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7 October 1986

Review of Draft CSRS Regulation

Reference: Draft [redacted] Civil Service Retirement System STAT

Comments/Suggestions

1. Reference: "Synopsis - (b) Policy"

   Comments: Suggest expansion of last sentence of (b) Policy statement "Effective 1 January 1987... will process all retirement claims and pay all benefits" to include reference to the full range of administrative functions that are cited under "(g) (2) Responsibilities" in the draft regulation.

2. Reference: "C. Eligibility for Participation"

   Comments: Present draft wording is Okay as regards normal cases. Suggest confirm OGC's final opinion as regards eligibility for CSRS of certain 3rd country foreign nationals who are not eligible for U.S. Social Security coverage. If they are eligible for CSRS then provisions must be made for them in the regulations.

3. a. Reference: "(g)(2) Responsibilities of the Office of Personnel"

      Comments: Suggest expansion of wording of (2)(C) "Determine entitlements to benefits based on the service of employees" to include after the word determine, "and adjudicate disability, dependency, and other claims for entitlements to benefits."

   b. Reference: (2)(i) - Briefing of auditors

      Comments: Suggest rewrite of this statement to include in briefings definitive coverage of responsibilities and accountability of auditors as regards protection of identities of sensitive Agency personnel.

   c. Reference: (2)(j) - Polygraph for auditors

      Comments: Suggest broader wording to the effect that OPM auditors must meet security standards and successfully complete security requirements prescribed by the Agency rather than focus on just the polygraph requirement.

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d. Reference: (2)(k) - Request for Information from OPM

Comments: Suggest expansion of current wording to include other U.S. Government officials who may be subject to informational request from CIA. These are the same officials cited in the CIARDS regulation [redacted]

STAT

e. Reference: (2) (1) Response to requests for information from OPM.

Comments: The proposed policy statement represents current Agency policy based on statutory responsibility and authorities regarding protecting intelligence sources and information (Title 50 U.S. Code Sections 403 and 421-426).

More detailed comments are found in review comments relative to the addendum papers "Policy Issues in [redacted]

STAT

4. Other Suggestions

Consider adding another item under (g)(2) - Responsibilities of the Office of Personnel, relative to the authority to waive recovery of payments owed the Government when in the judgment of the Director of Personnel the individual is without fault and recovery would be against equity and good conscience. U.S. Code, Title 5 Section 8346 now provides Director, OPM with this authority.

5. Policy Issues in [redacted]

STAT

Reference: Memo dated 29 September 1986 same topic as above

Issue #2 - topic relative to limitations on information the Office of Personnel will provide OPM (i.e. - without identification of employees nor data relative to size of the Agency).

Comments: Suggest that rationale for CIA restrictions on release to OPM of employee identities, number of employees, etc., follows currently established policy. Current policy is based on statutory authorities contained in United States Code, Title 50.

Title 50, Section 403 (g) "Protection of Nature of Agency's Functions" hold the Director of Central Intelligence responsible for protecting intelligence sources and methods from unauthorized disclosure and specifically exempts the Agency from disclosure of the organization, functions, names, office titles, salaries and number of personnel employed by the Agency.

Subchapter IV, Title 50, Section 421 through 426, "Protection of Certain National Security Information" (based on P.L.-97-200 enacted in 1982,) imposes severe penalties for the disclosure of the identities of sensitive intelligence personnel to unauthorized sources.

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Title 50, Section 421 through 426, "Protection of Certain National Security Information" (based on P.L.-97-200 enacted in 1982,) imposes severe penalities for disclosure of the identities of sensitive intelligence personnel to unauthorized sources.

Section 423 of the Statute charges the President with submitting an annual report to the Congressional Intelligence Committees on measures taken to protect the identities of covert personnel. The President's annual report is to be based on information provided by the DCI on measures instituted to protect sensitive identifies and "on any other matters relevant the the protection of the identities of covert agents."

The terms covert agent is defined in Section 426 and includes staff officers and employees whose identities are classified information and who are serving outside the United States or have within the last five years served outside the United States.

Prior to using Title 50, Section 421 - 426 as the rationale for this policy question outside the CIA, it must be confirmed whether the Agency has provided the President with the information presented for the President's annual reports as required by the statute.

If annual reports have not gone forward, only the Title 50 Section 403 references should be used.

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 31, 1986

Executive Registry
86- 3525X

Circular No. A-76
Revised
Transmittal Memorandum #3

MEMORANDUM FOR HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: James C. Miller III
Director

SUBJECT: Delay Completion of A-76 Studies Until New Retirement Factors Issued.

