

Part III – Administrative, Procedural and Miscellaneous

Automatic Rollover

Notice 2005-5

I. PURPOSE

This notice provides guidance relating to automatic rollover provisions under § 401(a)(31)(B) of the Internal Revenue Code (“Code”) as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16 (“EGTRRA”).

II. BACKGROUND

Section 401(a)(31)(A) of the Code and §1.401(a)(31)-1 of the Income Tax Regulations provide that a distributee of any eligible rollover distribution, as defined in § 402(f)(2)(A), may elect to have such distribution paid directly to an eligible retirement plan and that such distribution must be made in the form of a direct rollover to the specified eligible retirement plan. Section 402(f)(1) requires that the plan administrator provide a written explanation to the recipient of the provisions under which the recipient may have the distribution paid directly to an eligible retirement plan as defined in § 402(c)(8) in a direct rollover.

Sections 411(a)(11) and 417(e) permit plans qualified under § 401(a) to include provisions allowing for the immediate distribution of a separating participant’s benefit without such participant’s consent where the present value of the nonforfeitable accrued benefit is less than \$5,000.

Section 657 of EGTRRA amended § 401(a)(31)(B) of the Code to require that mandatory distributions of more than \$1,000 from a plan qualified under § 401(a) be paid in a direct rollover to an individual retirement plan (i.e., an individual retirement account as described in § 408(a) or an individual retirement annuity described in § 408(b)) of a designated trustee or issuer if the distributee does not make an affirmative election to have the amount paid in a direct rollover to an eligible retirement plan or to receive the distribution directly. Section 657(a) of EGTRRA also added a notice provision to § 401(a)(31)(B)(i) of the Code which requires that the plan administrator notify the distributee in writing (either separately or as part of the § 402(f) notice) that the distribution may be paid in a direct rollover to an individual retirement plan.

Section 657(c)(2)(A) of EGTRRA directed the Department of Labor to issue regulations providing safe harbors under which 1) a plan administrator’s designation of an institution to receive the automatic rollover and 2) the initial

investment choice for the rolled-over funds would be deemed to satisfy the fiduciary responsibility provisions of § 404(a) of the Employee Retirement Income Security Act of 1974 ("ERISA").

Section 657(d) of EGTRRA provided that the § 401(a)(31)(B) of the Code requiring automatic rollovers of certain mandatory distributions to individual retirement plans will not become effective until the Department of Labor issues safe harbor regulations.

On September 28, 2004, the Department of Labor issued final regulations (29 CFR § 2550.404a-2) pursuant to § 657(c)(2)(A) of EGTRRA. 69 FR 58017. Section 2550.404a-2 of those regulations establishes a safe harbor under which a fiduciary of an employee pension benefit plan subject to Title I of ERISA will be deemed to have satisfied his or her fiduciary duties under § 404(a) of ERISA in connection with an automatic rollover of a mandatory distribution described in § 401(a)(31)(B) of the Code. Section 2550.404a-2(c) provides the conditions under which a fiduciary qualifies for the safe harbor described in the preceding sentence. The safe harbor contained in § 2550.404a-2 applies only to employee pension benefit plans covered under Title I of ERISA. The safe harbor contained in § 2550.404a-2 also applies to automatic rollovers of \$1,000 or less.

III. QUESTIONS AND ANSWERS

Q-1. To what distributions do the automatic rollover requirements of § 401(a)(31)(B) apply?

A-1. The automatic rollover requirements apply to any mandatory distribution that is more than \$1,000 and is an eligible rollover distribution that is subject to the direct rollover requirements that are in § 401(a)(31). Thus, in order for a plan that provides for such mandatory distributions to be qualified under § 401(a), it must satisfy the automatic rollover provisions of § 401(a)(31)(B). Pursuant to Q&A-16 of § 1.401(a)(31)-1 of the Income Tax Regulations, an eligible rollover distribution in the form of a plan loan offset amount is not subject to the automatic rollover provisions of § 401(a)(31)(B).

Q-2. What is a mandatory distribution?

A-2. A mandatory distribution is a distribution that is made without the participant's consent and that is made to a participant before the participant attains the later of age 62 or normal retirement age. A distribution to a surviving spouse or alternate payee is not a mandatory distribution for purposes of the automatic rollover requirements of § 401(a)(31)(B). Although § 411(a)(11) generally prohibits mandatory distributions of accrued benefits attributable to employer contributions with a present value exceeding \$5,000, the automatic rollover provisions of § 401(a)(31)(B) apply without regard to the amount of the distribution as long as the amount exceeds \$1,000.

Q-3. How is the automatic rollover requirement of § 401(a)(31)(B) satisfied?

A-3. In order to satisfy the automatic rollover requirement of § 401(a)(31)(B), a plan must provide that, when making a mandatory distribution that exceeds \$1,000 and that is an eligible rollover distribution, if, after receiving the notice described in § 402(f), a participant fails to elect to receive a mandatory distribution directly or have it paid in a direct rollover to an eligible retirement plan, the distribution will be paid in a direct rollover to an individual retirement plan.

Q-4. When do the automatic rollover provisions of § 401(a)(31)(B) become effective with respect to mandatory distributions?

