

109TH CONGRESS
2^D SESSION

S. 3951

To amend the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 to increase the retirement security of women and small business owners, and for other purposes.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 27, 2006

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

A BILL

To amend the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 to increase the retirement security of women and small business owners, 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; AMENDMENT OF 1986 CODE;**

4 **TABLE OF CONTENTS.**

5 (a) SHORT TITLE.—This Act may be cited as the
6 “Women’s Retirement Security Act of 2006”.

7 (b) AMENDMENT OF 1986 CODE.—Except as other-
8 wise expressly provided, whenever in this Act an amend-

1 ment or repeal is expressed in terms of an amendment
 2 to, or repeal of, a section or other provision, the reference
 3 shall be considered to be made to a section or other provi-
 4 sion of the Internal Revenue Code of 1986.

5 (c) TABLE OF CONTENTS.—The table of contents for
 6 this Act is as follows:

Sec. 1. Short title; amendment of 1986 Code; table of contents.

TITLE I—PROVISIONS TO INCREASE RETIREMENT SAVINGS

Subtitle A—Employee Access to Retirement Savings at Work

- Sec. 101. Employees not covered by qualified retirement plans or arrangements entitled to participate in payroll deposit IRA arrangements.
 Sec. 102. Credit for small employers maintaining payroll deposit IRA arrangements.
 Sec. 103. Establishment of automatic IRAs.
 Sec. 104. Establishment of TSP II Board.

Subtitle B—Other Provisions

- Sec. 111. Modifications to computation of saver's credit.
 Sec. 112. Qualified cash or deferred arrangements must allow long-term employees working more than 500 but less than 1,000 hours per year to participate.
 Sec. 113. Transfers of unused benefits of health flexible spending arrangement to certain retirement plans.
 Sec. 114. Computation of limits on IRA and Roth IRA contributions.
 Sec. 115. Contributions of military death gratuities to certain tax-favored accounts.

TITLE II—PROVISIONS PROVIDING FOR PRESERVATION OF INCOME

- Sec. 201. Exclusion of certain qualified annuity payments.
 Sec. 202. Exclusion for lifetime annuity payments.
 Sec. 203. Joint study of application of spousal consent rules to defined contribution plans.
 Sec. 204. Facilitating longevity insurance.

TITLE III—PROVISIONS ENSURING EQUITY IN DIVORCE

- Sec. 301. Elimination of current connection requirement under Railroad Retirement Act for certain survivors.
 Sec. 302. Permitting divorced spouses and widows and widowers to remarry after turning 60 without a penalty under Railroad Retirement Act.
 Sec. 303. Repeal of jurisdictional requirement for court to treat military retirement pay as property of the military member and spouse.

TITLE IV—PROVISIONS TO IMPROVE FINANCIAL LITERACY

Sec. 401. Grants to community-based taxpayer clinics to provide retirement savings advice.

Sec. 402. Treatment of qualified retirement planning services.

Sec. 403. Retirement handbook and retirement readiness checklist.

TITLE V—INCENTIVES FOR SMALL BUSINESSES TO ESTABLISH AND MAINTAIN RETIREMENT PLANS FOR EMPLOYEES

Sec. 501. Credit for qualified pension plan contributions of small employers.

Sec. 502. Deduction for pension contributions allowed in computing net earnings from self-employment.

Sec. 503. Exemption of deferral-only qualified cash or deferred arrangements from top-heavy plan rules.

Sec. 504. Extension of time for small pension plans to adopt required plan qualification amendments.

1 **TITLE I—PROVISIONS TO IN-**
 2 **CREASE RETIREMENT SAV-**
 3 **INGS**

4 **Subtitle A—Employee Access to**
 5 **Retirement Savings at Work**

6 **SEC. 101. EMPLOYEES NOT COVERED BY QUALIFIED RE-**
 7 **TIREMENT PLANS OR ARRANGEMENTS ENTI-**
 8 **TLED TO PARTICIPATE IN PAYROLL DEPOSIT**
 9 **IRA ARRANGEMENTS.**

10 (a) IN GENERAL.—Subpart A of part I of subchapter
 11 A of chapter 1 (relating to pension, profit-sharing, stock
 12 bonus plans, etc.) is amended by inserting after section
 13 408A the following new section:

14 **“SEC. 408B. RIGHT TO PAYROLL DEPOSIT IRA ARRANGE-**
 15 **MENTS AT WORK.**

16 “(a) REQUIREMENT TO PROVIDE PAYROLL DEPOSIT
 17 IRA ARRANGEMENT.—Each employer (other than an em-
 18 ployer described in subsection (e)) shall provide to each

1 applicable employee of the employer for any calendar year
2 the opportunity to participate in a payroll deposit IRA ar-
3 rangement which meets the requirements of this section.

4 “(b) PAYROLL DEPOSIT IRA ARRANGEMENT.—For
5 purposes of this section—

6 “(1) IN GENERAL.—The term ‘payroll deposit
7 IRA arrangement’ means a written arrangement of
8 an employer—

9 “(A) under which an applicable employee
10 eligible to participate in the arrangement may
11 elect to contribute to an individual retirement
12 plan established by or on behalf of the employee
13 by having the employer make periodic direct de-
14 posit or other payroll deposit payments (includ-
15 ing electronic payments) to the plan by payroll
16 deduction, and

17 “(B) which meets the requirements of
18 paragraph (2).

19 “(2) ADMINISTRATIVE REQUIREMENTS.—The
20 requirements of this paragraph are met with respect
21 to any payroll deposit IRA arrangement if—

22 “(A) the employer must make the pay-
23 ments elected under paragraph (1)(A) on or be-
24 fore the later of—

1 “(i) the due date for the deposit of
2 tax required to be deducted and withheld
3 under chapter 24 (relating to collection of
4 income tax at source on wages) for the
5 payroll period to which such payments re-
6 late, or

7 “(ii) the 30th day following the last
8 day of the month with respect to which the
9 payments are to be made,

10 “(B) subject to a requirement for reason-
11 able notice, an employee may elect to terminate
12 participation in the arrangement at any time
13 during a calendar year, except that if an em-
14 ployee so terminates, the arrangement may pro-
15 vide that the employee may not elect to resume
16 participation until the beginning of the next cal-
17 endar year,

18 “(C) each employee eligible to participate
19 may elect, during the 60-day period or other pe-
20 riod specified by the Secretary before the begin-
21 ning of any calendar year (and during the 60-
22 day period or other period specified by the Sec-
23 retary before the first day the employee is eligi-
24 ble to participate), to participate in the ar-
25 rangement, or to modify the employee’s election

1 under the arrangement (including the amounts
2 subject to the arrangement and the manner in
3 which such amounts are invested), for such
4 year,

5 “(D) the employer provides—

6 “(i) immediately before the beginning
7 of each period described in subparagraph
8 (C), a notice to each employee of the em-
9 ployee’s opportunity to make the election
10 and the maximum amount which may be
11 contributed to an individual retirement
12 plan on an annual basis, and

13 “(ii) if the arrangement includes an
14 automatic contribution arrangement, the
15 notices required under subsection (g) with
16 respect to the automatic contribution ar-
17 rangement,

18 “(E) subject to subsection (f), the arrange-
19 ment provides that an employee may elect to
20 have contributions made to any individual re-
21 tirement plan specified by the employee, and

22 “(F) if the arrangement does not include
23 an automatic contribution arrangement—

24 “(i) the arrangement requires the em-
25 ployer to take all reasonable actions to so-

1 licit from all employees eligible to partici-
2 pate in the arrangement an explicit elec-
3 tion to either participate or not to partici-
4 pate in the arrangement, and

5 “(ii) the arrangement provides that if
6 an employee fails to make an explicit elec-
7 tion under clause (i) within the time pre-
8 scribed under the arrangement, the em-
9 ployee will be treated as having made an
10 election to participate in the arrangement
11 (and amounts shall be invested on behalf
12 of the participant) in the same manner as
13 if the arrangement had included an auto-
14 matic contribution arrangement under sub-
15 section (g).

16 “(c) APPLICABLE EMPLOYEE DEFINED; RELATED
17 DEFINITIONS AND RULES.—For purposes of this sec-
18 tion—

19 “(1) APPLICABLE EMPLOYEE.—

20 “(A) IN GENERAL.—The term ‘applicable
21 employee’ means, with respect to any calendar
22 year, any employee—

23 “(i) who was not eligible under a
24 qualified plan or arrangement maintained

1 by the employer for service for the pre-
2 ceding calendar year, and

3 “(ii) with respect to whom it is rea-
4 sonable to expect that the employee will
5 not be eligible during the calendar year
6 under such a qualified plan or arrange-
7 ment.

8 “(B) SPECIAL RULES.—For purposes of
9 subparagraph (A)(i)—

10 “(i) ELIGIBILITY.—An employee shall
11 be treated as eligible under a plan for a
12 preceding calendar year if, as of the last
13 day of the last plan year ending in the pre-
14 ceding calendar year, the employee has sat-
15 isfied the plan’s eligibility requirements.

16 “(ii) EXCLUDED PLANS.—A qualified
17 plan or arrangement shall not be taken
18 into account under this paragraph if—

19 “(I) the plan or arrangement is
20 frozen as of the first day of the pre-
21 ceding calendar year, or

22 “(II) in the case of a plan or ar-
23 rangement under which the only con-
24 tributions are discretionary on the
25 part of the sponsor, there has not

1 been an employer contribution made
2 to the plan or arrangement for the 2-
3 plan-year period ending with the last
4 plan year ending in the second pre-
5 ceding calendar year and it is not rea-
6 sonable to assume that an employer
7 contribution will be made for the plan
8 year ending in the preceding calendar
9 year.

10 “(2) EXCLUDABLE EMPLOYEES.—An employer
11 may elect to exclude from treatment as applicable
12 employees under subparagraph (A)—

13 “(A) employees described in section
14 410(b)(3),

15 “(B) employees who have not attained the
16 age of 18 before the beginning of the calendar
17 year,

18 “(C) employees who have not completed at
19 least 3 months of service with the employer,

20 “(D) employees who will be eligible to par-
21 ticipate in a qualified plan or arrangement of
22 the employer upon completion of eligibility re-
23 quirements described in section 410(a)(1)(A)
24 (without regard to section 410(a)(1)(B)),

1 “(E) employees who are eligible to make
2 salary reduction contributions under an ar-
3 rangement which meets the requirements of
4 section 403(b), and

5 “(F) all employees of the employer if the
6 employer maintains an arrangement described
7 in section 408(p).

8 “(3) QUALIFIED PLAN OR ARRANGEMENT.—
9 The term ‘qualified plan or arrangement’ means a
10 plan, contract, pension, or trust described in section
11 219(g)(5).

12 “(4) EXCEPTION FOR EMPLOYEES OF GOVERN-
13 MENTS AND CHURCHES.—The term ‘applicable em-
14 ployee’ shall not include an employee of—

15 “(A) a government or entity described in
16 section 414(d), or

17 “(B) a church or a convention or associa-
18 tion of churches which is exempt from tax
19 under section 501, including any employee de-
20 scribed in section 414(e)(3)(B).

21 “(5) DESIGNATION OF APPLICABLE EMPLOY-
22 EES.—The Secretary shall issue guidelines for deter-
23 mining the class or classes of employees to be cov-
24 ered by a payroll deposit IRA arrangement. Such
25 guidelines shall provide that if an employer elects

1 under paragraph (2) to exclude employees from the
2 arrangement, the employer shall specify the classi-
3 fication or categories of employees who are not so
4 covered.

5 “(d) PAYROLL DEPOSIT IRA CONTRIBUTIONS
6 TREATED LIKE OTHER CONTRIBUTIONS TO INDIVIDUAL
7 RETIREMENT PLANS.—

8 “(1) TAX TREATMENT UNAFFECTED.—The fact
9 that a contribution to an individual retirement plan
10 is made on behalf of an employee under a payroll de-
11 posit IRA arrangement instead of being made di-
12 rectly by the employee shall not affect the deduct-
13 ibility or other tax treatment of the contribution or
14 of other amounts under this title.

15 “(2) PAYROLL SAVINGS CONTRIBUTIONS TAKEN
16 INTO ACCOUNT.—Any contribution made on behalf
17 of an employee under a payroll deposit IRA arrange-
18 ment shall be taken into account in applying the lim-
19 itations on contributions to individual retirement
20 plans and the other provisions of this title applicable
21 to individual retirement plans as if the contribution
22 had been made directly by the employee.

23 “(e) EXCEPTION FOR CERTAIN SMALL AND NEW
24 EMPLOYERS.—

1 “(1) IN GENERAL.—The requirements of this
2 section shall not apply for any calendar year to an
3 employer if—

4 “(A) the employer did not have more than
5 10 employees who received at least \$5,000 of
6 compensation from the employer for the pre-
7 ceding calendar year, or

8 “(B) was not in existence at all times dur-
9 ing the 2 preceding calendar years and did not
10 have more than 100 employees who received at
11 least \$5,000 of compensation from the employer
12 on any day during either of the 2 preceding cal-
13 endar years.

14 “(2) OPERATING RULES.—In determining the
15 number of employees for purposes of this sub-
16 section—

17 “(A) any rule applicable in determining the
18 number of employees for purposes of section
19 408(p)(2)(C) shall be applicable under this sub-
20 section,

21 “(B) all members of the same family
22 (within the meaning of section 318(a)(1)) shall
23 be treated as 1 individual, and

24 “(C) any reference to an employer shall in-
25 clude a reference to any predecessor employer.

