

Part III. Administrative, Procedural, and Miscellaneous

Eligible Rollover Distributions

Notice 2000-32

I. PURPOSE

This notice provides additional relief 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"). Transition relief and guidance relating to the exception was initially provided in Notice 99-5, 1999-3 I.R.B. 10. In response to comments from representatives of plan sponsors and recordkeepers regarding their significant difficulties in implementing certain requirements of Notice 99-5, this notice provides permanent relief to sponsors of qualified plans where records pertaining to pre-1989 contributions are unavailable, and also provides transition relief to sponsors of both qualified plans and § 403(b) annuities from certain other requirements of Notice 99-5.

II. BACKGROUND

Section 401(a)(31) requires a qualified 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 all or any portion of the balance to the credit of an employee in a qualified plan is an eligible rollover distribution. However, as exceptions to this general rule, that section specifies certain distributions that are not eligible rollover distributions.

Prior to amendment by RRA 98, the only exceptions to the definition of eligible rollover distribution provided for in § 402(c) were any distribution that is one of a series of substantially equal periodic payments made for certain periods, 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 qualified nonelective and qualified matching contributions that were treated as elective contributions, plus earnings on these contributions and on elective contributions, 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. The date described in the preceding sentence is hereinafter referred to as the "'89 date" and the amounts described in the preceding sentence are hereinafter referred to as "pre-'89 401(k) amounts." Contributions not made under a qualified CODA, such as matching contributions or profit-sharing 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 reduction 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.

Notice 99-5 provided transition relief from the requirements of § 6005(c)(2)(A) and (B) of RRA 98 by permitting qualified plans and § 403(b) annuities to treat those distributions made in calendar year 1999 that would have been eligible rollover distributions under § 402(c)(4) immediately prior to its amendment by RRA 98 as eligible rollover distributions for all purposes under the Code.

Notice 99-5 also provided that, for purposes of § 6005(c)(2)(A) and (B) of RRA 98, "a hardship distribution described in § 401(k)(2)(B)(i)(IV)" includes only amounts described in § 1.401(k)-1(d)(2)(ii), including pre-'89 401(k) amounts, and does not include amounts that are distributable under the Code without regard to the hardship of the employee. Similar rules were provided with respect to § 403(b) annuities. In addition, Notice 99-5 provided that if another event occurs, such as the employee's separation from service or attainment of age 59 1/2, so that distribution of an amount is permitted under the Code, without regard to hardship, 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). Lastly, Notice 99-5 provided that 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. Notice 99-5 provided that the above rules were first applicable to distributions made after December 31, 1999.

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. RELIEF

Representatives of plan sponsors and recordkeepers have raised concerns about certain of the requirements of Notice 99-5. Those representatives indicated that, in many cases, plan records were inadequate to comply with the requirement that amounts treated as ineligible for rollover by reason of RRA 98 be limited to the amount described in § 1.401(k)-1(d)(2)(ii), particularly with respect to pre-'89 401(k) amounts. In addition, it was stated that, in light of the extensive revisions to computer systems required to prevent "Y2K" problems, plan sponsors and recordkeepers were unable to modify their systems to comply with certain other requirements of Notice 99-5 by January 1, 2000, the date transition relief under Notice 99-5 became no longer available.

In response to these concerns, the requirements of Notice 99-5 are modified as follows:

Pre-'89 401(k) Amounts. As noted, under Notice 99-5, amounts that are ineligible for rollover by reason of § 6005(c)(2)(A) of RRA 98 are limited to amounts described in § 1.401(k)-1(d)(ii), including pre-'89 401(k) amounts. Concerns have been raised that, in many instances, plan records do not make it possible to distinguish pre-'89 401(k) amounts from other amounts credited to an employee's account as of the '89 date.

Accordingly, if a qualified plan's records are not reasonably available to segregate an employee's pre-'89 401(k) amounts from other amounts that, as of the '89 date, were credited to the employee's account, then, for purposes of determining what is an eligible rollover distribution, the plan must treat the other amounts as described in § 401(k)(2)(B)(i)(IV). That is, the other amounts are treated the same as pre-'89 401(k) amounts and elective contributions and are therefore treated as ineligible for rollover when distributed on account of hardship.

Satisfaction of Another Statutory Distributable Event. Notice 99-5 provides that, if another event occurs, such as the employee's separation from service or attainment of age 59 1/2, so that distribution of an amount is permitted under § 401(k)(2)(B), § 403(b)(7) or § 403(b)(11) without regard to hardship, 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). Plan sponsors and recordkeepers indicated to the Service that, in many instances, their systems are unable to track whether a distribution made on account of hardship under the terms of the plan might also be distributable under another statutory provision.

Therefore, as an alternative to the rule in Notice 99-5, until further guidance is issued, a distribution that is described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11) and that is made as a hardship distribution under the terms of a qualified plan or § 403(b) annuity may be treated as ineligible for rollover even though another event has occurred that could entitle the recipient to a distribution without regard to hardship under § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11). Thus, for example, if a profit-sharing plan containing a qualified CODA provides that in-service distributions are available only upon hardship, an in-service distribution made to a participant aged 62 may, to the extent of elective contributions and other amounts described in § 1.401(k)-1(d)(2)(ii) (including amounts described in (i) above that are treated as pre-'89 401(k) amounts), be treated as ineligible for rollover. Alternatively, if the rule in Notice 99-5 is followed, the distribution in this example to the age-62 participant may be treated as eligible for rollover.

Allocation of Basis. The plan sponsor and recordkeeper community also raised concerns about the feasibility of timely programming their systems to follow the basis allocation rules of Notice 99-5. Therefore, until further guidance is issued, if a portion of a hardship distribution from a qualified plan or a § 403(b) annuity is not includible in gross income, the portion of the distribution that is not includible in gross income may be allocated to the portion ineligible for rollover or the portion eligible for rollover (or between the two portions) using any reasonable method.

A qualified plan or § 403(b) annuity generally must, in applying the above rules, be consistent in the treatment of all distributions.

V. EFFECT ON OTHER DOCUMENTS

Notice 99-5 is modified.

VI. DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' 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.