

Domestic Partners' Rights Expand Under PPA Distribution Provisions

By Todd Solomon, Esq. and William Hansen, Esq.

On Aug. 17, 2006, the Pension Protection Act of 2006 (PPA) enacted two provisions that are beneficial to employees who are currently in a domestic partnership or similar relationship. The two PPA provisions are:

- 1) Section 826 regarding hardship withdrawals; and
- 2) Section 829 regarding account balance rollovers for non-spouse beneficiaries.


This article will analyze these two sections of the PPA and their effect on domestic partnerships.

Hardship Distributions

Employee benefit plans may allow a participant to receive a distribution from his or her plan account balance due to certain financial hardship events (e.g., medical, tuition and funeral expenses). Before enactment of the PPA, an employee benefit plan could only allow a participant to receive a hardship withdrawal due to a financial hardship affecting the participant or a spouse or dependent of the participant.

Section 826 of the PPA adds to the list of persons that may be taken into account in determining whether a participant may receive a hardship withdrawal. Effective Aug. 17, 2006, an employee benefit plan may permit hardship distributions for expenses related to medical, tuition (educational) and funerals for a "primary beneficiary" under the plan (see box).

Who Is a Primary Beneficiary?

A primary beneficiary under the plan is an individual who is named as beneficiary under the plan and has a right to all, or a fraction of, the participant's account balance following the participant's death. 

The employee benefit plan must follow all other relevant provisions regarding hardship withdrawals. Section 826 of the PPA applies to employee benefit plans under Sections

401(k), 403(b), 457(b) and 409A of the Internal Revenue Code.

In effect, this provision enables a participant to withdraw funds from his account balance to pay for certain expenses of the participant's domestic partner, but only if the domestic partner is the primary beneficiary under the plan. This change is significant because many, if not most, domestic partners do not meet the tax code's definition of "dependent" and same-sex spouses do not qualify as "spouses" under federal law due to the federal Defense of Marriage Act.

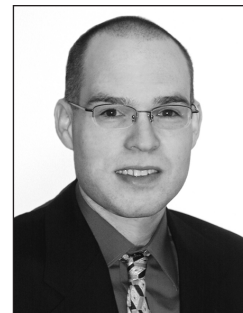
Non-spouse IRA Rollovers

Before enactment of the PPA, only a surviving spouse could roll over the account balance of a deceased participant into his or her own individual retirement account (IRA). All other beneficiaries (including dependents, siblings and all other non-spouse beneficiaries) were generally required to withdraw the account balance in a lump sum or during a five-year period following the year of the date of the participant's death. The enactment of the PPA now enables non-spouse beneficiaries to roll over the deceased participant's account balance to an inherited IRA.

An inherited IRA must be established for the purpose of receiving the deceased participant's account balance in a manner that identifies it as an IRA with respect to a deceased individual (e.g., Jane Doe as beneficiary of John Doe). What complicates this new rollover provision are the minimum required distribution rules under Code Section 401(a)(9). In short, once a participant reaches a certain age (the minimum required distribution beginning date), the participant is required to receive a minimum distribution from his account balance. Under Section 401(a)(9), generally, there are two rules that affect beneficiaries who inherit an account balance from a deceased participant (see box on p. 12).

Before the IRS released guidance, many viewed the PPA provision allowing non-spouse

See *Domestic Partners*, p. 12



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beneficiary rollovers as extremely favorable in solving an inequity in employee benefit plan tax rules. However, in Notice 2007-7, the IRS attempted to clarify the provision and it became apparent that the IRS was going to interpret the provision more conservatively than many first thought. Moreover, Notice 2007-7 took more than one such conservative position.

Rules Affecting Beneficiaries

The Five-year Rule

The five-year rule requires the beneficiary receiving an account balance from a deceased participant to receive the entire amount by the fifth calendar year following the year of the participant's death.

The Life-Expectancy Rule

The life expectancy rule states that a minimum required distribution occurs each year based upon the life expectancy of the non-spouse beneficiary. 

First, some initially believed that this provision would be a requirement for all qualified employee benefit plans; however, the IRS interpreted this provision as purely optional. Therefore, it is up to each individual benefit plan sponsor to decide whether or not to allow IRA rollovers by non-spouse beneficiaries such as domestic partners.

Second, the provision seemed to grant the ability to stretch out distributions throughout the beneficiary's life expectancy to certain non-spouse beneficiaries who inherited an account balance for a death that occurred before Jan. 1, 2006 as well as after that date. However, Notice 2007-7 effectively limited this relief to only those non-spouse beneficiaries who inherited an account balance based upon the death of a participant that occurred after Jan. 1, 2006.

More transition guidance is expected from the IRS regarding these issues; however, it is not known whether it will grant the broad relief that may have been originally intended.