1 “(f) DEPOSITS TO INDIVIDUAL RETIREMENT PLANS
2 OTHER THAN THOSE SELECTED BY EMPLOYEE.—

3 “(1) IN GENERAL.—An employer shall not be
4 treated as failing to satisfy the requirements of this
5 section or any other provision of this title merely be-
6 cause the employer makes all contributions (or all
7 contributions on behalf of employees who do not
8 specify an individual retirement plan, trustee, or
9 issuer to receive the contributions) to—

10 “(A) individual retirement plans specified
11 in paragraph (2), or

12 “(B) individual retirement plans under the
13 payroll tax deposit system established under
14 paragraph (3).

15 “(2) PLANS OF A DESIGNATED TRUSTEE OR
16 ISSUER.—An employer may elect to have contribu-
17 tions for all applicable employees participating in a
18 payroll deposit IRA arrangement made to individual
19 retirement plans of a designated trustee or issuer
20 under the arrangement. The preceding sentence
21 shall not apply unless each participant is notified in
22 writing that the participant’s balance may be trans-
23 ferred without cost or penalty to another individual
24 retirement plan established by or on behalf of the
25 participant.

1 “(3) PAYROLL TAX DEPOSIT SYSTEM.—The
2 Secretary, in consultation with the TSP II Board,
3 shall establish a system under which an employer—

4 “(A) includes with each deposit of tax re-
5 quired to be deducted and withheld under chap-
6 ter 24 the aggregate amounts, for the period
7 covered by the deposit, which applicable employ-
8 ees designated under subsection (b)(1)(A) (or
9 are deemed to have designated under subsection
10 (b)(2)(F)(ii) or under an automatic contribu-
11 tion arrangement described in subsection (g))
12 for contribution to individual retirement plans,
13 established on behalf of the employees under
14 paragraph (4), and

15 “(B) specifies, in such manner as the Sec-
16 retary may prescribe, for each applicable em-
17 ployee for whom a contribution is to be made
18 the following information:

19 “(i) The employee’s name and TIN.

20 “(ii) The amount of the contribution.

21 “(iii) The investment options selected
22 by the employee (or deemed to have been
23 selected by the employee under such auto-
24 matic contribution arrangement) and the

1 amount of the contribution allocated to
2 each option.

3 “(4) ESTABLISHMENT AND MAINTENANCE OF
4 ACCOUNTS UNDER PAYROLL TAX DEPOSIT SYS-
5 TEM.—

6 “(A) IN GENERAL.—Subject to the provi-
7 sions of this section and section 408C, the TSP
8 II Board shall provide for the establishment
9 and maintenance of individual retirement plans
10 (including automatic IRAs) into which contribu-
11 tions may be deposited through the payroll tax
12 deposit system. To the maximum extent prac-
13 ticable, the TSP II Board shall—

14 “(i) enter into contracts with persons
15 eligible to be trustees of individual retire-
16 ment plans under section 408 to establish
17 such plans, to provide the investment
18 funds and investment management, and to
19 provide notice, record keeping, and other
20 administrative services, and

21 “(ii) ensure that the costs of invest-
22 ment management and administration are
23 kept to a minimum, including through con-
24 sideration of the use of investments which
25 involve passive management and which

1 seek to replicate the performance of a por-
2 tion of the market.

3 “(B) PAYROLL DEPOSIT FEATURES.—The
4 TSP II Board shall establish procedures so that
5 contributions may be made to individual retire-
6 ment plans (including automatic IRAs) through
7 the payroll tax deposit system described in
8 paragraph (3) without undue administrative or
9 paperwork requirements on employers partici-
10 pating in the payroll tax deposit system. Such
11 procedures shall ensure that only 1 such plan
12 may be established for each TIN.

13 “(C) LIMITATION ON ROLLOVERS TO
14 PLANS OUTSIDE THE SYSTEM.—If—

15 “(i) any amount is paid or distributed
16 out of an individual retirement plan estab-
17 lished under this paragraph, and

18 “(ii) such amount is paid into an indi-
19 vidual retirement plan established outside
20 of the payroll tax deposit system,

21 the payment described in clause (ii) shall be
22 treated as a rollover contribution for purposes
23 of section 408(d)(3) if and only if the balance
24 to the credit of the individual in such individual
25 retirement plan or arrangement immediately be-

1 fore the payment described in clause (i) was at
2 least \$15,000.

3 “(g) COORDINATION WITH AUTOMATIC ENROLL-
4 MENT AND OTHER DEFAULT ELECTION PROVISIONS.—

5 “(1) IN GENERAL.—A payroll deposit IRA ar-
6 rangement may provide that contributions under the
7 arrangement will be made pursuant to an automatic
8 contribution arrangement but only if the arrange-
9 ment meets requirements similar to the require-
10 ments applicable to an eligible automatic contribu-
11 tion arrangement under section 414(w). The Sec-
12 retary shall modify such requirements to the extent
13 necessary to carry out the purposes of this section.

14 “(2) DEFAULT INVESTMENTS.—If an employee
15 is deemed under an automatic contribution arrange-
16 ment to have made an election to participate in a
17 payroll deposit IRA arrangement—

18 “(A) the employee shall be deemed to have
19 made an election to make contributions in the
20 amount specified in paragraph (3),

21 “(B) such contributions shall be trans-
22 ferred to—

23 “(i) an automatic IRA, or,

24 “(ii) if the employer has made an elec-
25 tion under subsection (f)(2), to an indi-

1 vidual retirement plan of the designated
2 trustee or issuer but only if the require-
3 ments of subparagraph (C) are met with
4 respect to such individual retirement plan,
5 and

6 “(C) such contributions shall be invested
7 as provided in paragraph (4).

8 “(3) AMOUNT OF CONTRIBUTIONS.—

9 “(A) IN GENERAL.—The amount specified
10 in this paragraph is 3 percent of compensation.

11 “(B) AUTHORITY OF BOARD TO PROVIDE
12 FOR ANNUAL INCREASES.—The TSP II Board
13 may by regulation provide for annual increases
14 in the percentage of compensation an employee
15 is deemed to have elected under paragraph (2)
16 but in no event shall the percentage of com-
17 pensation an employee is deemed to have elect-
18 ed exceed 8 percent.

19 “(C) CONTRIBUTION LIMIT.—The con-
20 tributions under paragraph (2) on behalf of an
21 employee for any calendar year shall not exceed
22 the dollar limits applicable to the employee for
23 the calendar year under section 219 or 408A.

24 “(4) INVESTMENT IN LIFE CYCLE FUND OR
25 OTHER INVESTMENTS SPECIFIED BY THE BOARD.—

1 Amounts contributed under paragraph (2) shall be
2 invested in—

3 “(A) a life cycle fund similar to the life
4 cycle funds offered under the Thrift Savings
5 Fund established under subchapter III of chap-
6 ter 84 of title 5, United States Code, or

7 “(B) such other investment or investments
8 as the TSP II Board specifies in regulations
9 and which entails asset allocation and extensive
10 diversification.

11 A fund or investment shall meet the requirements of
12 this paragraph only if it is consistent with regula-
13 tions prescribed by the Secretary of Labor under
14 section 404(c)(5) of the Employee Retirement In-
15 come Security Act of 1974.

16 “(5) COORDINATION WITH WITHHOLDING.—
17 The Secretary shall modify the withholding exemp-
18 tion certificate under section 3402(f) so that any no-
19 tice and election requirements with respect to an
20 automatic contribution arrangement which is part of
21 a payroll deposit IRA arrangement may be met
22 through the use of such certificate.

23 “(h) MODEL NOTICE.—The Secretary, in consulta-
24 tion with the TSP II Board, shall—

1 “(1) provide a model notice, written in a man-
2 ner calculated to be understandable to the average
3 worker, that is simple for employers to use—

4 “(A) to notify employees of the require-
5 ment under this section for the employer to pro-
6 vide certain employees with the opportunity to
7 participate in a payroll deposit IRA arrange-
8 ment, and

9 “(B) to satisfy the requirements of sub-
10 section (b)(2)(D).

11 “(2) provide uniform forms for enrollment, in-
12 cluding automatic enrollment, in a payroll deposit
13 IRA arrangement, and

14 “(3) establish a web site or other electronic
15 means for small employers to access and use to ob-
16 tain information on payroll deposit IRA arrange-
17 ments and to obtain required notices and forms.”.

18 (b) PREEMPTION OF CONFLICTING STATE LAWS.—

19 Section 514(e)(1) of the Employee Retirement Income Se-
20 curity Act of 1974 (29 U.S.C. 1144(e)(1)), as added by
21 section 902 of the Pension Protection Act of 2006, is
22 amended to read as follows:

23 “(1) IN GENERAL.—Notwithstanding any other
24 provision of this section, this title shall supersede

1 any law of a State which would directly or indirectly
2 prohibit or restrict—

3 “(A) the inclusion in any plan of an auto-
4 matic contribution arrangement, or

5 “(B) the establishment or operation of a
6 deposit IRA arrangement meeting the require-
7 ments of section 408B of the Internal Revenue
8 Code of 1986 (and the inclusion in such ar-
9 rangement of an automatic contribution ar-
10 rangement).

11 The Secretary may prescribe regulations which
12 would establish minimum standards that an auto-
13 matic contribution arrangement would be required to
14 satisfy in order for this subsection to apply in the
15 case of such arrangement. This subsection shall
16 apply to a plan or arrangement without regard to
17 whether this title applies to such plan or arrange-
18 ment.”.

19 (c) NOTICE OF AVAILABILITY OF INVESTMENT
20 GUIDELINES.—Section 408(i) (relating to reports) is
21 amended by adding at the end the following new sentence:
22 “Any report furnished under paragraph (2) to an indi-
23 vidual shall include notice of the availability of, and meth-
24 ods of acquiring, the basic investment guidelines prepared
25 by the Secretary of Labor.”.

1 (d) DEVELOPMENT OF BASIC INVESTMENT GUIDE-
2 LINES.—

3 (1) IN GENERAL.—The Secretary of Labor
4 shall, in consultation with the Secretary of Treasury,
5 develop and publish basic guidelines for investing for
6 retirement. Except as otherwise provided by the Sec-
7 retary of Labor, such guidelines shall include—

8 (A) information on the benefits of diver-
9 sification,

10 (B) information on the essential dif-
11 ferences, in terms of risk and return, between
12 various pension plan investments, including
13 stocks, bonds, mutual funds, and money market
14 investments,

15 (C) information on how an individual's
16 pension plan investment allocations may differ
17 depending on the individual's age and years to
18 retirement and on other factors determined by
19 the Secretary of Labor,

20 (D) sources of information where individ-
21 uals may learn more about pension rights, indi-
22 vidual investing, and investment advice, and

23 (E) such other information related to indi-
24 vidual investing as the Secretary of Labor de-
25 termines appropriate.

1 (2) CALCULATION INFORMATION.—The guide-
2 lines under paragraph (1) shall include addresses for
3 Internet sites and worksheets which a participant or
4 beneficiary in a pension plan may use to calculate—

5 (A) the retirement age value of the partici-
6 pant's or beneficiary's nonforfeitable pension
7 benefits under the plan (expressed as an annu-
8 ity amount and determined by reference to var-
9 ied historical annual rates of return and annu-
10 ity interest rates), and

11 (B) other important amounts relating to
12 retirement savings, including the amount which
13 a participant or beneficiary would be required
14 to save annually to provide a retirement income
15 equal to various percentages of their current
16 salary (adjusted for expected growth prior to
17 retirement).

18 (3) PUBLIC COMMENT.—The Secretary of
19 Labor shall provide at least 90 days for public com-
20 ment on proposed guidelines before publishing the
21 final guidelines.

22 (4) RULES RELATING TO GUIDELINES.—The
23 guidelines under paragraph (1)—

1 (A) shall be written in a manner calculated
 2 to be understood by the average plan partici-
 3 pant, and

4 (B) may be delivered in written, electronic,
 5 or other appropriate manner to the extent such
 6 manner would ensure that the guidelines are
 7 reasonably accessible to participants and bene-
 8 ficiaries.

9 (e) PENALTY FOR FAILURE TO PROVIDE ACCESS TO
 10 PAYROLL SAVINGS ARRANGEMENTS.—Chapter 43 (relat-
 11 ing to qualified pension, etc., plans) is amended by adding
 12 at the end the following new section:

13 **“SEC. 4980H. REQUIREMENTS FOR EMPLOYERS TO PRO-**
 14 **VIDE EMPLOYEES ACCESS TO PAYROLL DE-**
 15 **POSIT IRA ARRANGEMENTS.**

16 “(a) GENERAL RULE.—There is hereby imposed a
 17 tax on any failure by an employer to meet the require-
 18 ments of subsection (d) for a calendar year.

19 “(b) AMOUNT.—

20 “(1) IN GENERAL.—The amount of the tax im-
 21 posed by subsection (a) on any failure for any cal-
 22 endar year shall be \$100 with respect to each em-
 23 ployee to whom such failure relates.

