

The Pension Protection Act of 2006, H.R. 4, contains some provisions of particular interest to public pension plans that provide benefits for police officers, firefighters and emergency medical workers (“public safety employees”). For example, Section 828 of the Act adds new paragraph (10) to Section 72(t) of the Internal Revenue Code (the “Code”) which would enable these groups of employees to receive payments from the plan if they leave active service after age 50, instead of age 55, without having to worry about the additional 10% early distribution tax. Section 845 of the Act enables these same groups of retirees, among others, to exclude from gross income up to \$3,000 per year of pension payments that are directed by the plan to pay qualified health insurance premiums of the retired employee. We have identified certain preliminary issues that we hope the Internal Revenue Service (the “IRS”) will resolve by issuance of public guidance or response to a letter.

We are providing a copy of our questions below and invite your comments. We would appreciate knowing if you believe any of the questions should be clarified or if some questions should not be asked either because the answer is so clear the IRS could not reasonably come up with a different answer or because asking the question is too likely to result in an answer that will be too difficult for our clients to administer.

Our questions are as follows:

1. Section 72(t) of the Internal Revenue Code (the “Code), imposes an additional 10% tax on the taxable part of an early distribution from a qualified pension Plan unless an exception applies. One exception that provides relief from the 10% tax applies to a distribution made to an employee after separation from service after attainment of age 55. As administered by the Service, the 10% additional tax did not apply if the employee separated from service at any time during the year he or she attained age 55. Section 828 of the Act adds a new paragraph (10) to Section 72(t) to provide in effect that, in the case of a state or local police officer, firefighter or emergency medical services worker the Section shall be applied by substituting “age 50” for “age 55.” This provision, which applies to distributions after the enactment of the Act, raises two immediate questions:
 - (a) Will an otherwise qualified employee who separates from service in the year he or she attains age 50 but before his or her 50th birthday be able to receive plan distributions without being concerned about the 10% tax?

It appears that the answer should be yes if the Service simply substitutes “age 50” for “age 55” in determining the applicability of the 10% tax to a qualified public safety employee. The Service position has been that the tax does not apply to an employee who separates from service during or after the calendar year in which the employee attained age 55. See, for example, Notice 87-13, A-20.

- (b) The change applies to distributions after the date of the enactment of the Act. Will a plan need to file two 2006 Forms 1099R with respect to a public safety employee who received one or more 2006 distributions

before enactment and one or more distributions in 2006 after enactment that would have been subject to the tax in the absence of enactment?

The answer could be yes if the words “shall apply to distributions after the date of the enactment ...” are interpreted to mean “distributions made after the date of the enactment.” However, the words could just as reasonably, for example, mean “distributions reported after the date of the enactment.” We believe a less rigid interpretation would avoid administrative problems for the 2006 tax year on the part of both the Service and the reporting plans.

- (c) Although the amendment on its face seems to apply to public safety employees who separate from service after age 50 before the date of enactment, could the Service confirm this?
- (d) Could the guidance on this change incorporate the definition of public safety officer?

This is because definitions of this term, or similar terms, vary from one Code Section to another. Compare the definition in the amendment to Section 72(t) to the definition in the amendment to Section 402. Many of the people who will be administering these changes do not have access to the Internal Revenue Code, much less the U.S. Code.

- 2. Section 845 of the Act provides for a tax-free distribution from a pension plan of up to \$3,000 per year to help pay premiums on health insurance or long-term care insurance for a retired public safety officer, his spouse and dependents. In order for these amounts to be tax free the plan participant must elect after termination of employment to have payments forwarded directly from the pension plan to the accident or health insurance plan or long-term care provider. If the participant gets the payment, even for a moment, it would appear to be taxable. There are several questions that need to be answered, including the following:
 - (a) The employee must have separated from service due to disability or after attaining normal retirement age.
 - (i) Does this mean early retirees will never receive this tax benefit?
 - (ii) What is normal retirement age? Is the normal retirement age in the eligible retirement plan, which is usually not higher than age 50 for public safety employees, the age that will be used for this purpose?
 - (b) New Section 402(l)(6)(B) of the Code provides that a plan will not be treated as violating the requirements of Section 401 of the Code merely because it provides for an election with respect to amounts that are otherwise distributable from the Plan.

Does this mean that a plan will need to be amended to expressly provide for employee elections and distributions in order to enable the retired employees to receive the tax benefit?

- (c) The income tax exclusion is for “qualified health insurance premiums” which means premiums for coverage by an accident or health insurance plan or qualified long-term care insurance contract.
 - (i) Does the term “accident or health insurance plan” include an employer’s self-insured medical or dental care plan?
 - (ii) Does the term include a plan of a different employer than the one that maintains the eligible retirement plan?
 - (iii) Does the term include an individual contract purchased by the employee?
- (d) If a plan allows an election under Section 402(l):
 - (i) Can the plan limit the plans to which tax-free transfers may be made? For example, could the plan limit transfers only to accident or health insurance plans maintained by the same employer that maintains the eligible retirement plan?
 - (ii) Is each eligible retiree required to make a specific election to receive this benefit, or can the plan simply treat employees as having made the election if they are having insurance premiums deducted, including those who are having premiums deducted on the date of enactment of the amendment?
 - (iii) If individual elections are required, must they be in writing?
- (e) The income tax election is available only for “direct payments” to the insurer.
 - (i) If the former employer maintains a health and accident plan and the eligible retirement plan transmits the payments to the employer to be forwarded to the health and accident plan, is the “direct payment” requirement met?
 - (ii) What if the eligible retirement plan forwards the premiums through an insurance agency or other third party?

It would seem that these practices should be acceptable because the purpose of the direct payment requirement is to prevent the payments from being received by the employee.

- (f) Could the Service incorporate the definition of “public safety officer” in the guidance issued under this amendment? See 1.(d), above, for the reason.