

Tax-Qualified Retirement Plans: Amendments and Other Year-End Action Items

October 29, 2010

As the end of the year approaches, it is important for plan sponsors to review whether any qualified plan actions must be taken prior to year-end. This LawFlash describes potential year-end notices and plan amendments that may be required for tax-qualified retirement and savings plans. This list is not exhaustive, but is intended to serve as a reminder of items that should be reviewed and considered before the end of the year.

PLAN AMENDMENTS

Amendments to comply with certain provisions of the Pension Protection Act of 2006 (PPA) relating to stock diversification requirements, benefit restrictions, and hybrid plans are required to be adopted by the last day of the first plan year beginning on or after January 1, 2010. Thus, calendar-year plans must adopt these amendments by December 31, 2010. Additionally, amendments relating to the Heroes Earnings and Assistance Relief Tax Act of 2008 (HEART Act) are also required to be adopted by the end of 2010 for calendar-year plans. Collectively bargained and governmental plans may have later effective dates and/or amendment deadlines. Also, certain rules may differ for multiemployer plans. If your plan is not a collectively bargained, governmental, or multiemployer plan, the list below will help you determine if any amendments are required for your plan by the end of the 2010 plan year.

Required Amendments

Below is a list of amendments relating to changes in the law that may need to be adopted by the end of the 2010 plan year.

Defined Contribution Plan Amendments

Amendment	Explanation
Right to Diversify Publicly Traded Employer Securities	Effective for plan years beginning after December 31, 2006, participants, alternate payees, and beneficiaries must be permitted to diversify, no less frequently than quarterly, the investment of amounts attributable to elective deferrals and after-tax contributions that are invested in publicly traded employer securities. Additionally, participants with at least three years of service, alternate payees, and beneficiaries must be permitted to diversify, no less frequently than quarterly, the investment of amounts attributable to employer

Amendment	Explanation
	<p>contributions that are invested in publicly traded employer securities.</p> <p>For this purpose, a plan must offer at least three investment options (other than employer securities) that have materially different risk and return characteristics. This rule does not apply to an ESOP if (1) the ESOP does not hold any elective deferrals, employee after-tax contributions, or employer matching contributions and (2) the plan is a separate plan from any other plan maintained by the employer.</p> <p>Additionally, the final regulations clarify that the diversification rights of participants who receive matching or profit-sharing contributions in employer stock must include the ability to both transfer out of and back into the employer stock funds.</p> <p>Pursuant to Internal Revenue Service (IRS) Notice 2009-97, amendments must be adopted by the last day of the first plan year beginning on or after January 1, 2010. Final regulations outlining the requirements of employer stock diversification were issued on May 19, 2010.</p>
Required Minimum Distribution Waiver in 2009	<p>The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) modified the required minimum distribution (RMD) rules for 2009 by waiving any 2009 RMD for defined contribution plans. The method by which a plan treated RMD waivers in 2009 depended upon whether the plan complied with the RMD requirements by forcing the commencement of distributions at age 70½ or by only paying the required minimum amount each year.</p> <p>In IRS Notice 2009-82, the IRS provided guidance (including sample amendments) to reflect the waiver of the 2009 required minimum distributions.</p> <p>While plan sponsors may decide to adopt amendments earlier, amendments to comply with the required RMD waiver changes are not required to be implemented until the last day of the 2011 plan year (2012 plan year for governmental plans).</p>
Automatic Contribution Arrangements	<p>Final regulations governing automatic contribution arrangements were issued on February 24, 2009. While many provisions were effective during the 2009 plan year, the following provisions were effective for plan years beginning on and after January 1, 2010:</p> <ul style="list-style-type: none"> • Employee deferrals under a “qualified automatic contribution arrangement” must be made using a Code Section 414(s) definition of compensation. • Plans must be amended, as necessary, to comply with the “eligible automatic contribution arrangement” provisions outlined in the final regulations. <p>Amendments adopting these provisions must be adopted by the later of (i) the last day of the 2010 plan year or (ii) the due date of the employer’s tax return that includes the first day of the 2010 plan year.</p>
Hurricane/Flood Relief	<p>The Emergency Economic Stabilization Act of 2008 provides for optional flood-related distributions, special loan rules, and the ability to</p>

Amendment	Explanation
	recontribute amounts that were withdrawn for home purchases. Amendments implementing these rules must generally be adopted by the end of the 2010 plan year.

