

Automatic Rollovers—The Continuing Saga

By Marty Heming, Esq.

On December 28, 2004, the IRS released Notice 2005-5 which provided additional guidance on automatic rollovers. This guidance expands upon and supplements the Department of Labor (DOL) final regulations governing the safe harbor rules for automatic rollovers that were issued on September 28, 2004 as described in detail in the Winter 2004 Plan Horizons' DOL Corner. This article will focus on the additional guidance given by the IRS.

Generally, automatic rollovers are a creature of the changes that EGTRRA made to Code section 401(a)(31). Specifically, prior to EGTRRA, a plan could be written to provide the default option for distributions of \$5,000 or less was to make a lump sum cash payment without the consent of the participant. EGTRRA changed the default for any cash out between \$1,001 and \$5,000 from a cash distribution to the establishment of IRA in the name of the participant. The rules were to go into effect after the final regulations were issued by the DOL. These regulations were to provide safe harbor investments for the automatic rollover which would protect the fiduciary in selecting the investment for the automatic rollover.

The DOL issued its final automatic rollover regulations, and they are effective for all distributions on and after March 28, 2005. In a nutshell, the Regulations require the automatic rollover to be invested in approved IRAs designed to minimize risk, preserve assets and maintain liquidity. The IRS guidance in Notice 2005-5 addresses several practical problems that automatic rollovers present to plan administrators. This guidance is in question and answer format. Its most important provisions are as follows:

Q&A-9 provides that a plan won't be disqualified for failing to operate in accordance with its terms (including the automatic rollover provisions) with respect to mandatory distributions merely because it does not process mandatory distributions for which the

participant doesn't affirmatively elect direct rollover or direct payment due to a lack of sufficient administrative procedures for automatic rollovers, if the distributions are made on or before December 31, 2005. As a practical matter, this means that if the employer and its third party administrator don't yet have the automatic rollover process in place on March 28, 2005, they can delay mandatory distributions until the end of the year.

Q&A-16 provides that a plan that currently provides for mandatory distributions must be amended to meet the automatic rollover rules by the end of the first plan year ending on or after March 28, 2005. For calendar years, this means December 31, 2005. However, plans with year-ends between April and December must be amended before the relevant year-end.

The amendment requirement may be satisfied by the adoption of a sample amendment provided by the IRS as follows:

SAMPLE AMENDMENT:

"In the event of a mandatory distribution greater than \$1,000 in accordance with the provisions of section(s) _____, if the participant does not elect to have such distributions paid directly to an eligible retirement plan specified by the participant in a direct rollover or receive the distribution directly in accordance with section(s) _____, then the plan administrator will pay the distribution in a direct rollover to an individual retirement plan designated by the plan administrator."

If this is adopted in a substantially similar form in a timely manner, the plan will keep its status as a pre-approved plan and the employer will have reliance on the previously issued opinion letter.

As explained in Q&A-12, the automatic rollover rules apply only to plans that provide for mandatory cash out provisions. If a plan document currently has a provision mandating distribution

for accounts of \$5,000 or less, the plan can be amended to eliminate the provision which requires the plan to make the mandatory lump sum distribution to eligible participants without violating IRC section 411(d)(6). While not specifically so stating, this Q&A also provides authority for a plan to be amended to eliminate the mandatory cash out for all distributions of greater than \$1,000, which some employers are doing because forced distributions of \$1,000 or less are not subject to the mandatory rollover requirements.

Q&A-15 provides that, under Section 401(a)(31), the administrator must notify the participant in writing (either separately or as part of the 402(f) notice) that absent an affirmative election, the distribution will be paid to an IRA. The notice must identify the IRA issuer or trustee. The notice may be sent electronically if done in accordance with the rules otherwise provided for 402(f) notices. The notice will be deemed sent if sent to the participant's last known address, even if it is returned as undeliverable. It should be noted that in addition to this notice, the participants must be furnished a Summary Plan Description (SPD) or Summary of Material Modifications (SMM) in order to invoke the DOL safe harbor. This notice under the IRS rules is in addition to the notice required under the DOL safe harbor rules.

The IRS notice contains answers to other questions concerning the application of the automatic rollover rules.

