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EMPLOYEE BENEFITS TAXATION -- FUTURE OUTLOOK

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A discussion of the effect of recent changes in tax structures on employee benefits -- their value to employees, limitations on deductibility by employers, taxability to employees, and the direction of likely future changes. Will the continued emphasis on additional revenue generation result in a shift in employer emphasis toward additional cash compensation versus employee benefits?

MR. H. ROBERT EPLEY, III: In 1974, when ERISA was passed, and since then with all the other legislation, the subject of Employee Benefits has become a political football. Recently, in December, the House passed the tax reform bill, H.R. 3838, which reflects a continuation of many of the policy trends established in the 1982 and 1984 tax acts. Some of these trends are:

- o Tightening of the benefit and contribution limits;
- o Tightening of non-discrimination rules; and
- o A continued bias against the elective features of some of the tax deferred compensation programs.

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On March 18th, Senator Packwood released the side-by-side analysis that compares the Packwood proposal with the current law; the President's tax reform proposal from last year that was called Treasury II; and H.R. 3838, which came out of the House on December 17th. The next day, March 19th, the Senate Finance Committee began its mark-up of the Packwood proposal. Dallas Salisbury, the luncheon speaker at the Business Session and Luncheon, gave us a very succinct update on this mark-up of the employee benefits portion of the Senate Finance Committee's tax bill. Let me mention briefly some of my thoughts about what we in the private sector can do to influence tax reform legislation, particularly with respect to employee benefit plans:

- Remember that without proper input, individual Senators and Congressmen will not have the resources and clout to push for change.

- The most effective presentations are those that show the actual impact of changes on constituents and voters, rather than those that present predictions based on general statements and theories. I think as a group of actuaries we have to remember this, because many things we do involve generic statements and predictions. That's not what Congress is looking for in order to understand how it should vote on tax bills.

The input should offer solutions, not just readdress problems. As actuaries, we have access to data that can refute some of the many myths associated with employee benefits and document the social value they serve. One of the biggest myths is that these programs primarily serve the wealthy, and that lower paid people don't share in the benefits to a comparable degree. To the extent you can provide hard data to Congress, that will help. To the extent you can get your clients, the actual plan sponsors, to get involved, that also helps.

As I said, things are moving pretty quickly in the Senate. If you want to influence the process there, there's still time. But you have to act quickly.

The Senate Finance mark-up will continue through most of April, leaving the end of April and all of May for completing the Committee Report, with introduction of the bill on the Senate Floor in early June. Floor action may take all of June, if not more time than that.

It is expected that July and early August will be for the joint conference to work out the differences between the House and Senate versions, with final passage, it is hoped, on or around August 15th, when Congress adjourns.

A lot of the things that have been said over the past year have been in favor of maintaining 401(k)s, yet at the same time, take a look at what is changing in taxation. With lower tax rates now, maybe the lowest we'll ever see, and no favorable tax treatment in the future, why do we keep pushing for our generic thought that 401(k)s should remain alive? And yet that's what we as actuaries, what we as promoters of employee benefits, have done. I would think that 401(k)s could be done away with. I'm not sure that many people would agree with me, but I would like to raise that from a devil's advocate point of view as we get started into our Session today, so that we can debate, and discuss, and think what really is happening in Washington and how we want to play a part.

Now, let me introduce Gary Hallenbeck, who will give you his comments and insights on the tax implications in the pension, capital accumulation, and qualified plan area. Gary is a Vice President and Principal with Towers, Perrin, Forster & Crosby. He is in its Los Angeles office, where he is responsible for managing the Employee Benefits Services Department.

MR. GARY T. HALLENBECK: As Bob indicated, for the last two years we've all been watching the steady march forward of various legislative proposals with tax consequences for qualified plans. Without retracing the history of what those various proposals has been, I don't think there is much doubt that we're now within several months of final legislation that is going to contain some tax changes for qualified plans, and the substance of those changes is beginning to take form.

It seems to me that all the proposals are driven by one or more of three factors. First and foremost, a search by the federal government for additional revenue to address the continuing deficit that has been bedeviling us for the last four or five years. Second, a growing sentiment in Congress which would act to reduce and/or eliminate any feature of the tax code deemed to provide more advantage to the highly paid employee relative to the average employee.

Third, there seems to be a shift in public policy coming about which would provide more emphasis to the retirement income aspect of distributions from qualified plans.

