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Law Changes Require Amendment to Retirement Plans

The Pension Protection Act of 2006 (PPA) and the Heroes Earnings Assistance and Relief Act of 2008 (HEART Act) made some changes in the provisions of the law which have an impact on retirement plans. Some provisions were optional while others were mandatory. Plan sponsors were allowed to operationally comply with the new rules without immediately updating their plan document for these changes. The deadline for updating your plan document for the PPA is the last day of your 2009 plan year (e.g., 12/31/2009 for calendar year plans) and the deadline for updating your plan for the HEART Act is the last day of your 2010 plan year. This newsletter provides a summary of the provisions of these two laws and explains the defaults that will be applied to your plan, unless a separate election is made under Article II of the amendment.

Optional Provisions that Require an Election on the Amendment

Vesting Provision—effective for plan years beginning on or after 1/1/07: prior to the PPA, plan sponsors could subject nonelective contributions to a vesting schedule of up to a seven-year graded or a five-year cliff. The PPA reduced the maximum number of vesting years down to

a six-year graded or a three-year cliff schedule. Any plan that used a schedule that was not as generous at each vesting year as either the six-year graded or three-year cliff schedule was required to switch to one that satisfied one of these schedules for any nonelective contributions made for plan years beginning on or after 1/1/07. If your plan did not comply with the new vesting requirements, American Trust previously prepared an amendment for your plan to be effective with your 2007 plan year. The PPA amendment will therefore reflect that your plan already complies with this provision.

Non-spousal Rollovers—effective for distributions made after 12/31/06: prior to the PPA, a non-spousal beneficiary could only receive a distribution from the plan in the form of a lump-sum cash distribution or as annual payments based on a period of time not to exceed their life expectancy. PPA allows non-spousal beneficiaries the option to roll their account balance under the plan to an inherited IRA. Distributions may then be made through the IRA instead of the retirement plan. The non-spousal rollover provision was an optional provision for the 2007 to 2009 years, but is mandatory for plan years beginning in 2010. The default is to allow non-spousal beneficiary rollovers.

Hardship Distributions for Expenses of Beneficiaries—effective as of 8/17/2006: prior to PPA, plan sponsors could allow a participant to receive an in-service distribution on account of hardship for certain expenses incurred by the participant, the participant's spouse and dependents. This PPA provision would allow an additional qualifying expense in that a participant could take an in-service distribution to pay certain expenses incurred by the participant's named beneficiary, as well. The default is to not allow hardship distribution for expenses of beneficiaries.

In-Service Distributions of Pension Dollars—effective for plan years beginning after 6/30/2008: this only affects your plan if it is a money purchase pension plan, target benefit plan, or if assets from either of these two types of plans have been transferred (merged) into your plan. Under IRS rules, a participant cannot receive an in-service distribution of money purchase or target benefit assets until the participant has attained the plan's stated normal retirement age. The PPA set restrictions on what can be used as a normal retirement age under a plan. As a general rule, the normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. The IRS has indicated that a normal retirement age of 62 is deemed to be within this general rule and would not be questioned. A retirement age of less than age 62 would be subject to a facts and circumstances determination by the IRS. If your plan has money purchase or target benefit assets and allows for an in-service withdrawal at an age of less than 62, the default will be to increase the age at which withdrawals are available to age 62.

Qualified Reservist Distributions

This provision allows a participant who is ordered or called to active duty for a period in excess of 179 days, or for an indefinite period, to take a distribution of elective deferrals under the plan while out on military leave. The distribution is not subject to the 10 percent excise tax for early withdrawal. The default is to not allow for qualified reservist distributions.

Continued Benefit Accruals

This is a provision of the HEART Act that allows a plan sponsor to treat an individual who dies or becomes disabled on or after 1/1/2007, while performing qualified military service with respect to the employer as if the individual had resumed employment in accordance with the individual's reemployment rights under USERRA on the day preceding the death or disability. The individual would then be treated as if he/she was employed on the date of death or disability for plan purposes. The default is to not apply the continued benefit accrual provision.

Other Provisions of the New Laws that do not Require an Election on the Plan Amendment

There are a number of other provisions within these two laws that have an impact on your retirement plan which are included in the amendment, but do not require an election. A detailed explanation of these provisions can be found within the Articles of the PPA/HEART Act plan amendment. Below is a brief explanation of some of the more applicable provisions.

180-day Notification Period: previously, distribution paperwork sent to a participant was only valid for 90 days. The PPA increased the maximum notice period for distribution paperwork to participants to 180 days.

Roth IRA Rollover: for distributions made after 12/31/07, a participant may elect a direct rollover to a Roth IRA of any rollover-eligible distribution. This is similar to an IRA conversion to a Roth IRA. For distributions prior to 2010, a rollover/conversion to a Roth IRA is only permitted for individuals whose adjusted gross income does not exceed certain levels. However, beginning in 2010 the income thresholds are removed. In addition, any taxable distribution rolled to a Roth IRA in 2010 will be taxed ratably during 2011 and 2012.

Differential Wage Payments: the HEART Act changes the law to require that any differential pay paid to an individual on military leave after 12/31/2008, can be included as taxable wages and counted as compensation for plan purposes.