Federal Regulatory Update

Robert L. Gauss, Partner
Ice Miller LLP
One American Square, Suite 2900
Indianapolis, IN 46282-0200
(317) 236-2133
gauss@icemiller.com
Current Topics

- Status of IRS’ Determination Letter program.
- Developments Regarding Normal Retirement Age Regulations.
- Update Regarding Definition of “Governmental Plan.”
- DROPs and Excess Benefit Plans
- Mandatory vs. Optional Membership
Topic 1 – Status of IRS’ Determination Letter Program

- 2007 – IRS Commissioner established a five year cycle for determination letter applications (and remedial amendment program).
- Cycle C and Cycle E have applied to governmental plans.
- Current determination letter serves as an “insurance policy” for the plan, and confirms that the plan is qualified under Code § 401(a).
- IRS is bound by a determination letter until it expires or the law has changed.
Plan with a current determination letter may use the IRS’ voluntary correction program (“VCP”).

Plan also may use the IRS’ self-correction program (“SCP”).

A current determination letter markedly reduces potential issues if the IRS audits the plan.

Current determination letter is helpful/required for purposes of some foreign investments (Form 8802 submissions).
Topic 1 – Status of IRS’ Determination Letter Program (cont.)

IRS Announcement 2015-19 (July 2015)

IRS announces its intention to eliminate determination letter program for individually designed plans effective January, 2017. Exception for initial qualification and plan termination.

IRS no longer will accept determination letter applications based on five-year remedial amendment cycles.

Determination letter program remains in place for pre-approved plans (i.e. master, prototype and volume submitter plans).
Topic 1 – Status of IRS’ Determination Letter Program (cont.)

- IRS announces intent to issue annual Required Amendments List and Operational Compliance List.
Pre-approved plans approach does not work for most governmental plans:

- Plan terms (statutes, ordinances, regulations, board rules).
- Unique characteristics of governmental plans/governmental employees do not fit nicely into pre-arranged plan format (i.e. tiers, special employee groups (public safety), vesting, retirement eligibility).
January 27, 2016 – Announcement from IRS and Treasury regarding Applicability of Normal Retirement Age Regulations to Governmental Pension Plans.

Latest in a string of developments which began in 2007 (“2007 NRA Regulations”).

Notice of proposed rulemaking attempts to address concerns and comments submitted in response to prior IRS notices.
General Rules

Governmental Plans must satisfy pre-ERISA vesting rules.

Use of a period of service to determine normal retirement age is permissible if the period of service is reasonable and uniformly applicable.

Governmental plan may specify a normal retirement age which is lower than age 65 (Revenue Ruling 71-147) if that age represents the age at which employees customarily retire in the industry.

Distinction between governmental plans which allow in-service distributions and those that do not.

- If in-service distributions - then NRA must meet reasonably representative requirement.
- If no in-service distributions - then NRA must satisfy pre-ERISA vesting rules (plan must specify the earliest age at which a member has the right to retire and receive unreduced retirement benefits based on service as of the date of retirement).
Safe Harbors

- **General Safe Harbor**
  - NRA = the later of age **62** or another specified date (*i.e.* fifth anniversary of plan participation).

- **Safe Harbors specific to governmental plans**
  - The later of age **60** or the age at which the participant has been credited with at least 5 years of service.
  - The later of age **55** and 10 years of service.
  - Combined age and years of service equals **80 or more**.
  - Any age with 25 years of service (in combination with another safe harbor that includes an age).
Public Safety Safe Harbor Rules

- Proposed Regulations establish Safe Harbors for Qualified Public Safety Employees within the meaning of Code § 72(t)(10)(b).
- Any employee of the state or political subdivision of a state who provides police protection, firefighting services, or emergency medical services within the jurisdiction.

Public Safety Safe Harbors

- NRA = age 50 or later.
- Combined age and years of service = 70 or more
- Any age with 20 years or more of service (no requirement for combination with another safe harbor).
Topic 2 – Developments Regarding Normal Retirement Age Regulations (cont.)

- Miscellaneous Considerations
  - Multiple NRAs
  - Other normal retirement ages (must satisfy a good faith determination of the typical retirement age for the industry in which the covered workforce is employed and consistent with pre-ERISA vesting rules).