Defined Benefit Plan Amendments

Amendment	Explanation
Three-Year Cliff Vesting for Cash Balance Plans	Benefits under a cash balance (or hybrid) plan in existence on June 29, 2005 must use a three-year cliff vesting schedule for all participants who have an hour of service in a plan year beginning after December 31, 2007. While this is a PPA change, IRS Notice 2009-97 extended the deadline for adopting this required change to the last day of the first plan year beginning on or after January 1, 2010.
Funding-Based Benefit Restrictions	<p>Under the new pension funding rules, benefit restrictions apply to certain underfunded defined benefit pension plans. For plans that are less than 80% but at least 60% funded, the plan generally cannot pay more than 50% of the participant’s accrued benefit in a lump sum, and it cannot be amended to increase benefits. For plans that are less than 60% funded, no benefit accruals are allowed (mandated plan freeze) and tighter benefit restrictions apply (no lump sum payments may be made). These rules are effective for plan years beginning after December 31, 2007.</p> <p>IRS Notice 2009-97 extended the deadline for adopting funding-based restriction amendments to the last day of the first plan year beginning on or after January 1, 2010.</p> <p>On June 25, 2010, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (the Act) was enacted. This law gives single-employer defined benefit plans a two-year reprieve from the funding restrictions enacted by PPA for benefit accruals and social security level income options and also provides funding relief in certain situations. The Act also provides funding relief for multiemployer pension plans and plans sponsored by 501(c)(3) charities. While the due dates for amendments implementing these new rules are not clear at this time, it may be worthwhile to consider including amendments for these changes with the PPA-required funding restriction changes.</p>
Hybrid Plan Changes	The PPA made several changes that are applicable to hybrid pension plans, including cash balance plans. IRS Notice 2009-97 extended the deadline for adopting such amendments (other than the elimination of the lump-sum whipsaw) until the last day of the first plan year beginning on or after January 1, 2010. Treasury issued final and proposed regulations on October 19, 2010. The regulations contain different effective dates. We will issue a LawFlash addressing these due dates and the impact of the regulations in the near future.
Normal Retirement Age	On May 22, 2007, the IRS issued final regulations establishing standards

Amendment	Explanation
	for establishing normal retirement age (NRA) for defined benefit and money purchase pension plans. The IRS subsequently released Notice 2007-69, which provides temporary relief for certain plans whose definition of NRA may need to change to comply with the final regulations. Sponsors of defined benefit plans with an NRA between 55 and 62 that are amending their plans to comply with the requirements of IRS Notice 2007-69 have until the last day of the first plan year beginning after June 30, 2008 (or if later, the tax return deadline (plus extensions) for the sponsor's return that includes the first day of the first plan year beginning after June 30, 2008) to amend their plans to comply with the new rules.
Required Minimum Distributions	IRS Notice 2005-95 extended the time by which defined benefit pension plans must be amended to comply with the required minimum distribution rules under Code Section 401(a)(9) to the end of the plan's remedial amendment cycle. Thus, plans filing in Cycle E must adopt conforming amendments by January 31, 2011.