24 “(2) TAX NOT TO APPLY WHERE FAILURE NOT
 25 DISCOVERED AND REASONABLE DILIGENCE EXER-

1 CISED.—No tax shall be imposed by subsection (a)
2 on any failure during any period for which it is es-
3 tablished to the satisfaction of the Secretary that the
4 employer subject to liability for the tax did not know
5 that the failure existed and exercised reasonable dili-
6 gence to meet the requirements of subsection (d). In
7 no event shall the tax be imposed with respect to
8 any failure that ends before the expiration of 90
9 days after the employer has responded or has had a
10 reasonable opportunity to respond to a request for
11 confirmation of compliance under subsection (c).

12 “(3) TAX NOT TO APPLY TO FAILURES COR-
13 RECTED WITHIN 30 DAYS.—No tax shall be imposed
14 by subsection (a) on any failure if—

15 “(A) the employer subject to liability for
16 the tax under subsection (a) exercised reason-
17 able diligence to meet the requirements of sub-
18 section (d), and

19 “(B) the employer provides the payroll de-
20 posit IRA arrangement described in section
21 408B to each employee eligible to participate in
22 the arrangement by the end of the 30-day pe-
23 riod beginning on the first date the employer
24 knew, or exercising reasonable diligence would
25 have known, that such failure existed.

1 “(4) WAIVER BY SECRETARY.—In the case of a
2 failure which is due to reasonable cause and not to
3 willful neglect, the Secretary may waive part or all
4 of the tax imposed by subsection (a) to the extent
5 that the payment of such tax would be excessive or
6 otherwise inequitable relative to the failure involved.

7 “(c) PROCEDURES FOR NOTICE.—Not later than 6
8 months after the date of the enactment of this section,
9 the Secretary shall prescribe and implement procedures
10 for obtaining from employers confirmation that such em-
11 ployers are in compliance with the requirements of sub-
12 section (d). The Secretary, in the Secretary’s discretion,
13 may prescribe that the confirmation shall be obtained on
14 an annual or less frequent basis, and may use for this
15 purpose the annual report or quarterly report for employ-
16 ment taxes, or such other means as the Secretary may
17 deem advisable.

18 “(d) REQUIREMENT TO PROVIDE EMPLOYEE ACCESS
19 TO PAYROLL DEPOSIT IRA ARRANGEMENTS.—The re-
20 quirements of this subsection are met if the employer
21 meets the requirements of section 408B.”.

22 “(f) COORDINATION WITH ERISA FIDUCIARY DU-
23 TIES.—Section 404(c)(2) of such Act (29 U.S.C.
24 1104(c)(2)) is amended—

1 (1) by inserting “or an individual retirement
2 plan designated by the employer under section 408B
3 of such Code” after “1986”,

4 (2) by inserting “(7 days after notice has been
5 given to an employee that an individual retirement
6 plan has been established on behalf of the employee
7 under section 408B of such Code)” after “estab-
8 lished” in subparagraph (C), and

9 (3) by inserting “or with respect to an indi-
10 vidual retirement plan designated by an employer
11 under section 408B of such Code” after “arrange-
12 ment” in the last sentence.

13 (g) CONFORMING AMENDMENTS.—

14 (1) The table of sections for subpart A of part
15 I of subchapter A of chapter 1 is amended by insert-
16 ing after the item relating to section 408A the fol-
17 lowing new item:

“Sec. 408B. Right to payroll deposit IRA arrangements at work.”.

18 (2) The table of sections for chapter 43 is
19 amended by adding at the end the following new
20 item:

“Sec. 4980H. Requirements for employers to provide employees access to pay-
roll deposit IRA arrangements.”.

21 (h) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to calendar years beginning after
23 December 31, 2007.

1 **SEC. 102. CREDIT FOR SMALL EMPLOYERS MAINTAINING**
 2 **PAYROLL DEPOSIT IRA ARRANGEMENTS.**

3 (a) IN GENERAL.—Subpart D of part IV of sub-
 4 chapter A of chapter 1 (relating to business related cred-
 5 its) is amended by adding at the end the following new
 6 section:

7 **“SEC. 45N. SMALL EMPLOYER PAYROLL DEPOSIT IRA AR-**
 8 **RANGEMENT COSTS.**

9 “(a) GENERAL RULE.—For purposes of section 38,
 10 in the case of an eligible employer maintaining a payroll
 11 deposit IRA arrangement meeting the requirements of sec-
 12 tion 408B (without regard to whether or not the employer
 13 is required to maintain the arrangement), the small em-
 14 ployer payroll deposit IRA arrangement cost credit deter-
 15 mined under this section for any taxable year is the
 16 amount determined under subsection (b).

17 “(b) AMOUNT OF CREDIT.—

18 “(1) IN GENERAL.—The amount of the credit
 19 determined under this section for any taxable year
 20 with respect to an eligible employer shall be equal to
 21 the lesser of—

22 “(A) \$25 multiplied by the number of ap-
 23 plicable employees (within the meaning of sec-
 24 tion 408B(c)) for whom contributions are made
 25 under the payroll deposit IRA arrangement re-

1 ferred to in subsection (a) for the calendar year
2 in which the taxable year begins, or

3 “(B) \$250.

4 “(2) DURATION OF CREDIT.—No credit shall be
5 determined under this section for any taxable year
6 other than a taxable year which begins in the first
7 2 calendar years in which the eligible employer
8 maintains a payroll deposit IRA arrangement meet-
9 ing the requirements of section 408B.

10 “(3) COORDINATION WITH SMALL EMPLOYER
11 STARTUP CREDIT.—No credit shall be allowed under
12 this section for any taxable year if a credit is deter-
13 mined under section 45E for the taxable year.

14 “(c) ELIGIBLE EMPLOYER.—For purposes of this
15 section, the term ‘eligible employer’ means, with respect
16 to any calendar year in which the taxable year begins, an
17 employer which maintains a payroll deposit IRA arrange-
18 ment meeting the requirements of section 408B and
19 which, on each day during the preceding calendar year,
20 had no more than 100 employees.”.

21 (b) CREDIT ALLOWED AS PART OF GENERAL BUSI-
22 NESS CREDIT.—Section 38(b) (defining current year busi-
23 ness credit) is amended by striking “and” at the end of
24 paragraph (29), by striking the period at the end of para-

1 graph (30) and inserting “, and”, and by adding at the
2 end the following new paragraph:

3 “(31) in the case of an eligible employer (as de-
4 fined in section 45N(c)) maintaining a payroll de-
5 posit IRA arrangement meeting the requirements of
6 section 408B, the small employer payroll deposit
7 IRA arrangement cost credit determined under sec-
8 tion 45N(a).”.

9 (c) CLERICAL AMENDMENT.—The table of sections
10 for subpart D of part IV of subchapter A of chapter 1
11 is amended by adding at the end the following new item:

“Sec. 45N. Small employer payroll deposit IRA arrangement costs.”.

12 (d) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years beginning after
14 December 31, 2007.

15 **SEC. 103. ESTABLISHMENT OF AUTOMATIC IRAS.**

16 (a) IN GENERAL.—Subpart A of part I of subchapter
17 A of chapter 1 (relating to pension, profit-sharing, stock
18 bonus plans, etc.), as amended by section 101, is amended
19 by inserting after section 408B the following new section:

20 **“SEC. 408C. AUTOMATIC IRAS.**

21 “(a) GENERAL RULE.—An automatic IRA shall be
22 treated for purposes of this title in the same manner as
23 an individual retirement plan. An automatic IRA may also
24 be treated as a Roth IRA for purposes of this title if it
25 meets the requirements of section 408A.

1 “(b) AUTOMATIC IRA.—For purposes of this section,
2 the term ‘automatic IRA’ means an individual retirement
3 plan (as defined in section 7701(a)(37)) which meets the
4 investment and fee requirements under the regulations
5 under subsection (c).

6 “(c) INVESTMENT AND FEE REQUIREMENTS.—

7 “(1) IN GENERAL.—The TSP II Board, in con-
8 sultation with the Secretary and the Secretary of
9 Labor, shall, not later than 1 year after the date of
10 the enactment of this section, prescribe regulations
11 which set forth the requirements of this subsection
12 which an individual retirement plan must meet in
13 order to be treated as an automatic IRA.

14 “(2) INVESTMENT OPTIONS.—The regulations
15 under paragraph (1) shall provide that an automatic
16 IRA shall allow the individual on whose behalf the
17 individual retirement plan is established to invest
18 contributions to, and earnings of, the plan in all of
19 the following investment options:

20 “(A) Options which are similar to all in-
21 vestment options which are available (at the
22 time the plan is established) to a participant in
23 the Thrift Savings Fund established under sub-
24 chapter III of chapter 84 of title 5, United
25 States Code.

1 “(B) Any other investment option specified
2 in the regulations.

3 Such regulations shall specify which of the invest-
4 ment options shall be treated as default investment
5 options for purposes of section 408B(g)(4).

6 “(3) INVESTMENT FEES.—

7 “(A) IN GENERAL.—The regulations under
8 paragraph (1) shall provide that an automatic
9 IRA shall not charge any investment fees
10 which, in the aggregate, are not reasonable (as
11 determined under such regulations).

12 “(B) INVESTMENT FEES.—For purposes of
13 this paragraph, the term ‘investment fees’ in-
14 cludes any fee, commission, asset management
15 fee, compensation for services, or any other
16 charge or fee specified in the regulations under
17 paragraph (1) which is imposed with respect to
18 the automatic IRA.”.

19 (b) MANDATORY TRANSFERS.—Section
20 401(a)(31)(B) is amended—

21 (1) by inserting “(including an automatic
22 IRA)” after “individual retirement plan” each place
23 it appears, and

24 (2) by adding at the end the following new sen-
25 tence: “Any amount so transferred (and any earn-

1 ings thereon) shall be invested in a default invest-
 2 ment described in section 408B(g)(4).”.

3 (c) CLERICAL AMENDMENT.—The table of sections
 4 for subpart A of part I of subchapter A of chapter 1 is
 5 amended by inserting after the item relating to section
 6 408B the following new item:

“Sec. 408C. Automatic IRAs.”.

7 (d) EFFECTIVE DATE.—The amendments made by
 8 this section shall apply to calendar years beginning on or
 9 after the date on which proposed and temporary or final
 10 regulations described in section 408C(c) of the Internal
 11 Revenue Code of 1986 (as added by this Act) are issued.

12 **SEC. 104. ESTABLISHMENT OF TSP II BOARD.**

13 (a) ESTABLISHMENT.—There is established in the ex-
 14 ecutive branch of the Government a TSP II Board. The
 15 board shall be established and maintained in the same
 16 manner as the Federal Retirement Thrift Investment
 17 Board under subchapter VII of chapter 84 of title 5,
 18 United States Code.

19 (b) EXECUTIVE DIRECTOR.—The TSP II Board shall
 20 appoint an Executive Director in a similar manner and
 21 with similar functions as the Executive Director of the
 22 Federal Retirement Thrift Investment Board under sec-
 23 tion 8474 of title 5, United States Code.

24 (c) DUTIES OF BOARD.—The TSP II Board shall es-
 25 tablish policies and procedures for—

1 (1) establishment and maintenance of individual
2 retirement plans under the payroll tax deposit sys-
3 tem established under section 408B(f)(3) of the In-
4 ternal Revenue Code of 1986,

5 (2) the investment and management of con-
6 tributions to such individual retirement plans,

7 (3) the amount of contributions, and the invest-
8 ment of such contributions, under automatic con-
9 tribution arrangements under section 408B(g) of
10 such Code, including the designation of investment
11 funds in which such contributions may be invested,
12 and

13 (4) the establishment of automatic IRAs under
14 section 408C of such Code, including the issuance of
15 regulations under subsection (c) of such section.

16 (d) BEST PRACTICES.—The TSP II Board shall, on
17 a continual basis, prescribe and encourage best practices
18 (including cost efficiencies and innovations) in enrollment,
19 investment, distribution, and other procedures or arrange-
20 ments relating to retirement savings and investment. In
21 carrying out its responsibilities under this section, the
22 TSP II Board may implement (by contract or otherwise)
23 pilot projects to help assess the efficacy and workability
24 of specific practices and arrangements.

1 (e) EXPANSION OF USE OF IRAS BY SELF-EM-
2 PLOYED AND OTHER INDIVIDUALS.—The TSP II Board
3 shall establish procedures to disseminate information
4 (through use of the Internet and other appropriate means)
5 to—

6 (1) facilitate and encourage the use by self-em-
7 ployed and other individuals of automatic debit and
8 similar arrangements for investment in individual re-
9 tirement plans, including automatic IRAs,

10 (2) facilitate and encourage efforts by voluntary
11 associations to promote savings in individual retire-
12 ment plans, including automatic IRAs, by their
13 members and others, and

14 (3) facilitate and encourage the direct deposit
15 of Federal and State income tax refunds in indi-
16 vidual retirement plans, including automatic IRAs.

17 (f) EXCLUSIVE INTEREST.—The members of the
18 TSP II Board shall discharge their responsibilities solely
19 in the interest of participants and beneficiaries under the
20 payroll tax deposit system established under section 408B
21 of the Internal Revenue Code of 1986.

22 (g) OTHER PROVISIONS MADE APPLICABLE.—The
23 provisions of subsections (f)(3), (g), (i), and (j) of section
24 8472 of title 5, United States Code, shall apply to the
25 TSP II Board.

