



New law expands tax exemption to defined contribution government plans

On June 29, 2015, President Obama signed into law the “Defending Public Safety Employees’ Retirement Act.” This new law expands the exemption from the 10% penalty tax on early distributions to qualified public safety employees from defined contribution governmental plans.

Background

The Internal Revenue Code (IRC) imposes a 10% penalty tax on early distributions from qualified retirement plans. However, this penalty tax does not apply to early distributions from eligible deferred compensation plans maintained by tax-exempt employers or governmental employers under IRC section 457. In addition, the IRC provides for several exemptions from the 10% tax on early distributions. For example, plan distributions made on or after the date the employee attains age 59½ or distributions made to an employee following separation from service after reaching age 55 are not subject to the 10% additional tax.

Effective for distributions made after August 17, 2006, the Pension Protection Act of 2006 (PPA) provided that the 10% early withdrawal penalty tax did not apply to distributions made from a governmental defined benefit pension plan to a qualified public safety employee who separated from service during or after the calendar year in which the employee reached age 50. A qualified public safety employee is an employee of a State or of a political subdivision of a State (such as a county or city) whose principal duties include services requiring specialized training in the area of police protection, firefighting services, or emergency medical services for any area within the jurisdiction of the State or the political subdivision of a State.

Impact of new law

The new law made the following changes:

- In addition to governmental defined benefit plans, the exception from the 10% penalty tax on early distributions now also applies to distributions from governmental defined contribution plans made to qualified public safety employees.
- The definition of qualified public safety employee is expanded to include federal employees who are law enforcement officers, customs and border protection officers, firefighters and air traffic controllers.

In addition, the new law clarifies that the 10% penalty tax will not apply to participants who are receiving substantially equal periodic payments and later take another distribution under this expanded exemption. The later distribution will not be treated as a modification of the substantially equal periodic payments.

Next steps

The new law applies to distributions made after December 31, 2015. Plan sponsors should consult with their legal counsel regarding the impact of the new law on their plans and their participants.

Compliance Advisory by Prudential Retirement

The Compliance Advisory is published by Prudential Retirement, a Prudential Financial business, to provide clients with information on current developments affecting qualified retirement plans. This publication is distributed with the understanding that Prudential Retirement is not rendering legal advice. Plan sponsors should consult their attorneys about the application of any law to their retirement plans.

Editor: Julie Koos (563) 585-6811

©2015 Prudential Financial Inc. and its related entities.

Prudential, the Prudential logo, the Rock symbol and Bring Your Challenges are service marks of Prudential Financial, Inc., and its related entities, registered in many jurisdictions worldwide.