The "Federal Employees' Retirement System Act of 1986" was enacted on June 6, 1986. Section 307 of this law states:

Sec. 307. USE OF "NORMAL-COST PERCENTAGE".

Notwithstanding any other provision of law, the normal-cost percentage (as defined by section 8401(23) of title 5, United States Code, as added by this Act) of the Federal Employees' Retirement System shall be used to value the cost of the System for all purposes in which the cost of the System is required to be determined by the Federal Government, including any comparisons between the cost of performing commercial activities under contract with commercial sources and the cost of performing those activities using Government facilities and personnel.

Since this provision became effective upon enactment, the retirement rate (27.9 percent) issued in the August 1985 revision to A-76 is not longer applicable. As a result, there is currently no retirement factor for use in A-76 cost comparisons that meets the legal requirement of Section 307.

All A-76 studies with bid/proposal openings on or after June 6, 1986, where the cost comparison decision (contract award or cancellation of the solicitation) has not been approved will be postponed pending issuance of the new retirement factors, and inclusion in the cost calculations. We expect these factors to be issued in August 1986.

This revision is effective upon publication.

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so invested for 5 pl[illegible] ... e same ratio oution from an ESOP that satisfies the preceding conditions will not qualify for this exception from the early distribution tax unless such distribution is attributable to assets that have been invested in employer securities for the 5-year period. Tacking of investment periods is permitted.

For example, amounts transferred to an ESOP would qualify for the exception 3 years after transfer provided such amounts meet the investment criteria for 2 years prior to such transfer. In addition, amounts transferred to an ESOP following a reversion from a defined benefit pension plan would qualify for this exception if a majority of such amounts are invested in employer securities upon transfer and the 5 year investment requirement is met. The conferees intend that a first-in, first-out rule be used for purposes of determining the length of time a plan has held securities distributed to a participant.

The conference agreement follows the effective date provisions of the Senate amendment.

Direct transfer option

The conference agreement does not contain the provision in the Senate amendment.

3. Taxation of Distributions

Present Law

In general

Under present law, a distribution of benefits from a tax-favored retirement arrangement generally is includible in gross income unless the amount distributed represents the employee's investment in the contract (i.e., basis). In the case of a distribution from a qualified plan or an IRA, such a distribution is includible in the year in which it is paid or distributed. Under a tax-sheltered annuity, benefits are includible in income when paid or made available.

Lump-sum distributions

Under present law, a lump-sum distribution from a qualified plan may qualify for special 10-year forward income averaging. In addition, the portion of a lump sum attributable to contributions prior to January 1, 1974, may qualify for capital gains treatment.

Basis recovery rules

Present law provides special rules for the treatment of basis (e.g., emplolyee contributions) when an individual receives a distribution from a tax-favored retirement arrangement. If an amount is received before the annuity starting date (i.e., the date on which an amount is first received as an annuity), the individual is treated as first receiving employee contributions, which are nontaxable, and then taxable income.

In the case of amounts received after the annuity starting date, each payment received by an employee generally is treated, in part, as a return of the employee's contributions and, in part, as taxable income. The portion of each payment treated as a return of to each payment as the employee's total contributions bear to the total expected payments over the period of the annuity. In the case of a straight-life annuity, the employee's life expectancy, as of the annuity starting date, is treated as the period over which the annuity is to be paid for purposes of computing his total expected return under the contract. Where the employee dies prior to the expiration of the employee's anticipated life expectancy, no deduction is provided for the employee's unrecovered basis. On the other hand, an employee whose actual life is longer than anticipated at the time benefits commence effectively excludes from income an amount in excess of the employee's total contributions.

In addition, under present law, a special rule applies under certain circumstances to annuity payments from qualified plans. Under the special rule, if an individual's first 3 years of annuity payments after the annuity starting date will equal or exceed the individual's aggregate employee contributions, all distributions are treated as a return of employee contributions (and thus nontaxable) until all of the individual's employee contributions have been recovered. Thereafter all distributions are fully taxable.

House Bill

Constructive receipt under a tax-sheltered annuity

Under the House bill, benefits under a tax-sheltered annuity are includible in income only when benefits are actually received. The provision is effective for distributions after December 31, 1985.

10-year averaging and pre-1974 capital gains treatment

Effective for distributions made after December 31, 1985, the House bill repeals 10-year forward averaging, phases out pre-1974 capital gains treatment over a 6-year period, makes 5-year forward averaging (calculated in the same manner as 10-year averaging under present law) available for one lump-sum distribution received by an individual after age 59½ and, under a transition rule, permits certain individuals to apply 5-year averaging to one lump-sum distribution received before age 59½.

