TRANSAMERICA CENTER
FOR RETIREMENT STUDIES℠

Date: Monday, February 28, 2005

TCRS 2005-01: IRS Notice 2005-5. *Also See TCRS 2004-07*

In Notice 2005-5, the Internal Revenue Service (IRS) issued guidance relating to Automatic Rollover provisions under section 401(a)(31)(B) of the Internal Revenue Code (Code) as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). This guidance supplements the final regulations issued by the Department of Labor (DOL) on September 28, 2004, which we summarized in TCRS 2004-07.

The Transamerica Center for Retirement Studies (TCRS) has prepared this summary to promote understanding of the newly issued guidance and its implications for plan sponsors. These highlights include comments made by representatives from the IRS and other industry panel members during the recent Western Benefits Conference in Los Angeles.

Highlights of IRS Notice 2005-5

- The new rules apply to sections 401(a) plans, including 401(k) plans, and 403(b) plans.
- The new rules apply to mandatory cash-outs ($1,001 - $5,000) made on or after March 28, 2005 that are eligible rollover distributions.
- Mandatory cash-outs of $1,000 or less that are eligible rollover distributions may, but need not, be included in the amount rolled over to an IRA.
- Notice 2005-5 provides a sample "good faith amendment" which plan sponsors may use to amend their plans to comply with the automatic rollover rules.
- A plan sponsor who elects to comply with the automatic rollover rules must amend its plan by the last day of the first plan year ending on or after March 28, 2005 (December 31, 2005 for calendar plans).
- A plan sponsor may amend its plan to remove the mandatory cash-out provision for amounts between $1,001-$5,000 before March 28, 2005, and not adopt the automatic rollover rules.
- If a plan subject to the joint and survivor and pre-retirement survivor annuity requirements is amended to reduce the mandatory cash-out to amounts of $1,000 or less, participant consent for distributions of amounts between $1,001-$5,000 will be necessary but spousal consent will not be.
- If a plan sponsor has not fully implemented the automatic rollover procedures, a plan administrator may delay processing mandatory distributions during 2005 under the new rules, provided the mandatory distributions are processed by December 31, 2005.
- Absent an affirmative election by the participant to receive a mandatory distribution directly or have the amount paid in a direct rollover, the plan administrator may establish an automatic rollover IRA on behalf of the participant with a financial institution selected by the plan administrator. The plan administrator may use the participant's last known address on the employer's records for this purpose.
- An IRA provider will not be treated as failing to meet the applicable disclosure requirements if the disclosure, which uses the participant's last known address on the records of the employer, is returned as undeliverable.
- The portion of a distribution that is attributable to a rollover contribution is subject to the automatic rollover rules even though the rollover contributions are excluded in determining the threshold for mandatory cash-outs under a plan.
- An eligible rollover distribution in the form of a loan offset is not subject to the automatic rollover rules.
- A distribution to a surviving spouse or to an alternate payee under a qualified domestic relations order is not subject to the automatic rollover requirements.

- If the 403(b) plan is a governmental plan, the delayed effective date, as explained below, for a governmental section 414(d) plan would apply.
- Governmental plans under Code section 414(d) and governmental eligible deferred compensation plans under Code section 457(b) are required to comply with the new rules for distributions made on or after 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 new rules do not apply to non-governmental Code section 457(b) plans.
- The new rules also apply to non-electing church plans under Code section 414(c), even though they are not subject to the vesting rules of Code section 411. Non-electing church plans must comply with these rules 60 days after the close of the earliest church convention with authority to amend the plan that occurs on or after January 1, 2006.

Western Benefits Conference Notes and Subsequent IRS Guidance

- In a subsequent guidance released this month, the IRS extended the deadline for adopting the amendment to reduce the mandatory cash-out from March 27, 2005 to the last day of the first plan year ending on or after March 28, 2005. For calendar plans, this new deadline is December 31, 2005. For a plan that uses an off-calendar plan year, this deadline could be before December 31, 2005. For example, a plan with an April 1 to March 31 plan year must adopt the amendment by March 31, 2005. Notwithstanding this extension, operational compliance with the new rules is required beginning on March 28, 2005.
- If a plan terminates before March 28, 2005, the plan sponsor can take the approach that the plan does not need to comply with the new rules.
- A loan offset would not be subject to the automatic rollover rules, but will be used to determine if the $5,000 threshold is exceeded.
- An IRS representative confirmed that plan administrators can still send participant distribution notices to the last known address of the participant even if the address is incorrect in order to establish that communication has been attempted. The IRS representative recommended that plan administrators show "good faith effort" to find participants who terminated prior to March 28, 2005.
- If a participant fails to come forward to claim his automatic rollover IRA, the IRA provider is responsible for the proper disposition of assets, e.g. escheating to the State.
- Treatment of beneficiaries, death benefits and minimum distributions must be determined according to the terms of the IRA, not the plan the rollover came from.
- Subsequent IRS guidance confirmed that master and prototype sponsors or volume submitter practitioners (such as Transamerica) may amend their IRS pre-approved plans to reduce the mandatory cash-out amount to any amount that is $1,000 or less without causing the pre-approved plans to be treated as individually designed. Transamerica is in the process of amending its pre-approved plans for this purpose.
- A Department of Labor representative indicated that for purposes of the safe harbor automatic rollover rules, a 30-90 day bond fund would be a permissible investment, but cautioned plan sponsors to exercise prudence and use their best judgment.