AUTOMATIC CONTRIBUTION ARRANGEMENTS.—  
13         Notwithstanding any other provision of this section, any  
14         law of a State which would directly or indirectly prohibit  
15         or restrict the inclusion in any plan of an automatic con-  
16         tribution arrangement (as defined in section 404(c)(4)(B))  
17         shall be superseded. The Secretary may prescribe regula-  
18         tions which would establish minimum standards that such  
19         arrangements would be required to satisfy in order for this  
20         paragraph to apply.”.

21         (g) CORRECTIVE DISTRIBUTIONS.—

22                 (1) IN GENERAL.—Section 414 of the Internal  
23         Revenue Code of 1986 (relating to definitions and  
24         special rules) is amended by adding at the end the  
25         following new subsection:



1 “(w) AUTOMATIC CONTRIBUTION ARRANGEMENTS.—

2 “(1) IN GENERAL.—For purposes of this title,  
3 the amount of any corrective distribution from a  
4 plan shall be treated as if the amount had never  
5 been held in such plan and shall be treated as a pay-  
6 ment of compensation from the employer maintain-  
7 ing the plan to the employee receiving the distribu-  
8 tion.

9 “(2) CORRECTIVE DISTRIBUTION.—For pur-  
10 poses of this subsection, the term ‘corrective dis-  
11 tribution’ means a distribution from an applicable  
12 employer plan of all amounts attributable to an erro-  
13 neous automatic contribution.

14 “(3) ERRONEOUS AUTOMATIC CONTRIBU-  
15 TION.—For purposes of this subsection, the term  
16 ‘erroneous automatic contribution’ means an elective  
17 contribution made on behalf of an employee under  
18 any applicable employer plan pursuant to a plan pro-  
19 vision treating the employee as having elected to  
20 have the employer make such elective contribution  
21 until the employee affirmatively elects not to have  
22 such contribution made or affirmatively elects to  
23 make contributions at a specified level, if the fol-  
24 lowing requirements are satisfied:

1           “(A) Within the applicable period, the em-  
2           ployee notifies the plan administrator that the  
3           employee elects to have the elective contribution  
4           treated as an erroneous automatic contribution.

5           “(B) The sum of the elective contributions  
6           that are treated as erroneous automatic con-  
7           tributions with respect to an employee does not  
8           exceed \$500.

9           “(4) APPLICABLE EMPLOYER PLAN.—For pur-  
10          poses of this subsection, the term ‘applicable em-  
11          ployer plan’ has the meaning given such term by  
12          subsection (v)(6)(A).

13          “(5) APPLICABLE PERIOD.—For purposes of  
14          this subsection, the term ‘applicable period’ means,  
15          with respect to an employee, the 3-month period  
16          which begins on the first date that an amount is  
17          withheld from compensation payable to the employee  
18          in order to make a plan contribution pursuant to a  
19          plan provision described in paragraph (3).”.

20          (2) VESTING CONFORMING AMENDMENTS.—

21                 (A) INTERNAL REVENUE CODE OF 1986.—

22                         (i) Section 411(a)(3)(G) of such Code  
23                         is amended by inserting “an erroneous  
24                         automatic contribution under section  
25                         414(w),” after “402(g)(2)(A),”.

1                   (ii) The heading of section  
2                   411(a)(3)(G) of such Code is amended by  
3                   inserting “OR ERRONEOUS AUTOMATIC  
4                   CONTRIBUTION” before the period.

5                   (iii) Section 401(k)(8)(E) of such  
6                   Code is amended by inserting “an erro-  
7                   neous automatic contribution under section  
8                   414(w),” after “402(g)(2)(A),”.

9                   (iv) The heading of section  
10                  401(k)(8)(E) of such Code is amended by  
11                  inserting “OR ERRONEOUS AUTOMATIC  
12                  CONTRIBUTION” before the period.

13                  (B) EMPLOYEE RETIREMENT INCOME SE-  
14                  CURITY ACT OF 1974.—Section 203(a)(3)(F) of  
15                  the Employee Retirement Income Security Act  
16                  of 1974 (29 U.S.C. 1053(a)(3)(F)) is amended  
17                  by inserting “an erroneous automatic contribu-  
18                  tion under section 414(w) of such Code,” after  
19                  “402(g)(2)(A) of such Code,”.

20                  (h) SENSE OF CONGRESS.—It is the sense of Con-  
21                  gress that—

22                   (1) automatic contribution arrangements and  
23                   automatic contribution increase arrangements are a  
24                   powerful means of increasing savings and retirement  
25                   security;

1           (2) implementation of such arrangements  
2 should be considered broadly by employers, including  
3 employers that are not subject to the Employee Re-  
4 tirement Income Security Act of 1974; and

5           (3) to the extent that there are remaining ob-  
6 stacles preventing employers from adopting such ar-  
7 rangements, there should be a public dialogue re-  
8 garding ways to address such obstacles.

9           (i) EFFECTIVE DATE.—

10           (1) IN GENERAL.—Except as provided by para-  
11 graph (2), the amendments made by this section  
12 shall apply to plan years beginning after December  
13 31, 2005.

14           (2) SECTION 403(b) CONTRACTS.—The amend-  
15 ments made by subsection (e) shall apply to years  
16 beginning after December 31, 1998.

17           (3) REGULATIONS.—Final regulations under  
18 section 404(c)(4)(B)(iv) of the Employee Retirement  
19 Income Security Act of 1974 shall be issued no later  
20 than 6 months after the date of the enactment of  
21 this Act.

22 **SEC. 102. EXTENSION AND EXPANSION OF SAVER'S CREDIT.**

23           (a) EXTENSION.—Section 25B(h) of the Internal  
24 Revenue Code of 1986 (relating to termination) is amend-  
25 ed by striking “2006” and inserting “2010”.

1 (b) EXPANSION.—Section 25B(b) of such Code (re-  
 2 lating to applicable percentage) is amended to read as fol-  
 3 lows:

4 “(b) APPLICABLE PERCENTAGE.—For purposes of  
 5 this section—

6 “(1) IN GENERAL.—The applicable percentage  
 7 is the percentage determined in accordance with the  
 8 following table:

| <b>“If the adjusted<br/>gross income is:</b> | <b>The applicable<br/>percentage is:</b> |
|--|--|
| Not over \$15,000 .....                      | 50                                       |
| Over \$15,000 but not over \$20,000 .....    | 20                                       |
| Over \$20,000 but not over \$25,000 .....    | 10                                       |
| Over \$25,000 .....                          | 0.                                       |

9 “(2) SPECIAL RULE FOR JOINT RETURNS AND  
 10 HEAD OF HOUSEHOLDS.—Paragraph (1) shall be ap-  
 11 plied for any taxable year by substituting for each  
 12 dollar amount otherwise in effect under the table for  
 13 the taxable year the following:

14 “(A) In the case of a joint return, twice  
 15 the dollar amount.

