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TCRS 2008-04: Internal Revenue Service Notice 2008-30 – Guidance Relating To Certain Distribution-Related Provisions Of The Pension Protection Act Of 2006 (PPA)

On March 24, 2008, the Internal Revenue Service published Notice 2008-30, providing guidance on certain distribution-related provisions of PPA that are effective in 2008. This Summary highlights the following distribution provisions affecting defined contribution plans:

- Rollovers from eligible retirement plans to Roth IRAs;
- Qualified Optional Survivor Annuities (QOSAs) as an alternative to Qualified Joint and Survivor Annuities (QJSAs) for defined contribution plans subject to the funding standards of section 412 of the Internal Revenue Code; and
- Gap-period earnings for distributions of excess deferrals.

Rollovers from Eligible Retirement Plans to Roth IRAs

Background

Prior to PPA, a Roth IRA could only accept a rollover contribution of amounts distributed from another Roth IRA, from a non-Roth IRA (traditional IRA or SIMPLE IRA) or from a designated Roth account under a retirement plan. Rollover contributions to a Roth IRA are referred to as “qualified rollover contributions”. A qualified rollover contribution from a non-Roth IRA to a Roth IRA is referred to as a “conversion”. For distributions before 2010, a conversion contribution is permitted only if the IRA owner’s adjusted gross income does not exceed certain limits.

PPA Change

PPA amended the definition of a qualified rollover contribution to include rollovers from qualified plans described in Internal Revenue Code (“Code”) section 401(a), Code sections 403(a) and 403(b) annuity plans and eligible governmental Code section 457(b) plans (collectively referred to as “plan” or “eligible retirement plan” in this Summary) to a Roth IRA made after December 31, 2007.

Under Notice 2008-30:

- A plan must permit a participant or a spouse beneficiary to elect a direct rollover of an eligible rollover distribution to a Roth IRA.
- A participant or a spouse beneficiary may also elect an indirect rollover (a rollover within 60 days of a distribution) to a Roth IRA.
- A plan may, but is not required to allow rollovers by non-spouse beneficiaries, but if it does, the rollover may only be made by a direct trustee-to-trustee transfer.
- The taxable portion of the rollover is includible in gross income at the time of the distribution from the eligible retirement plan.
- For tax years beginning before 2010, a qualified rollover contribution is not permitted if in the year of the distribution an individual’s modified adjusted gross income exceeds \$100,000 or if the individual is married and filing a separate return. Effective with the 2010 tax year, the above income restriction is removed.
- An eligible rollover distribution that is paid to a participant or the participant’s spouse is subject to 20% mandatory withholding. However, if the distribution is rolled directly to a Roth IRA, mandatory withholding will not apply. Similarly, a distribution that is directly rolled over to a Roth IRA by a non-spouse beneficiary is not subject to mandatory withholding.
- The 10% additional tax for early distributions does not apply to a rollover from an eligible retirement plan other than a Roth IRA. However, the taxable portion of the rollover will be assessed the 10% additional tax if distributed within the 5 taxable-year period beginning with the taxable year of the rollover to the Roth IRA. Thus, for purposes of applying this additional tax, each such rollover from an eligible retirement plan other than a Roth IRA has its own separate 5 taxable-year period (aging period).
- A surviving spouse who makes a rollover to a Roth IRA may elect to treat the Roth IRA as his or her own or to establish the Roth IRA in the decedent’s name with the surviving spouse as the beneficiary (also referred to as an “inherited Roth IRA”). A non-spouse beneficiary cannot treat the inherited Roth IRA as his or her own. Unlike a spouse beneficiary, a non-spouse beneficiary cannot make regular contributions to an inherited Roth IRA.

Qualified Optional Survivor Annuities (QOSAs)

Under PPA, a plan that is subject to the minimum funding standards of Code section 412, like a money purchase plan, is required to provide an additional survivor annuity option referred to as a Qualified Optional Survivor Annuity or "QOSA". This provision is generally effective for annuity starting dates in plan years beginning on and after January 1, 2008, with a delayed effective date for collectively bargained plans.

Under Notice 2008-30:

- A QOSA is an annuity for the life of a married participant with either 75% or 50% of the annuity continuing to the spouse after the participant's death. If a plan's QJSA normal form is less than 75%, the QOSA must be 75% and if the QJSA normal form is 75% or more, the QOSA is 50%.
- Generally, spousal consent is required for a married participant to waive a plan's QJSA and elect an alternative distribution form. However, if the participant waives a plan's QJSA and elects instead a QOSA that is actuarially equivalent to the plan's QJSA, spousal consent will not be required because a QOSA, by definition, satisfies the conditions of a QJSA.
- A plan is not required to provide an alternative form to the Qualified Pre-retirement Survivor Annuity (QPSA) that is based on the QOSA.
- A plan that is required to provide a QOSA must provide a married participant an opportunity to elect the QOSA during an election period and must also provide a written explanation of the terms and conditions of the QOSA. Notice 2008-30 allows the plan to meet the required written explanation for the QOSA by satisfying the current written explanation for the QJSA (which includes the terms and conditions of the QOSA). The plan must treat the QOSA as an optional form of benefit available under the plan.
- A plan that is amended to add a QOSA after the effective date of the QOSA (January 1, 2008 for a calendar plan) but before the last day of the plan's 2009 plan year (general deadline for plan sponsors to adopt PPA-related provisions) will be subject to the anti-cutback rules of Code section 411(d)(6). Accordingly, a plan amendment that implements a QOSA may eliminate a distribution form or reduce or eliminate a subsidy with respect to a plan distribution form only to the extent such reduction or elimination is permitted under applicable regulations.
- A plan that provides a QJSA for a married participant that includes a 50% survivor annuity and also provides an optional joint annuity that includes a spouse survivor annuity percentage of 75% and is at least actuarially equivalent to the plan's single life annuity payable at the same time as the optional joint annuity will meet the QOSA requirements of PPA. Thus, no plan amendment or administrative change is required. Otherwise, the plan must be amended and administered according to the QOSA provisions of PPA.

Gap Period Earnings for Distributions of 401(k) Excess Deferrals

Background

Currently, gap period earnings are required to be included in distributions of excess deferrals if the 401(k) plan credits gain or loss during the gap period. The gap period runs from the last day of the participant's taxable year (typically December 31) through the date of distribution of the excess deferrals. This rule applies to pre-tax deferrals and designated Roth 401(k) deferrals, and continues to apply even after the 2008 elimination of gap period earnings for excess contributions and excess aggregate contributions by PPA.

Pending technical corrections to PPA would limit the crediting of earnings on excess deferrals to earnings through the last day of the participant's taxable year.

Under Notice 2008-30:

- An interim plan amendment to provide for the crediting of gap period earnings is not required to be adopted by a plan sponsor until the last day of a plan's 2009 plan year (December 31, 2009 for a calendar plan year). Certain plans that are submitted to the Internal Revenue Service for a determination letter will be required to include gap period earnings in their plan document.
- Although the required plan amendment is delayed until 2009, administratively, plans must include gap period earnings in the distribution of excess deferrals that relate to taxable years beginning on or after January 1, 2007, pending the outcome of technical corrections.

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