

Morgan Lewis

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October 12, 2010

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

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# Year-End Planning

- Annual Notices for Qualified Plans
- Required Amendments
- IRS Determination Letter Filings
- Puerto Rico Transfer Deadline
- Questions

# Annual Notices

- Safe Harbor 401(k) Plan Notices
- Automatic Enrollment Notices (Including Safe Harbor Designs)
- Qualified Default Investment Alternative
- Defined Benefit Plan Annual Funding Notice
- Participant Benefit Statements
- Other Notices

# Safe Harbor 401(k) Notice

- Traditional Safe Harbor Notice
  - Notice describing the safe harbor contribution and other material plan features.
  - Notice must be provided no less than 30 and no more than 90 days prior to the beginning of the plan year.

# Safe Harbor 401(k) Notice (cont'd)

- “Wait and See” Safe Harbor Notice
  - Available to plan sponsors who may want to provide a 3% nonelective safe harbor contribution to satisfy nondiscrimination testing. Allows decision to be made at a later time.
  - Notice explaining that a safe harbor contribution may be made must be provided to participants no less than 30 and no more than 90 days prior to the beginning of the plan year.

# Safe Harbor 401(k) Notice (cont'd)

- “Wait and See” Approach (cont'd)
  - If a plan sponsor decides to make the safe harbor contribution, a subsequent notice is required before the end of the plan year informing participants of the contribution.
  - Notice must be provided no less than 30 and no more than 90 days before the end of the plan year.
  - Failure to provide the “Traditional” or “Wait and See” notices could result in the inability to use the safe harbor to satisfy nondiscrimination testing for a particular year.

# Supplemental Notice for Mid-Year Suspension/Reduction Safe Harbor Contribution

- Mid-Year Suspension/Reduction of Safe Harbor Employer Contributions
  - IRS has proposed regulations (effective for amendments adopted on or after 5/18/09) that permit the suspension or reduction of safe harbor nonelective contributions for an employer that experiences a substantial business hardship
  - Supplemental notice must be given at least 30 days in advance and employees must be provided with an opportunity to adjust deferral elections

# Automatic Enrollment Notice

- Auto enrollment notices are required to be given both before a participant is initially auto enrolled and on an annual basis.
- The notice must describe the automatic enrollment process and may be combined with the qualified default investment alternative (QDIA) notice.
- Notice must be provided at least 30 days prior to the beginning of each plan year.
  - For calendar year plans – December 1
- Failure to provide the notice could result in a penalty of up to \$1,000 per violation per day.



# Qualified Default Investment Alternative Notice

- Qualified Default Investment Alternative (QDIA) Notice
  - Applies to savings plans that invest participant contributions in a QDIA
  - Must be provided to all participants that have been or may be defaulted into the QDIA
  - Must be separate from other notices, but may be combined with a safe harbor and/or automatic enrollment notice
  - Must be provided at least 30 days prior to the beginning of the plan year
    - *For calendar year plans - December 1*

# Defined Benefit 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, 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.
- For calendar year plans, the notice is due on April 30, 2011.

# Participant Benefit Statements

- *Defined Benefit Plans.* Plan sponsors of defined benefit plans must either (i) provide benefit statements every three years to participants who are active employees or (ii) 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 each calendar quarter.
- *Non-Participant-Directed Defined Contribution Plans.* Non-participant-directed defined contribution plans are required to provide participant statements annually.
  - Notice must be provided on or before the date the Form 5500 is filed.
    - *For calendar year plans - July 31 or October 15 (if extension is obtained)*

# Notice of Consequences of Failure to Defer Benefits

- Participant consent is required to distribute benefits that have a present value exceeding \$5,000.
- Consent is only considered “valid” if participants are properly informed of their right to defer receipt of the distribution.
- Proposed regulations issued in 2008; until issuance of final regulations, plan sponsors should comply in good faith.

# Notice of Benefit Restrictions

- Funding-Based Benefit Restrictions
  - If a plan is  $< 80\%$  but  $\geq 60\%$  funded, the plan generally cannot pay more than 50% of the participant's accrued benefit in a lump sum and cannot be amended to increase benefits
  - If a plan is  $< 60\%$  funded, no benefit accruals are allowed and tighter benefit restrictions apply (e.g., no lump-sum payments may be made)
    - *Effective for plan years beginning after December 31, 2007*
- *Note: The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (enacted June 25, 2010) provides a two-year reprieve from funding restrictions for benefit accruals and social security level income options for single employer pension plans.*

# Other Notices

- 402(f) Notice
  - Required to be provided to recipients of eligible rollover distributions, effective as of January 1, 2010
  - Updated model notices for
    - *Roth-designated accounts*
    - *Non-Roth-designated accounts*

# Plan Amendments

Required by December 31, 2010

- Defined Contribution Plan Amendments
- Defined Benefit Plan Amendments
- Amendments Affecting Both Defined Contribution and Defined Benefit Plans

# Defined Contribution Plan Amendments

## Right to Diversify Employer Securities

- For plan years beginning after December 31, 2006
  - Participants, alternate payees and beneficiaries must be permitted to diversify (no less frequently than quarterly) amounts attributable to pre-tax deferrals and after-tax contributions that are invested in publicly traded employer stock.
  - Participants with at least three years of service must also be permitted to diversify (no less frequently than quarterly) the investment of amounts attributable to employer contributions that are invested in publicly traded employer stock.
- Amendments required by the last day of the first plan year that begins on or after January 1, 2010.



