RE: **Notice 2008-30: Pension Protection Act Distribution-Related Issues: Summary of Guidance Applicable to Governmental Retirement Plans**

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This memorandum summarizes certain guidance provided by IRS Notice 2008-30 related to retirement plan distributions, but is not intended to completely describe all related rules. In addition, the authors are not attorneys and the information provided should not be considered legal advice or opinion. Plan administrators and other benefit professionals responsible for reviewing and updating plan provisions should consult Notice 2008-30. Additionally, qualified legal counsel should be consulted to ensure that plan provisions comply with applicable laws and regulations.

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On March 5, 2008, the U.S. Treasury Department and the Internal Revenue Service (IRS) issued Notice 2008-30 providing guidance, in a question and answer format, on certain retirement plan distribution-related provisions of the 2006 Pension Protection Act (PPA) that are effective in 2008. Earlier guidance on PPA distribution issues was provided in IRS Notice 2007-7 which primarily addressed distribution provisions that were effective beginning in 2007 and earlier.

While much of Notice 2008-30 is applicable only to private-sector plans, this memorandum summarizes portions of the guidance applicable to governmental retirement plans, including 403(b), 457(b), and grandfathered 401(k) plans, related to:

- Rollovers from eligible retirement plans to Roth IRAs,
- Interest rate assumptions for lump sum distributions, and
- Gap-period earnings for excess deferrals.

Notice 2008-30 also provides guidance regarding qualified optional survivor annuities (QOSAs) for plans subject to IRC § 401(a)(11). However, since governmental plans are not subject to § 401(a)(11), the QOSA guidance is not discussed in this memorandum.

**Rollovers from Eligible Retirement Plans to Roth IRAs**

Prior to enactment of the PPA, Internal Revenue Code (IRC) § 408 provided that a Roth IRA could only accept a "qualified rollover contribution" from another Roth IRA, a non-Roth IRA (i.e., a traditional IRA or SIMPLE IRA) or from a designated Roth account under a retirement plan. A rollover from a non-Roth IRA to a Roth IRA is referred to as a "conversion."

Effective January 1, 2008, PPA § 824 extends the definition of a qualified rollover contribution under IRC § 408 to include rollovers to a Roth IRA from qualified plans under IRC § 401(a), annuity plans under §§ 403(a) and 403(b), and governmental 457(b) plans.

Notice 2008-30 clarifies:

- Generally, when a distribution is rolled over from an eligible retirement plan to a Roth IRA, the previously untaxed amounts distributed from the Roth account are included in the individual's gross income. For taxable years beginning prior to January 1, 2010, a qualified rollover contribution is not permitted if the individual's modified adjusted gross

income exceeds $100,000 or if the individual is married and files a separate income tax return. [Q&A-1]

- The 10% additional tax under IRC § 72(t) does not apply to amounts included in gross income due to a qualified rollover contribution to a Roth IRA. However, if such amounts are distributed within five years of the rollover, the 10% additional tax does apply as if the distribution were includable in gross income. [Q&A-3]

- Under § 401(a)(31)(A), a plan must allow a distributee of an eligible rollover distribution to elect a direct rollover to a Roth IRA. The rollover is not subject to the mandatory 20% withholding requirements of § 3405(c), even if the distribution is includable in gross income. Additionally, a direct rollover distribution to a Roth IRA by a nonspouse beneficiary is not subject to mandatory withholding. However, distributees may elect to have amounts withheld if they so choose. [Q&A-4, Q&A-6]

- Beneficiaries may make qualified rollover contributions to a Roth IRA, provided they are eligible based on modified adjusted gross income and filing status. [Q&A-7]

**Interest Rate Assumptions for Lump Sum Distributions**

For private-sector plans, IRC § 417(e)(3) provides rules for determining the value of plan benefits provided in the form of "cash outs" and lump-sum distributions.[1] Under these rules, the present value of the distribution may not be less than the present value calculated using the specified interest rate and mortality table. Generally, § 417(e)(3) does not apply to governmental plans, either for the purpose of determining cash outs or minimum lump-sum distributions. However, governmental plans are required to use the 417(e)(3) interest rates when calculating the value of certain benefits subject to benefit limitations under IRC § 415(b).