16 “(B) In the case of a head of a household,  
 17 1½ times the dollar amount.”.

18 (c) ADJUSTMENT FOR INFLATION.—Section 25B of  
 19 such Code is amended by redesignating subsection (h) as  
 20 subsection (i) and by inserting after subsection (g) the fol-  
 21 lowing new subsection:

1       “(h) ADJUSTMENT FOR INFLATION.—In the case of  
 2 any taxable year beginning after December 31, 2008, each  
 3 dollar amount in the table contained in subsection (b)(1)  
 4 shall be increased by an amount equal to—

5               “(1) such dollar amount, multiplied by

6               “(2) the cost-of-living adjustment determined  
 7 under section 1(f)(3) for such calendar year by sub-  
 8 stituting ‘calendar year 2007’ for ‘calendar year  
 9 1992’ in subparagraph (B) thereof.

10 If any increase under the preceding sentence is not a mul-  
 11 tiple of \$1,000, such increase shall be rounded to the near-  
 12 est multiple of \$1,000.”.

13       (d) EFFECTIVE DATE.—The amendments made by  
 14 this section shall apply to taxable years beginning after  
 15 December 31, 2006.

16 **SEC. 103. DISPOSITION OF UNUSED HEALTH BENEFITS IN**  
 17 **FLEXIBLE SPENDING ARRANGEMENTS.**

18       (a) IN GENERAL.—Section 125 of the Internal Rev-  
 19 enue Code of 1986 (relating to cafeteria plans) is amended  
 20 by redesignating subsections (h) and (i) as subsections (i)  
 21 and (j), respectively, and by inserting after subsection (g)  
 22 the following:

23       “(h) CONTRIBUTIONS OF CERTAIN UNUSED HEALTH  
 24 BENEFITS.—

1           “(1) IN GENERAL.—For purposes of this title,  
2 a plan or other arrangement shall not fail to be  
3 treated as a cafeteria plan solely because qualified  
4 benefits of a participant under such plan include a  
5 health flexible spending arrangement under which  
6 not more than \$500 of unused health benefits may  
7 be contributed on behalf of the participant to—

8           “(A) a qualified retirement plan (as de-  
9 fined in section 4974(c)), or

10           “(B) an eligible deferred compensation  
11 plan (as defined in section 457(b)) maintained  
12 by an eligible employer described in section  
13 457(e)(1)(A).

14           “(2) TREATMENT OF CONTRIBUTION OF UN-  
15 USED HEALTH BENEFITS.—

16           “(A) IN GENERAL.—For purposes of this  
17 title, contributions described in paragraph (1)  
18 shall be treated as elective contributions made  
19 pursuant to an election by the participant be-  
20 tween such contributions and compensation  
21 which would otherwise be includible in the gross  
22 income of the employee.

23           “(B) EXCLUSION OR DEDUCTION.—Con-  
24 tributions described in paragraph (1) shall be  
25 excluded from gross income, or included in

1 gross income and allowed as a deduction, to the  
2 same extent that elective contributions would be  
3 so treated under this title.

4 “(3) HEALTH FLEXIBLE SPENDING ARRANGE-  
5 MENT.—For purposes of this subsection, the term  
6 ‘health flexible spending arrangement’ means a flexi-  
7 ble spending arrangement (as defined in section  
8 106(c)) which is a qualified benefit and only permits  
9 reimbursement for expenses for medical care (as de-  
10 fined in section 213(d)(1) without regard to sub-  
11 paragraphs (C) and (D) thereof).

12 “(4) UNUSED HEALTH BENEFITS.—For pur-  
13 poses of this subsection, the term ‘unused health  
14 benefits’ means, with respect to a participant, the  
15 excess of—

16 “(A) the maximum amount of reimburse-  
17 ment allowable to the participant with respect  
18 to a plan year under a health flexible spending  
19 arrangement, taking into account any election  
20 by the participant, over

21 “(B) the actual amount of reimbursement  
22 with respect to such year under such arrange-  
23 ment.”.

24 (b) SPECIAL RULES.—The Secretary of the Treasury  
25 shall prescribe such rules as are appropriate to carry out



1 the purposes of the amendments made by this section.  
2 Such rules may permit elections by plan sponsors with re-  
3 spect to the year to which the contributions relate and may  
4 provide for special treatment for purposes of applying the  
5 requirements applicable to such contributions.

6 (c) EFFECTIVE DATE.—The amendment made by  
7 subsection (a) shall apply to years beginning after Decem-  
8 ber 31, 2005.

9 **SEC. 104. DIRECT PAYMENT OF TAX REFUNDS TO INDI-**  
10 **VIDUAL RETIREMENT PLANS.**

11 (a) IN GENERAL.—Paragraph (3) of section 219(f)  
12 of the Internal Revenue Code of 1986 is amended to read  
13 as follows:

14 “(3) TIME WHEN CONTRIBUTIONS MADE.—

15 “(A) IN GENERAL.—Except as provided in  
16 subparagraph (B), for purposes of this sub-  
17 section, a taxpayer shall be deemed to have  
18 made a contribution to an individual retirement  
19 plan on the last day of the preceding taxable  
20 year if the contribution is made on account of  
21 such taxable year and is made not later than  
22 the time prescribed by law for filing the return  
23 for such taxable year (not including extensions  
24 thereof).

1                   “(B) DIRECT PAYMENT OF TAX REFUNDS  
2 TO INDIVIDUAL RETIREMENT PLANS.—

3                   “(i) IN GENERAL.—To the extent pro-  
4 vided in rules prescribed by the Secretary,  
5 a tax refund owed to a taxpayer and paid  
6 directly to an individual retirement plan  
7 shall be deemed a contribution made by  
8 the taxpayer—

9                   “(I) on the last day of the tax-  
10 able year to which such refund re-  
11 lates, and

12                   “(II) on account of such taxable  
13 year.

14                   “(ii) LIMITATION.—This subpara-  
15 graph shall not apply to a tax refund un-  
16 less such refund is shown on a return filed  
17 not later than the time prescribed by law  
18 for filing the return for the taxable year to  
19 which such refund relates (not including  
20 extensions thereof).