# Defined Contribution Plans (cont'd)

## Required Minimum Distribution Waiver

- The Worker, Retiree, and Employer Recovery Act of 2008 waived 2009 required minimum distribution payments.
- Notice 2009-82 provided guidance (including sample amendments) to reflect the 2009 waiver.
- Amendments required by last day of 2011 plan year.

# Defined Contribution Plans (cont'd)

## Hurricane/Flood Relief

- The Emergency Economic Stabilization Act of 2008 provided for optional flood-related distributions, special loan rules and the ability to recontribute amounts that were withdrawn for home purchases.
- Amendments must generally be adopted by the end of the 2010 plan year.

# Defined Benefit Plans

## Hybrid Plan Amendments

- Cash balance plans required to 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.
- The Pension Protection Act of 2006 made several additional changes applicable to hybrid pension plans, including adopting a market rate of interest, among other items.
  - Upon release of final regulations, plan sponsors will need to take immediate action to amend their plans to comply with the new rules.

# Defined Benefit Plans (cont'd)

## Hybrid Plan Amendments

- Amendments for hybrid plan changes are required to be made by the last day of the first plan year beginning on or after January 1, 2010.

# Defined Benefit Plans (cont'd)

## Funding-Based Benefit Restrictions

- Rules regarding funding-based benefit restrictions were effective for plan years beginning after December 31, 2007.
- Notice 2009-97 extended the deadline for adopting the funding-based restrictions.
- Amendments implementing rules required to be adopted by the last day of the first plan year beginning on or after January 1, 2010.

# Defined Benefit Plans (cont'd)

## Normal Retirement Age

- Final regulations setting forth the standards for normal retirement age (“NRA”) were released on May 22, 2007.
- In Notice 2007-69, the IRS provided temporary relief for plans that may need to be amended to comply with the final regulations.
- Amendments implementing the changes are required to be adopted by the last day of the first plan year beginning after June 30, 2008 (or, if later, the tax return deadline, plus extensions, for the plan sponsor’s return that includes the first day of the first plan year beginning after June 30, 2008).

# Discretionary Amendments

- Amendments to make discretionary changes (such as plan design changes) must be adopted by the end of the plan year in which they are implemented.
- Calendar year plans must be amended by December 31, 2010.

# HEART Act Amendments

- Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART Act")
- Mandatory Provisions Include
  - Military differential pay
  - Beneficiary death benefits



# HEART Act Amendments (cont'd)

## Mandatory Provisions

- Military Differential Pay
  - If differential pay is provided, such payments are required to be included as plan compensation for testing and other Internal Revenue Code limits. May be included optionally for purposes of contributions and benefit accruals.
- Beneficiary Death Benefits
  - The beneficiary of a participant who dies in qualifying military service must receive benefits as though the participant had returned to active employment and then died (such as immediate vesting, etc.).

# HEART Act Amendments (cont'd)

- Optional Provisions Include
  - Distribution of elective deferrals
  - Military benefit accruals on death or disability
  - Qualified reservist distributions

# HEART Act Amendments (cont'd)

## Optional Provisions

- Distribution of Elective Deferrals
  - May treat an individual who is on active duty for more than 30 days as having terminated employment for purposes of the ability to take a distribution of elective deferrals; participant suspended from making deferrals for six months.
- Military Benefit Accruals on Death/Disability
  - Plan may provide additional accruals or contributions to participants who die or become disabled while performing qualified military service.

# HEART Act Amendments (cont'd)

## Optional Provisions

- Qualified Reservist Distributions
  - Plan may provide for distribution of elective deferrals to a reservist who is ordered or called to active duty for more than 179 days (or indefinitely). Favorable repayment provisions and no suspension of deferrals required.
- Amendments for mandatory and optional HEART Act provisions are required to be adopted by the last day of the first plan year beginning on or after January 1, 2010.

# IRS Determination Letter Program

- Determination Letter Cycle Amendments
  - Cycle E is for employers with EINs that end in “5” or “0” that wish to file for a determination letter
    - *Plans must be amended to include items on the IRS’s Cumulative List*
    - *Plans must submit the determination letter application to the IRS by January 31, 2011*

# Transfers and Spin-offs to Puerto Rico Plans

- Transfers or spin-offs from a dual-qualified (United States and Puerto Rico) plan funded through a U.S. trust to a Puerto Rico-only qualified plan are generally prohibited and such a transfer is generally taxable to participants and can affect the U.S. tax-qualified status of the US plan.
- Revenue Ruling 2008-40 provides a transition period, which expires on December 31, 2010, during which such transfers are permitted without any adverse tax consequences.

# Transfers and Spin-offs to Puerto Rico Plans (cont'd)

- Reasons for spin-off
  - U.S. source income issues
  - Difficulty of complying with divergent qualification requirements
- Need to act soon to meet December 31, 2010 deadline, especially for defined contribution plans

**Questions?**



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