



## One Minute Memo<sup>®</sup>

# IRS Releases Guidance on Model Tax Notices, Contributions of Unused Paid Time Off, and Automatic Enrollment Features

The IRS recently issued guidance that (1) updates the model tax notices provided to participants and beneficiaries who receive lump sum distributions, (2) provides rules for converting payments for paid time off into contributions under defined contribution plans, and (3) clarifies the rules for automatic enrollment features under 401(k) plans. A brief summary of this guidance is provided below.

### *402(f) Model Tax Notice*

The IRS issued two model tax notices for compliance with Code Section 402(f)—one for a distribution of designated Roth contributions and one for distribution of traditional contributions. A participant or beneficiary eligible to receive a distribution of both types of contributions will need to receive both explanations.

The new model notices address relatively recent issues such as rollovers to Roth IRAs, rollovers by non-spouse beneficiaries to inherited IRAs, and the waiver of the 10% early distribution penalty on qualified reservist distributions. A plan may continue to customize a model notice by omitting any sections that do not apply to the plan (e.g., removing the employer stock section if the plan does not contain employer stock).

While the new notices may be used immediately, the IRS stated that the prior model notice may be used, and will be considered an appropriate model for compliance, through December 31, 2009.

### *Contribution of Unused Paid Time Off*

The IRS issued Revenue Rulings 2009-31 and 2009-32. Both Rulings provide situations under which a defined contribution plan may convert a participant's accrued but unused paid time off (e.g., vacation pay, sick pay, etc.) into a non-elective profit sharing contribution. The Rulings, however, do not provide a non-discrimination safe harbor for such contributions and, consequently, plans offering the contributions would need to test to ensure that they do not discriminate in favor of highly compensated employees. Further, the Rulings do not address the impact of state wage laws requiring the payment of unused paid time off upon an employee's termination of employment. Plan sponsors should review these state laws prior to amending their plans to convert such payments into company contributions.

Additionally, the Rulings provide that 401(k) plans may permit participants to make elective deferrals attributable to payments for their unused paid time off. Many 401(k) plans already offer this feature, and the Rulings simply clarify how these features may be structured.

## *Automatic Enrollment*

The IRS issued Notice 2009-65, which provides two sample plan amendments for adding an automatic enrollment feature to a 401(k) plan under rules created by the Pension Protection Act of 2006. One amendment provides a basic automatic contribution arrangement, while the second is an eligible automatic contribution arrangement (EACA) that allows employees to opt out of the automatic enrollment and withdraw their automatic contributions within 90 days of the first automatic contribution. These amendments may be adopted by employers as late as the end of the plan year in which the amendment is to be effective, but automatic contributions cannot begin until a reasonable period (generally, at least 30 days) after employees are given notice of the automatic contribution arrangement and their right to opt out of the arrangement.

The IRS also issued Revenue Ruling 2009-30, which provides two methods for structuring automatic increases in an eligible employee's default contribution percentage. In the first example, the IRS ruled that an increase in the default percentage that is tied in part to an increase in the employee's base compensation is permissible, although this would not constitute an EACA because the default contribution percentage is based on factors other than the period of time during which participants have participated in the automatic contribution arrangement. In the second example, the IRS ruled that a plan may increase an eligible employee's default contribution percentage on a date other than the first day of the plan year without violating the requirements for the qualified automatic contribution safe harbor for nondiscrimination testing or the uniformity requirement for EACAs. Of course, in both situations, participants will continue to have the right to change their contribution percentages at any time.

*For a copy of the 402(f) model tax notices (and assistance in conforming the model notices to your company's retirement plans) or additional information regarding the IRS guidance referenced above, please contact the Seyfarth Shaw attorney with whom you work, or any Employee Benefits attorney on our website ([www.seyfarth.com/EmployeeBenefits](http://www.seyfarth.com/EmployeeBenefits)).*



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