21                   “(iii) DIRECT PAYMENT.—For pur-  
22 poses of this subparagraph, a tax refund is  
23 paid directly to an individual retirement  
24 plan if it is paid in the form of a direct

1 transfer from the Secretary to the trustee  
2 or issuer of the individual retirement plan.

3 “(iv) TAX REFUND.—For purposes of  
4 this subparagraph, the term ‘tax refund’  
5 means any overpayment of an internal rev-  
6 enue tax under section 6401 which the  
7 Secretary may credit or refund under sec-  
8 tion 6402 (after application of subsections  
9 (c), (d), and (e) thereof).”.

10 (b) REGULATIONS.—

11 (1) IN GENERAL.—Not later than 1 year after  
12 the date of enactment of this Act, the Secretary of  
13 the Treasury shall issue rules which permit a tax-  
14 payer—

15 (A) to elect to have all or any portion of  
16 a tax refund owed to the taxpayer paid directly  
17 to an individual retirement plan,

18 (B) to specify the individual retirement  
19 plan to which such tax refund is to be paid  
20 (and the investment option in which such tax  
21 refund is to be invested), and

22 (C) to the extent provided in rules pre-  
23 scribed by the Secretary, to specify the taxable  
24 year on account of which such payment is  
25 made,

1       except that the Secretary may require that the  
2       amount subject to such an election exceed a dollar  
3       threshold determined by the Secretary as necessary  
4       or appropriate to ensure the administrability of such  
5       elections.

6           (2) INFORMATION.—The Secretary may require  
7       that the taxpayer provide, and agree to the disclo-  
8       sure of, any information necessary to pay the tax re-  
9       fund to the individual retirement plan specified by  
10      the taxpayer.

11          (3) SPECIAL RULE.—The Secretary may pro-  
12      vide that if, for any reason, the trustee or issuer  
13      does not accept payment of a tax refund, the tax re-  
14      fund shall instead be paid as if the taxpayer had not  
15      elected a direct payment to an individual retirement  
16      plan.

17          (c) EFFECTIVE DATE.—The amendments made by  
18      this section shall apply to taxable years the due date for  
19      which (without regard to any extension) occurs after the  
20      date on which final rules implementing the amendments  
21      made by this section are prescribed.

1           **TITLE II—FACILITATING**  
2 **GUARANTEED INCOME FOR LIFE**

3 **SEC. 201. EXCLUSION OF CERTAIN QUALIFIED ANNUITY**  
4           **PAYMENTS.**

5           (a) EXCLUSION.—

6                 (1) QUALIFIED PLANS.—Section 402(e) of the  
7 Internal Revenue Code of 1986 (relating to exempt  
8 trusts) is amended by adding at the end the fol-  
9 lowing new paragraph:

10                   “(7) EXCLUSION OF PERCENTAGE OF LIFETIME  
11 ANNUITY PAYMENTS.—

12                         “(A) IN GENERAL.—In the case of a life-  
13 time annuity payment to a qualified distributee  
14 from a qualified trust (within the meaning of  
15 subsection (c)(8)(A)) maintained in connection  
16 with a defined contribution plan, gross income  
17 shall not include 10 percent of the amount oth-  
18 erwise includible in gross income (determined  
19 without regard to this paragraph). For pur-  
20 poses of this paragraph, payments from an an-  
21 nuity contract distributed by the qualified trust  
22 shall be treated as payments from the qualified  
23 trust.

24                         “(B) LIMITATION.—

25                                 “(i) IN GENERAL.—If—

1           “(I) the aggregate amount of  
2           lifetime annuity payments to the dis-  
3           tributee during the taxable year which  
4           are includible in gross income (deter-  
5           mined without regard to this para-  
6           graph) and which are subject to this  
7           paragraph or to rules similar to the  
8           rules of this paragraph (other than  
9           section 72(b)(5) or 101(d)(4)), ex-  
10          ceeds

11           “(II) 50 percent of the applicable  
12          amount for the taxable year under  
13          section 415(a),

14          then the aggregate amount otherwise ex-  
15          cludable under subparagraph (A) for the  
16          taxable year shall be reduced by 10 percent  
17          of the portion of such excess which is allo-  
18          cable under clause (ii) to payments which  
19          are subject to this paragraph.

20           “(ii) ALLOCATION RULE.—Any excess  
21          described in clause (i) for any taxable year  
22          shall be allocated ratably among all life-  
23          time annuity payments to the qualified dis-  
24          tributee described in clause (i)(I).

1                   “(C) DEFINITIONS.—For purposes of this  
2 paragraph—

3                   “(i) LIFETIME ANNUITY PAYMENT.—

4                                 “(I) IN GENERAL.—Except as  
5 provided in this clause, the term ‘life-  
6 time annuity payment’ means a dis-  
7 tribution from an annuity contract  
8 which is a part of a series of substan-  
9 tially equal periodic payments (not  
10 less frequently than annually) made  
11 over the life of the qualified dis-  
12 tributee or the joint lives of the quali-  
13 fied distributee and the qualified  
14 distributee’s designated beneficiary.  
15 For purposes of this paragraph, the  
16 term ‘annuity contract’ means a com-  
17 mercial annuity (as defined in section  
18 3405(e)(6)), other than an endowment  
19 or life insurance contract.

20                                 “(II) CERTAIN FLUCTUATING  
21 PAYMENTS.—Annuity payments shall  
22 not fail to be treated as part of a se-  
23 ries of substantially equal periodic  
24 payments merely because the amount  
25 of the periodic payments may vary in

1 accordance with investment experi-  
2 ence, reallocations among investment  
3 options, actuarial gains or losses, cost  
4 of living indices, a constant percent-  
5 age (not less than zero) applied not  
6 less frequently than annually, or simi-  
7 lar fluctuating criteria.

8 “(III) CERTAIN CHANGES IN THE  
9 MODE OF PAYMENT.—Annuity pay-  
10 ments shall not fail to be treated as  
11 part of a series of substantially equal  
12 periodic payments merely because the  
13 period between each such payment is  
14 lengthened or shortened, but only if at  
15 all times such period is not longer  
16 than 1 year.

17 “(IV) PERMITTED REDUC-  
18 TIONS.—Annuity payments shall not  
19 fail to be treated as part of a series  
20 of substantially equal periodic pay-  
21 ments merely because, in the case of  
22 an annuity payable over the lives of  
23 the qualified distributee and the quali-  
24 fied distributee’s designated bene-  
25 ficiary, the amounts paid after the



1 death of the qualified distributee or  
2 the qualified distributee's designated  
3 beneficiary are less than the amounts  
4 payable during their joint lives.