Defined Contribution and Defined Benefit Plan Amendments

Amendment	Explanation
HEART Act	<p>The HEART Act provides enhanced benefits for qualified plan participants who enter active military service. Certain provisions are required and some are optional. Amendments are required to be adopted by the last day of the first plan year beginning on or after January 1, 2010 (or by December 31, 2010 for calendar-year plans).</p> <p>Mandatory provisions include:</p> <ul style="list-style-type: none"> • Beneficiary Death Benefits. Providing a beneficiary of a participant who died in qualifying military service with benefits as though the participant had returned to active employment and then died. • Military Differential Pay. If differential pay is provided to employees performing uniformed service on active duty for more than 30 days, the employment relationship is considered to continue while the employee is receiving differential pay and the differential pay must be treated as qualified plan compensation. IRS Notice 2010-15 confirmed that differential wage payments are only required to be included as plan compensation for purposes of testing and other Internal Revenue Code (Code) limits, but not for purposes of contributions and benefit accruals. <p>Optional provisions include:</p> <ul style="list-style-type: none"> • Military Benefit Accruals on Death or Disability. Qualified plans are permitted to provide additional accruals or contributions to participants who die or become disabled on or after January 1, 2007 while performing qualified military

Amendment	Explanation
	<p>service. Accruals are typically based on what the participant would have earned under Uniformed Services Employment and Reemployment Rights Act (USERRA) rules if the participant had been reemployed on the day preceding the date of death or disability and the terminated on the actual date of death or disability.</p> <ul style="list-style-type: none"> • Distribution of Elective Deferrals. An individual performing uniformed service on active duty for more than 30 days and who is receiving differential pay may, if the plan so provides, be treated as having terminated employment for purposes of eligibility to take a distribution of elective deferrals from a 401(k) plan (even if the employment relationship is otherwise considered to continue because the individual is receiving differential pay). A participant who takes a distribution under this provision is not permitted to make elective deferrals or after-tax employee contributions under the plan for six months after the distribution. <i>Note: IRS Notice 2010-15 clarified that offering this type of in-service withdrawal is optional. However, plans that were amended to permit this type of withdrawal prior to the release of Notice 2010-15 are not permitted to eliminate this distribution option due to the anticutback requirements of Code Section 411(d)(6).</i> • Qualified Reservist Distributions. Distributions under a 401(k) plan are permitted to a reservist who is ordered or called to active duty after September 11, 2001 for more than 179 days (or indefinitely). Qualified reservist distributions do not require a subsequent suspension of contributions.
<p>PPA Amendments for Non-Calendar-Year Plans</p>	<p>The deadline for adopting amendments under PPA is the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 for governmental plans). Sponsors of calendar-year plans were generally required to adopt PPA-related amendments by December 31, 2009. However, non-calendar-year plans may have a later deadline to adopt such amendments.</p>
<p>Rollovers by Non-Spouse Beneficiaries</p>	<p>Non-spouse beneficiaries of deceased participants may make an eligible rollover distribution in a direct trustee-to-trustee transfer to an “inherited” IRA. This provision was optional under the PPA for distributions made after 2006. The WRERA made this provision mandatory for plan years beginning after December 31, 2009. Plan sponsors are required to amend their plans to incorporate this change by the end of the plan year beginning after December 31, 2009 or, if later, the tax return deadline (plus extensions) for the sponsor’s return that includes the first day of such plan year.</p>
<p>Determination Letter Cycle Amendments</p>	<p>Under the IRS determination letter program, individually designed plans have staggered five-year remedial amendment cycles. The current cycle is Cycle E and applies to employers with employer tax identification numbers that end in 5 or 0. Plan sponsors that are required to file in</p>

Amendment	Explanation
	<p>Cycle E must submit their plans to the IRS by January 31, 2011.</p> <p>Prior to each cycle, the IRS releases a Cumulative List of plan amendments that describes all of the required provisions that must be included in each plan that is submitted for a determination letter. Plan sponsors should review the applicable IRS Cumulative List prior to submitting a plan for a determination letter to ensure that any additional amendments that are outlined on the Cumulative List are included in the plan document.</p>

Discretionary Amendments

Plan amendments for discretionary changes (i.e., changes not required by law, such as plan design changes) must be adopted by the end of the plan year in which the amendment is effective (unless earlier adoption is necessary to avoid a benefit cutback). Thus, calendar-year plans must be amended by December 31, 2010 for optional changes that took effect in 2010.