1 **Subtitle B—Other Provisions**

2 **SEC. 111. MODIFICATIONS TO COMPUTATION OF SAVER'S**
3 **CREDIT.**

4 (a) **IN GENERAL.**—Section 25B(b) (defining applica-
5 ble percentage), as amended by section 833 of the Pension
6 Protection Act of 2006, is amended to read as follows:

7 “(b) **APPLICABLE PERCENTAGE.**—For purposes of
8 this section—

9 “(1) **IN GENERAL.**—The applicable percentage
10 is—

11 “(A) if the taxpayer’s adjusted gross in-
12 come does not exceed the first threshold
13 amount plus \$5,000, 50 percent, reduced by 1
14 percentage point for each \$250 (or fraction
15 thereof) by which such adjusted gross income
16 exceeds the first threshold amount,

17 “(B) if the taxpayer’s adjusted gross in-
18 come exceeds the first threshold amount plus
19 \$5,000, but does not exceed the second thresh-
20 old amount plus \$5,000, 30 percent, reduced by
21 1 percentage point for each \$167 (or fraction
22 thereof) by which such adjusted gross income
23 exceeds the second threshold amount, and

1 “(C) if the taxpayer’s adjusted gross in-
2 come exceeds the second threshold amount plus
3 \$5,000, zero percent.

4 “(2) THRESHOLD AMOUNTS.—

5 “(A) JOINT RETURNS.—In the case of a
6 joint return—

7 “(i) the first threshold amount is
8 \$30,000, and

9 “(ii) the second threshold amount is
10 \$55,000.

11 “(B) OTHER RETURNS.—In the case of—

12 “(i) a head of household, the first and
13 second threshold amounts shall be 75 per-
14 cent of such amounts for joint returns, and

15 “(ii) any taxpayer not described in
16 subparagraph (A) or clause (i), the first
17 and second threshold amounts shall be 50
18 percent of such amounts for joint returns.

19 “(C) INFLATION ADJUSTMENT.—In the
20 case of any taxable year beginning in a calendar
21 year after 2006, each of the dollar amounts in
22 subparagraph (A) shall be increased by an
23 amount equal to—

24 “(i) such dollar amount, multiplied by

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

7 Any increase determined under the preceding
 8 sentence shall be rounded to the nearest mul-
 9 tiple of \$500.”.

10 (b) EFFECTIVE DATE.—The amendments made by
 11 this section shall apply to taxable years beginning after
 12 December 31, 2006.

13 **SEC. 112. QUALIFIED CASH OR DEFERRED ARRANGEMENTS**
 14 **MUST ALLOW LONG-TERM EMPLOYEES**
 15 **WORKING MORE THAN 500 BUT LESS THAN**
 16 **1,000 HOURS PER YEAR TO PARTICIPATE.**

17 (a) PARTICIPATION REQUIREMENT.—

18 (1) IN GENERAL.—Subparagraph (D) of section
 19 401(k)(2) (defining qualified cash or deferred ar-
 20 rangement) is amended to read as follows:

21 “(D) which does not require, as a condi-
 22 tion of participation in the arrangement, that
 23 an employee complete a period of service with
 24 the employer (or employers) maintaining the

1 plan extending beyond the close of the earlier
2 of—

3 “(i) the period permitted under sec-
4 tion 410(a)(1) (determined without regard
5 to subparagraph (B)(i) thereof), or

6 “(ii) subject to the provisions of para-
7 graph (14), the first period of 3 consecu-
8 tive 12-month periods during each of which
9 the employee has at least 500 hours of
10 service.”.

11 (2) SPECIAL RULES.—Section 401(k) (relating
12 to cash or deferred arrangements), as amended by
13 section 902 of the Pension Protection Act of 2006,
14 is amended by adding at the end the following new
15 paragraph:

16 “(14) SPECIAL RULES FOR PARTICIPATION RE-
17 QUIREMENT FOR LONG-TERM, PART-TIME WORK-
18 ERS.—For purposes of paragraph (2)(D)(ii)—

19 “(A) AGE REQUIREMENT MUST BE MET.—
20 Paragraph (2)(D)(ii) shall not apply to an em-
21 ployee unless the employee has met the require-
22 ment of section 410(a)(1)(A)(i) by the close of
23 the last of the 12-month periods described in
24 such paragraph.

1 “(B) NONDISCRIMINATION AND TOP-
2 HEAVY RULES NOT TO APPLY.—

3 “(i) NONDISCRIMINATION RULES.—In
4 the case of employees who are eligible to
5 participate in the arrangement solely by
6 reason of paragraph (2)(D)(ii)—

7 “(I) notwithstanding subsection
8 (a)(4), an employer shall not be re-
9 quired to make nonelective or match-
10 ing contributions on behalf of such
11 employees even if such contributions
12 are made on behalf of other employees
13 eligible to participate in the arrange-
14 ment, and

15 “(II) an employer may elect to
16 exclude such employees from the ap-
17 plication of paragraph (3) and sub-
18 section (m)(2).

19 “(ii) TOP-HEAVY RULES.—An em-
20 ployer may elect to exclude all employees
21 who are eligible to participate in a plan
22 maintained by the employer solely by rea-
23 son of paragraph (2)(D)(ii) from—

1 “(I) the determination of whether
2 the plan is a top-heavy plan under
3 section 416, and

4 “(II) if the plan is a top-heavy
5 plan under such section, the applica-
6 tion of the vesting and benefit re-
7 quirements under subsections (b) and
8 (c) of such section.

9 “(iii) VESTING.—For purposes of de-
10 termining whether an employee described
11 in clause (i) has a nonforfeitable right to
12 employer contributions (other than con-
13 tributions described in paragraph
14 (3)(D)(i)) under the arrangement, each
15 12-month period for which the employee
16 has at least 500 hours of service shall be
17 treated as a year of service.

18 “(iv) EMPLOYEES WHO BECOME
19 FULL-TIME EMPLOYEES.—This subpara-
20 graph shall cease to apply to any employee
21 after the date on which the employee meets
22 the requirements of section
23 410(a)(1)(A)(ii) without regard to para-
24 graph (2)(D)(ii).

1 “(C) EXCEPTION FOR EMPLOYEES UNDER
2 COLLECTIVELY BARGAINED PLANS, ETC.—Para-
3 graph (2)(D)(ii) shall not apply to employees
4 described in section 410(b)(3).

5 “(D) SPECIAL RULES.—

6 “(i) TIME OF PARTICIPATION.—The
7 rules of section 410(a)(4) shall apply to an
8 employee eligible to participate in an ar-
9 rangement solely by reason of paragraph
10 (2)(D)(ii).

11 “(ii) 12-MONTH PERIODS.—12-month
12 periods shall be determined in the same
13 manner as under the last sentence of sec-
14 tion 410(a)(3)(A).”.

15 (b) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to plan years beginning after De-
17 cember 31, 2007, except that, for purposes of section
18 401(k)(2)(D)(ii) of the Internal Revenue Code of 1986 (as
19 added by such amendments), 12-month periods beginning
20 before such date shall not be taken into account.

21 **SEC. 113. TRANSFERS OF UNUSED BENEFITS OF HEALTH**
22 **FLEXIBLE SPENDING ARRANGEMENT TO**
23 **CERTAIN RETIREMENT PLANS.**

24 (a) IN GENERAL.—Section 125 (relating to cafeteria
25 plans) is amended by redesignating subsections (h) and

1 (i) as subsections (i) and (j), respectively, and by inserting
2 after subsection (g) the following:

3 “(h) CONTRIBUTIONS OF CERTAIN UNUSED HEALTH
4 BENEFITS.—

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

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

14 “(B) an eligible deferred compensation
15 plan (as defined in section 457(b)) maintained
16 by an eligible employer described in section
17 457(e)(1)(A).

18 “(2) TREATMENT OF CONTRIBUTION OF UN-
19 USED HEALTH BENEFITS.—

20 “(A) IN GENERAL.—For purposes of this
21 title, contributions described in paragraph (1)
22 shall be treated as elective contributions made
23 pursuant to an election by the participant be-
24 tween such contributions and compensation

1 which would otherwise be includible in the gross
2 income of the employee.

3 “(B) EXCLUSION OR DEDUCTION.—Con-
4 tributions described in paragraph (1) shall be
5 excluded from gross income, or included in
6 gross income and allowed as a deduction, to the
7 same extent that elective contributions would be
8 so treated under this title.

9 “(3) HEALTH FLEXIBLE SPENDING ARRANGE-
10 MENT.—For purposes of this subsection, the term
11 ‘health flexible spending arrangement’ means a flexi-
12 ble spending arrangement (as defined in section
13 106(c)) which is a qualified benefit and only permits
14 reimbursement for expenses for medical care (as de-
15 fined in section 213(d)(1) without regard to sub-
16 paragraphs (C) and (D) thereof).

17 “(4) UNUSED HEALTH BENEFITS.—For pur-
18 poses of this subsection, the term ‘unused health
19 benefits’ means, with respect to a participant, the
20 excess of—

21 “(A) the maximum amount of reimburse-
22 ment allowable to the participant with respect
23 to a plan year under a health flexible spending
24 arrangement, taking into account any election
25 by the participant, over

1 “(A) IN GENERAL.—Notwithstanding para-
2 graph (1), applicable wage replacement income
3 not otherwise treated as compensation shall be
4 treated as compensation for purposes of this
5 section.

6 “(B) APPLICABLE WAGE REPLACEMENT
7 INCOME.—For purposes of this paragraph, the
8 term ‘applicable wage replacement income’
9 means any amount received by an individual—

10 “(i) as the result of the individual
11 having become disabled,

12 “(ii) as unemployment compensation
13 (as defined in section 85(b)),

14 “(iii) under workmen’s compensation
15 acts, or

16 “(iv) which constitutes wage replace-
17 ment income under regulations prescribed
18 by the Secretary.”.

19 (2) CERTAIN EXCLUDABLE AMOUNTS MAY BE
20 TAKEN INTO ACCOUNT FOR PURPOSES OF ROTH
21 IRAS.—Section 408A(c)(2) (relating to contribution
22 limit) is amended by adding at the end the following
23 new flush sentence:

24 “In determining the maximum amount under sub-
25 paragraph (A), subsections (b)(1)(B) and (c) of sec-

1 tion 219 shall be applied by taking into account
 2 compensation described in section 219(f)(8) without
 3 regard to whether it is includible in gross income.”.

4 (3) EFFECTIVE DATE.—The amendments made
 5 by this subsection shall apply to taxable years begin-
 6 ning after December 31, 2006.

7 (b) COMPUTATION OF MAXIMUM IRA DEDUCTION
 8 FOR ROTH IRAS USING COMPENSATION FROM 2 PRE-
 9 CEDING TAXABLE YEARS.—

10 (1) IN GENERAL.—Section 408A(c) (relating to
 11 treatment of contributions) is amended by adding at
 12 the end the following new paragraph:

13 “(8) COMPENSATION FROM PRECEDING 2
 14 YEARS MAY BE TAKEN INTO ACCOUNT.—

15 “(A) IN GENERAL.—A taxpayer may elect
 16 for purposes of paragraph (2) to take into ac-
 17 count any unused compensation from the 2 tax-
 18 able years immediately preceding the taxable
 19 year.

20 “(B) UNUSED COMPENSATION.—For pur-
 21 poses of this paragraph, the term ‘unused com-
 22 pensation’ means with respect to an individual
 23 for any taxable year the compensation includ-
 24 ible in the individual’s gross income for the tax-
 25 able year reduced by the sum of—

1 “(i) the amount allowed as a deduc-
2 tion under 219(a) to such individual for
3 such taxable year,

4 “(ii) the amount of any designated
5 nondeductible contribution (as defined in
6 section 408(o)) on behalf of such individual
7 for such taxable year,

8 “(iii) the amount of any contribution
9 on behalf of such individual to a Roth IRA
10 under this section for such taxable year,
11 and

12 “(iv) the amount of compensation in-
13 cludible in such individual’s gross income
14 for such taxable year taken into account
15 under section 219(c) in determining the
16 limitation under section 219 or paragraph
17 (2) for the individual’s spouse.

18 “(C) APPLICATION TO SPECIAL RULE FOR
19 MARRIED INDIVIDUALS.—Under rules pre-
20 scribed by the Secretary, in applying section
21 219(c) for any taxable year for purposes of ap-
22 plying paragraph (2)(A), unused compensation
23 of an individual or an individual’s spouse for
24 the 2 taxable years immediately preceding the
25 taxable year may be taken into account.”.

1 regarded any qualified rollover contribution from an
2 individual retirement plan (other than a Roth IRA)
3 to a Roth IRA.

4 “(2) MILITARY DEATH GRATUITY.—

5 “(A) IN GENERAL.—The term ‘qualified
6 rollover contribution’ includes a contribution to
7 a Roth IRA maintained for the benefit of an in-
8 dividual to the extent that such contribution
9 does not exceed the amount received by such in-
10 dividual under section 1477 of title 10, United
11 States Code, or under section 1967 of title 38
12 of such Code, if such contribution is made not
13 later than 1 year after the day on which such
14 individual receives such amount.

15 “(B) ANNUAL LIMIT ON NUMBER OF
16 ROLLOVERS NOT TO APPLY.—Section
17 408(d)(3)(B) shall not apply with respect to
18 amounts treated as a rollover by the subpara-
19 graph (A).