The subject of the legislation, with regard to tax consequences, falls really into two categories. One would be the tax treatment of distributions from qualified plans. The second would be the tax deductibility of company contributions. In addition, there has been an assortment of special provisions, probably the most significant of them having to do with asset reversions. I would like now to review briefly the key provisions that seem to be taking shape and are likely to be in the final legislation, and indicate what appear to be the consequences for companies in terms of plan design.

The distribution rules probably contain more than half the material in terms of what is likely to change, and there will be changes in a number of other areas, four in particular: minimum distribution rules, early distribution penalties and restrictions, lump sum treatments, and the recovery basis for determining the taxability of annuity payments.

In the minimum distribution area it would seem the objective would be to equalize the tax treatment of all tax favored retirement plans -- that is, to provide equal rules and restrictions to qualified plans, tax deferred annuities, IRAs and Simplified Employee Pension plans. Right now, at least in terms of when benefits have to commence, qualified plans have a distinct advantage over the other forms, in that benefits don't have to commence until April 1 of the year following the year in which an individual attains age 70 1/2 or the April 1 of the year following the year in which the individual retires, whichever is later. IRAs, Simplified Employee Pension plans, and qualified plans, for distributions to 5% owners, don't have that second part of the rule. That is, April 1 following the year in which you attained age 70 1/2 is the absolute rule in all those other situations.

If the House had its way, it would clean things up by applying the age 70 1/2 rule to all plans, including qualified plans, without exception. The Senate, at least as it was evidenced in the Packwood Proposals, would take a much more limited action in this area in terms of changing the rules for qualified plans.

All the Packwood Proposal would do would be to substitute the new definition of highly compensated employees that comes into play for discrimination purposes, substitute the limitation on 5% owners, making it applicable to highly compensated employees. To the extent the plan doesn't abide by those rules, both the House and the Senate seem to be in agreement that the 50% excise tax on the excess of the required distribution over the distribution that was actually made would apply to qualified plans equally as it now applies to IRAs.

As I personally view this change, whether the Senate prevails or the House prevails, I don't think it is a substantive issue for sponsors of employee benefit plans. All I think it will really do if the House prevails is to limit to some extent the opportunities for certain executives to delay the receipt of their pension benefits beyond attainment of age 70 1/2. I don't think that's a raging issue here today. More important, and probably the most devastating aspect of the distribution proposals, is in the area of early distribution rules. Right now, distributions from IRAs are subject to a 15% excise tax if the distribution takes place prior to death, disability or attainment of age 59 1/2. Both the House and Packwood Proposal would apply the same rule to qualified plans. This would be a dramatic change from the current situation where, in effect, there are no early distribution restrictions on qualified plans. There would, however, be an exemption if the form of distribution is periodic payments made at least annually over the lifetime of the distributee or the distributee and his or her spouse. Now for a defined contribution plan, the only way you would be able to get the advantage of that exemption would be if an annuity were actually purchased.

In the early distribution area, there are two proposals that would simplify administration problems for employers as they relate to 401(k) plans. Specifically, both proposals would allow for a current distribution of a balance owing to an individual if the plan were terminated and the individual's employment continued as long as there were no successor plan that followed the 401(k) plan. In addition, 401(k) plans would be permitted to have hardship distributions prior to 59 1/2, but only to the extent of the employees' elective deferrals. In other words, the investment income on the deferrals would not be eligible for a hardship withdrawal. Important to note, however, is that although the proposals would allow these two exceptions in terms of earlier

distributions from the 401(k) plan, in both cases the excise tax would still apply. Thus the individual who is in receipt of a distribution for either of those reasons would be subject to the 15% excise tax.

The second significant change in the distribution rules would be in the area of lump sum distribution. Here, the House and Senate appear to be arm-in-arm in wanting to reduce the tax advantages of receiving a distribution from a qualified plan in the form of a lump sum. They would achieve that by repealing the current 10 year averaging; replacing it with a shorter 5 year averaging provision; and phasing out, over the next six years, capital gains treatment with respect to the appropriate portion of a lump sum distribution. There is some provision in the Packwood proposal for limited grandfathering under these proposals for people who reached age 50 prior to January 1, 1987.

The House and Senate up to now appear to be in complete agreement on the recovery basis, that is, the tax basis for periodic distributions from qualified plans. This would involve two changes from the current tax status of these distributions. First, the order of taxation would be completely reversed, as probably everyone in this room knows. Currently when you withdraw or receive a distribution from a plan, if there is tax-free employee contribution money in the plan (that is, after-tax employee contributions), those contributions are deemed to have been returned first. Under the proposals, the order would be reversed, and all taxable money in an individual's account would be deemed to have been withdrawn before the individual is able to get back the after-tax contributions.