5 “(V) CERTAIN CONTRACT BENE-  
6 FITS.—The availability of a commuta-  
7 tion benefit or other feature permit-  
8 ting acceleration of annuity payments  
9 (or a modification of the period dur-  
10 ing which such a benefit is available),  
11 a minimum period of payments or a  
12 minimum amount to be paid in any  
13 event shall not affect the treatment of  
14 a distribution as a lifetime annuity  
15 payment.

16 “(VI) TRUST PAYMENTS.—In the  
17 case of lifetime annuity payments  
18 being made to a qualified trust, pay-  
19 ments by the qualified trust to a  
20 qualified distributee of the entire  
21 amount received by the qualified trust  
22 with respect to the qualified dis-  
23 tributee shall constitute lifetime annu-  
24 ity payments if such payments are

1 made within a reasonable period after  
2 receipt by the qualified trust.

3 “(VII) QUALIFIED DOMESTIC RE-  
4 LATIONS ORDERS.—Annuity payments  
5 shall not fail to be treated as a series  
6 of substantially equal periodic pay-  
7 ments merely because the payments  
8 are reduced on account of a qualified  
9 domestic relations order (within the  
10 meaning of section 414(p)) that be-  
11 comes effective after the commence-  
12 ment of the annuity payments.

13 “(ii) QUALIFIED DISTRIBUTEES.—The  
14 term ‘qualified distributee’ means the em-  
15 ployee, the surviving spouse of the em-  
16 ployee, and an alternate payee who is the  
17 spouse or former spouse of the employee.

18 “(D) RECAPTURE TAX.—

19 “(i) IN GENERAL.—If—

20 “(I) an amount is not includible  
21 in gross income by reason of subpara-  
22 graph (A), and

23 “(II) the series of payments of  
24 which such payment is a part is sub-  
25 sequently modified (other than by rea-

1           son of death or disability) so that  
2           some or all future payments are not  
3           lifetime annuity payments,  
4           the qualified distributee's gross income for  
5           the first taxable year in which such modi-  
6           fication occurs shall be increased by an  
7           amount, determined under rules prescribed  
8           by the Secretary, equal to the amount  
9           which (but for subparagraph (A)) would  
10          have been includible in the qualified  
11          distributee's gross income if the modifica-  
12          tion had been in effect at all times, plus in-  
13          terest for the deferral period at the under-  
14          payment rate established under section  
15          6621.

16           “(ii) DEFERRAL PERIOD.—For pur-  
17          poses of this subparagraph, the term ‘de-  
18          ferral period’ means, with respect to any  
19          amount, the period beginning with the tax-  
20          able year in which (without regard to sub-  
21          paragraph (A)) the amount would have  
22          been includible in gross income and ending  
23          with the taxable year in which the modi-  
24          fication described in clause (i)(II) occurs.

1           “(E) INVESTMENT IN THE CONTRACT.—  
2           For purposes of section 72, the investment in  
3           the contract shall be determined without regard  
4           to this paragraph.”.

5           (2) QUALIFIED ANNUITY PLANS.—Section  
6           403(a) of such Code (relating to qualified annuity  
7           plans) is amended by adding at the end the following  
8           new paragraph:

9           “(6) EXCLUSION OF PERCENTAGE OF LIFETIME  
10          ANNUITY PAYMENTS.—Rules similar to the rules of  
11          section 402(e)(7) shall apply to distributions under  
12          any annuity contract to which this subsection ap-  
13          plies.”.

14          (3) PURCHASED ANNUITIES.—Section 403(b) of  
15          such Code (relating to purchased annuities) is  
16          amended by adding at the end the following new  
17          paragraph:

18          “(14) EXCLUSION OF PERCENTAGE OF LIFE-  
19          TIME ANNUITY PAYMENTS.—Rules similar to the  
20          rules of section 402(e)(7) shall apply to distributions  
21          under any annuity contract or custodial account to  
22          which this subsection applies.”.

23          (4) IRAS.—Section 408(d) of such Code (relat-  
24          ing to tax treatment of distributions) is amended by  
25          adding at the end the following new paragraph:

1           “(8) EXCLUSION OF PERCENTAGE OF LIFETIME  
2 ANNUITY PAYMENTS.—Rules similar to the rules of  
3 section 402(e)(7) shall apply to distributions out of  
4 an individual retirement plan.”.

5           (5) SECTION 457 PLANS.—Section 457(e) of  
6 such Code (relating to special rules for deferred  
7 compensation plans) is amended by adding at the  
8 end the following new paragraph:

9           “(18) EXCLUSION OF PERCENTAGE OF LIFE-  
10 TIME ANNUITY PAYMENTS.—Rules similar to the  
11 rules of section 402(e)(7) shall apply to distributions  
12 from an eligible deferred compensation plan of an el-  
13 igible employer described in subsection (e)(1)(A).”.

14          (b) EFFECTIVE DATE.—The amendments made by  
15 this section shall apply to distributions made after Decem-  
16 ber 31, 2005.

17 **SEC. 202. EXCLUSION FOR LIFETIME ANNUITY PAYMENTS.**

18          (a) LIFETIME ANNUITY PAYMENTS UNDER ANNUITY  
19 CONTRACTS.—Section 72(b) of the Internal Revenue Code  
20 of 1986 (relating to exclusion ratio) is amended by adding  
21 at the end the following new paragraph:

22           “(5) EXCLUSION FOR LIFETIME ANNUITY PAY-  
23 MENTS.—

24           “(A) IN GENERAL.—In the case of lifetime  
25 annuity payments received as an annuity under

1           1 or more annuity contracts in any taxable  
2           year, gross income shall not include the lesser  
3           of—

4                   “(i) 50 percent of the portion of the  
5                   lifetime annuity payments which (without  
6                   regard to this paragraph) is includible in  
7                   gross income under this section for the  
8                   taxable year, or

9                   “(ii) \$20,000.

10           “(B) COST-OF-LIVING ADJUSTMENT.—In  
11           the case of taxable years beginning after De-  
12           cember 31, 2006, the \$20,000 amount in sub-  
13           paragraph (A)(ii) shall be increased by an  
14           amount equal to—

15                   “(i) such dollar amount, multiplied by

16                   “(ii) the cost-of-living adjustment de-  
17                   termined under section 1(f)(3) for the cal-  
18                   endar year in which the taxable year be-  
19                   gins, determined by substituting ‘calendar  
20                   year 2005’ for ‘calendar year 1992’ in sub-  
21                   paragraph (B) thereof.

