

UPDATE!

President Bush Makes Proposal to Replace 401(k) Plans!

In an attempt to simplify retirement savings vehicles, President Bush is proposing new types of accounts to save for retirement while eliminating 401(k), SIMPLE, SARSEP, 403(b) and non-governmental 457 plans. Although these proposed changes are a long way from being passed, the proposed changes are set to become effective by January 1, 2004.

We have a commitment to keep our clients and referral sources informed of any new legislation or **proposed** legislation that could affect saving for retirement. We also feel a commitment to share our views regarding these proposed changes. We will be providing communications regarding these proposed changes to our clients and referral sources in the near future. **MVP Plan Administrators, Inc.** plans to write to our local representatives, Senators and Representatives regarding our views on the impact these proposed changes have on retirement plans.

Below is an outline of the types of **Accounts**, proposed by President Bush, that the Treasury Department announced on January 31, 2003:

Employer Retirement Savings Account (ERSAs):

This type of account is being proposed in order to simplify employer sponsored retirement plans by consolidating 401(k), SIMPLE 401(k), 403(b), and 457 plans into a single type of Plan. The ERSA can be sponsored by any employer.

The proposal includes provisions that would "simplify" the administration of defined contribution plans, such as 401(k) Plans:

- There would be a single test to show that the plan meets the nondiscrimination rules with respect to ratio percentage coverage. Under this test, the percentage of non-highly compensated employees covered under the plan would have to be at least 70% of the percentage of highly compensated employees covered under the plan. All other coverage testing would be repealed.
- Permitted disparity and cross-testing would be prohibited for all defined contribution plans.
- Top heavy rules would be repealed for all defined contribution plans.
- A uniform definition of compensation for all purposes in defined contribution plans would be established. The definition would be W-2 wages plus the amount of ERSA deferrals.
- A simplified definition of highly compensated employee would be adopted. The definition proposed is any employee whose compensation in the prior year was above the Social Security wage base for that year would be considered highly compensated.

The following limitations would remain the same:

- Compensation \$200,000
- Annual Addition \$ 40,000
- Deferrals \$ 12,000 (to increase \$1,000 each year until 2006)
- "Catch-Up Contributions" \$ 2,000 (to increase \$1,000 each year until 2006)
- Employer Deductibility 25%

After-tax contributions to an ERSA would generally accrue earnings tax-free, similar to Roth IRAs and the proposed RSAs and LSAs. Currently, the earnings of after-tax contributions are taxable upon distribution.

Assistant Secretary Olson stated in the announcement, *“The overwhelming complexity of current rules imposes substantial burdens on employers and workers. Because employer sponsorship of retirement is voluntary, this complexity discourages many employers from offering any plan at all. This is especially true of small employers who together employ about 4 out of every 10 American workers. It’s one important reason why only 50% of working Americans have any pension plan at all. I’m confident that the simpler rules will encourage employers to create new plans for their employees because creating a qualified plan will be much easier”.*

According to the Treasury Department press release, the proposed legislations will reduce unnecessary complexity regarding testing requirements and will significantly reduce employer compliance costs. Additionally, the press release stated that coverage and participation will increase because firms that are currently not offering retirement plans, because of the compliance costs, will be more likely to offer the ERSA plans under the proposal.

MVP Plan Administrators, Inc. is concerned that this “simplified” plan would have the exact **OPPOSITE** affect on employer sponsored retirement plans than what is being described. For example, we administer a number of qualified retirement plans that use either **permitted disparity** or a **cross-testing method** of allocating profit sharing contributions in their plan. These types of methods essentially allow employers to provide a higher rate of benefit to employees whose compensation is generally higher than most in the company while providing a lower rate of benefit to all other eligible employees. Such as a cross-tested plan where the maximum contribution of \$40,000 may be provided to a highly compensated employee (typically the owner) and a 5% contribution of pay would be provided to all other employees. This type of allocation method allows the employer to provide a maximum benefit to himself for retirement while providing a 5% of pay benefit to all his employees. If the proposed ERSA is passed, this type of allocation would be prohibited. Therefore, in order for this employer to provide himself with the maximum benefit of \$40,000, he would have to provide all his employees with a contribution of 20% of their compensation! Most employers, *especially small employers*, would not be able to afford that type of benefit. The result: the employer would not provide **ANY** benefit to the employees!

MVP Plan Administrators, Inc. also does not believe that costs associated with compliance testing will be reduced as a result of the proposal. Yes, it is true that there are quite a few tests that need to be performed each year for a qualified retirement plan. However, these tests have already been dramatically simplified with the introduction of Safe Harbor contributions and gateway provisions for cross-tested plans. Safe harbor contributions provide relief from most discrimination testing for many retirement plans, such as automatically satisfying 401(k) and 401(m) testing and top heavy testing. If a plan sponsor is choosing a third party administrator (TPA) properly, they should not have increased costs due to compliance testing. **MVP Plan Administrators, Inc.** invoices our clients for services performed on an all inclusive fee schedule which alleviates the guess work in determining costs associated with their retirement plan. If these proposed changes are passed, it would not change the amount we currently bill for administrative services. The reason . . . we still have to perform testing; we still have to calculate employer contributions and forfeitures; we still have to inform participants of their benefits and rights; we still have to make distributions from the plan; we still have to keep the plan in compliance with all current legislation; and most importantly we still have to report all of this and more to the government each year!

Retirement Savings Accounts (RSAs):

RSAs could only be used for retirement savings. They would consolidate traditional IRAs and Roth IRAs by simplifying the very different rules regarding eligibility and tax treatment. The proposals would allow Americans to save up to \$7,500 (in addition to amounts contributed to LSAs) in a RSA. Like current law with Roth IRAs, contributions will not be deductible. However, the earnings accumulated and any distribution after age 58 would be tax free. Essentially, an RSA is similar to a Roth IRA. The proposal basically leaves Roth IRA’s “as is” with the exception of changing its name to a RSA. The proposal also states that existing traditional or nondeductible IRAs may be converted to RSAs, but are not required to convert. However, if they do not convert to an RSA, then no new contributions will be allowed (other than rollover contributions) to be

deposited into them. Lastly, the \$7,500 contribution limit will be indexed for inflation for future years.

Lifetime Savings Accounts (LSAs):

LSAs would replace MSAs (Medical Savings Account) and would allow Americans to save regardless of age or income and can be used for any type of saving, such as saving for your children's education, the purchase of a new home, healthcare needs, or to start your own business. The LSA would allow an individual to contribute \$7,500 each year and make penalty free withdrawals. The \$7,500 contribution limit will be indexed for inflation for future years. In addition, the contributions would not be deductible. However, the earnings accumulated would be tax free. Taxpayers would no longer be required to document qualified expenses, financial institutions would not need to explain complicated rules to participants, and the government would not need to verify the qualifying expense.

Overall, the changes proposed are good for plan sponsors and all Americans with the EXCEPTION of the elimination of cross testing and permitted disparity. The elimination of cross testing and permitted disparity would outweigh the benefits of ALL of these proposed changes.

MVP Plan Administrators, Inc. looks forward to hearing your thoughts. We will be providing communications regarding these proposed changes as well as our intentions of making certain that our concerns are voiced and heard. Please feel free to contact us at (866) 687-6877 with any concerns or questions you may have.