20 “(C) APPLICATION OF SECTION 72.—For
21 purposes of applying section 72 in the case of
22 a distribution which is not a qualified distribu-
23 tion, the amount treated as a rollover by reason
24 of subparagraph (A) shall be treated as invest-
25 ment in the contract.”.

1 (2) PROVISION IN EFFECT AFTER PENSION
2 PROTECTION ACT.—Subsection (e) of section 408A,
3 as in effect after the amendments made by section
4 824 of the Pension Protection Act of 2006, is
5 amended to read as follows:

6 “(e) QUALIFIED ROLLOVER CONTRIBUTION.—For
7 purposes of this section—

8 “(1) IN GENERAL.—The term ‘qualified rollover
9 contribution’ means a rollover contribution—

10 “(A) to a Roth IRA from another such ac-
11 count,

12 “(B) from an eligible retirement plan, but
13 only if—

14 “(i) in the case of an individual retire-
15 ment plan, such rollover contribution meets
16 the requirements of section 408(d)(3), and

17 “(ii) in the case of any eligible retire-
18 ment plan (as defined in section
19 402(c)(8)(B) other than clauses (i) and (ii)
20 thereof), such rollover contribution meets
21 the requirements of section 402(c),
22 403(b)(8), or 457(e)(16), as applicable.

23 For purposes of section 408(d)(3)(B), there shall be
24 disregarded any qualified rollover contribution from

1 an individual retirement plan (other than a Roth
2 IRA) to a Roth IRA.

3 “(2) MILITARY DEATH GRATUITY.—

4 “(A) IN GENERAL.—The term ‘qualified
5 rollover contribution’ includes a contribution to
6 a Roth IRA maintained for the benefit of an in-
7 dividual to the extent that such contribution
8 does not exceed the amount received by such in-
9 dividual under section 1477 of title 10, United
10 States Code, or under section 1967 of title 38
11 of such Code, if such contribution is made not
12 later than 1 year after the day on which such
13 individual receives such amount.

14 “(B) ANNUAL LIMIT ON NUMBER OF
15 ROLLOVERS NOT TO APPLY.—Section
16 408(d)(3)(B) shall not apply with respect to
17 amounts treated as a rollover by the subpara-
18 graph (A).

19 “(C) APPLICATION OF SECTION 72.—For
20 purposes of applying section 72 in the case of
21 a distribution which is not a qualified distribu-
22 tion, the amount treated as a rollover by reason
23 of subparagraph (A) shall be treated as invest-
24 ment in the contract.”.

1 (b) HEALTH SAVINGS ACCOUNTS AND ARCHER
2 MSAs.—Sections 220(f)(5) and 223(f)(5) are each
3 amended by adding at the end the following flush sen-
4 tence:

5 “For purposes of subparagraphs (A) and (B), rules
6 similar to the rules of section 408A(e)(2) (relating
7 to rollover treatment for contributions of military
8 death gratuity) shall apply.”.

9 (c) EDUCATION SAVINGS ACCOUNTS.—Section
10 530(d)(5) is amended by adding at the end the following
11 new sentence: “For purposes of this paragraph, rules simi-
12 lar to the rules of section 408A(e)(2) (relating to rollover
13 treatment for contributions of military death gratuity)
14 shall apply.”.

15 (d) EFFECTIVE DATES.—

16 (1) IN GENERAL.—Except as provided by para-
17 graphs (2) and (3), the amendments made by this
18 section shall apply with respect to deaths from inju-
19 ries occurring on or after the date of the enactment
20 of this Act.

21 (2) APPLICATION OF AMENDMENTS TO DEATHS
22 FROM INJURIES OCCURRING ON OR AFTER OCTOBER
23 7, 2001, AND BEFORE ENACTMENT.—The amend-
24 ments made by this section shall apply to any con-
25 tribution made pursuant to section 408A(e)(2),

1 220(f)(5), 223(f)(5), or 530(d)(5) of the Internal
2 Revenue Code of 1986, as amended by this Act, with
3 respect to amounts received under section 1477 of
4 title 10, United States Code, or under section 1967
5 of title 38 of such Code, for deaths from injuries oc-
6 ccurring on or after October 7, 2001, and before the
7 date of the enactment of this Act if such contribu-
8 tion is made not later than 1 year after the date of
9 the enactment of this Act.

10 (3) PENSION PROTECTION ACT CHANGES.—Sec-
11 tion 408A(e)(1) of the Internal Revenue Code of
12 1986 (as in effect after the amendments made by
13 subsection (a)(2)) shall apply to taxable years begin-
14 ning after December 31, 2007.

15 **TITLE II—PROVISIONS PRO-**
16 **VIDING FOR PRESERVATION**
17 **OF INCOME**

18 **SEC. 201. EXCLUSION OF CERTAIN QUALIFIED ANNUITY**
19 **PAYMENTS.**

20 (a) EXCLUSION.—

21 (1) QUALIFIED PLANS.—Section 402(e) (relat-
22 ing to exempt trusts) is amended by adding at the
23 end the following new paragraph:

24 “(7) EXCLUSION OF PERCENTAGE OF LIFETIME
25 ANNUITY PAYMENTS.—

1 “(A) IN GENERAL.—In the case of a life-
2 time annuity payment to a qualified distributee
3 from a qualified trust (within the meaning of
4 subsection (c)(8)(A)) maintained in connection
5 with a defined contribution plan, gross income
6 shall not include 10 percent of the amount oth-
7 erwise includible in gross income (determined
8 without regard to this paragraph). For pur-
9 poses of this paragraph, payments from an an-
10 nuity contract distributed by the qualified trust
11 shall be treated as payments from the qualified
12 trust.

13 “(B) LIMITATION.—

14 “(i) IN GENERAL.—If—

15 “(I) the aggregate amount of
16 lifetime annuity payments to the dis-
17 tributee during the taxable year which
18 are includible in gross income (deter-
19 mined without regard to this para-
20 graph) and which are subject to this
21 paragraph or to rules similar to the
22 rules of this paragraph (other than
23 section 72(b)(5) or 101(d)(4)), ex-
24 ceeds

1 “(II) 50 percent of the applicable
2 amount for the taxable year under
3 section 415(a),
4 then the aggregate amount otherwise ex-
5 cludable under subparagraph (A) for the
6 taxable year shall be reduced by 10 percent
7 of the portion of such excess which is allo-
8 cable under clause (ii) to payments which
9 are subject to this paragraph.

10 “(ii) ALLOCATION RULE.—Any excess
11 described in clause (i) for any taxable year
12 shall be allocated ratably among all life-
13 time annuity payments to the qualified dis-
14 tributee described in clause (i)(I).

15 “(C) DEFINITIONS.—For purposes of this
16 paragraph—

17 “(i) LIFETIME ANNUITY PAYMENT.—

18 “(I) IN GENERAL.—Except as
19 provided in this clause, the term ‘life-
20 time annuity payment’ means a dis-
21 tribution from an annuity contract
22 which is a part of a series of substan-
23 tially equal periodic payments (not
24 less frequently than annually) made
25 over the life of the qualified dis-

1 tributee or the joint lives of the quali-
2 fied distributee and the qualified
3 distributee's designated beneficiary.
4 For purposes of this paragraph, the
5 term 'annuity contract' means a com-
6 mercial annuity (as defined in section
7 3405(e)(6)), other than an endowment
8 or life insurance contract.

9 “(II) CERTAIN FLUCTUATING
10 PAYMENTS.—Annuity payments shall
11 not fail to be treated as part of a se-
12 ries of substantially equal periodic
13 payments merely because the amount
14 of the periodic payments may vary in
15 accordance with investment experi-
16 ence, reallocations among investment
17 options, actuarial gains or losses, cost
18 of living indices, a constant percent-
19 age (not less than zero) applied not
20 less frequently than annually, or simi-
21 lar fluctuating criteria.

22 “(III) CERTAIN CHANGES IN THE
23 MODE OF PAYMENT.—Annuity pay-
24 ments shall not fail to be treated as
25 part of a series of substantially equal

1 periodic payments merely because the
2 period between each such payment is
3 lengthened or shortened, but only if at
4 all times such period is not longer
5 than 1 year.

6 “(IV) PERMITTED REDUC-
7 TIONS.—Annuity payments shall not
8 fail to be treated as part of a series
9 of substantially equal periodic pay-
10 ments merely because, in the case of
11 an annuity payable over the lives of
12 the qualified distributee and the quali-
13 fied distributee’s designated bene-
14 ficiary, the amounts paid after the
15 death of the qualified distributee or
16 the qualified distributee’s designated
17 beneficiary are less than the amounts
18 payable during their joint lives.

19 “(V) CERTAIN CONTRACT BENE-
20 FITS.—The availability of a commuta-
21 tion benefit or other feature permit-
22 ting acceleration of annuity payments
23 (or a modification of the period dur-
24 ing which such a benefit is available),
25 a minimum period of payments or a

1 minimum amount to be paid in any
2 event shall not affect the treatment of
3 a distribution as a lifetime annuity
4 payment.

5 “(VI) TRUST PAYMENTS.—In the
6 case of lifetime annuity payments
7 being made to a qualified trust, pay-
8 ments by the qualified trust to a
9 qualified distributee of the entire
10 amount received by the qualified trust
11 with respect to the qualified dis-
12 tributee shall constitute lifetime annu-
13 ity payments if such payments are
14 made within a reasonable period after
15 receipt by the qualified trust.

16 “(VII) QUALIFIED DOMESTIC RE-
17 LATIONS ORDERS.—Annuity payments
18 shall not fail to be treated as a series
19 of substantially equal periodic pay-
20 ments merely because the payments
21 are reduced on account of a qualified
22 domestic relations order (within the
23 meaning of section 414(p)) that be-
24 comes effective after the commence-
25 ment of the annuity payments.

1 “(ii) QUALIFIED DISTRIBUTEES.—The
2 term ‘qualified distributee’ means the em-
3 ployee, the surviving spouse of the em-
4 ployee, and an alternate payee who is the
5 spouse or former spouse of the employee.

6 “(D) RECAPTURE TAX.—

7 “(i) IN GENERAL.—If—

8 “(I) an amount is not includible
9 in gross income by reason of subpara-
10 graph (A), and

11 “(II) the series of payments of
12 which such payment is a part is sub-
13 sequently modified (other than by rea-
14 son of death or disability) so that
15 some or all future payments are not
16 lifetime annuity payments,

17 the qualified distributee’s gross income for
18 the first taxable year in which such modi-
19 fication occurs shall be increased by an
20 amount, determined under rules prescribed
21 by the Secretary, equal to the amount
22 which (but for subparagraph (A)) would
23 have been includible in the qualified
24 distributee’s gross income if the modifica-
25 tion had been in effect at all times, plus in-

1 terest for the deferral period at the under-
2 payment rate established under section
3 6621.

4 “(ii) DEFERRAL PERIOD.—For pur-
5 poses of this subparagraph, the term ‘de-
6 ferral period’ means, with respect to any
7 amount, the period beginning with the tax-
8 able year in which (without regard to sub-
9 paragraph (A)) the amount would have
10 been includible in gross income and ending
11 with the taxable year in which the modi-
12 fication described in clause (i)(II) occurs.

13 “(E) INVESTMENT IN THE CONTRACT.—
14 For purposes of section 72, the investment in
15 the contract shall be determined without regard
16 to this paragraph.”.

17 (2) QUALIFIED ANNUITY PLANS.—Section
18 403(a) (relating to qualified annuity plans) is
19 amended by adding at the end the following new
20 paragraph:

21 “(6) EXCLUSION OF PERCENTAGE OF LIFETIME
22 ANNUITY PAYMENTS.—Rules similar to the rules of
23 section 402(e)(7) shall apply to distributions under
24 any annuity contract to which this subsection ap-
25 plies.”.

1 (3) PURCHASED ANNUITIES.—Section 403(b)
2 (relating to purchased annuities) is amended by add-
3 ing at the end the following new paragraph:

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

9 (4) IRAS.—Section 408(d) (relating to tax
10 treatment of distributions), as amended by section
11 1201 of the Pension Protection Act of 2006, is
12 amended by adding at the end the following new
13 paragraph:

14 “(9) EXCLUSION OF PERCENTAGE OF LIFETIME
15 ANNUITY PAYMENTS.—Rules similar to the rules of
16 section 402(e)(7) shall apply to distributions out of
17 an individual retirement plan.”.

18 (5) SECTION 457 PLANS.—Section 457(e) (relat-
19 ing to special rules for deferred compensation plans)
20 is amended by adding at the end the following new
21 paragraph:

22 “(19) EXCLUSION OF PERCENTAGE OF LIFE-
23 TIME ANNUITY PAYMENTS.—Rules similar to the
24 rules of section 402(e)(7) shall apply to distributions

1 from an eligible deferred compensation plan of an el-
2 ible employer described in subsection (e)(1)(A).”.

3 (b) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to distributions made after Decem-
5 ber 31, 2006.

