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**Re: Mandatory Rollover of Automatic Cash-out Distributions**

Dear Clients and Other Friends:

In December, the IRS issued Notice 2005-5 providing additional guidance about mandatory rollovers of automatic cash-out distributions of \$1,001 to \$5,000. The new rules apply to distributions made by qualified plans on or after March 28, 2005. The IRS guidance supplements regulations issued by the Department of Labor last September, which were discussed in our October 8, 2004 client letter. Plan sponsors should make a decision before March 28 to either:

1. Make arrangements with an IRA vendor that will agree to accept automatic rollovers of distributions in the \$1,001 to \$5,000 range, or
2. Amend their plans to eliminate automatic cash-outs of amounts over \$1,000.

If a decision is made to eliminate automatic cash-outs over \$1,000, the amendment should probably be adopted before March 28, 2005.

Plan sponsors that decide to implement the automatic rollover provisions have more time. In that case, most plans must be amended and all automatic rollovers must be completed before the end of the first plan year ending on or after March, 28, 2005. While this gives calendar year plans considerable time, fiscal year plans may need to act much sooner.

The following summarizes the new rules and recaps the earlier DOL guidance.

**IRS Rules**

- The new rules apply to most qualified retirement plans (even if they are not ERISA plans) with the exception of 457(b) plans maintained by tax exempt organizations. Governmental plans, church plans and 403(b) plans are subject to the new rules. (However, the effective date for governmental and certain church plans is extended to 2006.)
- The new rules apply to cash-out distributions of more than \$1,000 made to participants who have not yet attained the plan's normal retirement age (or age 62 if later). The automatic rollover requirement does not apply to:
  - (a) Distributions to a QDRO alternate payee, surviving spouse, or other death benefit recipient.

(b) Distributions to participants who have attained normal retirement age. (However, if a plan's normal retirement age is earlier than age 62, the automatic rollover requirement applies to distributions before age 62 even if the participant is past normal retirement age.)

(c) Distributions of \$1,000 or less.

Note, when determining whether a distribution is more than \$1,000 for purposes of the automatic rollover rules, it appears that rollover account balances must be taken into account, even if the plan allows rollover account balances to be disregarded in determining whether spousal consent to the distribution is required.

- In lieu of an automatic rollover to an IRA chosen by the plan sponsor, the participant must be given an opportunity to elect a cash distribution or a rollover to some other IRA select by the participant.
- Either a traditional IRA or a deemed IRA (i.e., an IRA within the sponsor's 401(k) plan) can be used for the automatic rollover.
- Participants must be notified of the new rule. The notice can be included in the special tax notice (the "402(f) Notice") that is currently required in connection with distributions.
- An amendment to eliminate involuntary distributions or restrict them to amounts of \$1,000 or less will not violate the anti-cutback rule.
- If the automatic cash-out threshold is reduced to amounts of \$1,000 or less, spousal consent is still not required for distributions of \$5,000 or less, even if the plan is subject to the Qualified Joint and Survivor and Preretirement Survivor Annuity Requirements. (For this purpose, the plan can provide that rollover account balances will be disregarded.)
- As noted above, if plan sponsors want to adopt the automatic rollover rules, they will not be treated as failing to comply with the rules as long as all distributions are made by the end of the 2005 Plan Year (December 31, 2005, for calendar year plans) and a plan amendment is also adopted by that date.

### **Final DOL Rules**

- The DOL guidance provides a fiduciary safe harbor and gives broad relief for what might otherwise be prohibited transactions in connection with selecting IRAs to receive the automatic rollovers. For example, banks or other financial institutions can select themselves or an affiliate as an IRA provider in connection with the mandatory rollovers.

- The IRA must be maintained by a bank, insurance company or similar institution. As noted above, deemed IRAs under a 401(k) plan are also permissible.
- The agreement with the IRA provider must be enforceable by the participant. The agreement must provide that the funds will be invested in a product to preserve principal and provide a reasonable rate of return.
- The fees and expenses of establishing and maintaining the IRA may be charged to the account but they must be reasonable. These fees and expenses should not exceed the amounts charged for comparable IRAs that are not established in connection with the mandatory rollover rule.
- SPDs must be updated or a Summary of Material Modifications must be provided describing the automatic rollover provisions. This is in addition to the automatic rollover notice that must be given to participants and which can be included in the Code Section 402(f) Notice described above.

We have already talked to many of you regarding the implementation of the new rules. If you have not heard from us, or you have questions or need help implementing the new rules, please contact us.

Very truly yours,

Anthony R. Battles

ARB/hgn/jks