Plan Sponsor Voice
Nationwide Retirement Solutions
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Nationwide produces this publication to provide public defined contribution plan sponsors with information about federal legislative and regulatory activity that may be relevant to plan administration and/or design.

PLAN SPONSOR ALERT

A Special Edition of your Federal Legislative and Regulatory Report

January 31, 2005

Tax Proposals Seriously Impact Governmental Employee Benefit Plans

At the request of Senate Finance Chairman Charles Grassley and Ranking Member Max Baucus, the staff of the Joint Committee on Taxation prepared and released late last week its report entitled "Options to Improve Tax Compliance and Reform Tax Expenditures." This 400+ page report contains recommendations that would significantly affect individual taxpayers and employers. Many of the report's retirement proposals are clearly aimed at conforming 457 and 403(b) plans to the 401(k) model by eliminating many the features that now differentiate these plans. Many of the proposals are revenue raisers that are estimated to save the Federal government $164 billion over the next ten years. If adopted, these recommendations would affect:

Governmental Qualified Plans**—**Repeal of the current 414(h) pre-tax pick-up of employee contributions. Employee contributions to a State or local government plan designated as employee contributions would be treated as employee after tax contributions and would be includible in an employee's gross income and subject to FICA taxation. According to the report, the repeal of the pre-tax pick-up rules would eliminate the inequities in the tax system between governmental and private sector retirement plans.

457 Plans**—**Application of the 10% early distribution tax to governmental 457 plans for all distributions prior to age 59½. Currently governmental 457 plans are not subject to the 10% early distribution tax on distributions made prior to age 59½ unless the distribution is made from a separate rollover account that includes 401, 403(b) or IRA rollover amounts. This exception would be repealed and all distributions from 457 plans prior to age 59½ would be subject to this tax. The rationale, according to the report, is that because governmental 457 plans provide benefits that are similar to those under qualified retirement plans, the 457 plans should also be subject to the early distribution tax.

403(b) Plans**—**Repeal of the 403(b) long service catch-up provision. Certain long service employees, such as schoolteachers, who did not defer the full amount they could have in prior years, would no

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longer be permitted to make additional deferrals after 15 years of service with their employer. Other 403(b) proposals would:

- Repeal employer 403(b) post employment contributions. Currently 403(b) employers make may contributions for terminated employees based on assumed compensation after termination for up to five years after the employee has terminated employment.
- Repeal the universal availability requirement for making salary deferrals to a 403(b) plan. Non-governmental 403(b) plans would be subject to the Average Deferral Percentage (ADP) test that applies to private sector 401(k) plans.

Health and Welfare Plans**—**Subject amounts paid through a cafeteria plan to FICA taxes. Currently these amounts are not subject to FICA taxes. In addition to this proposal, the report recommends:

- Repeal of the provision that permits Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs), and Health Reimbursement Accounts (HRAs) to reimburse over- the-counter drugs used for medical care and treatment. Under this proposal, for example, only prescription drugs and insulin expenses would be reimbursable from an FSA account.
- Abolishment of employer sponsored Dependent Care Accounts. A non-refundable tax credit would be offered in place of these accounts.

Medicare Payroll Tax—Extends Medicare coverage on a mandatory basis to all employees of State and local governments, without regard to their dates of hire or participation in a retirement system.

Individual Taxpayers**—**Repeal of the deduction for interest paid on home equity loans.

The complete Committee report may be downloaded from**:** http://www.house.gov/jct/s-2-05.pdf

Nationwide is currently reviewing these proposals outlined in the Committee's report and will cover them in more detail in this month's Federal Legislative and Regulatory Report.

Keeping watch

Nationwide Retirement Solutions continues to monitor SEC and various attorneys-general investigations into mutual-fund trading practices and related issues. You can find the most recent information on these issues on the Employer page of your plan Web site. In addition, we report guidance on legislative and regulatory activity relevant to government sector defined contribution plans through *Plan Sponsor Voice* newsletter – distributed quarterly – next edition due in February 2005.

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