On installment distributions, currently and for a long time there have been two alternative tax treatments. The three year recovery rule made the payments completely tax free until the individual had received his or her entire tax-free interest in the plan, as long as that would happen within three years. The exclusion ratio rule required you to calculate the employee's interest, relative to the total interest, and that would determine the taxable and non-taxable portions of every installment payment. Under both proposals currently on the Hill, the three year recovery rule would be repealed, and no matter what the size of the employee's interest in the distribution, the exclusion ratio rule would apply.

Now, what all these changes in the distribution rules have really boiled down to is that there is no doubt that early distribution penalties are going to substantially reduce the participation in 401(k) plans, as well as in more traditional 401(a) savings plans. I think the virtual elimination of favorable tax treatment on lump sum distributions, in combination with the exemption from the early distribution penalty if you receive payments in the form of periodic payments over the lifetime of the individual, is going to spark much interest among employees in receiving distributions in some form of annuity. In the pattern that we've seen in the past defined contribution plans, 90% or more of the employees always elect the lump sum. I think we're going to have, and the plan administrator is going to have to come to grips with, the need to provide annuities as a form of payment for an increasing number of distributees, particularly those who elect early retirement and leave the company before age 59 1/2. Looking further down the road, these changes, in combination with some of the other proposals in Congress, may very well lead to a longer term swingback in the defined benefit direction, away from the defined contribution movement that has been around for the last four or five years, principally sparked by the 401(k) developments.

From the area of deductibility of contributions, everything that I've seen continues to be focused on defined contribution plans, and to varying degrees, the proposals would curtail the contributions to such plans. The House and Senate are both in agreement on retaining the 15% of aggregate compensation contribution limit, but they would limit it to some extent. First of all, the current credit carryover provision would be abolished. That is the provision that says that if you put only 9% in for your employees this year, you could carry forward the difference between 9% and 15%, the 6%, and make additional contributions in the future. Both the House and the Senate appear to intend to do away with this provision. Excess contributions would be treated quite differently under the two proposals. The House would impose a 10% excise tax on such contributions, and the Senate would merely continue the current tax law which allows you to carry forward those excess contributions until a future year when you might have room within the tax limits to get a current deduction.

Probably the scariest and potentially most important provision with regard to deductibility of contributions in either proposal is the House Proposal that

would reduce the 15% limit by Social Security contributions on behalf of the eligible participants. If you think, for instance, of a plan where all the eligible participants are earning less than $42,000, the effect of that provision would be to take the 15% limit and reduce it by the 5.7% of the Social Security contribution that goes for OASDI; you would end up with a maximum limit on employer contributions of 9.3% of payroll. For those companies that use a defined contribution plan as their sole retirement income vehicle, this would drastically reduce the benefits that would be provided, especially for the highly paid employees. Therefore, it might well, if enacted, lead companies that have only a defined contribution plan to consider adopting a defined benefit plan to continue to provide, in total, the same level of benefits that their employees have come to expect to receive. It is also possible that, in combination with some of the other proposals concerning the limitation of benefits on highly paid employees, it will spark a further expansion of companies' interest in exploring and designing nonqualified supplemental plans to take care of their executives.

In the area of special rules, the House and Senate both appear to want to impose an excise tax on the amount of pension assets that an employer takes back into its own coffers as a result of a plan termination. The House bill and the Packwood proposals have a 10% excise tax. I understand that at the luncheon Dallas Salisbury mentioned 15%, so it may be that 10% has already been boosted up. If so, it is very unlikely that it will come down, because the provision has no purpose other than to assure that the government gets its share of the money that an employer needs to recapture. Whether it is 10% or 15%, I don't think it will significantly alter company actions, because, generally speaking, those companies that are taking steps to recapture assets are doing so because they need the money for their business. If they have to give 10% or 15% to the Government, that still leaves 90% or 85% for internal purposes.

In summary, the program had asked a question about the tax changes and their implications for the future of employee benefit plans and whether, in fact, the proposed changes may draw more employers to totally abandon plans and perhaps put more money into the pockets of their employees. I certainly don't think the tax-specific changes are going to do anything of the sort. If there is any

result of these particular changes, I think it will be to accelerate a move back to the defined benefit direction and away from defined contribution plans.

