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# *CORRESPONDENCE MEMORANDUM*

**DATE:** October 25, 2006

**TO:** Deferred Compensation Board

**FROM:** Bob Conlin, Director of Legislation, Communications and Planning
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**SUBJECT:** Federal Legislative Report: Pension Protection Act of 2006

On August 17, 2006, President Bush signed into law the much-anticipated pension reform legislation that had been working its way through Congress for more than a year. The Pension Protection Act of 2006 (PPA), which was signed into law as Public Law 109-280, makes numerous changes in federal laws governing pensions. Although the Act primarily addresses private sector pensions, it also includes a number of provisions that will have an effect on public plans, including Sec. 457 plans. Some of the more significant public plan changes are summarized below:

- EGTRRA Permanency. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) contained a number of provisions geared towards enhancing retirement savings for Americans. For example, EGTRRA did the following:

  - ✓ Increased the limits on deferrals to Sec. 457 plans (and other savings vehicles) and provided inflation based indexing of those limits in future years (the limit in 2006 is $15,000; in 2007 it is $15,500).
  - ✓ Provided for catch-up contributions for those age 50 and over.
  - ✓ Created a Saver's Credit, which is a non-refundable tax credit available to lower income participants who make qualified retirement savings contributions.
  - ✓ Provided for portability between Sec. 457 plans and other types of retirement plans.
  - ✓ Allowed for the purchase of service from pension plans using funds from a Sec. 457 plan account.

  When EGTRRA passed, it contained a sunset provision required by federal budgeting rules. Under that sunset provision, the majority of EGTRRA's enhanced pension and savings provisions were set to expire at the end of 2010. The PPA repealed the sunset provision, effectively making these enhanced provisions of EGTRRA permanent.

Reviewed and approved by Dave Stella, Deputy Secretary

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Signature Date

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- Rollovers by Non-Spouse Beneficiaries. Generally, prior to enactment of the PPA, federal law allowed the spouse of a deceased participant in a qualified pension plan, tax-deferred annuity, or Sec. 457 plan to "rollover" the participant's benefit to an IRA. Non-spouse beneficiaries were not allowed to make such rollovers.

  The PPA provides that the benefits received by a non-spouse beneficiary from a qualified retirement plan, a Sec. 457 plan, or a Sec. 403 (b) plan may be directly transferred to an IRA. The IRA is then treated for federal tax purposes as an inherited IRA and benefits must be distributed in accordance with the minimum distribution rules that apply to inherited IRAs.

- Hardship Distributions Applicable to Emergencies of a Non-Spouse. Prior to passage of the PPA, federal distribution rules allowed a Sec. 457 plan to permit distributions to participants where an unforeseen financial emergency arises with respect to a spouse or a dependent of the participant.

  The PPA directs the Treasury Department to modify its regulations to allow for distributions to participants in the event a beneficiary designated by the participant, even if not a spouse or dependent of the participant, experiences a qualifying hardship or unforeseen financial emergency. It does not appear that the PPA requires plans to offer this hardship provision for non-spouses; it is optional. Further guidance on the expanded hardship withdrawal provision is supposed to be released by the Secretary of the Treasury in February 2007.

- Public Safety Officer Withdrawals for Health and Long Term Care. Prior to the PPA, distributions from qualified government pension plans, Sec. 403(b) plans, and Sec. 457 plans were included in income for federal tax purposes in the year in which the distributions were made.

  The PPA provides that deductions from distributions from such plans to pay for health or long term care insurance premiums for "eligible retired public safety officers" are excludible from income, up to $3,000 per year. Under the PPA, an eligible retired public safety officer is a law enforcement officer, a firefighter, a chaplain, or a member of a rescue squad or ambulance crew who, by reason of disability or attainment of normal retirement age, separated from service as a public safety officer. This provision will only apply if the plan agrees to deduct and then directly remit premiums to an insurer. This provision becomes effective January 1, 2007.

- Removal of Early Distribution Penalty for Public Safety Employees. Prior to enactment of the PPA, a distribution from a qualified retirement plan prior to age 59 ½, death, or disability, was subjected to a 10% early withdrawal penalty. This penalty was imposed unless certain exceptions were met. Some of the exceptions included distributions to persons who had attained the age of 55, or distributions in the form of periodic payments.

  The PPA provides that the 10% early withdrawal penalty additionally does not apply to distributions from public pension plans that are made to "public safety employees" separating from service after age 50. For purposes of this provision, a public safety employee is considered an employee of a state or political subdivision of a state if the employee provides police protection, firefighting services, or emergency medical services within the state or political subdivision.

- <u>Tribal Pension Plans.</u> Prior to adoption of the PPA, tribal pension plans had been considered to be governmental plans by the Internal Revenue Service (IRS). Recently, the IRS began rethinking its position on tribal plans. Loss of governmental plan status would have subjected tribal plans to the federal pension requirements of the Employee Retirement Income Security Act (ERISA).

  The PPA provides that pension plans established and maintained by tribal governments are considered to be governmental plans. Qualified employees of these plans are those who perform "essential governmental services," not commercial activities.

- <u>Minimum Distribution Rules.</u> Prior to adoption of the PPA, qualified pension plans had to meet certain minimum distribution requirements. Proposed Treasury regulations interpreting these requirements would have jeopardized certain post-retirement adjustments made to pensions, like the post-retirement increases based on investment returns used by the Wisconsin Retirement System.

  The PPA requires the Secretary of the Treasury to issue regulations, under which a governmental plan is treated as complying with the minimum distribution requirements, if the plan complies with a reasonable, good faith interpretation of the statutory requirements. The intent of the PPA was for these regulations to apply for periods before the date of enactment of the PPA. This provision will allow the WRS to maintain its post-retirement, investment-based adjustments.