Under the House bill, individuals are permitted to make a one-time election with respect to a single lump sum received after the individual attains age 59½ (1) to claim, pursuant to the 6-year phase-out, capital gains treatment on that portion of the lump sum (if any) attributable to amounts contributed prior to 1974 and (2) to use 5-year forward averaging on the balance of the lump sum. In addition, the House bill provides a special transition rule under which any participant who attains age 50 before January 1, 1986, is permitted to make one election with respect to a single lump-sum distribution received prior to age 59½ (1) to claim pre-1974 capital gains treatment pursuant to the 6-year phase-out, and (2) to use 5-year forward averaging on the balance of the lump sum.

The House bill also permits individuals who separate from service in December 1985 and receive a lump-sum distribution in January 1986 to elect to treat the distribution as received in 1985 and to claim 10-year averaging (and capital gains treatment if appropriate) with respect to the distribution.

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Basis recovery rules

The Hous Declassified in Part - Sanitized Copy Approved for Release 2012/12/12 : CIA-RDP89-00066R000800020004-1 tributions from plans in which there are after-tax employee contributions. Under the House bill amounts received prior to the annuity starting date are treated as being made first out of taxable amounts (employer contributions and income) and, second, as being made out of nontaxable amounts (employee contributions). If an employee is only partially vested in the portion of the employer's benefits attributable to employer contributions (for example, in the case of a plan with a graduated vesting schedule), the employee is not taxed on a distribution to the extent that the distribution, when added to any prior distributions under the plan, exceeds the sum of (1) the employee's vested benefits attributable to employer contributions, plus (2) income on the employee's contributions.

With respect to amounts received after the annuity starting date, the special three-year basis recovery rule is eliminated. Thus, an employee must include in income a portion of each payment made on or after the employee's annuity starting date.

The House bill provides that in computing the portion of each payment that may be excluded from income, the employee's expected total return is to be determined as of the date of the payment. The bill limits the total amount that an employee may exclude from income to the total amount of the employee's contribution. In addition, if an employee's benefits cease prior to the date the employee's total contributions have been recovered, the amount of unrecovered contributions is allowed as a deduciton to the annuitant for his last taxable year. For purposes of the provisions of present law relating to net operating losses, the deduction is treated as related to a trade or business of the employee.

The provisions relating to the basis recovery rules for amounts received before a participant's annuity starting date are generally effective for distributions made after December 31, 1985, but do not apply to employee contributions made prior to January 1, 1986.

The repeal of the special 3-year basis recovery rule generally is effective with respect to any individual whose annuity starting date is after July 1, 1986.

Senate Amendment

Constructive receipt under a tax-sheltered annuity

The Senate amendment is the same as the House bill, except that the provision is effective for distributions after December 31, 1986.

10-year averaging and pre-1974 capital gains treatment

The Senate amendment follows the House bill, except for the effective date and the special transition rule for individuals who have attained age 50 before January 1. The general effective date of the Senate amendment is taxable years beginning after December 31, 1986.

The Senate amendment provides a transition rule under which a participant who has attained age 50 before January 1, 1986, is permitted (1) to make one election (before or after attainment of age 59½) to use 5-year forward averaging (under the new tax rates) or [illegible] it regard to the requirement of attainment of age 59½, and (2) to elect capital gains treatment with respect to a lump-sum distribution, without regard to the six-year phase-out of capital gains treatment. An election under this transition rule to use income averaging on a lump sum received prior to age 59½ eliminates the availability of an election after age 59½ under the general rule.

Basis recovery rules

With respect to pre-annuity starting date distributions, the Senate amendment modifies the basis recovery rules to provide for pro-rata recovery of employee contributions. Thus, with respect to a pre-annuity starting date distribution, a participant is entitled to exclude that portion of the payment that bears the same ratio to the total payment as the participant's after-tax employee contributions (and amounts treated as after-tax employee contributions) bears to the total value of the participant's accrued benefit (or account balance) under the plan as of the date of distribution or as of such other time as the Secretary may prescribe. The Secretary is authorized to prescribe appropriate rules for estimating the amounts referred to in the prior sentence where precise calculation would be unjustifiably burdensome.

If an employee is only partially vested in the portion of the employee's benefits attributable to employer contributions (for example, in the case of a plan with a graded vesting schedule), the portion of the employee's accrued benefit that has not yet vested is not taken into account in determining the total value of the participant's accrued benefit.