MR. EPLEY: Vince Donnelly is a Fellow of the Society and is the Actuary for the American Council of Life Insurance in Washington, D.C. Vince has been involved in the group life and health business for 26 years, the last 11 of which have been with the American Council of Life Insurance, and he's been quite active in its lobbying efforts.

MR. VINCENT W. DONNELLY: Good morning! I think if I had been making this speech exactly one year ago today, I may not have felt like beginning with that hearty greeting. The life and health insurance business, which I represent for a living, was facing a tax reform bill that had been endorsed by President Reagan which proposed to greatly change the tax favored status of most employer-sponsored benefits. Employees, employers, insurers, and health care providers were just getting geared up for a massive public relations and lobbying effort. What a difference a year makes. The public relations and lobbying effort to which I just referred was intense, aggressive, expensive and apparently successful from the viewpoint of the life and health insurance business. Battles were fought with Treasury, the House Ways and Means Committee, the full House of Representatives and now the Senate Finance Committee. Tax reform legislation which was passed in December by the House, and the initial proposals put forth by Senator Packwood in March, while not being totally acceptable to the Employee Benefit business, represent a significant improvement over the legislation introduced by Congressman Rostenkowski one year ago. But as any good general knows, winning a few battles doesn't guarantee winning a war. Hopefully, an acceptable armistice regarding tax reform can be signed before this year ends. I'm not as positive as Gary is with regard to the schedule that has been set out and that we'll see something by August; I'm anticipating something by year end, though.

That really brings us to the purpose of this discussion, the direction of likely future changes in tax treatment of employer sponsored benefits. Just how important is the tax treatment of such benefits? I'd like to quote a friend of mine and fellow actuary, Mr. Philip Briggs, Vice Chairman of the Metropolitan, who opened an oral statement before the House Ways and Means

Committee last year as follows: "Present tax policy has led to the greatest private voluntary system of life and health insurance this world has ever seen. It has brought about the development of a mechanism called employee group life insurance, and employee group health insurance. The key to this development of this employee group insurance essential to its continuation is the favorable tax climate that permitted its development."

Phil went on to quantify for the Ways and Means Committee the success of employee benefits: group life insurance in force for American workers totalling almost two trillion dollars; one-half million employers of all sizes providing group life insurance to their employees; more than 162 million people with group health insurance, nearly half of them with major medical coverage of $1 million dollars or unlimited. Compare this to a short time ago as history counts time, no more than 75 years ago, when the average working man could become ill, forfeit his pay for the period of his illness, spend his meager savings in the process of his recovering, and none but family would care; or he could die early in his life, with nothing for his surviving family. Yes, the employee benefit story is a rousing success story. Perhaps too successful, for its success is making it a primary target for tax reform, deficit reduction, state mandated benefit laws, state health care practitioner laws, nondiscrimination standards, premium taxes -- the list goes on and on.

What does the future hold? It's hard to believe it doesn't hold more of the same. Let's look at a few very recent tax related developments which are having and will continue to have a very significant impact on the continuing success of employee benefit programs. The provision of the House and the Senate tax reform proposals which will establish uniform non-discrimination standards for health care plans is the first development. The second is the recent IRS regulations implementing the Tax Reform Act of 1984, which in their haste to close off the employer access to 501(c)(9) trusts, or so-called VEBAs, very nearly killed a legitimate and valuable employee benefit funding mechanism used by many employers, namely, experience rating and premium stabilization arrangements. The third development is the provision contained in the Consolidated Omnibus Budget Reconciliation Act, commonly referred to now as COBRA, which was signed into law by President Reagan; this threatens employers with the loss of the deductibility of the cost of their health care plans unless they offer

certain employees and dependents the option of continuing their protection once they are no longer eligible members of the group. Let's look at each of these a little more closely.

First of all, as I've previously noted, both the House and Senate versions of tax reform legislation propose the establishment of uniform nondiscrimination rules for employer sponsored life and health care plans. It's difficult, if not impossible, to be against nondiscrimination proposals. Legislators, when making speeches in favor of such proposals, usually emphasize the need to link tax-favored treatment to broad eligibility for benefits. The public, upon reading or hearing about such legislative proposals, perceives the existence of widespread abuse of the tax system by highly paid individuals. Despite the fact that group life insurance can honestly be called a universal benefit because it covers almost 100% of working Americans and despite the fact that more than 160 million persons have health care protection, it appears likely that employee benefits will be faced with many and varied nondiscrimination proposals for years into the future. The basic problem will not be defeating such legislation, but rather making it workable in a rapidly changing environment. To put it more simply, the problem will be to assure non-discrimination while at the same time not slowing down the drive towards health care cost containment, flexible compensation programs, or other worthy endeavors.

