



IRS Issues Guidance on Distribution-Related Provisions of PPA

The Pension Protection Act of 2006 (PPA) changed several rules relating to the payout of benefits from retirement plans. In Notice 2008-30, the IRS provides important guidance on some of these distribution-related provisions, including those regarding rollovers to Roth IRAs, minimum lump sums, and qualified optional survivor annuities.

Background

PPA contains many provisions affecting the payout of benefits from qualified plans, which have become effective for most plans. Guidance has been needed on several of these provisions to allow plan sponsors to properly administer their plans. Sponsors have been paying benefits based on their understanding of the rules and have been unsure how to amend their plans to include certain provisions.

Now, the IRS has issued Notice 2008-30 which provides much needed guidance on the distribution-related provisions of PPA, including important clarifications regarding the determination of minimum lump sums payable from defined benefit plans.

IRS Notice 2008-30

Rollovers to Roth IRAs

Prior to PPA, a Roth IRA could only accept a rollover from another Roth IRA, a non-Roth IRA, or a designated Roth account in a defined contribution plan (a qualified rollover contribution). A rollover from a non-Roth IRA must be included in gross income as if it were distributed to the participant.

PPA expanded the definition of qualified rollover contributions to include rollovers from qualified retirement plans, eligible governmental Section 457(b) plans, and Section 403(b) tax-sheltered annuities, effective for distributions made after December 31, 2007.

Notice 2008-30 provides guidance on rollovers to Roth IRAs –

- Distributing plans must offer participants the option to have an eligible rollover distribution rolled over to a Roth IRA. It is permitted, but not required, that plans offer this rollover option to non-spouse beneficiaries.

- Plan administrators are not responsible for confirming that a participant is eligible to make a rollover to a Roth IRA.
- Direct rollovers to Roth IRAs are not subject to mandatory withholding, even if the distribution is includible in gross income. However, the plan administrator is permitted to enter into a voluntary withholding agreement with a participant.

Qualified Optional Survivor Annuities

Defined benefit and money purchase plans must pay benefits in the form of a qualified joint and survivor annuity (QJSA) unless the participant and his/her spouse consent to another form of benefit. A QJSA is a joint and survivor annuity with a continuing percentage of at least 50% (and not more than 100%). Plans subject to the QJSA requirement must provide a written explanation of the terms and conditions of the QJSA to each participant.

PPA requires plans subject to the QJSA requirement to provide an additional survivor annuity option – referred to as a qualified optional survivor annuity (QOSA). If the continuing percentage under a plan's QJSA is less than 75%, the QOSA must provide a 75% continuing percentage. If the plan's QJSA provides a continuing percentage of at least 75%, the QOSA must provide a 50% continuing percentage. This new option is to be actuarially equivalent to a single life annuity. PPA requires that the terms and conditions of the QOSA be included in the QJSA notice.

Notice 2008-30 clarifies the QOSA rules –

- A plan that, before PPA, provided an optional form of payment that satisfied the new QOSA requirements does not have to be amended to formally designate that option as a QOSA.
- The QOSA must be actuarially equivalent to the single life annuity offered by the plan, and not the QJSA (even if the QJSA is subsidized).
- Spousal consent is required to waive a QJSA and elect a QOSA only if the QOSA is not actuarially equivalent to the QJSA.
- In satisfying the requirement to provide a written explanation of the QOSA, the plan must treat the QOSA as an optional form of benefit presently available and need not designate the optional form as a QOSA.
- Plans need not offer a preretirement survivor annuity that is based on a QOSA.
- Plan amendments that implement a QOSA are not eligible for relief from the anti cutback requirements of Section 411(d)(6).
- The requirement to offer a QOSA is effective for distributions with annuity starting dates in plan years beginning after December 31, 2007, with the potential for later effective dates for collectively bargained plans.

Minimum Lump Sums

Pre-PPA law specified the mortality table and interest rate used to determine minimum lump sum amounts (the applicable interest rate and applicable mortality table). A 1994 mortality table (projected to 2002) and the 30-year Treasury interest rate published by the IRS formed the basis of the mandated pre-PPA assumptions.

