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**Hearing Testimony for the Record
Senate Committee on Finance
Subcommittee on Long-Term Growth and Debt Reduction**

**"Small Business Pension Plans:
How Can We Increase Worker Coverage?"**

June 29, 2006

Introduction

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates the opportunity to submit our comments to the Senate Committee on Finance, Subcommittee on Long-Term Growth and Debt Reduction, June 29 hearing, "Small Business Pension Plans: How Can We Increase Coverage?" We fully support the Committee's efforts to increase retirement savings for millions of employees working for small business employers. These workers frequently do not have the opportunity to save through a workplace retirement plan.

ASPPA is a national organization of approximately 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

ASPPA would like to thank Chairman Gordon Smith (R-OR) and Ranking member John Kerry (D-MA) of the Senate Committee on Finance, Subcommittee on Long-Term Growth and Debt Reduction for examining these important issues. In particular, we would like to thank the efforts made by Senators Smith and Kent Conrad (D-ND) to examine the issues facing small business retirement plan coverage and the challenges faced by women in saving for retirement. ASPPA is hopeful that these efforts will ultimately produce comprehensive and valuable legislation that will bolster retirement plan coverage for millions of American workers.

ASPPA Supported Proposals

ASPPA strongly supports the following proposals and recommends the Committee incorporate these issues into possible future legislation designed to expand retirement plan coverage.

Increasing Retirement Savings through Automatic IRAs

ASPPA supports giving American workers access to an employer-based retirement savings program, specifically a payroll-deduction IRA, where they are not already covered by a qualified retirement plan is essential. Coupled with an expanded SAVER's credit, this legislative proposal will likely persuade more employers, particularly small businesses, to offer a qualified retirement plan to their workers. It should also greatly improve the retirement savings rates of lower-income workers (statistics clearly show that low- to moderate-income workers are significantly more likely to save for retirement when allowed to save at the workplace).

It is important to emphasize that employers offering a qualified retirement plan should not be required to also offer a payroll-deduction IRA. Requiring such employers to offer two plans would be unnecessarily burdensome and would actually serve to discourage the formation of the qualified retirement plans that provide more generous benefits to workers.

Amending 401(k) Plan Coverage Rules for Long-Term, Part-Time Workers

Under current law, employers can generally exclude part-time employees who work less than 1,000 hours per year from coverage under a defined contribution (DC) plan. This rule can exclude long-term, part-time employees from adequately preparing for retirement. In particular, this rule penalizes women who are more likely than men to work part-time.

ASPPA supports a requirement that employers sponsoring 401(k) plans would have to allow part-time employees to participate in the plan if they work at least 500 hours of service per year for three years. Requiring employers to include long-term, part-time employees while still excluding short-term or seasonal employees is consistent with the intent of current law and provides a vehicle for retirement savings for these workers, many of whom are women, who are working part-time on a more permanent basis.

To not impose any added cost to employers, employers should be permitted to permissively disaggregate those part-time workers for non-discrimination testing. Otherwise, employers would likely face significantly greater costs due to the addition of these part-time workers to the plan.

Allowing Participants with a Non-Working Spouse to Make Additional 401(k) Contributions

Many participants in 401(k) plans have non-working spouses who are full-time homemakers. These non-working spouses do not have the ability to save through an employer-sponsored retirement plan. Under IRC §402(g), working spouses who participate in a 401(k) plan are subject to an annual maximum contribution amount.

ASPPA supports allowing 401(k) plan participants who have non-working spouses to contribute an additional \$5,000 annually to the plan. This allowance would be accomplished by increasing the maximum annual contribution limit under IRC §402(g) by \$5,000. This change would significantly increase the ability of such participants to further support both the working and non-working spouse upon retirement.

Allowing Start-up Credit for New Small Business Retirement Plan Contributions

Non-discrimination rules require contributions that are often prohibitively expensive for many small businesses. Statistically, however, once small businesses adopt a retirement plan, they typically continue maintaining the plan. Therefore, ASPPA supports a provision that would provide contribution tax credits for the first three years of a new retirement plan. This credit would contribute greatly to expanding and maintaining small business retirement plan coverage.

Modifying the Top Heavy Rules for Deferral-Only 401(k) Plans

Many small employers are interested in providing a 401(k) plan. While some cannot afford to make employer contributions, they want to offer their employees the opportunity to build savings on a tax-favored basis. In a small-employer plan, the plan may be top heavy, depending on the demographics, the level of participation and the number of eligible employees. Top heavy status is measured at the end of the first year. If a key employee (business owner) has made any deferral in that first year, and the plan is determined to be top heavy, this deferral could trigger a contribution requirement of up to 3 percent of pay for all non-key employees. This requirement becomes a major disincentive for small employers to create a plan for their employees.