Let me give you one small but typical example of the problems I have been alluding to. The Proposals before the Senate Finance Committee include a requirement that an employer-sponsored group health insurance plan conform to nondiscrimination standards which are new to the health insurance business. The basic requirement is that 80% of the employees participate in the Plan, or that if this test is not met, the plan must benefit a reasonable classification of employees that does not discriminate in favor of highly compensated employees.

On the surface it sounds simple and highly logical, but consider the following: with the trend towards greater numbers of two-worker families, many employers are making their health plans contributory, and at the same time are toughening their administration of coordination of benefits, commonly referred to as COB. If you are an employer that offers employment primarily to the second worker,

your plan may be deemed discriminatory, merely because you can't pass the mechanical 80% participation test, due to the opting out by a significant portion of your work force.

Despite the fact that HMOs and PPOs are nearly becoming household words in the employee benefit business, they are not yet universally available. If an employer that is dearly committed to health care cost containment implements a PPO option at one of its plants but cannot at another of its plants, the employer is in jeopardy of disqualifying its entire program. Now, it is obviously not the purpose of the nondiscrimination legislation, nor the legislators who support it, to undercut the trend toward expanded employment opportunity or health care cost containment; however, the legislators remain committed to strong nondiscrimination rules, and so the problem, as I stated earlier, is one of conforming the legislation to existing practices rather than defeating it. In light of the rapidly changing employee benefits market, this will place extreme pressure on legislators, employers, consultants and insurers to make certain that the system is not damaged in the search for a good solution.

Let me address, secondly, experience rating arrangements. In 1984, Congress was told very emphatically that employers were abusing the special tax privileges granted the 501(c)(9), or VEBAs. As a result, the Tax Reform Act of that year contained severe restrictions on the timing and amount of the deductions that an employer could claim for contributions to its VEBA. There were also substantial penalties imposed, like a 100% excise tax, if the employer contributed in excess of the guidelines and then received a refund. While the problem being corrected probably was never as great or as pervasive as it was originally perceived, the real problem eventually became the legislation's inability to narrowly define a VEBA, thereby allowing the penalties (that is, the 100% excise tax) to become applicable to the typical experience rating arrangements which most large employers use to fund their group life and health insurance programs. Just as was the case with the non-discrimination legislation which I described earlier, the solution spilled over into an area which was not part of the problem.

Just a few days ago the IRS issued an announcement that clarified the status of experience rating arrangements, at least temporarily. And I emphasize the word *temporarily.* Looking to the future, it is likely that if employers are to continue to enjoy the deductibility of their contributions toward the costs of benefit programs they establish for their employees, increasing attention is going to be paid by the Treasury and the IRS to the nature of the funding arrangements established. Highly technical legislation and regulations should be anticipated by all of us within the employee benefits business.

Let me address now the topic of mandated coverage. Speaking of the future, recent legislative proposals winding their way through Congress give every indication that we will be faced with an increasing volume of federal efforts to control the tax favored status of benefits programs. Anyone who has been associated with the group insurance business in the recent past is quite familiar with efforts of state governments to mandate the expansion of employer sponsored benefit plans. Now it is growing rather apparent that we can add an increasing volume of federal involvement. Look at the areas where federal legislation either exists or is actively being considered: long-term care insurance, post employment medical coverage, and assistance for technology dependent children represent just the tip of the iceberg. I am certain that everyone in this room is probably aware that just a few days ago, President Reagan signed a piece of budget legislation which will now withdraw the deductibility of an employer's contributions toward the cost of a group medical plan if that plan fails to offer specially defined classes of employees and dependents the option to continue their group protection for up to three years after they fail to meet the plan's eligibility requirements. The handwriting is on the wall. Today, laid-off employees, divorced or separated spouses, and dependent children reaching the age of majority are being given special protection upon the loss of their employer sponsored benefits. Tomorrow it could very easily be retirees, various classes of health care providers, or long-term care, and the list goes on.

Hopefully, without giving too many specifics, or maybe leaving the specifics to your questions, I have given you a better perception of what is in store for employee benefit plans in the future. Now, some view all of this legislation as "making something good better," while others say it is "killing the goose

that laid the golden egg." Regardless of your personal point of view, all of us in the employee benefit business can probably agree with Dallas Salisbury's warning, "You ain't seen nothing yet!"