In addition, there was some confusion as to the application of the Section 401(a)(9) minimum required distribution rules to non-spouse beneficiaries if the participant dies before his or her "required beginning date" as defined in that section. The confusion arose as a result of potential conflicts between Q&As 17 and 19 of IRS Notice 2007-7.

Q&A 19 contains the general rule for determining minimum required distributions in the case of a non-spouse beneficiary rollover. It provides that the rules for determining minimum required distributions applicable

to a non-spouse beneficiary under the plan also apply to the IRA. Therefore, if the plan document uses the five-year rule, the IRA should use the five-year rule.

However, Q&A 17 contains a special exception to the general rule whereby a non-spouse beneficiary can treat the plan as using the life expectancy rule so long as the rollover is made before the end of the year following the year of the participant's death. In a special edition of "Employee Plans News" published on Feb. 13, 2007, the IRS clarified that the special rule of Q&A 17 trumps the general rule of Q&A 19.

Therefore, as long as the rollover is made before the end of the year following the year of the participant's death, a non-spouse beneficiary can elect to use the life expectancy rule for minimum required distributions from an IRA even if the distributing benefit plan had a provision utilizing the five-year rule. Consequently, several different scenarios could unfold depending on the time when the rollover is made, whether the death occurred before or after the required beginning date and a plan's provision as to use of the life expectancy or the five-year rule (see chart on p. 13).

Because of Sections 826 and 829 of the PPA, domestic partnership law has taken great strides forward. Despite the interpretation that Sections 826 and 829 of the PPA are optional for employers, several companies have already implemented the rules under these Sections in order to stay competitive for purposes of recruiting and retaining quality employees. Future IRS guidance will, hopefully, further clarify the provisions discussed in this article. 

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What Factors Can Affect Rollover Scenarios?

The following chart summarizes the minimum required distribution rules based upon the potential rollover scenarios (taking into account rules provided under Notice 2007-7 and the interpretation in *Employee Plans News*):

	<i>Completes Rollover in Year of Death of Participant</i>	<i>Completes Rollover in Calendar Year Following Year of Participant's Death</i>	<i>Completes Rollover after end of Calendar Year following Year of Participant's Death but Before Fifth Year Following Date of Participant's Death</i>
<i>Non-Spouse Beneficiary Inherits Account Balance Before Required Beginning Date</i>	Entire account balance may be rolled over and life expectancy rule may be used (unless participant elects to utilize five-year rule). Participant may elect to use life expectancy rule even if the plan utilizes five-year rule.	Minimum distribution for calendar year following year of participant's death may not be rolled over, and remaining portion of account balance may be rolled over. Life expectancy rule may be used (unless participant elects to utilize five-year rule). Participant may elect to use life expectancy rule even if the Plan utilizes five-year rule.	A rollover may occur; however, non-spouse beneficiary is required to take minimum distributions from the IRA and full balance must be distributed by end of fifth calendar year following date of death.*
<i>Non-Spouse Beneficiary Inherits Account Balance After Required Beginning Date</i>	Minimum required distribution during year of death is not eligible for rollover; remaining portion of account balance is eligible for rollover.	Minimum required distribution for calendar year following date of death and prior year are not eligible for rollover; remaining portion of account balance is eligible for rollover.	Minimum required distribution for year the death occurred and all subsequent years before the fifth year following the date of the participant's death are not eligible for rollover; remaining portion of account balance is eligible for rollover.

*A rollover may not occur if the rollover is not completed by the end of the fifth calendar year following the year of the date of death of the participant.

Cross-Trading (continued from page 10)

General Fiduciary Standards Apply

ERISA's general standards of fiduciary conduct also apply to the investment manager. Consequently, an investment manager must act prudently and solely in the interest of the participants and beneficiaries of the plans on whose behalf they are acting with respect to:

- 1) the decision to enter into a cross-trade; and
- 2) the terms of such cross-trade.

The rule covers the content requirements of Section 408(b)(19)(H), but does not apply in determining whether, or to what extent, the investment manager satisfies the other requirements for relief under Section 408(b)(19).

Effective Dates

ERISA Section 408(b)(19) is effective for transactions occurring after Aug. 17, 2006, and Congress directed the secretary of Labor to issue regulations by Feb. 13, 2007. The DOL's interim rule becomes effective April 13, 2007.

Comments Invited

Comments may be mailed to the Office of Exemption Determinations, Employee Benefits Security Administration, Room N-5700, U.S. Department of Labor, Washington, D.C. 20210, Attention: Cross-Trading Policies and Procedures Interim Final Rule. Comments may also be e-mailed to e-OED@dol.gov or through the federal e-rulemaking portal at <http://www.regulations.gov>. Electronic responses should contain "Cross-Trading Policies and Procedures Interim Final Rule" in the subject line.

Finding out More

The full text of the interim rule is available online at <http://www.dol.gov/ebsa/regs/fedreg/final/2007002290.htm>. 