ASPPA supports a modification of the top heavy rules so that salary deferrals by key employees (from their own compensation) are not considered employer contributions that trigger top heavy minimum contribution requirements. Removing this top heavy obstacle would encourage previously hesitant small employers to provide a 401(k) plan.

Amending Minimum Participation Rules Applicable to Small

Business Defined Benefit Plans to Increase Retirement Coverage for Small Employers

Eliminate the separate requirement to test for minimum participation rules where an employer provides a 7.5 percent minimum gateway contribution

The minimum participation rules of IRC §401(a)(26) are intended to ensure that a defined benefit (DB) plan is not used to disproportionately benefit only a few highly compensated employees (HCEs). The minimum participation rule under IRC §401(a)(26) requires that the DB plan cover at least **40 percent of employees or 50 employees, whichever is less, but no less than two employees.**

The concerns of IRC §401(a)(26) have, in large measure, been alleviated by the use of gateways for cross-testing now required by Treasury regulations. When there are two different plans covering employees, cross-testing is almost inevitably used to show that the plans are not discriminatory under the minimum participation rules. To use cross-testing, certain additional requirements (gateways) must be met. These gateways ensure that significant benefits are provided to all non-highly compensated employees (NHCEs). With the addition of a minimum gateway contribution requirement for non-discrimination testing, most NHCEs receive a minimum gateway contribution of between 5 and 7.5 percent of compensation. Consequently, the gateways eliminate the need for the protections of IRC §401(a)(26).

With these recent changes, the need to test under the minimum participation rules in addition to the gateway requirements is too restrictive and discourages the formation of plans covering significant numbers of NHCEs. Furthermore, it forces the employer to cover some employees under the DB plan while others are in the DC plan, which inevitably leads to issues of fairness.

ASPPA recommends a requirement that when an employer maintains a DC plan under which NHCEs receive a minimum gateway allocation of at least 7.5 percent of compensation, the employer would not be required to separately satisfy the IRC §401(a)(26) minimum participation rules for a DB plan where the DC plan is aggregated for the nondiscrimination and coverage rules of IRC §§401(a)(4) and 410(b).

Exempt DB plans of very small employers with only HCEs or employees otherwise excluded by statute from IRC §401(a)(26)

Defined benefit plans must satisfy the minimum participation rules of IRC §401(a)(26) even where an employer has only highly compensated employees (HCEs) or employees otherwise excludable by statute.

The minimum participation rules under IRC §401(a)(26) were enacted to eliminate abusive and discriminatory practices—that is, a situation in which a company covered a small number of HCEs or owners in one DB plan and covered the non-highly compensated employees (NHCEs) in another plan. There are situations with very small employers, however, where these rules serve no purpose since the only employees are owners, HCEs, or employees otherwise excluded from coverage by statute.

Accordingly, the minimum participation rules currently restrict the ability of such a company to design an effective benefit program or programs. This is an unintended consequence of the implementation of IRC §401(a)(26) and should be eliminated so these employers are not prevented from adopting their retirement plan of choice.

ASPPA supports allowing an exemption from the minimum participation rules under IRC §401(a)(26) for those plans with only HCEs or employees otherwise excludable by statute. For example, an employer in which the only two employees are also partners (owners) in the business could have a defined benefit plan for one partner and a defined contribution plan for the other. Under current law, this arrangement would not be permitted even though there are no other employees besides the business owners and thus no potential for abuse.

Summary

It is vital that Congress appreciate the barriers currently faced by small employers in providing small business retirement plan coverage. Senators Smith's and Conrad's efforts to provide incentives to expand small business retirement plan coverage are important efforts in the right direction. ASPPA looks forward to working with you to make these proposals a reality.

According to the Employee Benefits Research Institute, low- to moderate-income workers are almost 20 times more likely to save when covered by a workplace retirement plan. Of workers who earned \$30,000 to \$50,000 and were covered by an employer-sponsored 401(k)-type plan, 77.7 percent actually saved in the plan, while only 4 percent of workers at the same level of income, but not covered by a 401(k)-type plan, saved in an individual retirement account.

The proposed credit should be available for the first three years of the plan and equal to 50 percent of the amount of employer contributions for non-highly compensated employees that would otherwise be deductible to the extent of up to 3 percent of compensation.

IRC §§410(b)(3) and 410(b)(4) define "excludable" employees as nonresident aliens, collectively bargained employees, and people who do not meet age and/or service requirements. Furthermore, **Treas. Reg. §1.410(b)-6** adds the exclusion of terminated employees with less than 500 hours of service.