

Public Sector Compliance Wrap-up

The Worker, Retiree and Employer Recovery Act of 2008 (WRERA)¹ includes several technical corrections to the Pension Protection Act of 2006 (PPA'06) that affect public sector retirement and retiree health plans. This *Bulletin* summarizes the major public sector provisions of WRERA and provides information about extensions by the Internal Revenue Service (IRS) of several important compliance deadlines for public sector retirement plans.

PUBLIC SECTOR PROVISIONS IN WRERA

WRERA's public sector provisions modified PPA'06:

➤ **Rate of Return for Crediting Interest** PPA'06 required cash balance plans to credit interest on account balances at a market rate of return, defined in regulations to be a rate that fluctuates at least annually. Through changes to the Age Discrimination in Employment Act (ADEA), these cash balance provisions applied to public sector defined benefit plans that provide interest credit on account balances. Examples include refunds of employee contributions and provisions in Deferred Retirement Option Plans (DROPs). WRERA essentially eliminated the market rate of return requirements for public sector plans, by amending the ADEA to treat any rate of return or interest crediting method established under federal, state or local law as market rate of return that complies with ADEA requirements, effective as of the date of the original provision under PPA'06. Consequently, public sector defined benefit plans do not have to follow the market rate of return rules under PPA'06, and can continue to use their current rates, as established under applicable laws.

➤ **Rollovers** PPA'06 allowed, but did not require, qualified retirement plans to permit rollovers by nonspouse beneficiaries. Under WRERA, plans will be **required** to offer a direct rollover to nonspouse beneficiaries, effective for plan years beginning in 2010. WRERA allows designated Roth contributions from §403(b) or §401(k) plans to be directly rolled over to a Roth IRA tax-free and regardless of income limits, effective for distributions after December 31, 2007.

➤ **Temporary Waiver of Required Minimum Distributions** For 2009 only, WRERA provides a one-year waiver of required minimum distributions from defined contribution plans, including §401(a), §403(b) and public sector §457(b) plans. If a required minimum distribution from such plans is still made for 2009, it is not subject to the 20 percent mandatory withholding requirement and may be rolled over. Minimum distributions are generally required to be made by April 1 of the year following the year an individual reaches age 70½ or retires, whichever is later. If a minimum distribution was required for 2008, but not yet made, it is not eligible for waiver and must still be distributed.²

➤ **Self-Funded Plans Eligible for Special Tax Exclusion for Retired Public Safety Officers under PPA'06** The exclusion that permits public sector retirement plans to make a tax-free payment of up to \$3,000 annually to a health insurance plan on behalf of such officer was clarified under WRERA to include self-funded plans in the definition of health insurance for all years the exclusion applies.

IRS EXTENDS SEVERAL KEY COMPLIANCE DEADLINES FOR PUBLIC SECTOR PLANS

This section notes IRS extensions to several key compliance deadlines for public sector retirement plans.

¹ WRERA, which became Public Law No: 110-458 on December 23, 2008, is available on the following page of the Government Printing Office Web site: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_public_laws&docid=f:publ458.pdf

² For more information about this, see Segal's March 31, 2009 *Compliance Alert*, which is on the following page of Segal's Web site: <http://www.segalco.com/publications-and-resources/compliance-alert/archives/?id=1228>

§403(b) Regulations

IRS Notice 2009-3 provides limited relief from written plan requirements under §403(b) regulations.³ Under the regulations, §403(b) plans were required to have a written plan formally adopted by the plan sponsor no later than December 31, 2008. Under the Notice, plans now have until December 31, 2009 to adopt a written plan that satisfies §403(b) regulations, which must be effective retroactive to January 1, 2009. During 2009, §403(b) plans must still operate in compliance with a reasonable interpretation of the regulations, including requirements for coordinating transactions among multiple vendors and information sharing agreements, as applicable. Also, before the end of 2009, §403(b) plans must retroactively correct any failure to operate the plan consistent with written plan terms using the general principles of the IRS Employee Plans Compliance Resolution System (EPCRS).

Normal Retirement Age Regulations

In 2007, the IRS issued final regulations regarding qualified plan distributions at normal retirement age. For public sector plans, the regulations were to take effect for plan years beginning on or after January 1, 2009. However, last fall, the IRS extended this deadline two years for governmental plans: until plan years beginning on or after January 1, 2011.⁴

In 2007 regulations, the IRS required that a qualified plan's normal retirement age must not be "earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed." In addition, the regulations set out age 62 for general employees and 50 for public safety employees as safe harbor normal retirement ages and indicates that ages 55-62 can be used if the employer through facts and circumstances demonstrates the age is reasonable.

Thus, the regulations do not permit a normal retirement age that is based solely on years of service or based on a combination of years of service and age, where the age may be lower than the ages cited above (*e.g.*, Rule of 85). Public sector plans commonly define normal retirement age using a component of years of service. Since such plans may not be able to change their normal retirement age under state law requirements, even if required by the IRS, the regulations present a challenge to the public sector. One of the reasons the IRS extended the deadline for complying with normal retirement age regulations was so that they may address the concerns of public sector plans.

IRS Determination Letters

In 2005, the IRS established a process for qualified plans to file determination letter applications over a five-year

recurring cycle. A plan's cycle (and filing deadline) corresponds to the deadline for amending the plan to comply with legislative and regulatory changes as described in the IRS cumulative list of required modifications. The cycle is based on the type of plan or the employer identification number (EIN). All public sector plans are in Cycle C, which began February 1, 2008 and ended January 31, 2009. However, on November 5, 2008, the IRS announced a one-time extension of the deadline for public sector plans to submit determination letters during either Cycle C or Cycle E, which begins February 1, 2010 and ends January 31, 2011.

If a public sector plan did file under Cycle C, it will go to the front of the line for determination letters under that Cycle. Also, if such a plan uses the Voluntary Correction Program (VCP) to correct a failure to amend the plan on time for a compliance requirement, they will be eligible for reduced fees under that Program. If a public sector plan files under Cycle E, it must adopt interim plan amendments to comply with cumulative list for Cycles C, D and E. In addition, for public sector plans that file under Cycle E, their determination letter will still expire at the end of the next Cycle C (January 31, 2014), which means their cycle will last three years instead of five years.



As with all issues involving the interpretation or application of laws and regulations, plan sponsors should rely on their attorneys for authoritative advice on the interpretation and application of WRERA and the IRS guidance discussed in this Bulletin. Segal can be retained to work with sponsors of public sector plans and their attorneys on compliance.



ATLANTA	678.306.3100
BOSTON	617.424.7300
CALGARY	403.692.2264
CHICAGO	312.984.8500
CLEVELAND	216.687.4400
DENVER	303.714.9900
HARTFORD	860.678.3000
HOUSTON	713.664.4654
LOS ANGELES	818.956.6700
MINNEAPOLIS	952.857.2480
MONTREAL	514.989.3735
NEW ORLEANS	504.483.0744
NEW YORK	212.251.5000
PHILADELPHIA	215.854.4017
PHOENIX	602.381.4000
PRINCETON	609.520.2700
RALEIGH	919.233.1220
SAN FRANCISCO	415.263.8200
TORONTO	416.969.3960
WASHINGTON	202.833.6400

www.segalco.com

³ Notice 2009-3 (released December 11, 2008) is on the following page of the IRS Web site: <http://www.irs.gov/pub/irs-drop/n-09-03.pdf>

⁴ Notice 2008-98 (released October 10, 2008), is on the following page of the IRS Web site: <http://www.irs.gov/pub/irs-drop/n-08-98.pdf>