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PENSION ANALYST

Important information — New legislation

Retirement related provisions included in 2016 federal budget bill

Who's affected

These provisions affect sponsors of and participants in qualified defined benefit and defined contribution plans and 403(b) plans. Some provisions have a particular impact on governmental plans and non-electing church plans.

Background and summary

On December 18, 2015, President Obama signed into law the Consolidated Appropriations Act, 2016 (CAA). The primary purpose of this law was to keep the federal government "in business" through September 30, 2016. It is often referred to as the "budget bill" or "appropriations bill".

In addition to providing funding for the federal government, the section titled "Protecting Americans from Tax Hikes Act of 2015" (PATH Act) expanded the following special tax provisions involving retirement distributions:

- Rollovers to SIMPLE IRAs; and
- Early withdrawal penalty relief for qualified public safety officers.

The PATH Act also included an extensive set of provisions applying to church plans. These provisions were originally proposed in companion bills that were called The Church Plan Clarification Act of 2015.

Action and next steps

Plan sponsors should review the information provided in this publication to understand how it applies to their plans and participants. Some plan sponsors may need to amend their plans to permit rollovers to SIMPLE IRAs. Sponsors of defined contribution church plans that have been wary about adopting automatic enrollment designs may now feel more comfortable doing so. Naturally, the adoption of automatic enrollment features will also require plan amendments, as well as participant notification.

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Revisions to plan distribution rules

Rollovers to SIMPLE IRAs

Under prior law, eligible rollover distributions from qualified plans, 403(b) plans, governmental 457(b) plans and traditional IRAs could be rolled over to traditional IRAs, but not to SIMPLE IRAs. Only distributions from a SIMPLE IRA could be rolled over to another SIMPLE IRA.

Effective December 18, 2015, eligible distributions may also be rolled over from qualified plans, 403(b) plans, governmental 457(b) plans and traditional IRAs to SIMPLE IRAs. However, a two-year period must have expired since the date the employee first participated in the SIMPLE IRA before such a rollover can be made.

Expanded early withdrawal penalty relief for qualified public safety officers

A 10% early withdrawal penalty tax applies to distributions made from a qualified plan before the participant reaches age 59-1/2, dies or becomes disabled, unless an exception applies. One of these exceptions is for distributions made to an employee who separates from service with the employer on or after age 55. This is often referred to as the “separation from service” exception.

Effective for distributions made after August 17, 2006, the Pension Protection Act of 2006 (PPA) lowered the age threshold for the separation from service exception to age 50 for distributions made from a **governmental defined benefit pension plan** to a **qualified public safety employee**. For this purpose, a qualified public safety employee was defined as any employee of a State or 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.

The “Defending Public Safety Employees’ Retirement Act”, which was signed into law on June 29, 2015 expanded the age 50 separation from service exception to also apply to early distributions made to qualified public safety employees from **defined contribution governmental plans**. In addition, the law **expanded the definition of qualified public safety employee** to include federal employees who are law enforcement officers, customs and border protection officers, firefighters and air traffic controllers. All of these changes applied to distributions made after December 31, 2015.

The PATH Act has **further expanded the definition of qualified public safety employee** to include nuclear materials couriers, members of the US Capitol Police, members of the Supreme Court Police, and diplomatic security special agents of the US Department of State. This change also applies to distributions made after December 31, 2015.

Church Plan clarification

Basic concepts

In order to understand and appreciate the church plan clarification provisions, it is important to be familiar with some basic concepts and special definitions.

Under the Internal Revenue Code (Code) and ERISA, the term “church” includes both churches and associations or conventions of churches – for example, the Southern Baptist Convention. The term “church” also includes a religious order or a religious organization that (1) is an integral part of a church, and (2) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise. Examples of religious orders and organizations include monasteries, seminaries, and similar organizations.

A "church plan" is a plan established and maintained for its employees by a church. A church plan is not subject to ERISA Title I and Title IV requirements, unless it specifically elects to be covered by those rules. Unsurprisingly, most church plans are "non-electing church plans" that do not elect to be covered by ERISA. A non-electing church plan is subject to pre-ERISA coverage and vesting rules

Clarifications

Qualified retirement plans that are nonelecting church plans and 403(b) plans that are maintained by churches or qualified church-controlled organizations (QCCOs) are subject to special tax rules. A nonelecting church plan is also exempt from the reporting and disclosure requirements of ERISA. The PATH Act clarifies the application of a number of standard concepts and rules to church plans and QCCO-sponsored plans.

The controlled group rules are used to determine when organizations with common control or ownership must be considered a single employer for various retirement plan purposes. Existing law and regulations provide rules to determine when corporations, corporate-type entities and tax-exempt organizations other than churches and QCCOs are members of controlled groups. The new law provides a general rule that limits the aggregation of organizations that are eligible to sponsor church plans with other organizations.

While most 403(b) plans are defined contribution plans, some grandfathered church sponsored 403(b) defined benefit plans still exist. The PATH Act clarifies that the Code section 415(b) defined benefit limitations apply to participant accounts in these plans, for all plan years, including years beginning before December 18, 2015. The defined contribution annual additions limits do not apply.

The PATH Act contains a provision that specifically preempts State wage withholding laws that would directly or indirectly prohibit the use of an automatic contribution arrangement in a church plan, effective December 18, 2015. This provision requires the plan sponsor to provide annual participant notices regarding the arrangement, give participants the opportunity to opt out, and provide a default investment option for participants who do not make affirmative investment elections.
After December 18, 2015, assets may be transferred tax-free between a qualified church plan and a 403(b) plan or annuity contract that is maintained by the same church or convention or association of churches, provided the following two requirements are met:

- Each participant's or beneficiary's total accrued benefit immediately after the transfer or merger is equal to or greater than their total accrued benefit immediately before the transfer or merger; and
- Each participant's or beneficiary's total accrued benefit is 100% vested on and after the transfer or merger date.

Finally, the new law allows church plan assets to be invested in a group trust, without adversely affecting the tax status of the group trust, the church plan, or any other plans or trusts that invest in the group trust. This new law is effective for investments made after December 18, 2015.

Next steps

Plan sponsors should review their plan documents to determine if their plan needs to be amended to permit rollovers to SIMPLE IRAs. If Prudential Retirement provides document services for your plan and a plan amendment is required, we will work with you to ensure that your plan complies with this guidance. Sponsors of defined contribution church plans that wish to adopt an automatic enrollment feature should contact their Prudential representative.

Pension Analyst by Prudential Retirement
The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with information on current legislation and regulatory 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.

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