22           If any amount as increased under the preceding  
23           sentence is not a multiple of \$500, such amount  
24           shall be rounded to the next lower multiple of  
25           \$500.

1                   “(C) APPLICATION OF PARAGRAPH.—Sub-  
2                   paragraph (A) shall not apply to—

3                   “(i) any amount received under an eli-  
4                   gible deferred compensation plan (as de-  
5                   fined in section 457(b)) or under a quali-  
6                   fied retirement plan (as defined in section  
7                   4974(c)),

8                   “(ii) any amount paid under an annu-  
9                   ity contract which is received by the bene-  
10                  ficiary under the contract—

11                  “(I) after the death of the annu-  
12                  itant in the case of payments de-  
13                  scribed in subsection (c)(5)(A)(ii)(III),  
14                  unless the beneficiary is the surviving  
15                  spouse of the annuitant, or

16                  “(II) after the death of the annu-  
17                  itant and joint annuitant in the case  
18                  of payments described in subsection  
19                  (c)(5)(A)(ii)(IV), unless the bene-  
20                  ficiary is the surviving spouse of the  
21                  last to die of the annuitant and the  
22                  joint annuitant, or

23                  “(iii) any annuity contract that is a  
24                  qualified funding asset (as defined in sec-

1                   tion 130(d)), but without regard to wheth-  
2                   er there is a qualified assignment.

3                   “(D) INVESTMENT IN THE CONTRACT.—

4                   For purposes of this section, the investment in  
5                   the contract shall be determined without regard  
6                   to this paragraph.”.

7                   (b) DEFINITIONS.—Section 72(c) of the Internal  
8                   Revenue Code of 1986 is amended by adding at the end  
9                   the following new paragraph:

10                   “(5) LIFETIME ANNUITY PAYMENT.—

11                   “(A) IN GENERAL.—For purposes of sub-  
12                   section (b)(5), the term ‘lifetime annuity pay-  
13                   ment’ means any amount received as an annu-  
14                   ity under any portion of an annuity contract,  
15                   but only if—

16                   “(i) the only person (or persons in the  
17                   case of payments described in subclause  
18                   (II) or (IV) of clause (ii)) legally entitled  
19                   (by operation of the contract, a trust, or  
20                   other legally enforceable means) to receive  
21                   such amount during the life of the annu-  
22                   itant or joint annuitant is such annuitant  
23                   or joint annuitant, and

24                   “(ii) such amount is part of a series  
25                   of substantially equal periodic payments



1 made not less frequently than annually  
2 over—

3 “(I) the life of the annuitant,

4 “(II) the lives of the annuitant  
5 and a joint annuitant, but only if the  
6 annuitant is the spouse of the joint  
7 annuitant as of the annuity starting  
8 date or the difference in age between  
9 the annuitant and joint annuitant is  
10 15 years or less,

11 “(III) the life of the annuitant  
12 with a minimum period of payments  
13 or with a minimum amount that must  
14 be paid in any event, or

15 “(IV) the lives of the annuitant  
16 and a joint annuitant with a minimum  
17 period of payments or with a min-  
18 imum amount that must be paid in  
19 any event, but only if the annuitant is  
20 the spouse of the joint annuitant as of  
21 the annuity starting date or the dif-  
22 ference in age between the annuitant  
23 and joint annuitant is 15 years or  
24 less.

1           “(iii) EXCEPTIONS.—For purposes of  
2           clause (ii), annuity payments shall not fail  
3           to be treated as part of a series of substan-  
4           tially equal periodic payments—

5                   “(I) because the amount of the  
6                   periodic payments may vary in accord-  
7                   ance with investment experience, re-  
8                   allocations among investment options,  
9                   actuarial gains or losses, cost-of-living  
10                  indices, a constant percentage (not  
11                  less than zero) applied not less fre-  
12                  quently than annually, or similar fluc-  
13                  tuating criteria,

14                  “(II) due to the existence of, or  
15                  modification of the duration of, a pro-  
16                  vision in the contract permitting a  
17                  lump-sum withdrawal after the annu-  
18                  ity starting date, or

19                  “(III) because the period between  
20                  each such payment is lengthened or  
21                  shortened, but only if at all times  
22                  such period is no longer than 1 cal-  
23                  endar year.

24           “(B) ANNUITY CONTRACT.—For purposes  
25           of subparagraph (A) and subsections (b)(5) and

1 (x), the term ‘annuity contract’ means a com-  
2 mercial annuity (as defined by section  
3 3405(e)(6)), other than an endowment or life  
4 insurance contract.

5 “(C) MINIMUM PERIOD OF PAYMENTS.—

6 For purposes of subparagraph (A), the min-  
7 imum period of payments is a guaranteed term  
8 of payments which does not exceed the greater  
9 of—

10 “(i) 10 years, or

11 “(ii) the life expectancy of—

12 “(I) the annuitant as of the an-  
13 nuity starting date, in the case of life-  
14 time annuity payments described in  
15 subparagraph (A)(ii)(III), or

16 “(II) the annuitant and joint an-  
17 nuitant as of the annuity starting  
18 date, in the case of lifetime annuity  
19 payments described in subparagraph  
20 (A)(ii)(IV).

21 For purposes of this subparagraph, life expect-  
22 ancy shall be computed with reference to the ta-  
23 bles prescribed by the Secretary under para-  
24 graph (3). For purposes of subsection  
25 (x)(1)(C)(ii), the permissible minimum period of

1           payments shall be determined as of the annuity  
2           starting date and reduced by one for each sub-  
3           sequent year.

4           “(D) MINIMUM AMOUNT THAT MUST BE  
5           PAID IN ANY EVENT.—For purposes of subpara-  
6           graph (A), the minimum amount that must be  
7           paid in any event is an amount payable to the  
8           designated beneficiary under an annuity con-  
9           tract which is in the nature of a refund and  
10          does not exceed the greater of the amount ap-  
11          plied to produce the lifetime annuity payments  
12          under the contract or the amount, if any, avail-  
13          able for withdrawal under the contract on the  
14          date of death.”.