For plan years beginning on or after January 1, 2008, PPA § 302 changes the present value determination rules under § 417(e)(3). As a result, the "applicable interest rate" used to determine the present value is defined as the adjusted first, second and third "segment rates" based on corporate bond yields for the month before the date of the distribution.[2] The "applicable mortality table" is defined as the mortality table, as modified by the Treasury Secretary, based on the table specified for the plan year under § 430(h)(3)(A). Referred to as the "Applicable Mortality Table," it is updated and published annually by the IRS.

Private-sector plans are also required to provide a qualified joint and survivor annuity (QJSA) that is at least as valuable as any other optional form of benefit provided by the plan. However, the PPA changes to the 417(e)(3) interest and mortality factors may result in lump sum benefits that are more valuable than the QJSA. Transitional relief is provided in Notice 2008-30. As provided in Q&A-16, a plan will not fail to meet the requirement that a QJSA be at least as valuable as any other form of benefit under the plan, merely because the plan is amended to provide that a benefit subject to 417(e)(3) be calculated as the "greater of" the value of the benefit using the pre-PPA assumptions and the value using the post-PPA assumptions. This

[1] Under IRC § 411(a)(11), a private-sector plan may not distribute ("cash out") a terminating participant's benefit without the participant's consent if the present value of the benefit is greater than $5,000. This rule does not apply to governmental plans.

[2] These segment rates are determined using a yield curve based on investment-grade corporate bonds. The first segment applies to the first 60 months of cash flows, the second segment to cash flows from months 61 through 240, and the third to cash flows after 240 months. These adjusted segment rates are determined without regard to the 24-month averaging provided under § 430(h)(2)(D)(i). There is a transition rule that phases in the use of the segment rates over 5 years.

approach for using pre-PPA assumptions is applicable only through the end of the 2009 plan year. [Q&A-16 through Q&A-18]

Further implementation guidance related to PPA § 302 is provided in Revenue Ruling 2007-67.

**Gap-Period Earnings for Excess Deferrals**

Excess deferrals are participant contributions to a 401(k) or 403(b) plan that exceed the maximum deferrals allowed for a given year. Maximum deferrals are $15,500 in 2008, (or $20,500 if the individual is age 50 and older). Under the final regulations (TD 9324) recently issued under IRC § 402(g), for tax years beginning on or after January 1, 2007, a distribution of excess deferrals generally must include "gap-period earnings."

The "gap period" is the period between the end of the tax year in which the deferrals were made and up to seven days before the date the excess deferrals are distributed (returned) to the participant. These excess deferrals must be returned by April 15th of the year following the tax year in which the excess deferrals were made. The amount returned must include both the excess deferrals and the investment gains and losses earned on the excess deferrals during the gap period. These rules apply to pre-tax contributions, as well as contributions that are designated Roth contributions. The rules also apply to 401(k) or 403(b) plans sponsored by governments.

Notice 2008-30 provides guidance on the plan amendments necessary to incorporate gap-period earnings with the distribution of excess deferrals. Plans must operate in accordance with the new rules for tax years beginning on or after January 1, 2007. However, under Notice 2008-30, plans have until the last day of the 2009 plan year to adopt an interim plan amendment to reflect the new rules. However, for plans seeking IRS determination letters, plans submitted to the IRS for Cycle B (2/1/07 – 1/31/08) and Cycle C (2/1/08 – 1/31/09) must contain the gap-period language to receive a favorable determination. [Q&A-19 through Q&A-21]

It should be noted that the Pension Protection Technical Corrections Act, currently pending in Congress, would eliminate the requirement that distributions of excess deferrals include gap period earnings. Plan sponsors affected by these provisions should monitor this legislation.

The full text of Notice 2008-30 is available at: http://www.irs.gov/pub/irs-drop/n-08-30.pdf

**Circular 230 Notice**

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