Eligible Rollover Distributions

Notice 99–5

I. PURPOSE

This notice provides transition relief and guidance relating to the exception to the definition of eligible rollover distribution for certain hardship distributions. This exception was added to §§ 402(c)(4) and 403(b)(8)(B) of the Internal Revenue Code (the "Code") by § 6005(c)(2)(A) and (B) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206 ("RRA 98"). The transition relief responds to significant comment activity evidencing the inability of many plan administrators and taxpayers to adjust their systems to accommodate the new exception by January 1, 1999. In general, the relief granted allows both § 401(a) plans and § 403(b) annuities to delay implementation of the exception as it applies to distributions occurring before January 1, 2000.

II. BACKGROUND

Section 401(a)(31) requires a plan to permit distributees to elect to have an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee.

Section 403(b)(10) provides that a § 403(b) annuity must meet requirements similar to the requirements of § 401(a)(31).

Section 402(c)(4) generally provides that any distribution of the balance to the credit of an employee is an eligible rollover distribution. However, as exceptions to this general rule, that section specifies certain distributions of the balance to the credit of an employee that are not eligible rollover distributions.

Prior to amendment by RRA 98, the exceptions to the definition of eligible rollover distribution provided for in § 402(c) were limited to any distribution that is one of a series of substantially equal periodic payments, any distribution to the extent such distribution is required under § 401(a)(9), and any distribution that is not includible in gross income (determined without regard to the exclusion for net unrealized appreciation described in § 402(e)(4)).

Section 403(b)(8) provides that rules similar to those in § 402(c)(4) apply for purposes of determining the amount eligible for rollover from a § 403(b) annuity. Section 1.403(b)–2, Q&A–1 provides that an eligible rollover distribution from a § 403(b) annuity is an eligible rollover distribution described in § 402(c)(4) and § 1.402(c)–2, except that the distribution is from a § 403(b) annuity rather than a qualified plan.

Section 6005(c)(2)(A) of RRA 98 added § 402(c)(4)(C) to the Code, which specifies an additional exception to the definition of eligible rollover distribution for any hardship distribution described in § 401(k)(2)(B)(i)(IV), effective for distributions after December 31, 1998. Section 6005(c)(2)(B) of RRA 98 amended § 403(b)(8)(B) of the Code to include a specific reference to § 402(c)(4)(C). Thus, the new exception also applies to distributions from § 403(b) annuities.

Section 401(k)(2)(B)(i) provides that contributions made under a qualified cash or deferred arrangement ("CODA") are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 401(k)(2)(B)(i)(IV), an employee's elective contributions may be distributed upon the hardship of the employee. Section 1.401(k)–1(d)(2)(ii) provides that certain amounts, including earnings, credited to an employee's account as of a date specified in the plan containing the qualified CODA (which date generally was required to be before July 1, 1989) may also be distributed upon the hardship of the employee. Contributions not made under a qualified CODA, such as matching contributions or profit-sharing contributions that are not qualified nonelective contributions or qualified matching contributions, are not described in § 401(k)(2)(B)(i)(IV).

Sections 403(b)(1) and 403(b)(11) provide that amounts contributed pursuant to a salary reduction agreement for years beginning after December 31, 1988, are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 403(b)(11)(B), such amounts may be distributed upon the hardship of the employee. Amounts held in an annuity contract described in § 403(b)(1) as of the close of the last year beginning before January 1, 1989, and amounts contributed to the contract as nonelective employer contributions are generally not subject to distribution restrictions.

Sections 403(b)(7) and 403(b)(11) provide that amounts contributed to a custodial account described in § 403(b)(7) are not permitted to be distributed earlier than the occurrence of certain specified events. Under §§ 403(b)(7) and 403(b)(11), contributions made pursuant to a salary re-

duction agreement, as well as any other amounts held in the custodial account as of the close of the last year beginning before January 1, 1989, may be distributed upon the hardship of the employee.

III. DEFINITIONS

For purposes of this notice, a "§ 403(b) annuity" includes an annuity contract, a custodial account, and a retirement income account described in § 403(b) (see § 1.403(b)–2, Q&A-1) and a "qualified plan" is an employees' trust described in § 401(a) that is exempt from tax under § 501(a) or an annuity plan described in § 403(a) (see § 1.402(c)–2, Q&A-2).

IV. TRANSITION RELIEF

Concerns have been raised by a significant number of plan administrators and recordkeepers about the infeasibility of changing plan systems in time to comply with the new exception to the definition of eligible rollover distribution. Comments have referred to the fact that frequently an amount that is a hardship distribution described in § 401(k)(2)(B)(i)(IV) or § 403(b) is distributed in combination with other amounts that are eligible for rollover under § 402(c). Many plan administrators and recordkeepers have indicated that it is not possible for them, in time for distributions to be made in 1999, both to develop systems to reflect the change in treatment for the portion of a distribution that is no longer eligible for rollover because it is a hardship distribution described in § 401(k)(2)(B)(i)(IV) and to develop procedures to explain this change to distributees.