A-4. The automatic rollover requirements of § 401(a)(31)(B) apply to mandatory distributions made on or after March 28, 2005. Thus, the automatic rollover requirements of § 401(a)(31)(B) do not apply to mandatory distributions made prior to March 28, 2005. Section 657(d) of EGTRRA provides that the requirements of § 401(a)(31)(B) of the Code requiring automatic rollovers of mandatory distributions to individual retirement plans do not become effective until the Department of Labor prescribes final regulations implementing a fiduciary safe harbor related to automatic rollovers. The final regulations issued by the Department of Labor on September 28, 2004, provide that the regulations apply to any rollover of mandatory distributions made on or after March 28, 2005.

Q-5. Do the automatic rollover requirements of § 401(a)(31)(B) apply to governmental plans as described in § 414(d)?

A-5. Yes, the automatic rollover requirements apply to governmental plans (within the meaning of § 414(d)) that are required to comply with § 401(a)(31), even though these plans are not subject to the provisions of § 411. Thus, for example, in order for a plan of a state or local government to be qualified under § 401(a), the plan must comply with § 401(a)(31)(B). However, governmental plans will not be treated as failing to satisfy the requirements of § 401(a)(31)(B) if the automatic rollover provisions are not applied to mandatory distributions from such plans that are made prior to the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2006.

Q-6. Do the automatic rollover provisions of § 401(a)(31)(B) apply to governmental eligible deferred compensation plans described in § 457(b)?

A-6. Yes, § 457(d)(1)(C) provides that, in order to satisfy the distribution requirements of § 457(b)(5), a governmental eligible deferred compensation plan described in subsection (e)(1)(A) must meet requirements similar to the requirements of § 401(a)(31). However, the delayed compliance date set forth in

Q&A-5 applies. The automatic rollover requirements of § 401(a)(31)(B) do not apply to non-governmental § 457(b) plans.

Q-7. Do the automatic rollover provisions of § 401(a)(31)(B) apply to § 403(b) plans?

A-7. Yes, § 403(b)(10) provides that rules similar to the rules of § 401(a)(31) apply to § 403(b) plans. Thus, the automatic rollover provisions of § 401(a)(31)(B) apply to annuity contracts described in § 403(b)(1), custodial accounts described in § 403(b) (7), and retirement income accounts described in § 403(b)(9). If a § 403(b) plan is a governmental plan within the meaning of § 414(d), then the delayed compliance date in A-5 applies.

Q-8. Do the automatic rollover provisions of § 401(a)(31)(B) apply to church plans within the meaning of § 414(e) with respect to which the election provided in § 410(d) has not been made?

A-8. Yes, the requirements of § 401(a)(31)(B) of the Code apply to non-electing church plans even though these plans are not subject to the provisions of § 411. However, a non-electing church plan maintained for which the authority to amend the plan is held by a church convention (within the meaning of § 414(e)(3)) will not be treated as failing to satisfy the requirements of § 401(a)(31)(B) if the automatic rollover provisions are not applied to mandatory distributions from such plan that are made prior to the date that is 60 days after the close of the earliest church convention that occurs on or after January 1, 2006.

Q-9. If a plan that provides for mandatory distributions does not make a distribution to a participant who fails to affirmatively elect direct payment or a direct rollover for a mandatory distribution on or after March 28, 2005, because the plan administrator has not sufficiently established administrative procedures that allow the plan administrator to accomplish the automatic rollover of a mandatory distribution by that date, will the plan be treated as failing to operate in accordance with its terms?

A-9. No, a plan will not be treated as failing to operate in accordance with its terms (including the automatic rollover provisions) with respect to mandatory distributions merely because it does not process mandatory distributions for which the participant does not affirmatively elect direct rollover or direct payment due to a lack of sufficient administrative procedures for automatic rollovers, including establishing individual retirement plans to accept automatic rollovers, provided the mandatory distributions are made on or before December 31, 2005.

Q-10. Can a plan administrator set up an individual retirement plan for a participant who is receiving a mandatory distribution and who has not elected to have such distribution paid directly to an eligible retirement plan in a direct rollover or to receive the distribution directly?

A-10. Yes, if a participant receiving a mandatory distribution fails to elect to have such distribution paid to an eligible retirement plan in a direct rollover or to receive the distribution directly, the plan administrator may execute the necessary documents to establish an individual retirement plan on the participant's behalf with a financial institution selected by the plan administrator.¹ For this purpose, the plan administrator may use the participant's most recent mailing address in the records of the employer and plan administrator. The trustee or issuer of the individual retirement plan must provide a disclosure statement to the participant and provide a revocation period as prescribed in § 1.408-6. The trustee or issuer of the individual retirement plan will not be treated as failing to satisfy the disclosure requirements of § 1.408-6 merely because the disclosure statement is returned by the United States Postal Service as undeliverable after it was mailed to the participant using the address for the participant provided by the plan administrator as the participant's most recent mailing address in the records of the employer and plan administrator.

Q-11. May a mandatory distribution be paid to an individual retirement account under § 408(c) or a deemed individual retirement account under § 408(q) that is part of the plan that is making the distribution?