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

7 (a) LIFETIME ANNUITY PAYMENTS UNDER ANNUITY
8 CONTRACTS.—Section 72(b) (relating to exclusion ratio)
9 is amended by adding at the end the following new para-
10 graph:

11 “(5) EXCLUSION FOR LIFETIME ANNUITY PAY-
12 MENTS.—

13 “(A) IN GENERAL.—In the case of lifetime
14 annuity payments received as an annuity under
15 1 or more annuity contracts in any taxable
16 year, gross income shall not include the lesser
17 of—

18 “(i) 50 percent of the portion of the
19 lifetime annuity payments which (without
20 regard to this paragraph) is includible in
21 gross income under this section for the
22 taxable year, or

23 “(ii) \$20,000.

24 “(B) COST-OF-LIVING ADJUSTMENT.—In
25 the case of taxable years beginning after De-

1 cember 31, 2007, the \$20,000 amount in sub-
2 paragraph (A)(ii) shall be increased by an
3 amount equal to—

4 “(i) such dollar amount, multiplied by

5 “(ii) the cost-of-living adjustment de-
6 termined under section 1(f)(3) for the cal-
7 endar year in which the taxable year be-
8 gins, determined by substituting ‘calendar
9 year 2006’ for ‘calendar year 1992’ in sub-
10 paragraph (B) thereof.

11 If any amount as increased under the preceding
12 sentence is not a multiple of \$500, such amount
13 shall be rounded to the next lower multiple of
14 \$500.

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

17 “(i) any amount received under an eli-
18 gible deferred compensation plan (as de-
19 fined in section 457(b)) or under a quali-
20 fied retirement plan (as defined in section
21 4974(c)),

22 “(ii) any amount paid under an annu-
23 ity contract which is received by the bene-
24 ficiary under the contract—

1 “(I) after the death of the annu-
 2 itant in the case of payments de-
 3 scribed in subsection (c)(5)(A)(ii)(III),
 4 unless the beneficiary is the surviving
 5 spouse of the annuitant, or

6 “(II) after the death of the annu-
 7 itant and joint annuitant in the case
 8 of payments described in subsection
 9 (c)(5)(A)(ii)(IV), unless the bene-
 10 ficiary is the surviving spouse of the
 11 last to die of the annuitant and the
 12 joint annuitant, or

13 “(iii) any annuity contract that is a
 14 qualified funding asset (as defined in sec-
 15 tion 130(d)), but without regard to wheth-
 16 er there is a qualified assignment.

17 “(D) INVESTMENT IN THE CONTRACT.—
 18 For purposes of this section, the investment in
 19 the contract shall be determined without regard
 20 to this paragraph.”.

21 (b) DEFINITIONS.—Section 72(c) is amended by add-
 22 ing at the end the following new paragraph:

23 “(5) LIFETIME ANNUITY PAYMENT.—

24 “(A) IN GENERAL.—For purposes of sub-
 25 section (b)(5), the term ‘lifetime annuity pay-

1 ment’ means any amount received as an annu-
2 ity under any portion of an annuity contract,
3 but only if—

4 “(i) the only person (or persons in the
5 case of payments described in subclause
6 (II) or (IV) of clause (ii)) legally entitled
7 (by operation of the contract, a trust, or
8 other legally enforceable means) to receive
9 such amount during the life of the annu-
10 itant or joint annuitant is such annuitant
11 or joint annuitant, and

12 “(ii) such amount is part of a series
13 of substantially equal periodic payments
14 made not less frequently than annually
15 over—

16 “(I) the life of the annuitant,

17 “(II) the lives of the annuitant
18 and a joint annuitant, but only if the
19 annuitant is the spouse of the joint
20 annuitant as of the annuity starting
21 date or the difference in age between
22 the annuitant and joint annuitant is
23 15 years or less,

24 “(III) the life of the annuitant
25 with a minimum period of payments

1 or with a minimum amount that must
2 be paid in any event, or

3 “(IV) the lives of the annuitant
4 and a joint annuitant with a minimum
5 period of payments or with a min-
6 imum amount that must be paid in
7 any event, but only if the annuitant is
8 the spouse of the joint annuitant as of
9 the annuity starting date or the dif-
10 ference in age between the annuitant
11 and joint annuitant is 15 years or
12 less.

13 “(iii) EXCEPTIONS.—For purposes of
14 clause (ii), annuity payments shall not fail
15 to be treated as part of a series of substan-
16 tially equal periodic payments—

17 “(I) because the amount of the
18 periodic payments may vary in accord-
19 ance with investment experience, re-
20 allocations among investment options,
21 actuarial gains or losses, cost-of-living
22 indices, a constant percentage (not
23 less than zero) applied not less fre-
24 quently than annually, or similar fluc-
25 tuating criteria,

1 “(II) due to the existence of, or
2 modification of the duration of, a pro-
3 vision in the contract permitting a
4 lump-sum withdrawal after the annu-
5 ity starting date, or

6 “(III) because the period between
7 each such payment is lengthened or
8 shortened, but only if at all times
9 such period is no longer than 1 cal-
10 endar year.

11 “(B) ANNUITY CONTRACT.—For purposes
12 of subparagraph (A) and subsections (b)(5) and
13 (x), the term ‘annuity contract’ means a com-
14 mercial annuity (as defined by section
15 3405(e)(6)), other than an endowment or life
16 insurance contract.

17 “(C) MINIMUM PERIOD OF PAYMENTS.—
18 For purposes of subparagraph (A), the min-
19 imum period of payments is a guaranteed term
20 of payments which does not exceed the greater
21 of—

22 “(i) 10 years, or

23 “(ii) the life expectancy of—

24 “(I) the annuitant as of the an-
25 nuity starting date, in the case of life-

1 time annuity payments described in
2 subparagraph (A)(ii)(III), or

3 “(II) the annuitant and joint an-
4 nuitant as of the annuity starting
5 date, in the case of lifetime annuity
6 payments described in subparagraph
7 (A)(ii)(IV).

8 For purposes of this subparagraph, life expect-
9 ancy shall be computed with reference to the ta-
10 bles prescribed by the Secretary under para-
11 graph (3). For purposes of subsection
12 (x)(1)(C)(ii), the permissible minimum period of
13 payments shall be determined as of the annuity
14 starting date and reduced by one for each sub-
15 sequent year.

16 “(D) MINIMUM AMOUNT THAT MUST BE
17 PAID IN ANY EVENT.—For purposes of subpara-
18 graph (A), the minimum amount that must be
19 paid in any event is an amount payable to the
20 designated beneficiary under an annuity con-
21 tract which is in the nature of a refund and
22 does not exceed the greater of the amount ap-
23 plied to produce the lifetime annuity payments
24 under the contract or the amount, if any, avail-

1 able for withdrawal under the contract on the
2 date of death.”.

3 (c) RECAPTURE TAX FOR LIFETIME ANNUITY PAY-
4 MENTS.—Section 72 is amended by redesignating sub-
5 section (x) as subsection (y) and by inserting after sub-
6 section (x) the following new subsection:

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

9 “(1) IN GENERAL.—If—

10 “(A) any amount received under an annu-
11 ity contract is excluded from income by reason
12 of subsection (b)(5) (relating to lifetime annuity
13 payments) for any taxable year, and

14 “(B) a recapture event described in para-
15 graph (2) occurs in any subsequent taxable
16 year,

17 then gross income for the first taxable year in which
18 the recapture event occurs shall be increased by the
19 recapture amount.

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

22 “(A) the series of payments under an an-
23 nuity contract is subsequently modified so any
24 future payments are not lifetime annuity pay-
25 ments,

1 “(B) after the date of receipt of the first
2 lifetime annuity payment under the contract an
3 annuitant receives a lump sum and thereafter is
4 to receive annuity payments in a reduced
5 amount under the contract, or

6 “(C) after the date of receipt of the first
7 lifetime annuity payment under the contract the
8 dollar amount of any subsequent annuity pay-
9 ment is reduced and a lump sum is not paid in
10 connection with the reduction, unless such re-
11 duction is—

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

14 “(ii) due to the addition of, or in-
15 crease in, a minimum period of payments
16 (within the meaning of subsection
17 (c)(5)(C)) or a minimum amount that
18 must be paid in any event (within the
19 meaning of subsection (c)(5)(D)).

20 “(3) RECAPTURE AMOUNT.—

21 “(A) IN GENERAL.—For purposes of this
22 subsection, the recapture amount shall be the
23 amount, determined under rules prescribed by
24 the Secretary, equal to the amount which (but
25 for subsection (b)(5)) would have been includ-

1 ible in the taxpayer’s gross income if the modi-
 2 fication or reduction described in subparagraph
 3 (A), (B), or (C) of paragraph (2) had been in
 4 effect at all times, plus interest for the deferral
 5 period at the underpayment rate established by
 6 section 6621.

7 “(B) DEFERRAL PERIOD.—For purposes
 8 of this subsection, the term ‘deferral period’
 9 means, with respect to any amount, the period
 10 beginning with the taxable year in which (with-
 11 out regard to subsection (b)(5)) the amount
 12 would have been includible in gross income and
 13 ending with the taxable year in which the modi-
 14 fication or reduction described in subparagraph
 15 (A), (B), or (C) of paragraph (2) occurs.

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

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

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

23 “(C) encounters hardship.”.

24 (d) LIFETIME DISTRIBUTIONS OF LIFE INSURANCE
 25 DEATH BENEFITS.—

1 (1) IN GENERAL.—Section 101(d) (relating to
2 payment of life insurance proceeds at a date later
3 than death) is amended by adding at the end the fol-
4 lowing new paragraph:

5 “(4) EXCLUSION FOR LIFETIME ANNUITY PAY-
6 MENTS.—

7 “(A) IN GENERAL.—In the case of
8 amounts to which this subsection applies, gross
9 income for any taxable year shall not include
10 the lesser of—

11 “(i) 50 percent of the portion of life-
12 time annuity payments which (without re-
13 gard to this paragraph) is includible in
14 gross income under this section, or

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

17 “(B) RULES OF SECTION 72(b)(5) TO
18 APPLY.—For purposes of this paragraph, rules
19 similar to the rules of section 72(b)(5) and sec-
20 tion 72(x) shall apply, except that the term
21 ‘beneficiary of the life insurance contract’ shall
22 be substituted for the term ‘annuitant’ each
23 place it appears, and the term ‘life insurance
24 contract’ shall be substituted for the term ‘an-
25 nuity contract’ each place it appears.”.

1 (2) CONFORMING AMENDMENT.—Section
2 101(d)(1) is amended by inserting “or paragraph
3 (4)” after “to the extent not excluded by the pre-
4 ceding sentence”.

5 (e) EFFECTIVE DATE.—

6 (1) IN GENERAL.—The amendments made by
7 this section shall apply to amounts received in cal-
8 endar years beginning after the date of the enact-
9 ment of this Act.

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

1 pleted before the date which is 2 years after the date
2 of the enactment of this Act.

3 **SEC. 203. JOINT STUDY OF APPLICATION OF SPOUSAL CON-**
4 **SENT RULES TO DEFINED CONTRIBUTION**
5 **PLANS.**

6 (a) STUDY.—The Secretary of Labor and the Sec-
7 retary of the Treasury shall jointly conduct a study of the
8 feasibility and desirability of extending the application of
9 the requirements of section 205 of the Employee Retire-
10 ment Income Security Act of 1974 and sections
11 401(a)(11) and 417 of the Internal Revenue Code of 1986
12 (relating to spousal consent requirements) to defined con-
13 tribution plans to which such requirements do not apply.
14 Such study shall include consideration of—

15 (1) any modifications of such requirements that
16 are necessary to apply such requirements to such
17 plans, and

18 (2) the feasibility of providing notice and spous-
19 al consent in 1 or more electronic forms that are ca-
20 pable of authentication.

21 (b) REPORT.—Not later than 2 years after the date
22 of the enactment of this Act, the Secretaries shall report
23 the results of the study, together with any recommenda-
24 tions for legislative changes, to the Committees on Fi-
25 nance and Health, Education, Labor, and Pensions of the

1 Senate and the Committees on Ways and Means and Edu-
2 cation, and the Workforce of the House of Representa-
3 tives.

4 **SEC. 204. FACILITATING LONGEVITY INSURANCE.**

5 (a) IN GENERAL.—Paragraph (9) of section 401(a)
6 is amended by inserting after subparagraph (G) the fol-
7 lowing new subparagraph:

8 “(H) LONGEVITY INSURANCE.—

9 “(i) IN GENERAL.—For purposes of
10 this paragraph, any value attributable to
11 longevity insurance shall be disregarded in
12 determining the value of an employee’s in-
13 terest under a plan prior to the first date
14 that payments are made under the lon-
15 gevity insurance.

16 “(ii) LONGEVITY INSURANCE DE-
17 FINED.—For purposes of this subpara-
18 graph, the term ‘longevity insurance’
19 means an annuity payable on behalf of the
20 employee under which—

21 “(I) payments commence not
22 later than 12 months following the
23 calendar month in which the employee
24 attains age 85 (or would have at-
25 tained age 85),

1 “(II) payments are made in sub-
2 stantially equal periodic payments
3 (not less frequently than annually)
4 over the life of the employee or the
5 joint lives of the employee and the
6 employee’s designated beneficiary,
7 taking into account the rules of clause
8 (i) of section 402(e)(7)(D), except as
9 otherwise provided in subclause (III)
10 of such section,

11 “(III) prior to the death of the
12 employee, the annuity does not make
13 available any commutation benefit,
14 cash surrender value, or other similar
15 feature, and

16 “(IV) except as provided in rules
17 prescribed by the Secretary, in the
18 case of an employee’s death prior to
19 the date that payments commence, the
20 value of any death benefits paid may
21 not exceed the premiums paid for
22 such annuity, plus interest com-
23 pounded annually at 3 percent.