- Effective Date – January 1, 2017 or close of the legislative session that begins 3 months after the final regulations are published.
  - Prospective for employees hired after effective date.
  - Comments submitted to the IRS on April 26, 2016.
  - Comments by IAFF and Ice Miller specific to Qualified Public Safety Employees (comments related to definition, including consistency of treatment of similarly situated federal and state employees).
Retired reemployed situations

- Issues related to funding, early distribution penalty coding, bona fide separation, ADEA, and Social Security replacement plan status

IRS position (PLR 201147038, November 18, 2011)

- Employees who “retire” on one day in order to qualify for a benefit under the Plan, with the explicit understanding between the employee and employer that the employee will return to work are not separating from service with the employer:
  - Are not legitimately retired
  - Are not actually separated from service
  - Have not ceased performing services for the employer when they “retire”

- Such “retirements” will violate Code Section 401(a) and result in the threat of disqualification of the Plan under Code Section 401(a).
Topic 2 – Definitions of “Retirement”/”Separation from Service” for Purposes of NRA Regulations

Issues:

- Qualification for the Plan
  - Has the individual reached the earlier of age 62 or normal retirement age?
  - Is there a true separation from employment?

- Taxation for the Individual
  - Has the individual reached age 50, 55, or 59½?
  - Is there a true separation from service?
  - If a benefit is paid before 59½ without a separation from service, the employee would be subject to a 10% penalty.
Topic 2 – Definitions of “Retirement”/”Separation from Service” for Purposes of NRA Regulations (cont.)

- Keys
  - Length of separation
    - Facts and circumstances test
    - No established length of separation (“Safe Harbor”)
    - 12 months? 6 months?
  - Separation – real or not
    - No pre-arranged agreement
    - No continuation of employment agreement
  - Does Plan provide for in-service distributions?

- Contained in the Bipartisan Congressional Trade Priorities and Accountability Act of 2015
- Amended Code § 72(t)(10) to remove limitation for distributions only from a governmental defined benefit plan.
- Effective for distributions after December 31, 2015
Topic 3 – Developments Regarding the Term “Governmental Plan”

- Proposed regulations under Code § 414(d).
  - First developments since ANPRM issued November 8, 2011.
  - Notice is response to significant comments received to ANPRM (over 2,000 comments submitted regarding public charter schools).
  - Guidance permits participation of public charter school employees in governmental plans.
  - Proposed regulations under consideration include financial responsibility component and whether a governmental entity is responsible for the accrued benefits of the employees, including funding of benefits, if the employer were to cease to be a participating employer.
Topic 4 – DROPs and Qualified Excess Benefit Plans

Code § 415(m) authorizes Qualified Governmental Excess Benefit Arrangements ("QEBAs")

Requirements:
1. Portion of a governmental plan which is maintained solely to provide annual benefits which exceed the limits under Code § 415(b);
2. No election is provided at any time to the participant (directly or indirectly) to defer compensation; and
3. Excess benefits are not paid from the main trust for the plan (must be paid from a trust exclusive to the purpose of providing excess benefits).

IRS will not approve QEBA if DROP participation is by election (choice) and results in excess benefit.
Topic 5 – Mandatory vs. Optional Membership

Background

If a pension plan provides for optional participation, the option must be:

- A one-time irrevocable election at time “first eligible” for any retirement plan of employer
- A grandfather cash or deferred arrangement

Membership Options: Areas of Inquiry

- Optional participation
- Ongoing or revocable elections
- Transfer to another plan maintained by employer
- DROP entry

Revenue Ruling 2006-43
Topic 5 – Mandatory vs. Optional Membership (cont.)

Developments

- IRS cleared out 10-year + back-log
- Private letter rulings:
  - PLR 201417025
  - PLR 201443035
  - PLR 201425026
  - PLR 201509069
  - PLR 201529009
  - PLR 201532036
Mandatory, non-elective employee contributions may be picked-up under 414(h)(2) – PLR 201425026.

Where contributions are “level,” a choice of plans will not be treated as a CODA – PLR 201417025, PLR 201351030.

For a new employee, an election will not be a CODA if made at the time that employee is first eligible for any employer retirement plan.

IRS is not concerned with post-tax contributions.
QUESTIONS
Thank You!

Robert L. Gauss, Partner
Ice Miller LLP
One American Square, Suite 2900
Indianapolis, IN 46282-0200
(317) 236-2133
gauss@icemiller.com