



Electronic Dispatch

Employee Benefits Law Action Memo

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AMENDMENTS MAY BE REQUIRED TO DEFINED BENEFIT PLANS TO TAKE ADVANTAGE OF NEW RETROACTIVE ANNUITY STARTING DATE RULES

General Distribution Rules

Defined benefit plans and some defined contribution plans (namely, money purchase pension plans and other plans that provide for annuity forms of payment) are required to make distributions to a married participant in the form of a “qualified joint and survivor annuity” (“QJSA”), a form of annuity which provides a survivor benefit to the participant’s spouse upon the death of the participant. However, a participant, with the consent of his or her spouse, may elect to waive the QJSA in favor of another distribution form offered by the plan.

The Internal Revenue Code (“Code”) requires that a married participant be provided with written notification regarding the QJSA and the participant’s opportunity to waive it and elect another form of payment. In general, this notification must be provided to the participant at least 30, but not more than 90, days before the date as of which distributions to the participant commence. The date as of which distributions commence is referred to as the “annuity starting date.” Thus, the QJSA notification generally must be provided before any distribution to a participant may commence. This rule effectively prohibits retroactive payments from a plan.

1996 Legislative Change And Recent IRS Regulations

The Small Business Job Protection Act of 1996 created an exception to the Code’s generally applicable notice and consent rules. This exception allows a participant’s annuity starting date to be prior to the date that the QJSA notification is provided to the participant, thus allowing a distribution with a retroactive annuity starting date. For example, under the retroactive annuity starting date rules, a participant who became eligible for a normal retirement benefit as of her retirement on June 30, 2004, could elect that distributions to her commence retroactive to that date, even though she was not provided with the QJSA notice and does not make the appropriate election until several months later.

The IRS has issued final regulations regarding the application and implementation of the retroactive annuity starting date rules for plan years beginning on and after January 1, 2004. It should be noted that the final regulations are applicable to defined benefit plans only. Although the Code does not distinguish between defined benefit and defined contribution plans, it is the view of the IRS that, because the benefit provided under a defined contribution plan is equal to the participant’s account balance, the retroactive annuity starting date rules are simply not relevant for a defined contribution plan.

If the requirements of the final regulations are satisfied, the QJSA notice need not be provided at least 30 days before the participant’s annuity starting date and, under certain circumstances, may be provided after the annuity starting date. The regulations define how payments are made in the case of a retroactive annuity starting date and set conditions on the use of a retroactive annuity starting date.



Conditions For Retroactive Annuity Starting Date Under The Final Regulations

- Plan Must Provide For Retroactive Annuity Starting Dates. A defined benefit plan is not required to provide for retroactive annuity starting dates. However, a plan may apply the retroactive annuity starting date rules only if the plan document expressly provides for their application. If a plan does provide for retroactive annuity starting dates, the plan may impose conditions on their availability in addition to the limitations and conditions set forth in the final regulations. For example, a plan that includes a single sum payment as a benefit option may limit the election of a retroactive annuity starting date to those participants who do not elect a single sum payment. In no event may a participant be permitted to elect an annuity starting date that precedes the date upon which the participant could have otherwise started receiving benefits from the plan.
- Participant Must Affirmatively Elect Retroactive Annuity Starting Date With The Consent Of The Spouse. A distribution with a retroactive annuity starting date must be affirmatively elected by the participant in favor of a distribution with a prospective annuity starting date. In other words, the plan must allow the participant to choose between receiving benefit distributions calculated using a retroactive annuity starting date and benefit distributions calculated as of a prospective annuity starting date. The participant's spouse (determined as of the date that distributions actually commence, not as of the retroactive annuity starting date) must consent to the participant's election of a retroactive annuity starting date. However, such spousal consent is not required if the amount of the spouse's survivor payments under the form of benefit elected by the participant as of the retroactive annuity starting date is no less than the amount of the spouse's survivor payments would have been under a QJSA with a prospective annuity starting date.
- Benefits Paid Must Approximate Benefits That Would Have Been Paid If Benefits Had Actually Commenced On The Retroactive Annuity Starting Date. If a participant elects a retroactive annuity starting date, the participant must be put in approximately the same position that the participant would have been in had benefit payments actually commenced on the retroactive annuity starting date. This means that the benefits determined as of the retroactive annuity starting date must comply with the maximum benefit limitations of Code Section 415 and, for single sum distributions, the present value requirements of Code Section 417(e), as of the retroactive annuity starting date. Thus, the future periodic payments for a participant who elects a retroactive annuity starting date will be the same as the periodic payments that would have been paid to the participant had payments actually commenced on the retroactive annuity starting date. In addition, the participant must receive a make-up payment to reflect any missed payments for the period from the retroactive annuity starting date to the date of actual payment. The make-up payment must include an appropriate adjustment for interest. However, the regulations provide no guidance on what would be considered an "appropriate" interest adjustment.

Recommended Action

Plan sponsors that have been permitting retroactive annuity starting dates should immediately review current plan provisions and administrative procedures to determine if they are in compliance with the requirements of the final regulations which became effective on January 1, 2004 for calendar year plans. If they are not, and the plan sponsor wishes to continue to permit distributions with retroactive annuity starting dates, appropriate amendments should be adopted to bring the plan's provisions into compliance with the final regulations as soon as possible. Some plan sponsors that currently allow retroactive annuity starting dates may wish to discontinue offering retroactive annuity starting dates given the additional administrative burdens created by the final regulations. However, the elimination of retroactive annuity starting date rules might be viewed as a violation of the anti-cutback rules of Code Section 411(d)(6). Although the IRS has issued proposed regulations in which it indicates that retroactive annuity starting date provisions may be eliminated in some circumstances, those regulations have not yet become final and cannot be relied on.

Sponsors of defined benefit plans that currently do not permit retroactive annuity starting dates should consider whether, and to what extent, their plans should be revised. A plan is not required to implement the retroactive annuity starting

date rules. While the retroactive annuity starting date rules may offer participants significant flexibility with regard to the timing of benefit commencement, the rules create additional administrative burdens and potential costs for plan sponsors and administrators. The plan sponsor should also consult with the plan's actuary to determine if the availability of retroactive annuity starting dates would have any impact on the plan's funding.

A plan sponsor interested in implementing the retroactive annuity starting date rules should consider limiting their applicability. For example, the application of the rules might be limited to situations where the plan administrator, due to administrative error, fails to timely provide the QJSA notice to a participant. A plan also could provide that a retroactive annuity starting date may not precede the actual distribution date by more than a specified period (e.g., six months). However, until the IRS issues final regulations regarding whether a plan can be amended to eliminate retroactive annuity starting date provisions without violating the protected benefit rules of Code Section 411(d)(6), an amendment to add the retroactive annuity starting date rules to a defined benefit plan should be approached with caution.

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