With regard to post-annuity starting date distributions, the Senate amendment follows the House bill.

The Senate amendment also provides basis recovery rules for distributions from an IRA to which nondeductible contributions have been made. The rules are generally similar to the rules applicable to distributions from qualified plans.

The provisions relating to the basis recovery rules for amounts received before a participant's annuity starting date are generally effective for distributions made after December 31, 1986, but do not apply to employee contributions made prior to January 1, 1987 to the extent that, on May 5, 1986, such contributions were available for distribution under a plan before separation from service. Thus, except in the case of plans in which substantially all contributions are employee contributions, withdrawals made after the effective date, but prior to an individual's annuity starting date, are to be treated as made first from pre-1987 employee contributions that were available for in-service withdrawal. After all such contributions have been recovered, any subsequent distributions are taxed under the new pro-rata basis recovery rules of the bill. The repeal of the special 3-year basis recovery rule generally is effective with respect to any individual whose annuity starting date is after January 1, 1988.

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Conference Agreement

Constructive receipt under a tax-sheltered annuity

The conference agreement follows the House bill and the Senate amendment.

10-year averaging and pre-1974 capital gains treatment

The conference agreement follows the Senate amendment. Under the conference agreement, if an individual who has attained age 50 by January 1, 1986, elects, pursuant to the transition rule, to retain the capital gains character of the pre-1974 portion of a lump sum distribution, the capital gains portion is taxed at a rate of 20 percent. The 20 percent rate applies to all taxpayers, regardless of the maximum effective capital gains rate under present law.

Basis recovery rules

Pre-annuity starting date

The conference agreement generally follows the Senate amendment. However, under the conference agreement, employee contributions to a defined contribution plan or a separate account of a defined benefit plan (and the income attributable thereto) are treated as a separate contract for purposes of section 72 and application of the pro-rata rule. Thus, under the conference agreement, if an employee withdraws employee contributions from such a plan or account, then for tax purposes, the distribution will be considered to be part nontaxable, i.e., a return of employee contributions, and part taxable, i.e., a distribution of earnings on those contributions. The distribution will not, however, be considered to be attributable to employer contributions. If an employee withdraws all amounts attributable to employee contributions and such amount is less than the employee's contributions, the employee may recognize a loss.

Post-annuity starting date

The conference agreement follows the House bill and the Senate amendment, except that it extends the separate contract rule to post-annuity starting date distributions.

Rollovers

The conference agreement modifies the rules relating to rollovers of partial distributions. Under the conference agreement, partial distributions may be rolled over only if the distribution is due to the death of the employee, is on account of the employee's separation from service (including the separation from service of a self-employed individual) or is made after the employee has become disabled. The requirement that a partial distribution not be one of a series of periodic payments is eliminated.

Under a special rule, a distribution in satisfaction of the diversification requirements applicable under the agreement to employee stock ownership plans may be rolled over even if the distribution does not otherwise qualify for rollover treatment.

The conference agreement contains a special rule permitting amounts deposited in certain financially distressed financial institutions to be rolled over into an IRA or qualified plan notwithstanding that the rollover does not occur within 60 days of the date of the original distribution to the employee. Under this rule, the 60-day period does not include periods while the deposit is frozen. In addition, the individual has a minimum 10 days after the release of the funds to complete the rollover.

Individual retirement arrangements

The conference agreement follows the Senate amendment, with modifications. (*See* discussion in Part A.1., above.)

Effective dates

The basis recovery rules are generally effective with respect to distributions received after December 31, 1986. The repeal of the 3-year basis recovery rule is effective with respect to individuals whose annuity starting date is after July 1, 1986. The provision limiting the income exclusion to the amount of the employee's investment in the contract applies to individuals whose annuity starting date is after December 31, 1986.

The new rules with respect to partial distributions are effective with respect to amounts distributed after December 31, 1986. The special rule for frozen deposits is generally effective with respect to distributions after the date of enactment. With respect to amounts which were frozen and released prior to the date of enactment, the rollover must be completed within 60 days following the date of enactment.

4. Treatment of Loans

Present Law

An individual is permitted, under present law, to borrow from a qualified plan in which the individual participates (and to use his or her accrued benefit as security for the loan) provided the loan bears a reasonable rate of interest, is adequately secured, provides a reasonable repayment schedule, and is not made available on a basis that discriminates in favor of employees who are officers, shareholders, or highly compensated. However, no loan is permitted under the Employee Retirement Income Security Act of 1974 (ERISA) or the Code from a qualified plan to an owner-employee (i.e., a sole proprietor or more than 10-percent partner). Interest paid on a loan from a qualified plan is deductible.