MR. LAWRENCE J. RUPP: Vince, on this continuation question, does that mean there would be a Federal self-insured plan, as well as insured plans?

MR. DONNELLY: Larry, the legislation is aimed at employers who have plans. Whether those plans are insured or uninsured, the employer, as long as it meets the requirements (namely, it has 20 employees or more) would be required beginning July 1 of this year, to offer laid-off employees, employees losing employment voluntarily or involuntarily, all the dependents of deceased employees, and children who attain the age of majority and lose their coverage -- all of those would be required to be offered the option. In the case of dependents, it would be for 3 years, and, in the case of employees, for 18 months.

MR. RUPP: Vince, I would submit that this might be a red herring. In light of our experience in Wisconsin, which was one of the first states that had this kind of law, we really haven't seen that much of a problem. In fact, I think this has been a boon to our company, simply because we've been able to work with the continuation pool. Certainly, once the people got out from under the employer sponsorship, we have been able to rate this pool better than we had in the past with the individual conversion policies.

MR. DONNELLY: With regard to this legislation, and I think this is a good part of the result, group health conversions will basically disappear. In the Bill there is a requirement that you be given a conversion option, but I think the conversion given to an individual policy will pretty much go away, and I don't think the group insurance business really minds that all that much. One of the problems you have in the Federal legislation of this type is that probably not many people take that option because of the cost. That will possibly lead government into the idea of mandating that the employer next continue to pay what it was paying before the legislation was passed. That was not in this Bill right now.

MS. DOROTHEA D. CARDAMONE: You say this applies for employee groups of 20 or more. What about those that have not been providing any retiree coverage? Will the people leaving the plan because of retirement have to be provided something in this case?

MR. DONNELLY: No, the Bill does not apparently deal with the issue of continuing coverage after retirement. It deals primarily with the employees who have been laid-off and lose coverage as a result of being ineligible for the group. We have not interpreted this legislation as mandating a continuation of coverage into retirement.

MS. CARDAMONE: But it would seem like it could be interpreted that way, unless the legislation specifically excepted retirement.

MR. DONNELLY: The legislation has a provision in it that if somehow you're laid-off and you get other coverage, I think the perception was that you would become eligible for Medicare.

MS. CARDAMONE: At age 65?

MR. DONNELLY: Yes. It has those kinds of flaws in it because of the rush to get legislation through. Obviously, regulations would be key in interpreting the legislation.

MR. DAVID W. REIMER: Say you have a plan, and one year after a person commences on continuance, the plan has a major amendment. Is there any indication in the legislation of which benefit is being continued -- the one that was in force when he ceased to be employed or the one currently being offered?

MR. DONNELLY: The indication that we have, at least at this point, is that to the extent that the changes are being made in the plan, they would carry through to the improvements. We are always unsure in this day and age as to whether, if you decrease, the plans carry through, but the improvements would continue through the duration of the continuation of the option. The person would not be stuck with the old benefits if the plan changed; the benefits would be conveyed through the continuation. That's our understanding of the

legislation as of this moment. I think that's better for us, the insurance companies. Maybe for the employers, the confusion of the different plans over the period of three years would create a very difficult situation to administer.

MR. EPLEY: Let me now introduce Adrian Collins, who would like to refer to as the person we have with his finger on the pulse of what's going on in Washington right now. Adrian is a guest with us today and is Senior Benefits Consultant and Tax Advisor with Alexander & Alexander in New York. Adrian was Chairman of Treasury Committee for ERIC from its inception until 1982. He was a Senior Tax Counsel for Exxon for 15 years, and he's been involved in the Washington scene in many ways, assisting in the enactment of ERISA and many of its subsequent regulations.

MR. ADRIAN A. COLLINS: Perhaps I can give you a few insights that you can take back to your clients on the course of legislation for the future, and maybe some ideas on how the clients can best mold and shape that legislation to suit ends that are more laudable than those that are being sought by our people in Washington. It's such a beautiful day and it seems so far away from Washington that I think the tendency is to forget there is a mentality in that city that indicates that whenever you have tax legislation, it's time to make another installment in what I call the straitjacketing of the United States employee benefit plans. I think we began the process with the TEFRA, DEFRA and REA legislation. We often, as technicians and practitioners on a day to day basis, lose sight of the kind of philosophy that is insidiously working behind the scenes to bring benefits more into the realm of inflexible rules, lack of individual choice, and more mandating of the kind of employee welfare that certain people want, as opposed to the individual flexibility that we've had in the past.

