

THE ERISA LAW GROUP, P.A.

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March 23, 2005

March 28 Deadline—Please Review¹

To Our Clients and Friends:

Re: **Automatic IRA Rollovers of Small Accounts**

We are writing to make you aware of recent IRS and DOL guidance for automatic rollovers of small accounts. The Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”) changed the legal requirements with respect to cash-outs from certain qualified plans. Most plans provide for “cash-outs,” meaning that if the participant’s vested benefits are \$5,000 or less when he/she is entitled to payment, the plan is required under the document to pay that amount to the participant, whether or not the participant consents to the payment. We covered this development in our January 2005 client mailing (which I am sure you memorized). Operational compliance with the new requirements, described below, is required for distributions on or after March 28, 2005.

The new rules apply only to terminated participants who fail to elect a form of distribution and whose vested account balance is over \$1,000 and \$5,000 or less.²

Employers basically have two choices:

First choice: if you wish to retain the \$5,000 cash-out provision in your plan, you must comply with the new IRS and DOL requirements on rollovers by automatically taking the distribution and depositing it into an individual retirement account the employer will establish for the departed participant. This means you must find an IRA institution that will accept these rollovers **in conformance with the government’s requirements**. Your first inquiry likely should be with the current custodian of your plan’s investments. Once you have identified the

¹ If you are a “prototype” client, or in other circumstances, you have already received or will receive a mailing or other communication from us specific for your plan. If so, you certainly may review this, but you need not do so.

² We will call these individuals “affected participants.” For most plans, participants with \$1,000 or less who do not complete the payout forms will receive a lump sum payment, less 20% withholding, as in the past. The new IRA rollover rules do not apply to them.

institution and preliminarily received an indication from them that they will comply with the new requirements, we will need to address the necessary legal issues to protect your plan fiduciaries.³

Second choice: you can avoid the new requirements on automatic rollovers by amending your plan to lower the cash out limit to \$1,000 (meaning that if a participant has between \$1,000 and \$5,000, the participant may choose not to get paid out). This approach may be best for smaller plans, but may not be the best approach for everyone. Participants who previously could have been cashed out of your plan without their consent (because they had \$5,000 or less payable to them) would then retain their account until retirement or other distribution. You would need to keep track of them like other plan participants, and they are entitled to all of the same ERISA rights and documents as are active participants. You may also incur increased plan expenses based on per participant investment/recordkeeping charges and may need to prepare audited financial statements (depending on the circumstances). There are other potentially significant disadvantages, such as retaining fiduciary liability for them.

You must **operationally** comply with the new requirements for distributions made on or after **March 28, 2005**. This means that as of such date, **you may no longer** provide a lump sum distribution, less 20% withholding, to the affected participants. However, given the very, very late hour that the government has provided us with guidance, the IRS is permitting you to **suspend** distributions to affected participants while we get the plan's procedures and documents in shape (*e.g.*, you make your choice and amend the plan, and/or you select an IRA provider, we ensure their fees comply, enter into the agreement with them, update your plan and change your plan's administrative procedures).

If for whatever reason everything is not in place by March 28, 2005, that is not a problem. Because of the allowable suspension, you need not comply with the new rules and provide for the mandatory rollovers by March 28, 2005. You instead have until **December 31, 2005** to lift the suspension and implement the rollovers that were held in abeyance.

Furthermore, the deadline to **amend** your plan to comply with the new rules is also extended to the last day of the first plan year beginning after March 28, 2005. For a calendar year plan, this means December 31, 2005.⁴ We recommend we try to amend your plan and update applicable administrative forms sooner rather than later; but again, the government has granted us time, if it is needed.

³ For example, we will make sure that the required written agreement with the IRA provider accords with the regulations, most notably that its fee structure complies with the DOL rules, and we will amend the plan document, summary plan description and the disclosures to the affected participants as required by the new rules and otherwise. If these rules are not followed, you **retain fiduciary liability** over the IRAs of the affected participants for a period of time.

⁴ **However, for a plan with an April 1, 2005 plan year, an amendment would be required by March 31, 2005.**

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Please call me or Brian Scott of my office if you have questions.

Very truly yours,

THE ERISA LAW GROUP, P.A.

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JM/ac

cc: Brian Scott, Esq.
Geoff Thorpe, Esq.