15          (c) RECAPTURE TAX FOR LIFETIME ANNUITY PAY-  
16          MENTS.—Section 72 of the Internal Revenue Code of  
17          1986 is amended by redesignating subsection (x) as sub-  
18          section (y) and by inserting after subsection (x) the fol-  
19          lowing new subsection:

20          “(x) RECAPTURE TAX FOR MODIFICATIONS TO OR  
21          REDUCTIONS IN LIFETIME ANNUITY PAYMENTS.—

22                  “(1) IN GENERAL.—If—

23                          “(A) any amount received under an annu-  
24                          ity contract is excluded from income by reason

1 of subsection (b)(5) (relating to lifetime annuity  
2 payments) for any taxable year, and

3 “(B) a recapture event described in para-  
4 graph (2) occurs in any subsequent taxable  
5 year,

6 then gross income for the first taxable year in which  
7 the recapture event occurs shall be increased by the  
8 recapture amount.

9 “(2) RECAPTURE EVENT.—For purposes of  
10 paragraph (1), a recapture event occurs if—

11 “(A) the series of payments under an an-  
12 nuity contract is subsequently modified so any  
13 future payments are not lifetime annuity pay-  
14 ments,

15 “(B) after the date of receipt of the first  
16 lifetime annuity payment under the contract an  
17 annuitant receives a lump sum and thereafter is  
18 to receive annuity payments in a reduced  
19 amount under the contract, or

20 “(C) after the date of receipt of the first  
21 lifetime annuity payment under the contract the  
22 dollar amount of any subsequent annuity pay-  
23 ment is reduced and a lump sum is not paid in  
24 connection with the reduction, unless such re-  
25 duction is—

1           “(i) due to an event described in sub-  
2           section (c)(5)(A)(iii), or

3           “(ii) due to the addition of, or in-  
4           crease in, a minimum period of payments  
5           (within the meaning of subsection  
6           (c)(5)(C)) or a minimum amount that  
7           must be paid in any event (within the  
8           meaning of subsection (c)(5)(D)).

9           “(3) RECAPTURE AMOUNT.—

10           “(A) IN GENERAL.—For purposes of this  
11           subsection, the recapture amount shall be the  
12           amount, determined under rules prescribed by  
13           the Secretary, equal to the amount which (but  
14           for subsection (b)(5)) would have been includ-  
15           ible in the taxpayer’s gross income if the modi-  
16           fication or reduction described in subparagraph  
17           (A), (B), or (C) of paragraph (2) had been in  
18           effect at all times, plus interest for the deferral  
19           period at the underpayment rate established by  
20           section 6621.

21           “(B) DEFERRAL PERIOD.—For purposes  
22           of this subsection, the term ‘deferral period’  
23           means, with respect to any amount, the period  
24           beginning with the taxable year in which (with-  
25           out regard to subsection (b)(5)) the amount

1 would have been includible in gross income and  
 2 ending with the taxable year in which the modi-  
 3 fication or reduction described in subparagraph  
 4 (A), (B), or (C) of paragraph (2) occurs.

5 “(4) EXCEPTIONS TO RECAPTURE TAX.—Para-  
 6 graph (1) shall not apply in the case of any recap-  
 7 ture event which occurs because an annuitant—

8 “(A) dies or becomes disabled (within the  
 9 meaning of subsection (m)(7)),

10 “(B) becomes a chronically ill individual  
 11 within the meaning of section 7702B(c)(2), or

12 “(C) encounters hardship.”.

13 (d) LIFETIME DISTRIBUTIONS OF LIFE INSURANCE  
 14 DEATH BENEFITS.—

15 (1) IN GENERAL.—Section 101(d) of such Code  
 16 (relating to payment of life insurance proceeds at a  
 17 date later than death) is amended by adding at the  
 18 end the following new paragraph:

19 “(4) EXCLUSION FOR LIFETIME ANNUITY PAY-  
 20 MENTS.—

21 “(A) IN GENERAL.—In the case of  
 22 amounts to which this subsection applies, gross  
 23 income for any taxable year shall not include  
 24 the lesser of—

1           “(i) 50 percent of the portion of life-  
2           time annuity payments which (without re-  
3           gard to this paragraph) is includible in  
4           gross income under this section, or

5           “(ii) the amount in effect under sec-  
6           tion 72(b)(5)(A)(ii) for the taxable year.

7           “(B) RULES OF SECTION 72(b)(5) TO  
8           APPLY.—For purposes of this paragraph, rules  
9           similar to the rules of section 72(b)(5) and sec-  
10          tion 72(x) shall apply, except that the term  
11          ‘beneficiary of the life insurance contract’ shall  
12          be substituted for the term ‘annuitant’ each  
13          place it appears, and the term ‘life insurance  
14          contract’ shall be substituted for the term ‘an-  
15          nuity contract’ each place it appears.”.

16          (2) CONFORMING AMENDMENT.—Section  
17          101(d)(1) of such Code is amended by inserting “or  
18          paragraph (4)” after “to the extent not excluded by  
19          the preceding sentence”.

20          (e) EFFECTIVE DATE.—

21                 (1) IN GENERAL.—The amendments made by  
22                 this section shall apply to amounts received in cal-  
23                 endar years beginning after the date of the enact-  
24                 ment of this Act.



1           (2) SPECIAL RULE FOR EXISTING CON-  
2           TRACTS.—In the case of a contract in force on the  
3           date of the enactment of this Act that does not sat-  
4           isfy the requirements of section 72(c)(5)(A) of the  
5           Internal Revenue Code of 1986 (as added by this  
6           section), or requirements similar to such section  
7           72(c)(5)(A) in the case of a life insurance contract,  
8           any modification to such contract (including a  
9           change in ownership) or to the payments under such  
10          contract that is made to satisfy the requirements of  
11          such section (or similar requirements) shall not re-  
12          sult in the recognition of any gain or loss, any  
13          amount being included in gross income, or any addi-  
14          tion to tax that otherwise might result from such  
15          modification, but only if the modification is com-  
16          pleted before the date which is 2 years after the date  
17          of the enactment of this Act.

18 **SEC. 203. FACILITATION UNDER FIDUCIARY RULES OF CER-**  
19                           **TAIN ROLLOVERS AND ANNUITY DISTRIBUTI-**  
20                           **ONS.**

21          (a) IN GENERAL.—Section 404(c) of the Employee  
22          Retirement Income Security Act of 1974 (29 U.S.C.  
23          1104(c)), as amended by this Act, is amended by adding  
24          at the end the following new paragraph:

1           “(6) TREATMENT OF ROLLOVERS AND ANNUITY  
2 DISTRIBUTIONS.—

3           “(A) IN GENERAL.—In the case of an indi-  
4 vidual account plan which makes a transfer  
5 under section 401(a)(31)(A) of the Internal  
6 Revenue Code of 1986 to an individual retire-  
7 ment plan (as defined in section 7701(a)(37) of  
8 such Code) in connection with a participant or  
9 beneficiary, or makes a distribution to a partici-  
10 pant or beneficiary of an annuity contract de-  
11 scribed in subparagraph (B), the participant or  
12 beneficiary shall, for purposes of paragraph (1),  
13 be treated as exercising control over the trans-  
14 fer or distribution if—

15           “(i) the participant or beneficiary elected  
16 such transfer or distribution, and

17           “(ii) except as otherwise provided by the  
18 Secretary, the participant or beneficiary was, in  
19 connection with the election, given an oppor-  
20 tunity to designate any other individual retire-  
21 ment plan in the case of a transfer or any other  
22 annuity contract described in subparagraph (B)  
23 in the case of a distribution.