In response to these concerns, for distributions during calendar year 1999, the Service and Treasury will allow any distribution from a qualified plan or § 403(b) annuity to be treated as an eligible rollover distribution within the meaning of § 402(c)(4) for all purposes under the Code to the extent that the distribution would have been an eligible rollover distribution under the definition of eligible rollover distribution under § 402(c)(4) immediately prior to its amendment by RRA 98. However, a qualified plan or § 403(b) annuity is permitted to determine the amount of any eligible rollover distribution in 1999 using the definition of eligible rollover distribution in § 402(c)(4) as amended by RRA 98. The use of the amended definition by the qualified plan or § 403(b) annuity in 1999 will not affect the eligibility of a distributee to determine the portion of the distribution that is an eligible rollover distribution using the definition in effect under § 402(c)(4) prior to its amendment by RRA 98, if the distributee chooses to roll over the distribution within 60 days pursuant to § 402(c) or § 403(b)(8).

V. HARDSHIP DESCRIBED IN SECTION 401(k)(2)(B)(i)(IV)

For distributions after December 31, 1999, the following rules apply to hardship distributions described in § 401(k)(2)(B)(i)(IV):

A. The portion of a distribution from a qualified plan that is ineligible for rollover treatment because it is "a hardship distribution described in § 401(k)(2)(B)(i)(IV)" is the amount described in § 1.401(k)–1(d)(2)(ii). Similarly, the portion of a distribution from a custodial account described in § 403(b)(7) made on account of hardship that is ineligible for rollover treatment is the amount of contributions made pursuant to a salary reduction agreement increased by any other amounts held in the custodial account as of the close of the last year beginning before January 1, 1989. However, in the case of an annuity contract described in § 403(b)(1), the portion of a hardship distribution that is ineligible for rollover treatment is the amount of contributions made pursuant to a salary reduction agreement in years beginning after December 31, 1988, and does not include amounts held in the contract as of the close of the last year beginning before January 1, 1989, or amounts attributable to nonelective employer contributions (because both of these amounts are distributable without regard to the hardship of the employee).

B. If another event occurs, such as the employee's separation from service or attainment of age 59½, so that distribution of an amount is permitted, without regard to hardship, under § 401(k)(2)(B), § 403(b)(7) or § 403(b)(11), no amount distributed after that event is ineligible for rollover treatment on account of being a hardship distribution described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11). This rule applies regardless of whether the qualified plan or § 403(b) annuity characterizes the distribution as a hardship distribution described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11).

C. If a portion of a distribution that includes a hardship distribution is not includible in gross income, the portion of the distribution that is not includible in gross income is first allocated to the hardship distribution and then any remaining portion not includible in gross income is allocated to the portion of the distribution that is not a hardship distribution.

VI. REMEDIAL AMENDMENT PERIOD

Some plans may contain provisions that conflict with the definition of eligible rollover distribution in § 402(c)(4) of the Code as amended by § 6005(c)(2) of RRA 98. If these plans choose to comply in operation with the amended definition in 1999, they are not required to conform plan language to the amended definition prior to the date set forth below.

Section 1.401(b)–1T(b)(3) authorizes the Commissioner to designate a plan provision as a disqualifying provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements or (2) is integral to a qualification requirement that has been changed. Section 1.401(b)–1T(c)(3) authorizes the Commissioner, in the case of a disqualifying provision designated as described in the preceding sentence, to impose limits and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision.

Pursuant to § 1.401(b)–1T(b)(3) and (c)(3), a plan provision is hereby designated as a disqualifying provision if the plan provision is integral to the requirements of § 401(a)(31), but only to the extent such provision is amended to reflect the change made by § 6005(c)(2) of RRA 98, provided that the following conditions are satisfied. First, the plan provision must be amended to reflect the change made by § 6005(c)(2) of RRA 98 by no later than the last day of the first plan year beginning after December 31, 1998. (If an employer or plan administrator files a request for a determination letter on the qualified status of a plan by the last day of

the first plan year beginning after December 31, 1998, then the date by which the plan provision must be amended shall be extended through the 91st day following the applicable date under § 1.401(b)–1(e)(3)(i) or (ii).) Second, the plan provision as amended must be effective as of the first day the plan operates in accordance with the change made by § 6005(c)(2) of RRA 98.

VII. DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.