

January 2005

## Automatic Rollovers - Challenges for Compliance

On December 29, 2004, the Internal Revenue Service (IRS) issued Notice 2005-5 to provide guidance on the application of the new automatic rollover provisions governing cash-out distributions from most retirement plans.

### Background

Pension (including cash balance and defined benefit plans), profit sharing, 401(k) and other tax-qualified retirement plans are permitted to require a mandatory distribution, or cash-out, of a participant's accrued plan benefit if that benefit is \$5,000 or less at the time the participant separates from employment. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) changed the cash-out rules to require the plan administrator to set up an Individual Retirement Account (IRA) for the automatic rollover of any cash-out distribution in excess of \$1,000 if the participant does not elect either a direct payment or a direct rollover.

EGTRRA delayed the implementation of the automatic rollover provisions to provide time for the Department of Labor (DOL) to issue safe harbor regulations concerning the fiduciary aspects of the rollover process. As we discussed in an earlier Management Alert, the DOL has now issued these regulations, and the automatic rollover rules will apply to cash-out distributions made on or after March 28, 2005. To view the previous summary, please [click here](#).

### Which Plans and Distributions Are Impacted

The new rules will affect tax-qualified plans, 403(b) plans, governmental plans, deferred compensation plans sponsored by state or local governments under Section 457(b) of the Code, and church plans. (The automatic rollover requirements do not apply to non-governmental Section 457(b) plans.) It is important to note that although the new provisions impact a large number of plans, only certain types of mandatory distributions are subject to the rules. For example, distributions made to a spouse or alternate payee are not mandatory distributions for the purposes of the automatic rollover rules. Likewise,

deemed distributions made to offset a participant's failure to repay a plan loan are also not subject to the new provisions.

In general, benefits subject to mandatory cash-out are those in excess of \$1,000 and not more than \$5,000. However, the automatic rollover requirements may also apply to mandatory distributions in excess of \$5,000 if plan provisions exclude the value of rollover contributions in determining the participant's accrued benefit for cash-out purposes but then include the rollover contributions in the distribution.

### Plan Amendments Required

Employers must now decide whether to amend the plan's mandatory distribution provisions to comply with the new automatic rollover requirements, or to avoid the requirement by eliminating mandatory distributions for amounts above \$1,000. With some exceptions, plans that provide mandatory distributions in excess of \$1,000 must adopt a good faith plan amendment implementing the automatic rollover rule by the end of the first plan year ending on or after March 28, 2005. The IRS has issued a sample plan amendment that can be used for this purpose. An employer that does not wish to comply with the automatic rollover requirements will need to amend its plan to reduce the mandatory cash-out limit to \$1,000 or less, or to eliminate any mandatory cash-out, in order to avoid being subject to the new rules.

While governmental plans must comply with the new automatic rollover rules, IRS guidance permits compliance to be delayed until the close of the first regular legislative session of the legislative body with authority to amend the plan that begins on or after January 1, 2006. The same time frame will apply to governmental eligible deferred compensation plans described in Code Section 457(b). In the case of a non-electing church plan where amendment authority is held by a church convention, IRS guidance permits compliance to be delayed until 60 days after the close of the earliest church conference that occurs on or after January 1, 2006.

## Next Steps

IRS guidance provides that a plan will not fail to comply if automatic rollovers are not processed due to lack of sufficient administrative procedures as long as the automatic rollovers are made by December 31, 2005. This gives plans nine months to enter into agreements with IRA providers, revise forms and procedures, and update summary plan descriptions and other employee communications. This will include either updating the plan's Code section 402(f) notice ("Special Tax Notice") or providing a separate notice to anyone who will be receiving a mandatory distribution that will be subject to automatic rollover.

## Practical Considerations

The plan administrator must select an IRA provider and enter into a contract to cover automatic rollovers. Service providers to 401(k) and other plans are slowly preparing to establish such IRA arrangements, but many will not be ready by March 28, 2005 and some may choose not to become an IRA provider. While delayed compliance, as described above, will be permitted in 2005, many employers are considering elimination of the mandatory cash-outs above \$1,000 so that no automatic rollovers would be required. The IRS guidance notes that mandatory cash-outs are not protected benefits and may be eliminated at any time. While the IRS does not state in its guidance the effect of eliminating mandatory cash-outs after March 27, 2005, the conservative approach would be to adopt any elimination of mandatory cash-outs on or before March 27, 2005 so that the cash-out provisions in the plan are not in effect when the automatic rollover requirement is officially effective. In defined contribution plans, elimination of the mandatory cash-out would require an affirmative election by the participant to receive the account balance. For defined benefit plans, elimination of mandatory cash-outs could increase the number of small annuities paid from the plan.

*If you have any questions concerning automatic rollover rules and deadlines, please contact the Seyfarth Shaw LLP Employee Benefits Group attorney with whom you work or any Employee Benefits attorney on the website at [www.seyfarth.com](http://www.seyfarth.com).*

### ATLANTA

One Peachtree Pointe  
1545 Peachtree Street, N.E., Suite 700  
Atlanta, Georgia 30309-2401  
404-885-1500  
404-892-7056 fax

### BOSTON

Two Seaport Lane, Suite 300  
Boston, Massachusetts 02210-2028  
617-946-4800  
617-946-4801 fax

### CHICAGO

55 East Monroe Street, Suite 4200  
Chicago, Illinois 60603-5803  
312-346-8000  
312-269-8869 fax

### HOUSTON

700 Louisiana Street, Suite 3700  
Houston, Texas 77002-2797  
713-225-2300  
713-225-2340 fax

### LOS ANGELES

One Century Plaza  
2029 Century Park East, Suite 3300  
Los Angeles, California 90067-3063  
310-277-7200  
310-201-5219 fax

### NEW YORK

1270 Avenue of the Americas, Suite 2500  
New York, New York 10020-1801  
212-218-5500  
212-218-5526 fax

### SACRAMENTO

400 Capitol Mall, Suite 2350  
Sacramento, California 95814-4428  
916-448-0159  
916-558-4839 fax

### SAN FRANCISCO

560 Mission Street, Suite 3100  
San Francisco, California 94105  
415-397-2823  
415-397-8549 fax

### WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500  
Washington, D.C. 20006-4004  
202-463-2400  
202-828-5393 fax

### BRUSSELS

Boulevard du Souverain 280  
1160 Brussels, Belgium  
(32)(2)647.60.25  
(32)(2)640.70.71 fax

---

This newsletter is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact the firm's Employee Benefits Practice Group.