ANNUAL NOTICE REQUIREMENTS

Depending upon the type of qualified plan and the plan’s features, one or more annual notices may be required. Please carefully review the following notices to determine whether any are required to be issued for your plan.

Annual Safe-Harbor 401(k) Plan Notices

- **Traditional Safe-Harbor Plan Notice.** Safe-harbor 401(k) plans must provide an annual safe-harbor notice to all plan participants describing the safe-harbor contribution and other material plan features.
- **“Wait and See” Safe-Harbor Notice.** Sponsors of safe-harbor 401(k) plans that intend to satisfy the safe-harbor requirements through a 3% nonelective contribution may wish to follow the “wait and see” approach. Plan sponsors that follow this approach must provide a notice prior to the beginning of the plan year notifying eligible employees that the safe harbor may be adopted. Additionally, plan sponsors that previously provided a “wait and see” notice prior to the beginning of the ongoing plan year and that decide to implement a safe-harbor arrangement prior to the end of the plan year (by making the 3% nonelective contribution) must provide a supplemental notice to eligible employees informing them that the safe-harbor arrangement will be adopted.

The traditional safe-harbor notice and the contingent and supplemental notices must be provided at least 30 days and no more than 90 days prior to the beginning of the plan year. Thus, calendar-year plans will need to provide the applicable notice by December 1, 2010.

Note: If you previously provided a “wait and see” safe-harbor notice and have decided to implement the 3% nonelective safe-harbor contribution for this plan year, in addition to providing the notice described above, you will also need to amend your plan to provide for the safe-harbor contribution prior to the end of the plan year.

Qualified Default Investment Alternative Notices

Participant-directed 401(k) plans that invest participant contributions for which no affirmative investment election has been made into a qualified default investment alternative (QDIA) must provide an annual notice. The notice must be distributed to all participants who have been or may be defaulted into a QDIA. The notice must be provided at least 30 days before the beginning of each plan year. For calendar-year plans, notice must be provided by December 1, 2010.

A QDIA is an investment alternative (for example, a balanced fund or target-date fund) in a participant-directed 401(k) or profit-sharing plan into which participant contributions are “defaulted” if the participant has not made an affirmative investment election. If a plan fiduciary properly selects a QDIA and follows the specific QDIA requirements, which include providing an initial and an annual notice, the plan fiduciary will generally receive fiduciary protection for those defaulted investments under Section 404(c) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), because participants will be “deemed” to have elected to invest their contributions into the QDIA.

Note: One of the many QDIA notice requirements is that the notice be “separate” from any other notices that are provided. However, the QDIA notice is permitted (but not required) to be combined with the safe-harbor notice (described above) and the automatic enrollment notices (described below).

401(k) Plan Annual Automatic Enrollment Notice

Sponsors of 401(k) plans that automatically enroll participants must provide an annual notice to all eligible employees describing the circumstances under which contributions may be automatically contributed to the plan. This notice may be combined with the QDIA notice described above. This notice must be distributed at least 30 days, but no more than 90 days, prior to the beginning of each plan year. For calendar-year plans, the notice must be provided by December 1, 2010.

Note: There are a number of different automatic enrollment arrangements (for example, one arrangement simply provides for the automatic enrollment of participants, while another is linked to satisfying 401(k) plan discrimination tests), but each requires a notice.

Defined Benefit Plan Annual Funding Notice

Plan sponsors of single- and multiemployer defined benefit pension plans must provide an annual funding notice to participants, beneficiaries, and labor organizations representing participants. The notice must contain certain information about the plan, including the plan’s funding status for the previous two years, and a statement of the plan’s assets and liabilities, among other items.