24 “(iii) ADJUSTING AGE.—For purposes
25 of clause (ii)(I), the Secretary shall annu-

1 ally increase age 85 to reflect increases in
 2 life expectancy (as determined by the Sec-
 3 retary) that occur on or after January 1,
 4 2006, except that any such increased age
 5 which is not a whole number shall be
 6 rounded to the next lower whole number.”.

7 (b) RULES.—Not later than one year after the date
 8 of enactment of this Act, the Secretary of the Treasury
 9 shall prescribe rules under which all or a portion of a par-
 10 ticipant’s benefits under any plan described in section
 11 402(c)(8)(B) of the Internal Revenue Code of 1986 may
 12 be treated as longevity insurance under the rules of section
 13 401(a)(9)(H) of such Code.

14 (c) EFFECTIVE DATE.—The amendments made by
 15 this section shall apply to years beginning after December
 16 31, 2007.

17 **TITLE III—PROVISIONS**
 18 **ENSURING EQUITY IN DIVORCE**

19 **SEC. 301. ELIMINATION OF CURRENT CONNECTION RE-**
 20 **QUIREMENT UNDER RAILROAD RETIREMENT**
 21 **ACT FOR CERTAIN SURVIVORS.**

22 (a) IN GENERAL.—Section 2(d)(1) of the Railroad
 23 Retirement Act of 1974 (45 U.S.C. 231a(d)(1)), in the
 24 matter preceding paragraph (i), is amended by inserting

1 “, except with respect to survivors described in paragraph
2 (i), (ii), or (v),” after “December 31, 1995) and”.

3 (b) EFFECTIVE DATE.—The amendments made by
4 subsection (a) shall take effect on the date of enactment
5 of this Act and shall apply to annuity amounts accruing
6 for months on or after such date.

7 **SEC. 302. PERMITTING DIVORCED SPOUSES AND WIDOWS**
8 **AND WIDOWERS TO REMARRY AFTER TURN-**
9 **ING 60 WITHOUT A PENALTY UNDER RAIL-**
10 **ROAD RETIREMENT ACT.**

11 (a) IN GENERAL.—

12 (1) DIVORCED SPOUSE.—Section 2(c)(4) of the
13 Railroad Retirement Act of 1974 (45 U.S.C.
14 231a(c)(4) is amended by adding at the end the fol-
15 lowing new sentence: “For purposes of paragraph
16 (ii)(B), if a divorced wife marries after attaining age
17 60, such marriage shall be deemed not to have oc-
18 curred.”

19 (2) WIDOWS AND WIDOWERS.—Section
20 2(d)(1)(v) of the Railroad Retirement Act of 1974
21 (45 U.S.C. 231a(d)(1)(v)) is amended by adding at
22 the end the following new sentence: “For purposes
23 of this paragraph, if a widow marries after attaining
24 age 60, such marriage shall be deemed not to have
25 occurred.”

1 (b) EFFECTIVE DATE.—The amendments made by
 2 this section shall take effect on the date of enactment of
 3 this Act and shall apply to annuity amounts accruing for
 4 months on or after such date.

5 **SEC. 303. REPEAL OF JURISDICTIONAL REQUIREMENT FOR**
 6 **COURT TO TREAT MILITARY RETIREMENT**
 7 **PAY AS PROPERTY OF THE MILITARY MEM-**
 8 **BER AND SPOUSE.**

9 (a) IN GENERAL.—Section 1408(c) of title 10,
 10 United States Code, is amended by striking paragraph (4).

11 (b) EFFECTIVE DATE.—The amendment made by
 12 this section shall apply to final decrees issued on or after
 13 the date of the enactment of this Act.

14 **TITLE IV—PROVISIONS TO**
 15 **IMPROVE FINANCIAL LITERACY**

16 **SEC. 401. GRANTS TO COMMUNITY-BASED TAXPAYER CLIN-**
 17 **ICS TO PROVIDE RETIREMENT SAVINGS AD-**
 18 **VICE.**

19 (a) IN GENERAL.—Section 7526 (relating to low-in-
 20 come taxpayer clinics) is amended by adding at the end
 21 the following:

22 “(d) ADDITIONAL GRANTS FOR RETIREMENT SAV-
 23 INGS ADVICE.—

24 “(1) MAKING OF GRANTS.—The Secretary may,
 25 subject to the availability of appropriated funds,

1 make grants to qualified low-income taxpayer clinics
2 to provide retirement savings counseling to low-in-
3 come taxpayers.

4 “(2) USE OF GRANT FUNDS.—Grants under
5 paragraph (1) shall be used to—

6 “(A) develop the infrastructure necessary
7 to carry out retirement savings counseling for
8 low-income taxpayers, including the develop-
9 ment of software to assist low-income taxpayers
10 in beginning a retirement savings program,
11 monitoring their savings behavior, and taking
12 advantage of tax benefits provided under this
13 title to assist in retirement savings,

14 “(B) develop partnerships with certified fi-
15 nancial planners and other financial experts to
16 assist in carrying out the retirement savings
17 program, and

18 “(C) train advisors to assist low-income
19 taxpayers with retirement savings.

20 “(3) CRITERIA FOR AWARDS.—The provisions
21 of subsection (c)(4) shall apply in determining
22 whether to make a grant under paragraph (1).

23 “(4) LIMITATIONS AND SPECIAL RULES.—

24 “(A) AGGREGATE LIMITATION.—Unless
25 otherwise provided by specific appropriations,

1 the Secretary shall not allocate more than
2 \$25,000,000 per year (exclusive of costs of ad-
3 ministering the program) to grants under para-
4 graph (1).

5 “(B) LIMITATION ON ANNUAL GRANTS TO
6 A CLINIC.—The aggregate amount of grants
7 which may be made under paragraph (1) to a
8 clinic for a year shall not exceed \$100,000.

9 “(C) MULTI-YEAR GRANTS.—The provi-
10 sions of subsection (c)(3) shall apply to grants
11 under paragraph (1).

12 “(D) ADDITIONAL AMOUNTS.—Grants
13 under paragraph (1) shall be in addition to any
14 grants under subsection (a).”

15 (b) CONFORMING AMENDMENTS.—

16 (1) Section 7526(c) (relating to special rules
17 and limitations) is amended by striking “this sec-
18 tion” each place it appears and inserting “subsection
19 (a)”.

20 (2) Section 7526(c)(3) is amended by inserting
21 “under subsection (a)” after “award”.

22 (c) AUTHORIZATION OF APPROPRIATIONS.—There is
23 authorized to be appropriated for each fiscal year begin-
24 ning after September 30, 2006, \$25,000,000 to carry out
25 the provisions of this section.

1 **SEC. 402. TREATMENT OF QUALIFIED RETIREMENT PLAN-**
2 **NING SERVICES.**

3 (a) IN GENERAL.—Subsection (m) of section 132
4 (defining qualified retirement services) is amended by add-
5 ing at the end the following new paragraph:

6 “(4) NO CONSTRUCTIVE RECEIPT.—

7 “(A) IN GENERAL.—No amount shall be
8 included in the gross income of any employee
9 solely because the employee may choose between
10 any qualified retirement planning services pro-
11 vided by an eligible investment advisor and
12 compensation which would otherwise be includ-
13 ible in the gross income of such employee. The
14 preceding sentence shall apply to highly com-
15 pensated employees only if the choice described
16 in such sentence is available on substantially
17 the same terms to each member of the group of
18 employees normally provided education and in-
19 formation regarding the employer’s qualified
20 employer plan.

21 “(B) LIMITATION.—The maximum amount
22 which may be excluded under subparagraph (A)
23 with respect to any employee for any taxable
24 year shall not exceed \$1,000.

25 “(C) ELIGIBLE INVESTMENT ADVISER.—
26 For purposes of this paragraph, the term ‘eligi-

1 ble investment adviser’ means, with respect to
2 a plan, a person—

3 “(i) who—

4 “(I) is registered as an invest-
5 ment adviser under the Investment
6 Advisers Act of 1940 (15 U.S.C. 80b-
7 1 et seq.),

8 “(II) is registered as an invest-
9 ment adviser under the laws of the
10 State in which such adviser maintains
11 the principal office and place of busi-
12 ness of such adviser, but only if such
13 State laws are consistent with section
14 203A of the Investment Advisers Act
15 of 1940 (15 U.S.C. 80b-3a),

16 “(III) is a bank or similar finan-
17 cial institution referred to in section
18 408(b)(4),

19 “(IV) is an insurance company
20 qualified to do business under the
21 laws of a State, or

22 “(V) is any other comparably
23 qualified entity which satisfies such
24 criteria as the Secretary determines

1 appropriate, consistent with the pur-
2 poses of this subsection, and

3 “(ii) who meets the requirements of
4 subparagraph (D).

5 “(D) ADVISER REQUIREMENTS.—The re-
6 quirements of this subparagraph are met if
7 every individual employed (or otherwise com-
8 pensated) by a person described in subpara-
9 graph (C)(i) who provides investment advice on
10 behalf of such person to any plan participant or
11 beneficiary is—

12 “(i) an individual described in sub-
13 clause (I) of subparagraph (C)(i),

14 “(ii) an individual described in sub-
15 clause (II) of subparagraph (C)(i), but
16 only if such State has an examination re-
17 quirement to qualify for registration,

18 “(iii) registered as a broker or dealer
19 under the Securities Exchange Act of 1934
20 (15 U.S.C. 78a et seq.),

21 “(iv) a registered representative as de-
22 scribed in section 3(a)(18) of the Securi-
23 ties Exchange Act of 1934 (15 U.S.C.
24 78c(a)(18)) or section 202(a)(17) of the

1 Investment Advisers Act of 1940 (15
2 U.S.C. 80b–2(a)(17)), or

3 “(v) any other comparably qualified
4 individual who satisfies such criteria as the
5 Secretary determines appropriate, con-
6 sistent with the purposes of this para-
7 graph.

8 “(E) TERMINATION.—This paragraph
9 shall not apply to taxable years beginning after
10 December 31, 2011.”.

11 (b) CONFORMING AMENDMENTS.—

12 (1) Section 403(b)(3)(B) is amended by insert-
13 ing “132(m)(4),” after “132(f)(4),”.

14 (2) Section 414(s)(2) is amended by inserting
15 “132(m)(4),” after “132(f)(4),”.

16 (3) Section 415(c)(3)(D)(ii) is amended by in-
17 serting “132(m)(4),” after “132(f)(4),”.

18 (c) EFFECTIVE DATE.—The amendments made by
19 this section shall apply to taxable years beginning after
20 December 31, 2006.

21 **SEC. 403. RETIREMENT HANDBOOK AND RETIREMENT**
22 **READINESS CHECKLIST.**

23 (a) IN GENERAL.—Section 704 of the Social Security
24 Act is amended by adding at the end the following new
25 subsection:

1 “(f) RETIREMENT INFORMATION.—

2 “(1) IN GENERAL.—The Commissioner, in con-
3 sultation with the Social Security Advisory Board,
4 shall prepare—

5 “(A) the financial reference handbook de-
6 scribed in paragraph (2), and

7 “(B) the retirement readiness checklist de-
8 scribed in paragraph (3).

9 “(2) FINANCIAL REFERENCE HANDBOOK.—The
10 handbook described in this paragraph is a pamphlet
11 which—

12 “(A) includes definitions of basic financial
13 terms,

14 “(B) contains a listing of financial issues
15 and problems facing individuals who are retir-
16 ing and explanations of methods of dealing with
17 the issues and problems, and

18 “(C) is in a form readily understandable
19 by the average retiree.

20 “(3) READINESS CHECKLIST.—The checklist
21 described in this paragraph is a list of questions that
22 individuals need to consider in preparation for re-
23 tirement, including the following:

24 “(A) What annual income will the indi-
25 vidual need in retirement?

1 “(B) How many years will the individual
2 live in retirement?

3 “(C) What will be the cost of Medicare
4 premiums?

5 “(D) What will be the cost of insurance
6 necessary to supplement Medicare?

7 “(E) How will savings be invested in re-
8 tirement?

9 “(F) How will taxes affect your retirement
10 income?

11 The checklist will include answers to the questions
12 or directions as to where information is available to
13 answer the questions. All information shall be in a
14 form readily understandable to the average recipient
15 of the checklist.

16 “(4) REVISIONS.—The Commissioner shall peri-
17 odically revise and update the handbook and check-
18 list prepared under this subsection.

19 “(5) DISTRIBUTION OF MATERIALS.—

20 “(A) HANDBOOK.—The financial reference
21 handbook described in paragraph (2) shall be
22 included with materials provided to an indi-
23 vidual when the individual first applies for ben-
24 efits under title II and such other times as the
25 Commissioner determines appropriate.

1 “(B) CHECKLIST.—The retirement readi-
 2 ness checklist described in paragraph (3) shall
 3 be included with an individual’s annual social
 4 security account statement provided under sec-
 5 tion 1143.”.

6 (b) EFFECTIVE DATE.—The amendment made by
 7 this section shall take effect on the date of the enactment
 8 of this Act, but the handbooks and checklists required to
 9 be provided by such amendment shall be provided on or
 10 after January 1, 2008 (or such earlier date as the Com-
 11 missioner of Social Security may provide).

