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January 7, 2009

Worker, Retiree, and Employer Recovery Act of 2008 Provides Retirement Plan Relief

by Howard L. Clemons & Clare Stoudt**

The Worker, Retiree, and Employer Recovery Act of 2008[1] (the "Act") was signed into law by President Bush on December 23, 2008. The Act includes technical corrections to the Pension Protection Act of 2006 (the "PPA"), some of which may be viewed as more than what would normally be thought of as "technical corrections." The Act also provides relief to plan participants and pension plan sponsors impacted by the current economic crisis by suspending the requirement to receive minimum distributions for 2009. It also provides limited relief from the defined benefit plan funding rules enacted by the PPA for both single-employer defined benefit pension plans and multi-employer plans.

Suspension of Required Minimum Distributions for 2009

Participants in employer-provided qualified retirement plans are generally required to begin receiving distributions from the plan no later than the "required beginning date." The required beginning date is April 1st of the year following the later of the calendar year during which the participant attains age 70½ or, if the participant is not treated as a 5% owner, retires from employment under the plan. Although the first minimum distribution is due for the year during which the participant attains age 70½ or retires, the rules allow for a grace period until April 1 of the following year to make the first minimum distribution, generally resulting in a participant receiving two minimum distributions in the first year—one by April 1st as the minimum distribution for the prior year (i.e., the year during which the participant attained age 70½ or retired), and another by December 31st for the current year. Similar minimum distribution rules apply to Individual Retirement Accounts ("IRAs"). For a defined contribution plan, such as a 401(k) plan, the required minimum distribution is generally determined by dividing the account balance at the end of the prior year by the life expectancy of the participant and his or her designated beneficiary as determined under IRS tables.

[1] H.R. 7327.

Due to the dramatic drop in most participant retirement account balances as a result of the 2008 market downturn, taxpayers argued that requiring minimum distributions to be made based on account balances as of December 31, 2007, would result in excessive depletion of retirement assets based on account balance values that no longer exist. It was too late in the year for Congress to provide relief for minimum distributions required to be paid during 2008 based on December 31, 2007 account balances. However, as discussed below, the Act provides relief from the minimum distributions required for 2009.

The penalty for failure to take a required minimum distribution is a 50% excise tax on the amount that should have been distributed. Required minimum distributions, in contrast with most other distributions, are not eligible for rollover into another employer-provided qualified retirement plan or an IRA and are not subject to subject to the mandatory 20% income tax withholding which applies to an eligible rollover distribution.

The significant aspects of the relief are as follows:

- No minimum distribution is required **for calendar year 2009** from employer-provided qualified retirement plans and IRAs. The suspension is for one year. The 2010 minimum distribution is still required.

- The relief applies only to the minimum distributions **for 2009**. A participant whose first distribution year is 2008 (*i.e.*, he attains age 70½ in 2008) and who would normally receive his first minimum distribution **for 2008** by April 1, 2009, must still receive that initial minimum distribution. A participant whose first distribution year is 2009 (*i.e.*, he attains age 70½ in 2009) and who would normally receive his first minimum distribution **for 2009** by April 1, 2010, is not required to receive that distribution. However, no relief is provided for the required minimum distribution **for 2010** and that distribution must still be made no later than December 31, 2010.

- If the participant dies before the distribution of his benefit has begun in accordance with the required minimum distribution rules, then distributions of the participant's account must be distributed within five years after the death of the participant. Special rules apply for spouses of deceased participants and an election may be made to distribute the benefits over the lifetime or life expectancy of the designated beneficiary. In applying the five-year rule, however, the relief provision allows year 2009 to be ignored. For example, if the participant died in 2007, by ignoring 2009 the five-year period will end in 2013 instead of 2012.

- The suspension of the required minimum distributions for 2009 also means that a participant who receives a distribution of an amount which but for the Act would have been a required minimum distribution (and not eligible for rollover) but which due to the Act is not so required, will receive an eligible rollover distribution. To ease administration of this one-year relief provision, in administering the amount of a distribution which but for the relief provision would have been a required minimum distribution, a plan is not required to apply the direct rollover rules, nor to provide the written notice and explanation of direct rollover rights nor apply the mandatory 20% withholding which applies to an eligible rollover distribution. The participant may still, however, make an indirect rollover contribution of the distribution amount which would have been a required minimum distribution amount but for the minimum distribution relief pursuant to the 60-day rollover rule.