I think one thing that we should look at is the phrase "Things are not always what they seem." When this legislation was originally proposed by President Reagan in May of 1985, it was called the President's Tax Proposals for Fairness, Growth and Simplicity. I think if we recall that was the objective, we now find we have lost sight of simplicity, and one can debate whether there is any fairness or growth promotion as actual objectives in these benefit

provisions that are now on the table. What we can see is that there are certain proposals that keep surfacing over the last years since the President's Commission on pension policy first articulated them. One is a mandated sort of general pension coverage or general retirement coverage which doesn't allow for much flexibility. Another is the desire for life annuity options as opposed to mid-career money in hand. A third is a discouragement of individual choice and a lack of flexibility. And perhaps another is a certain conflict, or confusion, over the proper level of the ERISA protections, and this we see in the constant up and down of the 415 limitations on contributions. Congress can't quite get its act together on where the proper levels of contributions or benefits really ought to be. Of course, that gives us all fine careers making computations, but it doesn't really help an employer in planning where it should put its dollar for the best benefit of its group of employees.

Now let's take a look at the ostensible big ticket items, if you will. When this legislation was proposed, the real big ticket items that cost revenue were the new tax rate schedules. Depending on whose tax items we look at, the President's version would have cost $224 billion, the House version $134 billion, and the Senate Chairman's version roughly $131 billion. Now before all that revenue goes out for simplified tax rate schedules, somebody has to get it back if the objective of the Bill is to be revenue neutral. So let us keep that in mind, along with the personal exemptions that are to be raised. The President is very adamant about these two things for fairness, growth and simplicity. We lose another $163 billion with the exemption proposal, and, $147 billion is lost in the House proposal and $156 billion in the Senate Chairman's proposal.

Now one has to question why, in this installment of straitjacketing of benefits, employee benefits are in a revenue measure or tax measure to begin with, unless we are going to clean up our act? I think that this see-saw that we see in the House and Senate versions is not a cleaning up of the act, but a certain coming together of principles that are in opposition, and the result is going to be compromise, but compromise over a very short time frame. We know Senator Packwood must face primary elections this year, which means this Bill has to be done by the time he goes back for the July 20th Oregon primaries. And there are a number of other Congressmen who face reelections, and they all want it all

out of the way before they go home for campaigning. No one wants to have tax reform legislation very much up front, because some constituents are going to be hurt no matter what happens.

So why are the benefit provisions in there? This is another piggy-backing of employee benefits on the tax legislation, as we saw in TEFRA, DEFRA, and REA. The same pattern is coming back to haunt us: very short time frame, the House has completed its work, the Senate must accommodate a President who wants this legislation. Nobody in Washington really wanted it, but President Reagan is a very powerful statesman at this point, and he's put his weight behind it. Twice he went to the House to get the Bill passed, and he's not going to let it die, I don't believe. We see how much real popularity President Reagan has in the foreign affairs news the last few weeks. I do not believe that popularity will wane when it gets to his persuading the Congress on tax legislation. So one thing we can be fairly sure of (unless the President changes his mind, but I see nothing on the horizon to say he will, with regard to tax legislation), is that we will get a Bill, and we will get a law, and he will hammer it out on the big ticket items.

Along for the ride will come employee benefit provisions. Unless you and your clients make a definite noise with Congress, you may find that the provisions you really don't want will be on the table for the President's signature, swept up in this quick time frame of reform. This reform is really just change motivated by a certain philosophy in Congress among the staffers -- among the certain Congressmen who have any interest at all in the fact that the rich are becoming too rich and are being given too much flexibility. The individual is really not in command of his retirement income; it should be mandated as a life annuity option, and all other pay status distributions of any sort should be discouraged, even to the point of discouraging loans from plans, and discouraging withdrawals. All of those things are bad, so we will impose taxes on them, turn people away from early distributions, and encourage them to go into the IRAs and take their money over a period of time.

Now the big ticket items are really only five. The 401(k) plans are one: $15.9 billion in keeping them at the level that the President proposed, $4.7 billion revenue gain in keeping them at the level the House proposed, a loss of $0.4

billion by the Senate Chairman's amendments, because he would raise the level from $7,000 to $12,000. Everyone has perceived that as giving something away to the highly paid, as something that the rank and file would really not benefit from. This is going on in the Senate Committee, so what we are going to find is that in a very short time frame, when we come to conference, all of a sudden there will be a railroad, and there will be a compromise, and unless your people and others in this country make a clear statement to their Congressmen, then we will all lose. We will lose flexibility, and we will lose the kinds of ERISA protection we've had in the past, unless we are eternally vigilant.