12 **TITLE V—INCENTIVES FOR**
 13 **SMALL BUSINESSES TO ES-**
 14 **TABLISH AND MAINTAIN RE-**
 15 **TIREMENT PLANS FOR EM-**
 16 **PLOYEES**

17 **SEC. 501. CREDIT FOR QUALIFIED PENSION PLAN CON-**
 18 **TRIBUTIONS OF SMALL EMPLOYERS.**

19 (a) IN GENERAL.—Subpart D of part IV of sub-
 20 chapter A of chapter 1 (relating to business related cred-
 21 its), as amended by section 102, is amended by adding
 22 at the end the following new section:

1 **“SEC. 450. SMALL EMPLOYER PENSION PLAN CONTRIBU-**
2 **TIONS.**

3 “(a) GENERAL RULE.—For purposes of section 38,
4 in the case of an eligible employer, the small employer pen-
5 sion plan contribution credit determined under this section
6 for any taxable year is an amount equal to 50 percent
7 of the amount which would (but for subsection (f)(1)) be
8 allowed as a deduction under section 404 for such taxable
9 year for qualified employer contributions made to any
10 qualified retirement plan on behalf of any employee who
11 is not a highly compensated employee.

12 “(b) CREDIT LIMITED TO 3 YEARS.—The credit al-
13 lowable by this section shall be allowed only with respect
14 to the period of 3 taxable years beginning with the first
15 taxable year for which a credit is allowable with respect
16 to a plan under this section.

17 “(c) QUALIFIED EMPLOYER CONTRIBUTION.—For
18 purposes of this section—

19 “(1) DEFINED CONTRIBUTION PLANS.—In the
20 case of a defined contribution plan, the term ‘quali-
21 fied employer contribution’ means the amount of
22 nonelective and matching contributions to the plan
23 made by the employer on behalf of any employee
24 who is not a highly compensated employee to the ex-
25 tent such amount does not exceed 3 percent of such

1 employee's compensation from the employer for the
2 year.

3 “(2) DEFINED BENEFIT PLANS.—In the case of
4 a defined benefit plan, the term ‘qualified employer
5 contribution’ means the amount of employer con-
6 tributions to the plan made on behalf of any em-
7 ployee who is not a highly compensated employee to
8 the extent that the accrued benefit of such employee
9 derived from employer contributions for the year
10 does not exceed the equivalent (as determined under
11 regulations prescribed by the Secretary and without
12 regard to contributions and benefits under the Social
13 Security Act) of 3 percent of such employee's com-
14 pensation from the employer for the year.

15 “(d) QUALIFIED RETIREMENT PLAN.—

16 “(1) IN GENERAL.—The term ‘qualified retire-
17 ment plan’ means any plan described in section
18 401(a) which includes a trust exempt from tax
19 under section 501(a) if the plan meets—

20 “(A) the contribution requirements of
21 paragraph (2),

22 “(B) the vesting requirements of para-
23 graph (3), and

24 “(C) the distribution requirements of para-
25 graph (4).

1 “(2) CONTRIBUTION REQUIREMENTS.—

2 “(A) IN GENERAL.—The requirements of
3 this paragraph are met if, under the plan—

4 “(i) the employer is required to make
5 nonelective contributions of at least 1 per-
6 cent of compensation (or the equivalent
7 thereof in the case of a defined benefit
8 plan) for each employee who is not a high-
9 ly compensated employee who is eligible to
10 participate in the plan, and

11 “(ii) allocations of nonelective em-
12 ployer contributions, in the case of a de-
13 fined contribution plan, are either in equal
14 dollar amounts for all employees covered
15 by the plan or bear a uniform relationship
16 to the total compensation, or the basic or
17 regular rate of compensation, of the em-
18 ployees covered by the plan (and an equiv-
19 alent requirement is met with respect to a
20 defined benefit plan).

21 “(B) COMPENSATION LIMITATION.—The
22 compensation taken into account under sub-
23 paragraph (A) for any year shall not exceed the
24 limitation in effect for such year under section
25 401(a)(17).

1 “(3) VESTING REQUIREMENTS.—The require-
 2 ments of this paragraph are met if the plan satisfies
 3 the requirements of either of the following subpara-
 4 graphs:

5 “(A) 3-YEAR VESTING.—A plan satisfies
 6 the requirements of this subparagraph if an em-
 7 ployee who has completed at least 3 years of
 8 service has a nonforfeitable right to 100 percent
 9 of the employee’s accrued benefit derived from
 10 employer contributions.

11 “(B) 5-YEAR GRADED VESTING.—A plan
 12 satisfies the requirements of this subparagraph
 13 if an employee has a nonforfeitable right to a
 14 percentage of the employee’s accrued benefit de-
 15 rived from employer contributions determined
 16 under the following table:

“Years of service:	The nonforfeitable percentage is:
1	20
2	40
3	60
4	80
5	100.

17 “(4) DISTRIBUTION REQUIREMENTS.—In the
 18 case of a profit-sharing or stock bonus plan, the re-
 19 quirements of this paragraph are met if, under the
 20 plan, qualified employer contributions are distribut-
 21 able only as provided in section 401(k)(2)(B).

1 “(e) OTHER DEFINITIONS.—For purposes of this
2 section—

3 “(1) ELIGIBLE EMPLOYER.—

4 “(A) IN GENERAL.—The term ‘eligible em-
5 ployer’ means, with respect to any year, an em-
6 ployer which has no more than 25 employees
7 who received at least \$5,000 of compensation
8 from the employer for the preceding year.

9 “(B) REQUIREMENT FOR NEW QUALIFIED
10 EMPLOYER PLANS.—Such term shall not in-
11 clude an employer if, during the 3-taxable year
12 period immediately preceding the first taxable
13 year for which the credit under this section is
14 otherwise allowable for a qualified employer
15 plan of the employer, the employer or any mem-
16 ber of any controlled group including the em-
17 ployer (or any predecessor of either) established
18 or maintained a qualified employer plan with
19 respect to which contributions were made, or
20 benefits were accrued, for substantially the
21 same employees as are in the qualified employer
22 plan.

23 “(2) HIGHLY COMPENSATED EMPLOYEE.—The
24 term ‘highly compensated employee’ has the mean-

1 ing given such term by section 414(q) (determined
2 without regard to section 414(q)(1)(B)(ii)).

3 “(f) SPECIAL RULES.—

4 “(1) DISALLOWANCE OF DEDUCTION.—No de-
5 duction shall be allowed for that portion of the quali-
6 fied employer contributions paid or incurred for the
7 taxable year which is equal to the credit determined
8 under subsection (a).

9 “(2) ELECTION NOT TO CLAIM CREDIT.—This
10 section shall not apply to a taxpayer for any taxable
11 year if such taxpayer elects to have this section not
12 apply for such taxable year.

13 “(3) AGGREGATION RULES.—All persons treat-
14 ed as a single employer under subsection (a) or (b)
15 of section 52, or subsection (n) or (o) of section 414,
16 shall be treated as one person. All eligible employer
17 plans shall be treated as 1 eligible employer plan.

18 “(g) RECAPTURE OF CREDIT ON FORFEITED CON-
19 TRIBUTIONS.—

20 “(1) IN GENERAL.—Except as provided in para-
21 graph (2), if any accrued benefit which is forfeitable
22 by reason of subsection (d)(3) is forfeited, the em-
23 ployer’s tax imposed by this chapter for the taxable
24 year in which the forfeiture occurs shall be increased
25 by 35 percent of the employer contributions from

1 which such benefit is derived to the extent such con-
2 tributions were taken into account in determining
3 the credit under this section.

4 “(2) REALLOCATED CONTRIBUTIONS.—Para-
5 graph (1) shall not apply to any contribution which
6 is reallocated by the employer under the plan to em-
7 ployees who are not highly compensated employees.”.

8 (b) CREDIT ALLOWED AS PART OF GENERAL BUSI-
9 NESS CREDIT.—Section 38(b) (defining current year busi-
10 ness credit) , as amended by section 102, is amended by
11 striking “and” at the end of paragraph (30), by striking
12 the period at the end of paragraph (31) and inserting “,
13 and”, and by adding at the end the following new para-
14 graph:

15 “(32) in the case of an eligible employer (as de-
16 fined in section 450(e)), the small employer pension
17 plan contribution credit determined under section
18 450(a).”.

19 (c) CONFORMING AMENDMENTS.—

20 (1) Subsection (c) of section 196 is amended by
21 striking “and” at the end of paragraph (12), by
22 striking the period at the end of paragraph (13) and
23 inserting “, and”, and by adding at the end the fol-
24 lowing new paragraph:

1 “(14) the small employer pension plan contribu-
2 tion credit determined under section 450(a).”.

3 (2) The table of sections for subpart D of part
4 IV of subchapter A of chapter 1, as amended by sec-
5 tion 102, is amended by adding at the end the fol-
6 lowing new item:

“Sec. 450. Small employer pension plan contributions.”.

7 (d) EFFECTIVE DATE.—The amendments made by
8 this section shall apply to contributions paid or incurred
9 in taxable years beginning after December 31, 2006.

10 **SEC. 502. DEDUCTION FOR PENSION CONTRIBUTIONS AL-**
11 **LOWED IN COMPUTING NET EARNINGS FROM**
12 **SELF-EMPLOYMENT.**

13 (a) IN GENERAL.—Section 1402(a) (defining net
14 earnings from self-employment) is amended by striking
15 “and” at the end of paragraph (15), by striking the period
16 at the end of paragraph (16) and inserting “, and”, and
17 by inserting after paragraph (16) the following new para-
18 graph:

19 “(17) any deduction allowed under section 404
20 by reason of section 404(a)(8)(C) shall be allowed,
21 except that the amount of such deduction shall be
22 determined without regard to this paragraph.”.

23 (b) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to taxable years beginning after
25 December 31, 2006.

1 **SEC. 503. EXEMPTION OF DEFERRAL-ONLY QUALIFIED**
2 **CASH OR DEFERRED ARRANGEMENTS FROM**
3 **TOP-HEAVY PLAN RULES.**

4 (a) IN GENERAL.—Section 416(g) (defining top-
5 heavy plan) is amended by adding at the end the following
6 new paragraph:

7 “(5) EXCEPTION FOR DEFERRAL-ONLY CASH
8 OR DEFERRED ARRANGEMENTS.—In the case of a
9 plan which consists solely of a qualified cash or de-
10 ferred arrangement (as defined in section 401(k)(2))
11 under which no amounts may be contributed other
12 than elective deferrals (as defined in section
13 402(g)(3)), such plan shall not be treated as a top-
14 heavy plan.”.

15 (b) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to years beginning after December
17 31, 2006.

18 **SEC. 504. EXTENSION OF TIME FOR SMALL PENSION PLANS**
19 **TO ADOPT REQUIRED PLAN QUALIFICATION**
20 **AMENDMENTS.**

21 (a) IN GENERAL.—In the case of an eligible small
22 plan for which a remedial amendment period is established
23 under Internal Revenue Procedure 2005-66 (or any regu-
24 lation, revenue ruling, revenue procedure, or guidance pro-
25 viding for a similar period), no amendment to the plan
26 necessary for the plan to meet the qualification require-

1 ments under the Internal Revenue Code of 1986 shall be
2 required before the close of such period.

3 (b) ADDITIONAL REQUIREMENTS.—Subsection (a)
4 shall not apply to an eligible small plan unless—

5 (1) any amendment described in subsection (a)
6 applies retroactively to the period during which such
7 amendment would otherwise have been required to
8 be in effect,

9 (2) the plan is operated during the period de-
10 scribed in paragraph (1) as if the amendment were
11 in effect, and

12 (3) the plan meets such requirements as the
13 Secretary of the Treasury may prescribe to ensure
14 that the Secretary, the Secretary of Labor, employ-
15 ers maintaining the plan, and participants and bene-
16 ficiaries of the plan are adequately notified of the
17 terms of the plan actually in effect during a plan
18 year.

19 (c) ELIGIBLE SMALL PLAN.—For purposes of this
20 section—

21 (1) IN GENERAL.—The term “eligible small
22 plan” means a plan which, as of the beginning of a
23 remedial amendment or similar period described in
24 subsection (a), had 100 or fewer participants. For
25 purposes of this paragraph, all defined benefit plans

1 which are single-employer plans and are maintained
2 by the same employer (or any member of such em-
3 ployer's controlled group) shall be treated as 1 plan,
4 but only participants with respect to such employer
5 or member shall be taken into account.

6 (2) APPLICATION OF CERTAIN RULES IN DE-
7 TERMINATION OF PLAN SIZE.—For purposes of this
8 subsection—

9 (A) PLANS NOT IN EXISTENCE IN PRE-
10 CEDING YEAR.—In the case of the first plan
11 year of any plan, subparagraph (B) shall apply
12 to such plan by taking into account the number
13 of participants that the plan is reasonably ex-
14 pected to have on days during such first plan
15 year.

16 (B) PREDECESSORS.—Any reference in
17 paragraph (1) to an employer shall include a
18 reference to any predecessor of such employer.

19 (d) EFFECTIVE DATE.—This section shall apply to
20 amendments required to be adopted for plan years begin-
21 ning after December 31, 2006.

○