Subject to certain exceptions, a loan to a plan participant is treated as a taxable distribution of plan benefits. An exception to this general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $50,000 or (2) the greater of $10,000 or one-half of the participant's accrued benefit under the plan. This exception applies only if the loan must, by its terms, be repaid within five years or, if the loan is used to acquire or improve a principal residence of the participant or a member of the participant's family, within a reasonable period of time.

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House Bill

The House bill modifies the exception to the income inclusion rule by reducing the $50,000 limit on a loan by the participant's highest outstanding loan balance during the preceding 12-month period.

In addition, the extended repayment period permitted for purchase or improvement of a principal residence is amended to apply only to the purchase of the principal residence of the participant. Plan loans to improve an existing principal residence, to purchase a second home, and to finance the purchase of a home or home improvements for other members of the employee's family are subject to the 5-year repayment rule.

The House bill also requires that a plan loan be amortized in level payments, made not less frequently than quarterly, over the term of the loan.

The House bill also provides for the deferral of the deduction for interest paid by (1) all employees on loan secured by elective deferrals under a qualified cash or deferred arrangement or tax-sheltered annuity, and (2) key employees with respect to loans from any qualified plan or other tax-favored retirement plan. The deferral is to be accomplished by denying a current deduction for the interest paid and increasing the participant's basis under the plan by the amount of nondeductible interest paid.

The provisions would be effective for amounts received as a loan after December 31, 1985. Any renegotiation, extension, renewal, or revision after December 31, 1985, of an existing loan is treated as a new loan on the date of such renegotiation, etc.

Senate Amendment

As under the House bill, the Senate amendment modifies the exception to the income inclusion rule by reducing the $50,000 limit on a loan by the participant's highest outstanding balance during the preceding 12-month period.

In addition, the extended repayment period permitted for purchase or improvement of a principal residence is amended to apply only to the purchase of the principal residence of the participant or a lineal descendant of the participant. Thus, for example, plan loans to improve an existing principal residence, or to purchase a second home, are subject to the 5-year repayment rule.

The provisions are generally effective with respect to loans made after December 31, 1986. Any renegotiation, extension, renewal, or revision after December 31, 1986, of an existing loan is treated as a new loan on the date of such renegotiation, etc. The provision denying basis is effective for interest paid after December 31, 1986. The general effective date applies to the provision denying a deduction for interest paid on certain loans. Of course, prior to the effective date, the deductibility of interest will be subject to the general limits on deductibility of interest contained in the conference agreement.

Conference Agreement

The conference agreement follows the House bill, with modifications and clarifications as described below.

The conference agreement follows the House bill with respect to the reduction of the $50,000 limit on loans, with a clarification. Under the conference agreement, a loan, when added to the outstanding balance of all other loans from the plan, cannot exceed $50,000 reduced by the excess of the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made.

For example, a participant with a vested benefit of $200,000 borrows $30,000 from a plan on January 1. On November 1, the participant wants to borrow an additional amount without triggering a taxable distribution. At that time, the outstanding balance on the first loan is $20,000. The maximum amount the participant can borrow is $50,000, i.e., $20,000-$20,000-($30,000-$20,000).

The conference agreement follows the House bill with respect to the principal residence exception to the 5-year repayment rule and the level amortization rule. The conferees intend that the level amortization requirement does not apply to a period when the employee is on a leave of absence without pay for up to 1 year. In addition, the requirement does not preclude repayment or acceleration of the loan prior to the end of the commitment period. Thus, for example, the provision does not preclude a plan from requiring full repayment upon termination of employment.

The provisions are generally effective with respect to loans made after December 31, 1986. Any renegotiation, extension, renewal, or revision after December 31, 1986, of an existing loan is treated as a new loan on the date of such renegotiation, etc.

Under the conference agreement, the deduction of interest on all loans from a qualified plan or tax-sheltered annuity is subject to the general limits on deductibility of interest contained in the conference agreement. In addition, effective with respect to loans made, renegotiated, extended renewed, or revised after December 31, 1986, no deduction is allowed with respect to interest paid on (1) loans secured with elective deferrals under a qualified cash or deferred arrangement or a tax-sheltered annuity, and (2) any loan to a key employee (even if the interest on such loans is otherwise deductible under the general interest provisions of the agreement). Effective for interest paid after December 31, 1986, no basis is allowed with respect to any interest paid on a loan from a qualified plan or tax-sheltered annuity.

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