The other three or four things that are big tickets items for getting revenue back are not really big, not when compared with the loss of revenue on tax rate schedules, and not when compared with revenue and gain schedules up from investment of tax rate changes and other non-employee benefit changes. However, they are worth mentioning. The uniform tax treatment of distributions will gain about $10 billion or $8 billion worth of revenue, depending upon which way you slice it. Discouraging withdrawals before the age of 59 1/2 will gain $1.9 billion to $2.1 billion in revenue. The ESOP financing incentive eliminations we saw coming in DEFRA to give us some special financing advantages in ESOPs would be eliminated with the House Bill. However, they haven't been touched in the Senate Bill, so of course there will be a real conflict in conference about that. Section 415 limitations don't amount to much in revenue at all, which is confirming the point I'm trying to make. It is not a revenue-motivated set of proposals, but it is being masqueraded as a revenue-motivated set of proposals.

So I urge you -- if you have any interest at all in simplicity, in fairness and in growth -- to advise your clients of where they stand with these proposals, and to get them to write their Congressmen. Congressmen perceive lack of communication to Congress as approval that they can do whatever they please and whatever they think is going to compromise, and that of course is what they're going to have to do to get this legislation out of Congress and onto the President's desk.

In conclusion, all of the things you've heard this morning, I think, are worthy of thought from a long-term perspective. I'm offering my own private opinion, but it's based on a number of years hammering around in Washington and seeing how the system works. We probably will get our tax bill, because the President wants it. It will have employee benefit legislation in it, because there are people among Congressional staff who want it. And they are furthering the objective of less flexibility from the individual basis, less in the way of defined contribution plans, and more in the way of defined benefit plans and all other things that represent a compromise when it comes to limitations. Where should the ERISA protections lie? Let's tinker with it a little and maybe pick up a few billion in revenue -- not much, but a little.

In the end, I can leave you with these thoughts. Review what you have seen in the press with your clients, and get them to communicate with their Congressmen, because that is the way we will keep the employee benefit section of the tax law from riding through this railroad again.

MS. BARBARA J. LAUTZENHEISER: Are we getting any concern from the U.S. Chamber or employers about this? It seems to me it's not just the insurance industry or the actuarial profession that is concerned, but I would sense that the employers would be extremely concerned about this. Are we getting any indication from their parts of the concern?

MR. COLLINS: Yes, there are several groups representing employers. The APPWP has an employer contingent, and the ERIC group is still very much alive. They've made comments. I think one of the strongest lobbyists from the standpoint of the defined contribution plan is the Profit Sharing Council of America. I'm on its legal and legislative committee, and its President has been pounding the doors in Congress to show why profit sharing will be pretty well cut down unless these rules are tabled. These rules on penalizing lump sum distributions and some of the other 415 limitations changes tend to discourage smaller employers, because they throw up their hands in despair and say they can't afford even the cost of computing the change. So we do have certain employer groups working. The problem, of course, is that for most employers, benefit plan tax matters are low on the list, because the money just isn't there for them to devote their lobbying efforts to the cause. When you're

talking about investment tax credit losses and depreciation, those millions are very high on the list for a company. So we have to understand that as consultants we have got a constituency of our own, and it's up to us to bear it for what it's worth.

MS. LAUTZENHEISER: What about the unions? I sense that their contingents are going to be very concerned about the loss of some of these benefits, which I agree with you is going to occur.

MR. COLLINS: Yes, and I've seen some of these unions making some points, but unfortunately I don't see much effort on their part, and I don't guess that the unions get together very much. The AFL-CIO and the Teamsters have made comments during the legislation, but they just don't have the technical expertise on their staffs to really hit Congress where it is very important, and the timing is not all that good. I think there's a place for us to make our comments to clients regardless of where our interests lie, whether you're with an insurance company, whether you're with a private consulting firm, whether you have some other actuarial role to play. I think that wherever you have a relationship with a client that is an employer or a plan administrator, you should make known what's going on and get the client to get to its Congressmen and ward off some of these proposals.

MS. LAUTZENHEISER: Sounds like it's very imperative that we, as a profession, take a major role in doing that, since we have the expertise.

MR. COLLINS: If we don't, we have lost an opportunity. You're the ones who are technically proficient in the area. Who better to make the point?