

retirement

plan news

JANUARY/FEBRUARY 2005

Final Rules for Automatic Rollovers

The Department of Labor (DOL) has issued final rules authorizing the automatic rollover of involuntary cash-out amounts of less than \$5,000 (69 Federal Register 58018, September 28, 2004). The final rules include a provision that wasn't part of the temporary regulations. It permits (but does not require) amounts of \$1,000 or less to be automatically rolled over. This provision will make the cash-out rules easier to administer.

The goal is to preserve participants' principal, provide a reasonable rate of return, and maintain liquidity. The final rules become effective March 28, 2005.

The regulations contain five safe harbor requirements, which, if satisfied, will permit a direct rollover to be made to an individual retirement account (IRA) opened on behalf of a missing or unresponsive participant. If these regulations are followed, the employer's fiduciary responsibility will end once the funds are deposited into the IRA. The focus of this article is defined contribution rules. The five safe harbor requirements — and some related issues — are explained below.

Cash-out Amount Must Be Determined. A participant's nonforfeitable accrued balance — or vested account balance (VAB) — at the time of distribution will determine if the amount is \$5,000 or less. For example, if a participant terminates employment with a VAB of \$5,100, then his or her account balance cannot be automatically rolled into an IRA. But if the VAB sub-

sequently declines to \$4,700, the sponsor may cash out the participant. A plan may choose to disregard rollovers from unrelated employers' plans and base the \$5,000 on contributions made to the employer's plan(s).

Funds Must Be Rolled Over to an IRA. The rollover must be to a traditional IRA or to an individual retirement annuity. Once the rollover has occurred, it is treated as if the participant had established the IRA.

Only Regulated Financial Institutions May Be Used. Following are the financial institutions that may be used to set up IRA accounts: an FDIC-insured bank or savings association; an insured Credit Union; an insurance company whose products are protected by a state guarantee association; a federally regulated institution that offers a mutual fund registered under the Investment Act of 1940; or a Puerto Rican financial institution offering products that



satisfy this regulation for a plan subject to the Internal Revenue Code.

Only Permitted Investments May Be Used. The DOL has provided a list of approved investments that will allow the

(Continued on page 2)

CONTENTS

Final Rules for Automatic Rollovers

IRS and Social Security Cost-of-living Adjustments

DOL Guidance on Missing Participants

 **JOHNSON**
TRUST®

OFFICES IN WISCONSIN
AND ARIZONA

Final Rules for Automatic Rollovers *(Continued from page 1)*



employer to avoid liability for future investment results. The investment product must preserve principal, provide a reasonable rate of return, and seek to maintain the initial dollar amount

invested over time. Examples include certificates of deposit, money market funds, and stable value funds. The investment product must be offered by a “regulated financial institution.” And the employer must enter into a written agreement with an IRA account or annuity provider.

Protection from Fees and Expenses Must Be Provided. To protect low balance participants, the fees and expenses charged to an automatic rollover IRA may not exceed the fees and expenses charged for a comparable rollover IRA. Fees and expenses covered by the regulation include establishment charges, maintenance fees, investment expenses, termination costs, and surrender charges.

Other Issues. The final regulations state that the customer identification and

verification (CIP) requirements of the PATRIOT Act need only be satisfied at the time the participant or beneficiary first contacts the IRA provider. They also state that the beneficiary designation under the qualified retirement plan will *not* carry over to the IRA. The IRA provider may apply its own default beneficiary provisions until the IRA account owner completes a new beneficiary designation.

In early 2005, the IRS will issue a model plan amendment to permit the automatic rollover provisions to be utilized. Before these provisions may be used, participants must be given a Summary of Material Modifications and/or a Summary Plan Description.

We will be keeping you informed of further developments regarding automatic rollovers. ❖

IRS and Social Security Cost-of-living Adjustments

Most plan limitations will be increasing in 2005. Some of the increases are due to inflation adjustments, others (such as maximum 401(k) plan, 403(b) plan, SIMPLE plan, and 457 plan elective deferrals) were legislated by the Economic Growth and Tax Relief Reconciliation Act of 2001.

The Social Security taxable wage base (SSTWB) will also increase on January 1, 2005. Retirement plans that incorporate Social Security into benefit or contribution determinations are affected by the SSTWB. ❖

IRS LIMITS	2005	2004
DC Plan Annual Additions Limit	\$42,000	\$41,000
DB Plan Annual Benefits Limit	\$170,000	\$165,000
Maximum Compensation Limit	\$210,000	\$205,000
401(k), SARSEP, 403(b), and 457 Plan Deferrals/Catch-up	\$14,000/\$4,000	\$13,000/\$3,000
SIMPLE Deferrals/Catch-up	\$10,000/\$2,000	\$9,000/\$1,500
IRA Contributions/Catch-up	\$4,000/\$500	\$3,000/\$500
Highly Compensated Employee Compensation (for use in the following plan year tests)	\$95,000	\$90,000
Key Employee (Officer) Compensation	\$135,000	\$130,000
Social Security Taxable Wage Base (SSTWB)	\$90,000	\$87,900

DOL Guidance on Missing Participants

The Department of Labor (DOL) has *finally* issued guidance (Field Assistance Bulletin 2004-2) addressing the issue of missing retirement plan participants and approving administrative methods for dealing with the problems. The guidance emphasizes that an employer has a fiduciary responsibility to attempt to locate missing participants when a plan is being terminated or when a former employee is being involuntarily “cashed out.”