1. The automatic rollover rules apply to government plans, both qualified 401(a) plans and eligible deferred compensation plans described in 457(e)(1)(A). However, both have a delayed effective date, i.e., for distributions made after the close of the legislative session that begins on or after January 1, 2006. The automatic rollover requirements do not apply to non-government 457(b) plans.



continued on page 9

PBGC Encourages E-Filing of Premiums for Plan Years 2004 and 2005

By Diane Morstein

The Pension Benefit Guaranty Corporation (PBGC) is encouraging premium filers to prepare and submit premium filings and payments electronically via PBGC's e-filing system, called My Plan Administration Account (My PAA). All types of premium filings (Form 1-ES, Form 1-EZ, Form 1, Form 1 with Schedule A) may be filed electronically for plan years beginning in 2004 and 2005. If a payment is due, My PAA will allow you to pay via ACH, electronic check, or credit card and schedule the payment to be submitted on the day of your choice.

Electronic filing has many advantages over paper submissions. Filing preparation is easier and faster, with improved data accuracy. My PAA enables service providers and their clients to exchange premium information, notify each other of the next required action, track the progress of each plan's filing, receive confirmation that PBGC received the filing and payment, and view the plan's account history - all electronically.

For detailed information or to set up a My PAA account, please access PBGC's Web site, www.pbgc.gov, and click on the "Online Premium Filing (My PAA)" link.

If you have questions about My PAA or would like a copy of PBGC's pamphlet that describes premium e-filing in more detail, please call PBGC's toll-free practitioner number at 1-800-736-2444 (and select the "premium" option). Note: TTY/TDD users may call the federal relay service toll-free at 1-800-877-8339 and ask to be connected.*

Diane Morstein is a practitioner problem resolution officer and can be reached by calling (800) 736-2444, x4136.

Automatic Rollovers—The Continuing Saga *continued from page 8*

- The automatic rollover provision also applies to 403(b) plans. The effective date is not delayed unless the 403(b) plan is a government plan. It also applies to church plans with a delayed compliance date 60 days after the close of the church convention on or after January 1, 2006.
- If a participant in possession of the notice of mandatory distribution fails to respond to the notice, the administrator may execute the necessary documents to establish an IRA. Moreover, the trustee of the IRA will satisfy the disclosure requirements of 1.408-6 by sending the notice to the participant at his last known address, even if it is returned as undeliverable.
- A mandatory distribution may be paid either to an IRA under 408(c) or a deemed IRA under section 408(q) that is part of the plan that is making the distribution.
- A plan subject to the joint and survivor annuity rules may limit cash outs to distributions of \$1,000 or less and still not be required to provide the joint and survivor annuity option to any participant with an account of \$5,000 or less.
- Some plans provide that amounts in excess of \$5,000, which are attributable to rollover accounts, won't be counted for purposes of calculating the \$5,000 limit on mandatory cash-outs. If applicable, this permits amounts in excess of \$5,000 to be treated as mandatory

cash out distributions. If this provision is provided in the plan, the entire amount subject to mandatory distribution is also subject to the automatic rollover rules.

At the Los Angeles Benefit Conference (LABC), co-sponsored by NIPA, the IRS informally advised that additional guidance would be published prior to March 28th. It is anticipated that this guidance will do the following:

- Permit amendments reducing the cash out limit from \$5,000 to \$1,000 to be made by the last day of the plan year which contains March 28, 2005.
- Permit an amendment to the plan to eliminate the mandatory cash out by the last day of the plan year which contains March 28, 2005.
- Neither of the above amendments will cause a pre-approved plan to be treated as an individually designed plan.

As a practical matter, what steps must be taken to with respect to automatic rollovers, and when must such action be taken?

Prior to the deadline of March 28, 2005, each employer should be advised of the advantages and disadvantages of the continued use of the mandatory cash out rules. If the Plan is a fiscal year plan, any amendment with respect to the automatic rollover must be made no later than the end of the plan year that contains March 28, 2005.

If the decision is to keep the \$5,000 limit on the cash out, then a process must be put in place to (i) find one or more IRA providers and get contracts in place, (ii) modify the 402(f) notice or develop a supplemental notice meeting the rules of 401(a)(31) and (iii) prepare an SMM or revise the SPD before the first automatic rollovers are in place. The good news is that the IRS has given us until December 31, to implement these steps.

Finally, at the LABC the Department of Labor has informally advised that they will treat the Summary Plan Description and the Summary of Material Modifications as "furnished" under the Regulations and thus, qualified for the safe harbor, if it is sent by U.S. mail to the last known address of the former participant, even if it is return by the post office as undeliverable. No additional search for the participants is required as it would be if the plan were a terminated plan and one had lost participants.*

NIPA Board member Marty Heming is a partner with the law firm of Reish Luftman Reicher & Cohen practicing exclusively in the area of employee benefits, emphasizing the resolution of controversies with the IRS, DOL and PBGC. He can be reached at martyheming@reish.com or (310) 478-5656.

