



Defined Contribution Plan Year-End Roundup

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Automatic Rollover Rules Under EGTRRA

- General Rule
 - Plans must automatically roll over mandatory distributions of more than \$1,000 into a designated IRA, absent an affirmative election by participants to have such distributions paid in cash or as a direct rollover
 - Automatic rollover rules went into effect on March 28, 2005, but plan sponsors have until December 31, 2005 to comply
 - Plan sponsors need to decide whether to amend their plans to comply with the automatic rollover requirements or to eliminate mandatory distributions of benefits that are more than \$1,000

Automatic Rollover Rules Under EGTRRA (cont'd)

- To provide for automatic rollovers
 - Update the summary plan description (SPD) or provide a summary of material modifications (SMM) describing the automatic rollover provisions
 - Participants must be provided with an SMM or updated SPD before automatic rollovers can be executed

Automatic Rollover Rules Under EGTRRA (cont'd)

- To reduce the mandatory cashout threshold
 - Decide whether the reduced mandatory distribution amount (i.e., \$1,000) would apply to all recipients. The automatic rollover provisions apply only to participants, not spouses, other beneficiaries or alternate payees
 - Decide whether to permit only lump-sum payments for voluntary distributions of \$5,000 or less

Final 401(k) Regulations – Introduction

- Final 401(k) regulations collect and consolidate earlier guidance and make other changes and clarifications
- Final 401(k) regulations are effective January 1, 2006, but plan sponsors can adopt regulations for any plan year ending after December 29, 2004 as long as the regulations apply to that plan year and all subsequent plan years

Final 401(k) Regulations – Contribution Rules

- Minor conforming changes to address Roth 401(k) contributions and confirmation that a Roth 401(k) contribution feature must be offered on a nondiscriminatory basis
- New requirement that a plan must provide employees with an effective opportunity to make at least one deferred election change each year
- Codify earlier guidance permitting automatic enrollment provisions
- Preclude the pre-funding of contributions for purposes of accelerating employer deductions

Final 401(k) Regulations— Nondiscrimination Rules

- Restrictions on targeted “bottom-up” QNECs and QMACs to non-highly compensated employees for purposes of “ADP/ACP” testing
 - QNECs in excess of 5% of compensation may not exceed two times the plan’s “representative contribution rate”
 - QNECs of 5% or less to satisfy ADP and ACP tests (for maximum of 10% QNEC) are exempt from limits
 - Similar limits on QMAC contributions used to satisfy ACP testing

Final 401(k) Regulations– Nondiscrimination Rules (cont'd)

- Aggregation of ESOP and non-ESOP portions of a 401(k) plan now permitted for purposes of satisfying ADP/ACP tests
- Separate ESOP testing still required for other coverage and nondiscrimination testing
- So-called “gap period” income generally must be included with any returns of excess contributions, but (1) only to the extent income/losses would otherwise be allocated to the account if it were distributed, and (2) income during seven-day period before distribution can be disregarded

Final 401(k) Regulations – Miscellaneous

- Hardship distribution events expanded to include (1) funeral expenses for parent, spouse, children or dependents; and (2) repairs to principal residence that would qualify for a casualty deduction
- In applying a plan's break-in-service rules, elective deferrals to a 401(k) plan are taken into account for purposes of determining a participant's vested status
- Changes to plan documents or other administrative materials may or may not be necessary, depending upon the terms of the existing plan document and the employer's intended course of action

Hurricane Relief

- Relaxed hardship distribution rules
 - IRS and DOL relief
 - Permit easier access to retirement funds through loan and hardship withdrawals
 - Plan amendment by the last day of the 2006 plan year
- Katrina Emergency Tax Relief Act of 2005 (KETRA)
 - Permits easier access to retirement funds for certain individuals
 - Plan amendment by the end of the plan year beginning on or after January 1, 2007

Hurricane Relief (cont'd)

- Relaxed hardship and loan rules
 - A participant may take distributions or loans on account of Hurricane Katrina damage if the participant or his or her lineal descendants or ascendants, spouse or dependents principally resided or worked in an area affected by Hurricane Katrina
 - Employee representation of hardship sufficient
 - Six-month suspension does not apply
- Plan amendment by the last day of the 2006 plan year