A-11. Yes, a mandatory distribution may be paid to a participant's individual retirement account that meets the requirements of § 408(c) or to a participant's deemed individual retirement account that meets the requirements of § 408(q).

Q-12. Can a plan sponsor eliminate mandatory distributions from its plan without violating the anti-cutback provisions of § 411(d)(6) of the Code?

A-12. Yes, § 1.411(d)-4, A-2(b)(2)(v), provides that a plan sponsor may amend or change a plan to eliminate a provision which requires the plan to make a mandatory single-sum distribution to participants pursuant to § 411(a)(11) without violating § 411(d)(6).

¹ The staffs of the federal functional regulators that issued joint regulations requiring financial institutions to implement customer identification programs ("CIP") pursuant to § 326 of the USA PATRIOT Act have interpreted these regulations to require that when a plan administrator transfers funds of a former employee to a financial institution pursuant to § 401(a)(31)(B), the financial institution will not be required to implement its CIP until the former employee first contacts such institution to assert ownership or exercise control over the account. Accordingly, CIP compliance is not required at the time an employee benefit plan establishes an account and transfers the funds to the bank or other financial institution for purposes of a complying with the automatic rollover requirements of § 401(a)(31)(B).

Q-13. If a plan is subject to the joint and survivor annuity and preretirement survivor annuity requirements of § 401(a)(11) and the plan provides that an accrued benefit greater than \$1,000 but not greater than \$5,000 will be distributed to a participant only with the consent of the participant, would a distribution of such an accrued benefit be subject to spousal consent requirements?

A-13. No. Section 1.417(e)-1(b)(2)(i) provides that no spousal consent is required before the annuity starting date if the present value of the nonforfeitable benefit is not more than the cash-out limit in effect under § 411(a)(11).

Q-14. Are amounts attributable to rollover contributions that exceed \$5,000 subject to the automatic rollover provisions of § 401(a)(31)(B)?

A-14. Yes. Section 401(a)(31)(B) applies to the entire amount of a mandatory distribution. Thus, for example, the portion of the distribution attributable to a rollover contribution is subject to the automatic rollover requirements of § 401(a)(31)(B), even if that amount is excludable (under § 411(a)(11)(D)) from the determination of whether the present value of the nonforfeitable accrued benefit exceeds \$5,000.

Q-15. Is a plan administrator required to notify a participant to whom a mandatory distribution is going to be made that, absent the participant's affirmative election, the distribution will automatically be paid to an individual retirement plan in a direct rollover?

A-15. Yes. Section 401(a)(31)(B)(i) requires that the plan administrator notify the participant in writing (either separately or as part of the § 402(f) notice) that, absent an affirmative election by the participant, the distribution will be paid to an individual retirement plan. The notice must identify the trustee or issuer of the individual retirement plan. A plan administrator will not be treated as failing to satisfy this notice requirement merely because the notice is sent using electronic media in accordance with A-5 of § 1.402(f)-1. Further, for an eligible rollover distribution paid as an automatic direct rollover, a plan administrator will not be treated as failing to satisfy this notice requirement or section 402(f) with respect to an eligible rollover distribution merely because the notice is returned as undeliverable by the United States Postal Service after having been mailed to the participant using the participant's most recent mailing address in the records of the employer and plan administrator.

Q-16. When must a plan that provides for mandatory distributions be amended to include a provision that satisfies the requirements of § 401(a)(31)(B)?

A-16. Plans that provide for mandatory distributions and that do not already include the automatic rollover provisions must adopt a good faith plan amendment reflecting the automatic rollover requirements by the end of the first

plan year ending on or after March 28, 2005 (or in the case of a governmental plan in accordance with A-5). Included in the Appendix is a sample plan amendment that individual plan sponsors and sponsors (or volume submitter practitioners) of pre-approved plans can adopt or use in drafting individualized plan amendments. This sample plan amendment, or a plan amendment that is materially similar to this sample, will be a "good faith" plan amendment. The adoption of this sample amendment by a sponsor (or volume submitter practitioner) of a pre-approved plan will not cause such a plan to be treated as an individually designed plan. If a plan is amended by a timely good faith amendment reflecting the automatic rollover requirements, a plan amendment to a disqualifying provision related to the automatic rollover requirements can be made within the plan's EGTRRA remedial amendment period to the extent necessary to satisfy the automatic rollover requirements, as interpreted in published guidance. See § 2.03, Rev. Proc. 2004-25, 2004-16 IRB 791. To the extent necessary, such a remedial amendment may be made retroactively effective as of March 28, 2005, or, if later, the date on which the plan becomes subject to the automatic rollover requirements of § 401(a)(31)(B).

DRAFTING INFORMATION

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APPENDIX

Section 401(a)(31)(B) Sample Amendment

"In the event of a mandatory distribution greater than \$1,000 in accordance with the provisions of section _____, if the participant does not elect to have such distribution paid directly to an eligible retirement plan specified by the participant in a direct rollover or to receive the distribution directly in accordance with section(s) _____, then the plan administrator will pay the distribution in a direct rollover to an individual retirement plan designated by the plan administrator."