

ERISA Newsletter

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Nonspousal Rollover Option Becomes Mandatory in 2010

The Pension Protection Act of 2006 ("PPA") added an Internal Revenue Code provision that permits nonspouse beneficiaries who receive death benefits to roll over plan distributions if certain requirements are met. The details are complex, but in summary, the requirements are that there must be a direct trustee-to-trustee transfer from an eligible retirement plan to an IRA that is established for the purpose of receiving the plan distribution on behalf of the designated beneficiary who is a nonspouse individual. The transfer will then be treated as a direct rollover, thus avoiding inclusion in the beneficiary's taxable income (until later distributed from the IRA).

Nonspousal rollovers were not available before the new PPA provision, which became effective for distributions made after December 31, 2006. After PPA, plans were permitted to allow nonspouse beneficiaries the option of rolling over distributions, but plans were not required to provide that option.

The Worker, Retiree and Employer Recovery Act of 2008 makes the nonspousal rollover provision mandatory for plan years beginning after December 31, 2009. Plans will have to offer the rollover alternative to nonspouse beneficiaries receiving plan death benefits.

Some plans already implemented the nonspousal rollover option. However, most of those plans have not been amended to reflect the provision because, in general, amendments in response to PPA are not required until the end of 2009 (for calendar year plans). Most plans will be amended in 2009 for PPA.

If a plan allowed nonspousal rollovers in operation, the PPA amendment must identify the effective date of that permissive provision. If the plan did not previously allow nonspousal rollovers in operation, the PPA amendment must indicate that such provision will become effective January 1, 2010 (for calendar year plans). Although the deadline for adopting an amendment to reflect the new mandatory provision is arguably later, we see no reason not to include it with the PPA amendment in 2009.

Additionally, distribution notices and the plan's summary plan description are required to be updated to reflect this new provision.

Changes to Plan Design, Particularly Suspending Contributions, Must be Carefully Considered – Lesson Two Regarding the Economy’s Impact on Plans

Our April 2009 Newsletter discussed “Lesson One” on how the economy may require fiduciary action with respect to retirement plans. A second lesson to be learned from the impact of the economy on retirement (and health) plans is that if an employer decides to make changes to its plan, particularly to reduce contributions, such matter should be carefully considered under an umbrella of ERISA requirements.

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The rules governing the suspension or cessation of employer and employee contributions differ markedly depending on the plan type, for example, under a 401(k) plan, versus a safe harbor 401(k) plan (matching versus nonelective safe harbors are treated differently), versus a profit sharing plan, defined benefit plan, and so on and so forth. These rules also differ from plan to plan within plan types. For example, one employer may be able to cease contributions effective retroactively to the beginning of the current plan year, while other employers may be locked into contributions until the beginning of the next plan year. Some employers will have to provide certain ERISA-prescribed notices, and do so within certain deadlines; other employers will be required to simply amend their summary plan descriptions.

Some changes will require that participants be 100% vested, disregarding the vesting schedule; other changes will not require full vesting. Some changes will require plan amendments, whereas others will not. Some changes should be reviewed by the Internal Revenue Service (and other ERISA agencies) for approval; others will not warrant such approval.

With respect to health, cafeteria and other welfare plans that may be affected by the current crisis, other legal considerations come into play. As with retirement plans, the Internal Revenue Code and ERISA requirements will differ from plan to plan. Moreover, the variation of plan language in such documents will produce different conclusions for different employers with the same plan design objectives.

Following the proper law and procedures is critical for at least the following three reasons:

- (a) to ensure that the ceasing of contributions or other plan design changes will not be successfully challenged by the Internal Revenue Service, the Department of Labor, or the plan participants;
- (b) to ensure that the tax-qualified status of the plan is not adversely affected; and
- (c) to avoid applicable government penalties.

Three take-home points are:

- (a) common sense assumptions regarding these matters should be immediately dismissed;
- (b) conveying any information to employees before the issues are properly analyzed and addressed is imprudent; and
- (c) we recommend you consult with us early on in the consideration process.

IRS Posts Information Regarding its Review of Plan Processes

The Internal Revenue Service has posted information on its website that may be helpful to plan sponsors. The posting is part of the Employee Plans Team Audit program ("EPTA"), which is aimed at large plans.

The information consists of "internal control" questionnaires. The questionnaires can be accessed at <http://www.irs.gov/retirement/article/0,,id=206492,00.html>.

The questionnaires consist of the questions that an Employee Plans examiner will pose to a plan sponsor in the course of an examination. The questionnaires are aimed at four categories: (1) human resources, (2) payroll, (3) plan failures, and (4) plan administration. Of course, there will be some overlap among these categories. The questionnaires are a roadmap of the issues that will be raised during an inquiry by the IRS.

Examples of some of the questions are as follows:

1. What procedures or checks and balances do you have in place to identify operational failures?
2. Do you know of any operational or form failures with the plan?
3. Have the failures been corrected and how were they corrected?
4. What steps does the employer take to identify all members of the controlled group to the plan administrator?
5. What is your process for determining eligibility?
6. If errors are found during the administrative process, what is the process for resolving such errors?
7. Do you have any leased employees?

The IRS' dissemination of this information should prompt plan sponsors to carefully consider the questions to ensure they will have answers to those questions in the event of an inquiry, and also in general to ensure that there is an adequate recognition of responsibility and coordination.

To reduce or eliminate sanctions, discovering and properly correcting plan failures (for example, by utilizing the IRS Employee Plans Compliance Resolution System and/or Department of Labor correction programs) before government discovery will be critically important to the plan sponsor in the event of an audit.

Firm News

John Hughes was elected President of the Boise Chapter of the Western Pension & Benefits Conference. His two year term began on July 1, 2009.

This bulletin is intended to provide general information only and does not provide legal advice. This bulletin does not discuss potential exceptions to the above rules. The application of ERISA laws can be complex. For information regarding the impact of these developments under your particular facts and circumstances, please call us. This material may also be considered attorney advertising under court rules of certain jurisdictions.