PPA revised the applicable interest rate and applicable mortality table, beginning with 2008 plan years. The new assumptions are based on the interest rates and mortality table mandated by PPA for minimum funding purposes (i.e., the three "segment rates" derived from corporate bond yield curves and mortality based on a projection of the RP-2000 table).

IRS regulations require that a plan's QJSA benefit be at least as valuable as any other form of benefit payable under the plan for married participants. However, the regulations provide that benefits subject to Section 417(e)(3) (e.g., lump sums) do not violate this requirement if they are determined using the applicable interest rates and applicable mortality table.

Notice 2008-30 provides much anticipated guidance regarding the PPA minimum lump sum provisions –

- For plans that are amended to provide that benefits subject to Section 417(e)(3) (e.g., lump sums) will be the greater of the amount determined using the pre-PPA applicable interest and mortality assumptions or the amount determined using the post-PPA interest and mortality assumptions ("greater-of" benefits) –
 - Such Section 417(e)(3) benefits will not violate the requirement that the QJSA must be the most valuable form of benefit under the plan. Although the language in Notice 2008-30 regarding the period for which this relief will be available is not clearly written, it is our current understanding that the relief applies only until the last day of the first plan year beginning on or after January 1, 2009 (or the last day of first plan year beginning on or after January 1, 2011 for governmental plans).

BUCK COMMENT. *Although the period of time for which relief is available is not certain based on the language in Notice 2008-30, we believe that our interpretation is consistent with IRS intent. The IRS has promised to amend its regulations to reflect the relief granted by the notice, and it is hoped that this amendment will clarify the issue. Until it is resolved, plan sponsors might consider refraining from implementing an amendment that would commit a plan to providing "greater-of" benefits indefinitely.*

- If the "greater-of" provision is applied for only a specified period of time, after which Section 417(e)(3) benefits will be determined solely on the basis of the post-PPA applicable interest and mortality assumptions, relief from the Section 411(d)(6) anti-cutback provisions is provided. This relief applies only to the first plan amendment that implements the post-PPA applicable interest and mortality assumptions and it is available only if that amendment is adopted before the end of

the 2009 plan year (the 2011 plan year for governmental plans). For the purpose of determining whether an amendment will be treated as the first post-PPA amendment, amendments adopted on or before June 30, 2008 may be disregarded

BUCK COMMENT. *This Section 411(d)(6) relief is very good news for sponsors who have been following the greater-of approach for lump sum payments, but intend to do so only during a transition period. These sponsors now know that their plans can be appropriately amended to provide these payments.*

Other Uses of the 417(e)(3) Assumptions

Notice 2008-30 also provides Section 411(d)(6) anti-cutback relief for amendments that replace references to the pre-PPA applicable interest and mortality assumptions with references to the post-PPA applicable interest and mortality assumptions, without regard to whether such an amendment is required under PPA. For example, many plans refer to the Section 417(e)(3) assumptions for purposes of determining actuarial equivalence for non-Section 417(e) optional forms of benefit (e.g., joint and survivor benefits). The notice provides that plan amendments replacing the pre-PPA applicable assumptions with the post-PPA applicable assumptions will be deemed not to violate the anti-cutback rules.

Gap-Period Earnings

Final regulations mandate that 401(k) plan sponsors adjust excess deferrals (i.e., deferrals in excess of the annual limit – \$15,500 for 2008) for gains and losses from the end of the plan year to the actual distribution date (the "gap period") to the extent that a plan would credit a participant's account with income during that period if the entire account were distributed. For example, a 401(k) plan that is valued on a daily basis would have to include gap period income; a plan that is valued on an annual basis would not.

The notice provides that a 401(k) plan has until the end of the PPA remedial amendment period to include conforming language in the plan, unless the plan falls into either Cycle B or Cycle C. Those plans, and plans submitted for a determination letter before March 24, 2008, will be notified by the IRS that an amendment is required before a letter will be issued.

Conclusion

Notice 2008-30 provides much needed guidance for plan administrators. The relief provided for payment of lump sum benefits is especially welcome. Buck's consultants would be pleased to discuss the effects of this guidance on your plans.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.