The DOL provides four efficient, *mandatory* (and relatively inexpensive) methods of locating missing participants.

1. Send certified mail.
2. Review related plan records, such as other retirement and welfare benefit plans, for recent addresses. (Privacy issues must be addressed.)
3. Contact participant’s designated beneficiary.
4. Use letter forwarding services provided by the IRS and Social Security Administration.

Internet search tools, commercial locator services, and credit reporting agencies may also be used. If the participant still cannot be located, the employer may choose from the following distribution options.

Automatic Rollover to an Individual Retirement

Account. The DOL permits missing participant accounts of \$5,000 or less to be automatically rolled over to an IRA. (*See article on page 1.*) As an “enforcement matter,” the DOL says that when terminating a plan, fiduciaries should use the investment product guidance provided for automatic safe harbor rollovers for plan balances *over* \$5,000 as well. This will protect fiduciaries from liability for future IRA investment performance. For amounts over \$5,000, it is not clear whether or not the DOL rule permitting a direct rollover to an IRA at the same institution that holds the qualified plan assets applies.

Alternative Arrangements. The DOL prefers the IRA rollover distribution option. However, if a fiduciary is unable to locate an automatic IRA rollover provider, there are alter-

natives. Note that choosing an alternative will result in immediate tax liability for the participant.

Federally insured bank accounts. The employer must review all available information and restrictions on such accounts — interest rates, guarantee periods, associated bank charges, etc. And, should the participant “resurface,” he or she must have an unconditional right to withdraw funds.

State unclaimed property funds. If relevant state law permits, a fiduciary may transfer the missing participant’s funds to the state’s unclaimed property fund. Some states provide searchable Internet databases listing the names of unclaimed property owners, and some pay minimal interest on the funds. Although such a transfer is permitted, a state cannot *force* an ERISA plan to transfer unclaimed accounts to its state fund.

Before choosing one of these methods, the employer must consider a bank account’s interest and fee schedules and the availability of a searchable database for the unclaimed property fund. One distribution alternative that is *not* permitted by the DOL is using a 100% income-tax withholding rate to deposit all of a missing participant’s account with the IRS.

Exceptions. These rules may *not* be used by employers who sponsor money purchase plans or defined contribution plans that have an annuity payment distribution option, nor by employers that maintain another qualified retirement plan (other than an Employee Stock Option Plan).

Plan participants must be notified with a Summary of Material Modifications or an updated Summary Plan Description. Model plan amendment language from the IRS is expected. ❖



recent developments

■ **The EBSA issued proposed USERRA regulations in September 2004** for reservists called up for active military duty. The proposal would affect many facets of employment and have an impact on the operation of retirement plans. The most significant item is a deadline for depositing employer contributions (except matching amounts) for reemployed service members. The contributions must be made within 30 days of re-employment (or as soon as practical, if this is not possible). This deadline may be difficult to meet because an employer will need to determine applicable compensation, calculate the contribution amount, and contribute that amount to the plan.

Reservists who receive a distribution will have the option to repay that amount to the plan. Defined benefit plan participants will need to make adjustments to include the plan rate of interest that applies during the

leave period. No adjustment is necessary for defined contribution repayment amounts. The proposed regulations will not become effective until a public comment period ends and final regulations are issued.

■ **The U.S. Supreme Court has agreed to consider IRA creditor protection.** The assets of participants in qualified retirement plans that are subject to ERISA (i.e., plans that cover employees and owners) are protected from bankruptcy creditors. Currently, IRAs do not have similar creditor protection under federal law, although some states provide protection. The U.S. Supreme Court has agreed to hear a case (*Rousey v. Jacoway*) involving individuals seeking to exempt their IRAs from attachment by creditors. The case is an appeal of a U.S. 8th Circuit Court of Appeals ruling that IRA assets are not exempt from an individual's bankruptcy estate. A reversal of the

lower court's decision would be a major change in creditor law.

■ **The IRS Guidance Priority List for 2004-2005** includes a host of items that will impact retirement plans. The long anticipated final regulations governing 401(k) plans will be a major priority. Other highlights of what to expect from the IRS in the coming year are:

- Guidance on the acceptability of post-severance elective deferrals in 401(k) and similar plans
- Guidance on elective Roth 401(k) contributions
- Guidance on nondiscrimination testing for qualified plans in general
- Final regulations for defined contribution plans on eliminating an optional form of benefit
- Guidance on IRA abuses

We'll keep you abreast of developments on these and other IRS issues. ❖

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

Copyright © 2004 by NPI and McKay Hochman

555 Main Street
Suite 261
Racine, WI 53403

OFFICES IN WISCONSIN
AND ARIZONA

JOHNSON
TRUST®