The notice must generally be provided within 120 days following the end of the plan year. Small plans (covering fewer than 100 participants) must provide the notice by the filing due date of the plan’s IRS Form 5500. Additional notice requirements apply if the plan is subject to benefit restrictions due to failure to meet certain funding targets.

For calendar-year plans, the notice is due by April 30, 2011.

Notice of Consequences of the Failure to Defer Benefits

Under Code Section 411(a), a plan is required to obtain participant consent in order to distribute defined contribution or defined benefit plan benefits that have a present value exceeding \$5,000. The Code Section 411(a) regulations indicate that the consent is only valid if the participant is properly informed of the right to defer receipt of distribution. The PPA added the requirement that participants must also be informed of the consequences of failing to defer their distributions until normal retirement age. While the notice requirement is in effect for plan years beginning after December 31, 2006, the PPA included a “reasonable attempt to comply” standard until 90 days after the issuance of final regulations.

IRS Notice 2007-7 contained a safe harbor describing what would be considered a “reasonable attempt” to comply with the notice requirement. In October 2008, the IRS issued proposed regulations. Until the issuance of final regulations occur, plan sponsors should continue to take good-faith reasonable steps to comply with the notice requirements. We will issue a LawFlash when the final regulations are released.

Participant Benefit Statements

Depending upon the type of qualified plan, specific participant benefit statement requirements apply, as described below.

- **Defined Benefit Pension Plans.** Plan sponsors of defined benefit pension plans must either provide participant benefit statements every three years to vested participants who are active employees or provide an annual notice to participants describing how a benefit statement may be obtained.
- **Participant-Directed Defined Contribution Plans.** Participant-directed defined contribution plans are required to provide participant statements on a quarterly basis. Plan sponsors are deemed to timely provide statements if they are provided within 45 days following the end of the calendar quarter.
- **Non-Participant-Directed Defined Contribution Plans.** Plans that do not permit participants to individually direct their account balances are required to provide statements at least once each calendar year. Plan sponsors are deemed to timely provide statements if they are provided on or before the date on which the Form 5500 annual report is filed by the plan (including extensions).

Special Tax Notices

In IRS Notice 2009-68, the IRS issued two model safe-harbor Special Tax Notices for eligible rollover distributions from an employer plan that can be used to satisfy Code Section 402(f). The first notice applies to distributions that are not from a designated Roth account. The second safe-harbor notice is designed for distributions from a designated Roth account.

The revised notices serve as safe harbors for distributions made on and after January 1, 2010. Plan sponsors should ensure that their notices have been properly updated.

TRANSFERS AND SPIN-OFFS TO PUERTO RICO QUALIFIED PLANS BY DECEMBER 31, 2010

In Revenue Ruling 2008-40, the IRS clarifies that the transfer or spin-off of assets from a dual-qualified (United States and Puerto Rico) plan funded through a U.S. trust to a Puerto Rico-only qualified plan funded through a Puerto Rico trust is generally prohibited and that such a transfer is taxable to affected

participants and may jeopardize the U.S. tax-qualified status of the U.S. plan. However, Revenue Ruling 2008-40 provides a relief period expiring on December 31, 2010, during which such transfer will be allowed without any adverse tax consequences. Plan sponsors contemplating such a transfer or spin-off should act quickly in order to accomplish and complete the transfer or spin-off by the December 31, 2010 deadline. Any such transfer after that date will generally be taxable to the Puerto Rico residents participating in the plan and could jeopardize the tax-qualified status of the U.S. plan unless the Puerto Rico transferee plan makes an election to comply with U.S. qualification requirements under ERISA Section 1022(i)(2).

We understand that there have been recent discussions between practitioners and the IRS regarding open issues that exist relating to such transfers and that the IRS is considering extending the relief in Revenue Ruling 2008-40. However, as of the date that this LawFlash is being issued, we have no formal guidance from the IRS confirming any such extension. We will issue a LawFlash if such an extension is issued.

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