

RE: The Worker, Retiree, and Employer Recovery Act of 2008
FROM: Paul Zorn
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This memorandum summarizes changes to the Internal Revenue Code (Code) and other laws made by recent legislation. However, the author is not an attorney and the information provided is not legal advice or opinion. Moreover, the memorandum is not intended to provide a comprehensive description of the related rules. Plan administrators should consult with qualified legal counsel to ensure plan provisions comply with applicable laws and regulations.

On December 10, 2008, the U.S. House introduced and passed H.R. 7327, the Worker, Retiree, and Employer Recovery Act of 2008 (Recovery Act). The next day, the Act was taken up by the Senate and passed unanimously. The President is expected to sign the Act; however, he has not done so at the time of this writing. The Act provides funding (and other) relief for private-sector retirement plans along with technical corrections to the 2006 Pension Protection Act. Several of the provisions are applicable to governmental pension plans, including:

- **Market Rate of Return** – Under the Pension Protection Act and related regulations, certain hybrid defined benefit plans would be deemed to be age discriminatory unless the plan limited the annual interest credited on member accounts to no more than a “market rate of return.” Such hybrid plans include plans where the participant’s accumulated benefit is “expressed as the balance of a hypothetical account maintained for the participant” (possibly including deferred retirement option plans, interest credited on picked-up member contributions, and similar arrangements). Moreover, under related proposed regulations, “market rate of return” is based on long-term, investment-grade bond rates.

The Recovery Act amends the Age Discrimination in Employment Act (ADEA) to provide that a rate for crediting interest established under federal, state, or local law (including any administrative rule or policy adopted in accordance with such law) will be treated as a “market rate of return,” provided it does not violate other requirements of the ADEA. This provision is effective as if it had been included in the Pension Protection Act (i.e., for plan years after December 31, 2007). Generally, this means that governmental plans will not have to change how they credit interest on DROP accounts and member contribution accounts, provided the rate for crediting interest is established under law, or under a related administrative rule or policy.

- **Retired Public Safety Officer Distributions** – The Pension Protection Act allows qualified retired public safety officers to exclude up to \$3,000 annually from federal income taxation for distributions made from an eligible governmental plan to pay premiums for qualified health insurance or long-term care. In early 2007, the IRS ruled that this exclusion only applied to coverage provided by an insurance company and not to coverage provided by self-funded plans. However, the IRS later agreed to interpret the language to include self-funded plans. The Recovery Act formally corrects the statutory language to include coverage provided by self-funded plans. The change is effective for tax years beginning after December 31, 2006.

- **415 Mortality Table** – The Recovery Act changes the mortality table used for benefit limitation calculations under Code § 415 from the 1994 Group Annuity Reserving Table (with adjustments) to the “Applicable Mortality Table,” described under Code § 417(e)(3)(B). The change is effective for years beginning after December 31, 2008, but may be applied to years (or portions of years) beginning after December 31, 2007, if the plan so elects. The change will have a marginal effect on the 415 dollar limits. Note that the Applicable Mortality Table is not a fixed table; it will change each year to reflect improving life expectancy.
- **Rollovers to Nonspouse Beneficiaries** – The Pension Protection Act allowed (but did not require) qualified retirement plans to rollover benefits to nonspouse beneficiaries. Under the Recovery Act, rollovers to nonspouse beneficiaries are generally subject to the same rules as other eligible rollovers, including the requirement that plans allow beneficiaries to make direct rollovers of eligible rollover distributions. This provision is effective for plan years beginning after December 31, 2009.
- **Roth Rollovers** – The Pension Protection Act allowed distributions from qualified retirement plans, tax-sheltered annuities, and governmental 457 plans to be directly rolled over into a Roth IRA, provided the distribution is recognized as gross income. The Recovery Act clarifies that rollovers from a Roth account within a tax-qualified retirement plan or tax-sheltered annuity to a Roth IRA would not be subject to inclusion in gross income.
- **Minimum Distributions** – Generally, participants in qualified plans are required to take minimum distributions by April 1 of the year following (1) the year they retire or (2) the year they attain age 70½, whichever is later. The Recovery Act provides a temporary, one-year moratorium on required minimum distributions from individual retirement plans (e.g., IRAs) and defined contribution plans qualified under Code §§ 401(a), 403(a), 403(b), and governmental plans under § 457(b). The one-year moratorium is effective for minimum distributions beginning after December 31, 2008. (However, minimum distributions for 2008 must still be made.)

Additionally, as discussed in the Joint Committee on Taxation’s explanation of this provision, if a qualified plan distributes an amount to an individual in 2009 as an eligible rollover distribution, but the amount would otherwise have been a required minimum distribution, the plan is permitted (but not required) to offer the employee a direct rollover of the amount, and provide the employee with a written explanation of the rollover requirements. If the employee receives the distribution (instead of directly rolling it over), the distribution is not subject to the mandatory 20% withholding requirement and the employee can rollover the distribution by contributing it to an eligible retirement plan within 60 days of the distribution. Defined contribution plans may need to revise their Special Tax Notice given to employees receiving a lump-sum or other rollable distribution in order to reflect these changes.

- **Health Reimbursement Accounts** – In Revenue Ruling 2006-36, the IRS held that amounts paid under a health reimbursement arrangement (HRA) are not excludable from gross income if the plan allows amounts to be paid for medical benefits to a beneficiary who is other than the employee’s spouse or dependents. Under the ruling, such an HRA would be disqualified and no amount paid to any participant would be excludable from gross income.

The Recovery Act offers limited protection from Revenue Ruling 2006-36 by providing that amounts paid from an HRA will not fail to be excluded from gross income “solely because such plan, on or before January 1, 2008, provides for reimbursements of health care expenses of a deceased plan participant’s beneficiary.” However, this provision only applies to plans that are funded by a medical trust established in connection with a public retirement system, and that has been authorized by a state legislature or that received a favorable ruling under Code § 115. The provision applies to payments made before, on, or after the Recovery Act’s date of enactment.

The text of H.R. 7327 is available though the Thomas web site: <http://thomas.loc.gov/>
The Joint Committee on Taxation’s analysis is at: <http://www.house.gov/jct/x-85-08.pdf>

Circular 230 Notice

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