24           “(B) APPLICABLE ANNUITY CONTRACTS.—An  
25 annuity contract is described in this subparagraph if

1 it provides, either on an immediate or deferred basis,  
2 a series of substantially equal periodic payments  
3 (not less frequently than annually) for the life of the  
4 participant or beneficiary or the joint lives of the  
5 participant or beneficiary and such individual's des-  
6 ignated beneficiary. The rules of subclauses (II),  
7 (III), (IV), and (V) of section 402(e)(7)(C)(i) of the  
8 Internal Revenue Code of 1986 shall apply for pur-  
9 poses of this subparagraph.

10 “(C) IDENTIFICATION OF PLANS OR CONTRACTS  
11 DISREGARDED.—Under regulations prescribed by the  
12 Secretary, this paragraph shall apply without regard  
13 to whether the individual retirement plan receiving  
14 the transfer or the annuity contract being distrib-  
15 uted is specifically identified by the individual ac-  
16 count plan as available to the participant or bene-  
17 ficiary.

18 “(D) EXCEPTION.—Notwithstanding the pre-  
19 ceding provisions of this paragraph, paragraph  
20 (1)(B) shall not apply with respect to liability under  
21 section 406 in connection with the specific identifica-  
22 tion of any individual retirement plan or annuity  
23 contract as being available to the participant or ben-  
24 eficiary.”.

25 (b) EFFECTIVE DATE AND RELATED RULES.—

1           (1) EFFECTIVE DATE.—The amendment made  
2           by this section shall take effect on the date of the  
3           enactment of this Act.

4           (2) ISSUANCE OF FINAL REGULATIONS.—Final  
5           regulations under section 404(c)(6) of the Employee  
6           Retirement Income Security Act of 1974 (added by  
7           this section) shall be issued no later than 1 year  
8           after the date of the enactment of this Act.

9   **SEC. 204. CLARIFICATION OF TREATMENT OF DISTRIBUTIONS OF ANNUITY CONTRACTS.**

11          (a) IN GENERAL.—Clause (i) of section 402(e)(4)(D)  
12          is amended by adding after the second sentence the fol-  
13          lowing new sentence: “A distribution of an annuity con-  
14          tract from a trust or plan referred to in the first sentence  
15          of this clause may be treated as a part of a lump-sum  
16          distribution.”.

17          (b) EFFECTIVE DATE.—The amendment made by  
18          this section shall take effect as if included in section  
19          1401(b)(1) of the Small Business Job Protection Act of  
20          1996.

21   **TITLE III—SIMPLIFICATION AND**  
22   **EQUITY**

23   **SEC. 301. CLARIFICATION OF TREATMENT OF INDIAN TRIB-**  
24   **AL GOVERNMENTS.**

25          (a) DEFINITION OF GOVERNMENTAL PLAN.—

1           (1) AMENDMENT TO INTERNAL REVENUE CODE  
2           OF 1986.—Section 414(d) of the Internal Revenue  
3           Code of 1986 (definition of governmental plan) is  
4           amended by adding at the end the following: “The  
5           term ‘governmental plan’ includes a plan established  
6           or maintained for its employees by an Indian tribal  
7           government (as defined in section 7701(a)(40)), a  
8           subdivision of an Indian tribal government (deter-  
9           mined in accordance with section 7871(d)), an agen-  
10          cy or instrumentality (or subdivision) of an Indian  
11          tribal government, or an entity established under  
12          Federal, State, or tribal law which is wholly owned  
13          or controlled by any of the foregoing.”.

14          (2) AMENDMENT TO EMPLOYEE RETIREMENT  
15          INCOME SECURITY ACT OF 1974.—Section 3(32) of  
16          the Employee Retirement Income Security Act of  
17          1974 (29 U.S.C. 1002(32)) is amended by adding at  
18          the end the following: “The term ‘governmental  
19          plan’ includes a plan established or maintained for  
20          its employees by an Indian tribal government (as de-  
21          fined in section 7701(a)(40) of the Internal Revenue  
22          Code of 1986), a subdivision of an Indian tribal gov-  
23          ernment (determined in accordance with section  
24          7871(d) of such Code), an agency or instrumentality  
25          (or subdivision) of an Indian tribal government, or

1 an entity established under Federal, State, or tribal  
2 law that is wholly owned or controlled by any of the  
3 foregoing.”.

4 (b) EXTENSION TO ALL GOVERNMENTAL PLANS OF  
5 CURRENT MORATORIUM ON APPLICATION OF CERTAIN  
6 NONDISCRIMINATION RULES APPLICABLE TO STATE AND  
7 LOCAL PLANS.—

8 (1) IN GENERAL.—

9 (A) Subparagraph (G) of section 401(a)(5)  
10 and subparagraph (G) of section 401(a)(26) of  
11 such Code are each amended by striking “sec-  
12 tion 414(d)” and all that follows and inserting  
13 “section 414(d).”.

14 (B) Subparagraph (G) of section 401(k)(3)  
15 of such Code and paragraph (2) of section  
16 1505(d) of the Taxpayer Relief Act of 1997  
17 (Public Law 105–34; 111 Stat. 1063) are each  
18 amended by striking “maintained by a State or  
19 local government or political subdivision thereof  
20 (or agency or instrumentality thereof)”.

21 (2) CONFORMING AMENDMENTS.—

22 (A) The heading of subparagraph (G) of  
23 section 401(a)(5) of such Code is amended by  
24 striking “STATE AND LOCAL GOVERNMENTAL”  
25 and inserting “GOVERNMENTAL”.

1           (B) The heading of subparagraph (G) of  
 2           section 401(a)(26) of such Code is amended by  
 3           striking “EXCEPTION FOR STATE AND LOCAL”  
 4           and inserting “EXCEPTION FOR”.

