

Contributing Authors

Laurence A. Hansen
lhansen@lordbissell.com
312.443.0456

Linda J. Simon
lsimon@lordbissell.com
312.443.0672

Emily A. Bateman
ebateman@lordbissell.com
312.443.0629

www.lordbissell.com

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Effective Date For Automatic Rollovers Is March 28, 2005

Under current law, a qualified retirement plan can automatically distribute a benefit valued at \$5,000 or less to a terminated plan participant, without such participant's consent, in a distribution known as an "automatic" or "mandatory" distribution. The participant may affirmatively elect to have the distribution rolled over to another qualified plan or to an individual retirement account ("IRA") established by the participant. For purposes of determining whether a participant's account balance exceeds the \$5,000 threshold, plans can ignore the amount of any prior rollover into the plan.

Example: When Susan Jones became a participant in the X Corp 401(k) Plan, she rolled over her account balance from her prior employer's plan. Now, after two years working for X Corp, she has \$4,500 in her new 401(k) account and her rollover account has grown to \$20,000. When Susan terminates her employment with X Corp, the plan may automatically cash out her entire \$24,500 balance in the X Corp 401(k) Plan.)

Beginning on March 28, 2005, the maximum value of plan benefits that can be distributed without a participant's consent will be reduced from \$5,000 to \$1,000. Distributions of benefits valued between \$1,000 and \$5,000 cannot be distributed to a participant without the participant's consent. Without a participant's consent a plan can distribute benefits valued between \$1,000 and \$5,000 only by transferring them directly to an IRA established by the plan for the terminated participant.

This new rule, generally called the "automatic rollover rule" was added to the Internal Revenue Code by the Economic Growth and

Tax Relief Reconciliation Act of 2001 ("EGTRRA") and becomes effective March 28, 2005, as a result of recently issued Department of Labor ("DOL") regulations that explain how plans should implement the new rule. Plan sponsors should also be aware that prior rollovers into their plans must now be counted for purposes of determining whether a mandatory distribution will be subject to automatic rollover.

OPTIONS FOR COMPLIANCE

Under the DOL regulations and subsequent guidance the IRS issued late last year, plans essentially have two options for complying with the new rule:

- ◆ Limit mandatory distributions to benefits valued at \$1,000 or less; or
- ◆ Comply with the new regulations by providing that benefits valued at \$5,000 or less (but greater than the plan's mandatory distribution limit, which cannot exceed \$1,000) will be automatically rolled over to an IRA established by the plan for the participant, unless the participant affirmatively elects to receive the distribution in cash or have it rolled over to a qualified plan or different IRA.

STEPS TO TAKE

Plan sponsors should first determine whether to make automatic rollovers of benefits valued between \$1,000 and \$5,000. Most plans prefer to distribute small benefits in order to ease the recordkeeping for the plan. In the case of defined benefit pension plans, distributing small benefits can reduce Pension Benefit Guaranty Corporation (PBGC) premiums. Plan sponsors desiring to continue automatic distributions of benefits valued between \$1,000 and \$5,000 then must deter-

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mine whether they can find an IRA provider that will take on the task of establishing and maintaining IRAs for terminated participants. The results of this search will help the plan sponsor determine which option it will want to follow for its plan. After deciding how to comply with the new automatic rollover rule, the plan sponsor will need to:

- ◆ enter an agreement with one or more IRA providers, if it has decided to implement an automatic IRA rollover program. Note that the DOL regulations, which provide a safe harbor for plans to avoid fiduciary liability with respect to selection of the IRA provider, also set forth several requirements that must be met by the IRA provider agreement;
- ◆ amend its plan to specify how automatic distributions will be handled. The IRS has prepared a model amendment that can be used by plan sponsors that choose to implement the automatic rollover rule;
- ◆ amend the summary plan description for the plan and other employee communications and notices to comply with the new plan terms; and
- ◆ communicate the plan changes to the plan's outside service providers.

DEADLINES FOR COMPLIANCE

As discussed, plans must begin complying with the new rule for all mandatory distributions made on or after March 28, 2005. However, plan sponsors will generally have additional time to make the necessary plan amendments. Specifically, the IRS Notice provides that plan sponsors have until the first plan year ending after March 28, 2005, to amend their plans. For calendar year plans, the deadline for amendment is thus December 31, 2005. For non-calendar year plans, the deadline could be much earlier. For example, a plan with an April 1 to March 31 plan year, would need to be amended by March 31, 2005. A plan sponsor who is unable to establish procedures for complying with the new

requirements may defer the decision until the deadline for amending its plan. However, in the meantime the plan should not make any mandatory distributions to participants in excess of \$1,000 after March 28, 2005.

ABOUT THE AUTHORS

Partner Larry Hansen has more than 20 years of experience in the area of taxation, with an emphasis on employee benefits and executive compensation. Associates Linda Simon and Emily Bateman practice in the tax and employee benefits areas, focusing on qualified pension and 401(K) plans.