

Plan Action Required: IRS Issues Updated Safe Harbor Rollover Notices

The Internal Revenue Service recently issued (in IRS Notice 2009-68) two updated model rollover notices for use by plan administrators. The new notices update the previously issued "safe harbor" notices to reflect changes in the law and are written in a more reader-friendly manner to make it easier for recipients to understand. In light of the different tax treatment of Roth account distributions from 401(k) and 403(b) plans, the IRS issued two model "safe harbor" notices; one which applies to a designated Roth account distribution and one which applies to a distribution not from a designated Roth account. Plans using the new safe harbor notices to notify plan distribution recipients of their rollover rights, as required by Internal Revenue Code (the "Code") Section 402(f), should begin doing so no later than January 1, 2010. However, because the notices previously issued by the IRS do not reflect certain changes in law, it is suggested that the new notice(s) be used as soon as practicable.

402(f) Notice Requirement

Plan administrators for each of the following types of pension plans are required to provide participants with a written explanation of their eligible rollover distribution rights, referred to as a "402(f) notice," before making a distribution eligible for rollover: Code Section 401(a) qualified plans (including defined benefit plans making distributions in non-annuity forms, cash balance plans, Code Section 401(k) plans, profit sharing plans, money purchase plans, stock bonus plans and employee stock ownership plans), Code Sections 403(a) and 403(b) plans, and governmental Code Section 457(b) plans. An eligible rollover distribution is a plan distribution that may be rolled over to an "eligible retirement plan." However, only certain distributions, such as lump sum distributions and installments over a period shorter than the lesser of 10 years or life expectancy, may qualify as eligible rollover distributions. Other distributions, such as hardship distributions, life annuity distributions, installment distributions paid over 10 or more years and minimum required distributions pursuant to Code Section 401(a)(9), do not qualify as eligible rollover distributions. Eligible retirement plans, to which an eligible rollover distribution can be rolled over, include qualified plans (including defined benefit and 401(k) plans), 403(b) plans, IRAs and, where applicable, Roth IRAs. The 402(f) notice must be provided no later than 30 days (subject to waiver) prior to the distribution and as early as 180 days prior to the distribution.

Content of Notice

The required written explanation must describe, among other things, the conditions under which a recipient may directly transfer, in a "direct rollover," the distribution to an eligible retirement plan, the mandatory 20% federal income tax withholding that applies if an eligible distribution is not directly transferred to an eligible retirement plan, the timeframes by which a recipient must rollover the distribution (other than in a direct rollover) to an eligible retirement plan to avoid taxation on the rollover, and the situations where the distribution may be subject to restrictions and tax consequences after the rollover which are different from those applicable to a distribution from the distributing plan.

Use of the IRS Safe Harbor Notices

While a plan administrator may satisfy its 402(f) notice obligations by drafting its own notice (so long as the individually prepared notice includes the information required by Code Section 402(f)), Treasury regulations provide that a plan administrator will be deemed to satisfy its Code Section 402(f) notice obligations if it uses the model notice published by the IRS. In 2002, the IRS published a 402(f) model notice in Notice 2002-3. The "safe harbor" notices recently

published by the IRS update the prior IRS notice to reflect subsequent legal developments that affect the information that must be included in a 402(f) notice, including the Pension Protection Act of 2006, the Heroes Earnings Assistance and Relief Tax Act of 2008 and the Worker, Retiree and Employer Recovery Act of 2008. For example, the updated safe harbor notices include discussions regarding: Roth contributions, automatic rollovers of benefits which are more than \$1,000 and less than \$5,000, rollovers to Roth IRAs, non-spousal rollovers of eligible rollover distributions and the elimination of the Code 72(t) early withdrawal penalty tax for qualified reservist distributions.

A plan sponsor may modify the new notices issued by the IRS to reflect the particular terms of the plan, and omit explanations that are not relevant to the plan. For example, a plan which does not allow participants to make after-tax contributions may omit the discussion on distributions of after-tax contributions, which is included in the new IRS notices.¹ Finally, plan administrators will need to update the IRS safe harbor notices in the future to reflect relevant legal developments that occur subsequent the issuance of the safe harbor notices, in order to remain in compliance with the 402(f) notice requirements.

The IRS has noted that both model notices should be used if an individual is eligible to receive eligible rollover distributions from both a designated Roth account and from a non-Roth designated account in a 401(k) or 403(b) plan.

Unless the rules described in the model notices later change, plan administrators using the model notices contained in Notice 2009-68 will be deemed to satisfy the 402(f) notice requirements. The IRS indicated that it expects to publish a Spanish translation of these new notices. Plans using the old model notice published in IRS Notice 2002-3 (but revised, as applicable, to reflect applicable pension law changes since such Notice was published) will continue to be deemed to satisfy the 402(f) notice requirement, with respect to notices provided through December 31, 2009. But for most plan sponsors, it will be advisable to start using the new notices as soon as possible.

The new safe harbor notice for a designated Roth account distribution can be found at http://www.pbwt.com/docs/images/alerts_newsletters/Roth_Distribution_Notice.pdf and the new safe harbor notice for a distribution not from a designated Roth account can be found at http://www.pbwt.com/docs/images/alerts_newsletters/Notice_Other_than_Roth_Distribution.pdf. Members of the Employee Benefits and Executive Compensation Practice Group at Patterson Belknap Webb & Taylor LLP, listed below, are available to discuss any questions you may have regarding the 402(f) notice requirements, and to assist you in preparing compliant 402(f) notices that reflect the particular terms of your plans that are subject to the notice requirements. ♦

Endnotes

- 1 It should be noted that the newly issued safe harbor notices do not include a discussion of the special rollover rules that apply if a defined contribution plan has allowed participants to receive a distribution of amounts that would otherwise represent required minimum distribution but for the special waiver of such distributions for 2009. While formal notice is not required of these provisions, plan sponsors may wish to provide participants with information about them. Information regarding the permitted waiver of 2009 required minimum distributions from defined contribution plans and its implications for eligible rollover distributions can be found in the Firm's recently issued Client Alert "IRS Issues Guidance on 2009 Required Minimum Distributions for Defined Contribution Retirement Plans," which can be found at <http://www.pbwt.com/resources/publications/irs-2009-required-minimum-distributions/>.

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