5           (3) Section 401(k)(3)(G) of such Code is  
 6           amended by inserting “GOVERNMENTAL PLANS.—”  
 7           after “(G)”.

8           (c) CLARIFICATION THAT TRIBAL GOVERNMENTS  
 9           ARE SUBJECT TO THE SAME PLAN RULES AND REGULA-  
 10          TIONS APPLIED TO STATE AND OTHER LOCAL GOVERN-  
 11          MENTS AND THEIR POLICE AND FIREFIGHTERS.—

12          (1) AMENDMENTS TO INTERNAL REVENUE  
 13          CODE OF 1986.—

14           (A) POLICE AND FIREFIGHTERS.—Sub-  
 15          paragraph (H) of section 415(b)(2) of such  
 16          Code (defining participant) is amended—

17           (i) in clause (i), by striking “State or  
 18          political subdivision” and inserting “State,  
 19          Indian tribal government (as defined in  
 20          section 7701(a)(40)), or any political sub-  
 21          division”; and

22           (ii) in clause (ii)(I), by striking “State  
 23          or political subdivision” each place it ap-  
 24          pears and inserting “State, Indian tribal

1 government (as so defined), or any political  
2 subdivision thereof”.

3 (B) STATE AND LOCAL GOVERNMENT  
4 PLANS.—

5 (i) IN GENERAL.—Subparagraph (A)  
6 of section 415(b)(10) of such Code (relat-  
7 ing to limitation to equal accrued benefit)  
8 is amended—

9 (I) by inserting “, Indian tribal  
10 government (as defined in section  
11 7701(a)(40)),” after “State”;

12 (II) by inserting “any” before  
13 “political subdivision”; and

14 (III) by inserting “any of” before  
15 “the foregoing”.

16 (ii) CONFORMING AMENDMENT.—The  
17 heading of paragraph (10) of section  
18 415(b) of such Code is amended by strik-  
19 ing “SPECIAL RULE FOR STATE AND” and  
20 inserting “SPECIAL RULE FOR STATE, IN-  
21 DIAN TRIBAL, AND”.

22 (C) GOVERNMENT PICKUP CONTRIBU-  
23 TIONS.—Paragraph (2) of section 414(h) of  
24 such Code (relating to designation by units of  
25 government) is amended by striking “State or



1 political subdivision” and inserting “State, In-  
2 dian tribal government (as defined in section  
3 7701(a)(40)), or any political subdivision”.

4 (2) AMENDMENTS TO EMPLOYEE RETIREMENT  
5 INCOME SECURITY ACT OF 1974.—Section 4021(b) of  
6 the Employee Retirement Income Security Act of  
7 1974 (29 U.S.C. 1321(b)) is amended—

8 (A) in paragraph (12), by striking “or” at  
9 the end;

10 (B) in paragraph (13), by striking “plan.”  
11 and inserting “plan; or”; and

12 (C) by adding at the end the following:

13 “(14) established and maintained for its em-  
14 ployees by an Indian tribal government (as defined  
15 in section 7701(a)(40) of the Internal Revenue Code  
16 of 1986), a subdivision of an Indian tribal govern-  
17 ment (determined in accordance with section  
18 7871(d) of such Code), an agency or instrumentality  
19 of an Indian tribal government or subdivision there-  
20 of, or an entity established under Federal, State, or  
21 tribal law that is wholly owned or controlled by any  
22 of the foregoing.”.

23 (d) EFFECTIVE DATE.—The amendments made by  
24 this section shall apply to any year beginning before, on,  
25 or after the date of the enactment of this Act.

1 **SEC. 302. EXCESS CONTRIBUTIONS.**

2 (a) EXPANSION OF CORRECTIVE DISTRIBUTION PE-  
3 RIOD.—Subsection (f) of section 4979 of the Internal Rev-  
4 enue Code of 1986 is amended—

5 (1) by striking “2½ months” in paragraph (1)  
6 and inserting “6 months”, and

7 (2) by striking “2½ MONTHS” in the heading  
8 and inserting “6 MONTHS”.

9 (b) YEAR OF INCLUSION.—Paragraph (2) of section  
10 4979(f) of such Code is amended to read as follows:

11 “(2) YEAR OF INCLUSION.—Any amount dis-  
12 tributed as provided in paragraph (1) shall be treat-  
13 ed as earned and received by the recipient in the re-  
14 cipient’s taxable year in which such distributions  
15 were made.”.

16 (c) SIMPLIFICATION OF ALLOCABLE EARNINGS.—

17 (1) SECTION 4979.—Subsection (f) of section  
18 4979 of such Code is amended—

19 (A) by adding “through the end of the  
20 plan year for which the contribution was made”  
21 after “thereto” in paragraph (1), and

22 (B) by adding “through the end of the  
23 plan year for which the contributions were  
24 made” after “thereto” in paragraph (2)(B).

25 (2) SECTION 401(k) AND 401(m).—

1 (A) Clause (i) of section 401(k)(8)(A) is  
2 amended by adding “through the end of such  
3 year” after “such contributions”.

4 (B) Subparagraph (A) of section  
5 401(m)(6) of such Code is amended by adding  
6 “through the end of such year” after “to such  
7 contributions”.

8 (d) EFFECTIVE DATE.—The amendments made by  
9 this section shall apply to years beginning after December  
10 31, 2005.

11 **SEC. 303. FIDUCIARY RELIEF IN CONNECTION WITH**  
12 **CHANGE IN INVESTMENT OPTIONS.**

13 Section 404(c) of the Employee Retirement Income  
14 Security Act of 1974 (29 U.S.C. 1104(c)(1)), as amended  
15 by this Act, is amended by adding at the end the following  
16 new paragraph:

17 “(7) CHANGE IN INVESTMENT OPTIONS.—In  
18 the case of a change in the investment options under  
19 a plan, a participant or beneficiary shall be deemed  
20 to have exercised control over the assets in his or  
21 her account, if, after reasonable notice of the change  
22 in investment options is given to such participant or  
23 beneficiary, assets in the account of the participant  
24 or beneficiary—

1           “(A) are transferred to plan investment  
2 options in accordance with the affirmative elec-  
3 tion of the participant or beneficiary which oth-  
4 erwise meets the conditions of this subsection;  
5 or

6           “(B) in the absence of such an election  
7 and in the case in which fiduciary relief was  
8 provided under this subsection for prior invest-  
9 ment options, are transferred to plan invest-  
10 ment options with reasonably comparable risk  
11 and return characteristics, and in accordance  
12 with procedures set forth in such notice.”.

○