

Automatic Rollovers of Mandatory Distributions

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The Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”) amended section 401(a)(31)(B) of the Internal Revenue Code of 1986, as amended (“Code”), to require that a mandatory distribution of more than \$1,000 must be paid in a direct rollover to an IRA unless the participant makes an affirmative election either to have the amount rolled over to another retirement plan or to receive the distribution directly.

On December 28, 2004, the Internal Revenue Service (“IRS”) issued Notice 2005-5, which provides guidance on the application and scope of EGTRRA’s automatic rollover requirements.

Note: This summary only addresses the provisions of the IRS guidance that are of interest to churches and other non-profit employers.

Plans Covered by the Automatic Rollover Rules

There had been some question about the scope of the automatic rollover requirements.¹ The IRS guidance specifically states that the automatic rollover requirements apply to the following plans:

- Church plans (including non-electing church plans)
- 403(b) plans (including 403(b)(9) church retirement income accounts)
- Governmental plans (including governmental 457(b) plans)

Distributions Covered by the Automatic Rollover Rules

Notice 2005-5 provides that the automatic rollover rule applies to any mandatory distribution of more than \$1,000 that is an eligible rollover distribution.² All amounts included in such a mandatory distribution, including amounts attributable to rollover contributions, are subject to the automatic rollover rules. Thus, for example, in the case of a church plan that provides for mandatory cash-outs of account balances under \$7,500, the automatic rollover rules apply to the entire account balance, even the portion of an account which exceeds \$5,000 (the statutory limit for which mandatory cash-outs are permitted for ERISA-covered plans).

¹ For example, it was unclear whether the automatic rollover rules applied to church plans and other plans not subject to the Code’s restrictions on mandatory cash-outs.

² Prior to this guidance, there was some question as to whether the automatic rollover rules applied to amounts in excess of \$5,000. Notice 2005-5 specifically provides that amounts in excess of \$5,000 are, in fact, subject to the new rules.

In general, a mandatory distribution is any distribution to the participant made without the participant's consent prior to the participant's attaining the later of age 62 or normal retirement age. A distribution to a surviving spouse or to an alternate payee under a QDRO is not a mandatory distribution. In addition, an eligible rollover distribution in the form of a plan loan offset amount is not a mandatory distribution. Therefore, these distributions are not subject to the automatic rollover rules.

Rollovers to Deemed IRAs

The automatic rollover rules require that a plan must roll mandatory distributions over to an IRA, unless the distributee affirmatively elects another form of distribution. However, Notice 2005-5 specifically provides that this requirement can be met by rolling the amount over to a deemed IRA that is part of the plan making the distribution.

Notice to Participants

Plan administrators must provide written notification to each participant entitled to a mandatory distribution explaining the automatic rollover requirements. Notice 2005-5 states that this notice may be provided separately or as part of the Code section 402(f) notice relating to eligible rollover distributions. The notice must identify the trustee or issuer of the IRA.

Note: It will probably be more convenient to include this notice in the 402(f) notice on eligible rollover distributions which already must be provided to participants receiving mandatory distributions.

In addition to the notice given by the plan administrator, the IRA trustee or issuer must provide the participant with a disclosure statement that informs the participant of his or her right to revoke the rollover to the IRA within a 7-day revocation period.

According to the IRS, these notice requirements can be met by sending the notice to the participant's most recent mailing address in the records of the employer, even if the notice is later returned as undeliverable by the U.S. mail.

Effective Date

The new rules apply to all mandatory distributions made after March 28, 2005. Plans must be in operational compliance with these automatic rollover requirements by that date. However, plans can delay making mandatory distributions until after March 28, 2005, if the plan administrator has not yet established the administrative procedures necessary to accomplish the automatic rollovers, as long as such procedures are established and mandatory distributions (including those delayed because of the absence of adequate procedures) are made on or before December 31, 2005.

There is a special transition rule for church plans if a church convention has the amendment authority over a particular plan. Such a plan has until 60 days after the close

of the earliest church convention occurring after 2005 to comply with the new requirements.

Plan Amendments

Notice 2005-5 provides that plans must adopt a good faith amendment reflecting the automatic rollover requirements by the end of the plan year ending on or after March 28, 2005. For most plans, this will mean that the amendment will need to be adopted by December 31, 2005. Notice 2005-5 includes a sample model amendment which plan sponsors can use for this purpose.

Department of Labor Regulations

On September 28, 2004, the Department of Labor (“DOL”) issued final regulations for automatic rollover of plan distributions. The final rule protects retirement plan fiduciaries from liability under ERISA by providing a safe harbor in connection with the selection of an institution to provide the individual retirement plan and the selection of investments for such plans.

These DOL rules apply only to ERISA-covered plans. Thus, there is a question as to what non-ERISA plans, such as church plans, should do to meet their fiduciary obligations with regard to complying with the automatic rollover requirements.

In general, the fiduciary responsibilities applicable to administrators of non-ERISA plans are covered under state trust law and state prudent investor statutes. However, the ERISA requirements are generally based on the common law of trusts, which also provides the same foundation underlying state trust law. Thus, courts could look to ERISA case law or regulations in analyzing state requirements applicable to non-ERISA plans. Therefore, in the absence of a full review of applicable state law that may apply to non-ERISA plans, a church plan sponsor should consider following the requirements set forth in the DOL safe harbor in making automatic rollovers. We believe such an approach would in all likelihood satisfy applicable state law fiduciary requirements.

Options for Plan Sponsors

The compliance date for the automatic rollover requirements is just a few months away. Therefore, plan administrators whose plans include a mandatory cash-out provision need to decide relatively quickly which of the two following courses of action to take:

Option 1: Make the required plan amendment, set up the necessary administrative procedures, select an IRA provider to accept the plan’s mandatory distributions, and make such distributions by December 31, 2005.

Option 2: Amend the plan by December 31, 2005 to either:

- Eliminate mandatory cash-outs completely, or
- Provide that mandatory cash-outs will only occur for account balances of \$1,000 or less, with cash-outs above \$1,000 requiring participant consent.

(In either case, the plan will not be subject to the new rules.)

Whichever option you choose, you may also want to consider making mandatory cash-outs now permitted by your plan, prior to March 28, 2005, of all accounts that would become subject to the new automatic rollover rules.

Please contact Danny Miller or Erica Summers at 202-887-5711 if you have any questions about the issues discussed above.