Non-spouse Beneficiary Rollovers

The PPA permitted rollovers of distributions from qualified plans to non-spouse beneficiaries. The IRS interpreted the statutory rule to mean that plans could allow non-spouse beneficiary rollovers but were not required to do so. The IRS also took the position that a rollover of a distribution by a non-spouse beneficiary was not subject to direct rollover requirements, notice requirements or mandatory withholding requirements. Several members of Congress were unhappy with this interpretation and Congressional action to require employer-sponsored qualified retirement plans to offer non-spousal rollovers had been expected.

The Act provides that beginning in 2010 the term "eligible rollover distribution" applies to all non-spouse beneficiary rollovers that otherwise meet the requirements. In addition, effective for plan years beginning in 2010, rollovers by non-spouse beneficiaries will be subject to the same rules as other eligible rollovers, *i.e.* such rollovers will be subject to direct rollover requirements, notice requirements, and mandatory withholding requirements.

Minimum Funding Rules for Single-Employer Defined Benefit Pension Plans

Asset Valuation and Smoothing

The PPA reduced the period over which a plan sponsor could recognize unexpected gains and losses from four to two years. The application of this "smoothing" period under the PPA was uncertain and the IRS issued proposed regulations requiring the use of the fair market value of plan assets to determine the plan's current funding level.

The Act clarifies the ability of a plan sponsor to use smoothing to recognize unexpected losses over a 24-month period. This clarification should be helpful to plans dealing with the unexpected losses incurred in the current economic situation.

Extension of Funding Shortfall Transition Rules

The PPA generally required that a single-employer defined benefit pension plan amortize a funding shortfall over a seven-year period. A funding shortfall occurs when the present value of all benefits accrued under the plan exceeds the value of the plan's assets. Under a transition rule provided by the PPA, a plan was not required to establish funding shortfall amortization contributions if the plan met certain specified applicable funding targets: 92% for 2008, 94% for 2009, and 96% for 2010. The transition rule ceased to apply, however, in the event that in any plan year the plan missed its applicable funding target. With many plans expected to be less than 92% funded in 2008, the PPA transition provision would have ceased to be available, resulting in these plans' funding target jumping to 100%.

The Act amends the transition rule described above to allow plans that fail to meet the transition rule funding target percentage in a year to continue to use the transition rules for future years. For example, under the PPA, a plan that was only 91% funded for 2008 would be ineligible for the transition rule in 2009, *i.e.*, would have to fund to 100% rather than 94% in 2009, and would have to establish a funding shortfall amortization base to amortize the 9% funding shortfall. Under the Act, a plan that was only 91% funded for 2008 would have a funding shortfall of only 1% and would be eligible for the transition rule in 2009, *i.e.*, would have to fund only to 94% rather than 100% in 2009.

Benefit Accrual Limitation

The PPA provided that when a single-employer defined benefit pension plan experiences a severe funding shortfall, the plan must freeze future benefit accruals. A severe funding shortfall generally occurs when the ratio of the plan's assets to the plan's funding target for the plan year is less than 60%.

For the first plan year beginning after October 1, 2008 and before September 30, 2009, the Act provides that the ratio from the previous plan year—assuming that ratio was greater than the current plan year's ratio—may be used to determine whether benefit accrual must be frozen. Therefore, if the ratio for the plan year preceding the current plan year that begins between October 1, 2008 and September 30, 2009 is greater than 60%, the freeze on benefit accrual is avoided.

Lump Sum Payments of $5,000 or Less Released from Funding-Based Limitation on Payment

The PPA included a funding-based limitation that prohibited a single-employer defined benefit plan which fails to meet certain funding standards from making payment of benefits in an accelerated manner (*i.e.*, other than as annuity). The Act excludes from the funding-based limitation a lump-sum benefit of $5,000 or less, which may be immediately distributed without the participant's consent.

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