Hurricane Relief (cont'd)

- Qualified Hurricane Katrina distributions:
 - May be made to an individual who, on August 28, 2005, had a primary residence in a Hurricane Katrina disaster area and who suffered an economic loss because of Hurricane Katrina
 - Up to \$100,000
 - No 10% early-distribution penalty
 - Ratable income inclusion
 - Recontribution permitted

Hurricane Relief (cont'd)

- KETRA loans:
 - May be made to an individual who, on August 28, 2005, had a primary residence in a Hurricane Katrina disaster area and who suffered an economic loss because of Hurricane Katrina
 - Increased loan amounts
 - Lesser of \$100,000 or 100% of participant's account
 - ERISA loan security rules may require additional security
 - Loan repayments suspended for one year

New Determination Letter Process

- Cyclical remedial amendment periods for individually designed and pre-approved plans
 - Individually designed plans generally have a staggered five-year cycle
 - Cycle determined by last digit of employer identification number
 - Each pre-approved plan (M&P and volume submitter) generally has a six-year cycle
 - Pre-approved defined benefit plans will have a different six-year cycle than pre-approved defined contribution plans
- Extends EGTRRA remedial amendment period
 - To the end of the first remedial amendment cycle

New Determination Letter Process (cont'd)

- Plan sponsors need to apply for a new determination letter only once every 5/6 years (on cycle)
- Employers required to timely amend for interim qualification requirements
- IRS will issue annual cumulative list of qualification requirements
- Filing off-cycle discouraged

New Determination Letter Process (cont'd)

Cycle	EIN end	Last day of first (EGTRRA) cycle	Last day to submit determination letter	Next cycle ends
A	1 or 6	2/1/2006	1/31/2007	1/31/2012
B	2 or 7	2/1/2007	1/31/2008	1/31/2013
C	3 or 8	2/1/2008	1/31/2009	1/31/2014
D	4 or 9	2/1/2009	1/31/2010	1/31/2015
E	5 or 0	2/1/2010	1/31/2011	1/31/2016

New Determination Letter Process (cont'd)

- Cycles for specific types of plans
 - Multiemployer plans – Cycle D
 - Multiple employer plans – Cycle B
 - Governmental plans – Cycle C
- Controlled/affiliated service groups
 - Single plan – EIN used on Form 5500 controls cycle
 - Multiple plans – May elect Cycle A
 - Requires unanimous consent
 - Parent-subsubsidiary – May elect to cycle under parent EIN
- Mergers, acquisitions and spinoffs
 - Generally use the EIN of successor employer

New Determination Letter Process (cont'd)

- Pre-approved plans must generally file determination letters by January 31 of year following year in which cycle opens
- Mass submitters and national sponsors have until October 31 of calendar year in which cycle opens
- For defined contribution plans
 - Last day of initial (EGTRRA) cycle is 1/31/2011
 - Last day of next cycle is 1/31/2019

Roth 401(k) Contributions

- Effective as of January 1, 2006, 401(k) and 403(b) plans can offer participants the ability to make “Roth 401(k)” contributions
- Conceptually, a Roth 401(k) mimics the characteristics of a Roth IRA:
 - employees make contributions on an after-tax basis
 - contributions *and earnings* on contributions are not subject to tax at the time of distribution
 - employees are not subject to the income limits that apply to Roth IRAs

Roth 401(k) Contributions (cont'd)

- Significant technical requirements of Roth 401(k) contributions are as follows:
 - Roth 401(k) contributions count against the 402(g) limit for 401(k) contributions (\$15,000 for regular contributions and \$5,000 for catch-up contributions for 2006)
 - Distributions generally must satisfy 401(k) distribution limitations, that is, be made because of death, disability, termination of employment or hardship AND must satisfy a five-year holding requirement

Roth 401(k) Contributions (cont'd)

- Plans must separately account for Roth 401(k) contributions
- Roth 401(k) contributions are combined with regular pre-tax 401(k) contributions for purposes of nondiscrimination testing
- Roth 401(k) contributions are subject to required minimum distribution rules
- Rollovers of Roth 401(k) contributions must be made to a Roth IRA

Roth 401(k) Contributions (cont'd)

- In deciding whether to offer Roth 401(k) contributions, plan sponsors must consider the administrative complexity involved with offering another type of elective contribution
- Communicating the “pros and cons” of Roth 401(k) contributions to plan participants may be difficult – participants must consider current and future tax rates, time contributions will be in the plan, etc.

Post-Severance Payments Under Section 415 Proposed Regulations

- General Rule
 - Compensation under Section 415 does not include post-severance payments
- Exception
 - Timing: Compensation under Section 415 includes certain post-severance payments made within 2½ months following termination of employment
 - Type: Payments that, absent severance from employment, would have been made to the participant as regular compensation, including overtime, shift differential, commissions and bonuses
 - Type: Payments for accrued but unused sick, vacation or other leave that the participant could have used had his or her employment not terminated

Post-Severance Payments Under Section 415 Proposed Regulations (cont'd)

- Other rules
 - Exception does not apply to severance pay, unfunded nonqualified deferred compensation or parachute payments even if such payments are made within 2½ months following termination of employment
 - Section 415 compensation also includes military “make whole” payments for employees who enter active U.S. military service, provided such payments do not exceed amounts the employees would have received had they continued to work

Post-Severance Payments Under Section 415 Proposed Regulations (cont'd)

- Other rules
 - Corresponding proposed amendments under Sections 401(k), 403(b) and 457(b) of the Code were made so that former employees cannot make contributions to plans under Sections 401(k), 403(b) and 457(b) from post-severance payments unless such payments are deemed compensation under Section 415 of the Code
 - Although the effective date of the proposed regulations is January 1, 2007, plan sponsors can apply the rules right now

Annual Additions Under Section 415 Proposed Regulations

- Restorative payments are not annual additions

Qualified Plan Loans Under the New Bankruptcy Act

- Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 affects participants who file for bankruptcy on or after October 17, 2005 with outstanding qualified plan loans
- Prior to the new Bankruptcy Act, loan repayments were subject to an automatic stay. Accordingly, no payroll deductions were permitted after a bankruptcy petition had been filed
- Under the new Bankruptcy Act, loan repayments are no longer subject to an automatic stay

Qualified Plan Loans Under the New Bankruptcy Act (cont'd)

- Plan loans may not be discharged in bankruptcy
- A Chapter 13 reorganization plan may not materially alter the terms of a qualified plan loan, and amounts required to repay the qualified plan loan will not constitute “disposable income”

New Electronic Notice Guidance

- Proposed regulations permit expanded use of electronic transmission of notices, elections and consent
 - Not applicable to notices, elections and consent over which DOL or PBGC has authority
- Similar to existing DOL regulations:
 - Advance disclosure and consent required

New Electronic Notice Guidance (cont'd)

- Advance disclosure
 - Scope
 - Right to receive paper documents
 - Right to withdraw consent
 - Description of update procedures
 - Hardware and software specifications
- Advance consent
 - Manner that demonstrates participant can access electronic transmission

New Electronic Notice Guidance (cont'd)

- FARMS
 - Friendly (clear, user-friendly format)
 - Accessible (accessible to user)
 - Review (user has opportunity to review elections)
 - Modify and confirm (used has opportunity to modify and confirm elections)
 - Secure (safeguards to prevent others from making participant elections)

Medical Reimbursement Accounts Under Revenue Ruling 2005-55

- Profit-sharing plan may not provide a medical reimbursement account from which amounts may only be distributed for medical care expenses, and unused amounts are forfeited
- Such a restriction violates the vesting rules of the Code and ERISA

Medical Reimbursement Accounts Under Revenue Ruling 2005-55 (cont'd)

- Amounts payable from the medical reimbursement account could be distributed to reimburse medical expenses both before and after termination of employment, but would ultimately have to be available without restriction at termination of employment or normal retirement age
- No amount distributed from the profit-sharing plan will be excluded from gross income under Section 105(b) of the Code

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