

EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

LEGAL PERSPECTIVES

January 2003

IRS Issues Guidance on “Deemed IRAs”

The Internal Revenue Service has issued guidance for employers that wish to amend their qualified plans to provide for “deemed IRAs.” This guidance includes a sample amendment, which would allow a qualified plan to provide for deemed IRAs.

Background

The Economic Growth and Tax Relief Reconciliation Act of 2001 included a provision which allows qualified plans to provide for deemed IRAs for plan years beginning after December 31, 2002. Deemed IRAs are separate individual retirement accounts or annuities established by an employer under a qualified retirement plan. Only qualified plans which permit voluntary participant contributions (for example, 401(k) plans) may provide for deemed IRAs. Deemed IRAs may be either traditional IRAs or Roth IRAs. Deemed IRAs are subject to all the rules and regulations that apply to IRAs (except for the requirement that an IRA not be commingled with other assets). Deemed IRAs are treated as individual retirement accounts or annuities rather than qualified plan accounts.

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Requirements for Deemed IRAs

A qualified plan which provides for deemed IRAs must account separately for the deemed IRA contributions and earnings. The IRA rules — not the qualified plan rules — generally apply to deemed IRAs. This means that many of the rules applicable to qualified plans, for example, nondiscrimination requirements and certain reporting and disclosure requirements, will not apply to deemed IRAs held under a qualified plan. However, deemed IRAs will be subject to ERISA’s fiduciary and enforcement provisions, including its claims procedures.

Because deemed IRAs are subject to the rules and regulations applicable to IRAs generally, certain / *continued page 2*

Deemed IRAs

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limitations apply. For example, IRA contribution limits will apply. In 2003, the aggregate contribution limit that may be made to an IRA or Roth IRA is \$3,000 (\$3,500 if age 50 or over). However, the actual amount that a participant may contribute as well as the deductibility of a contribution to a deemed IRA will depend upon the type of IRA and the participant's adjusted gross income. Deemed IRA contributions for a taxable year may be made until April 15 of the following year. Finally, participants who have reached age 70 1/2 may contribute only to deemed Roth IRAs (subject to limitations).

Advantages and Disadvantages of Deemed IRAs

There are a number of advantages to adding deemed IRAs to a qualified plan. Contributions to deemed IRAs and earnings on those contributions will increase plan assets which, in some cases, may reduce plan investment fees. Qualified plans which

additional costs and time requirements associated with deemed IRAs. There are also additional costs and time requirements associated with plan amendments and employee communications such as updated summary plan descriptions, summaries of material modifications and related documents.

Open Issues

The IRS has not yet issued certain regulations addressing deemed IRAs. These regulations are expected to be released soon and will provide additional guidance on deemed IRAs. Hopefully, these regulations will address a number of open issues regarding deemed IRAs, including, for example, whether deemed IRA assets must be held in a separate trust under the plan, how to allocate expenses between deemed IRA assets and other qualified plan assets and how to report the deemed IRA assets.

Plan Amendments

If you decide to offer deemed IRAs, your plan documents will need to be amended to include the deemed IRA provisions no

Deemed IRAs provide participants with “one-stop” access to their IRAs and qualified plan accounts.

provide for automatic cash-outs of amounts of \$5,000 or less will be required to rollover cashed-out amounts greater than \$1,000 but not more than \$5,000 to “default IRAs” under the plan, unless the participant elects otherwise. The requirement to make mandatory rollovers to default IRAs will apply to distributions made after the Department of Labor issues final regulations on these rules. Once the mandatory default IRA rollover provisions are in effect, deemed IRAs may be used as default IRAs to satisfy this requirement in certain cases.

Participants also benefit from deemed IRAs. Deemed IRAs provide participants with “one-stop” access to their IRAs and qualified plan accounts. Participants who terminate employment may be more likely to leave their retirement funds in the qualified plan instead of rolling over the funds to a separate IRA outside the plan.

There are certain disadvantages to deemed IRAs. Because deemed IRAs must be accounted for separately and administered differently from other qualified plan accounts, there are

later than the date the plan first accepts deemed IRA contributions. However, if you wish to offer deemed IRA accounts during the 2003 plan year, the amendment does not need to be made until the end of such plan year. The IRS has issued a model amendment to add deemed IRAs to qualified plans. However, additional amendments will be required to incorporate the rules applicable to IRAs generally.

Next Steps

Deemed IRAs are optional — not required. If you are considering amending your qualified plan to provide for deemed IRAs, contact your plan administrator and legal counsel to discuss the administrative and legal issues.

If you have any questions about deemed IRAs or are considering amending your qualified plan to provide for deemed IRAs, please contact us. ☎

IRS Issues Guidance on Waivers of 60-Day Rollover Deadline

The Internal Revenue Service has issued guidance on waivers of the 60-day deadline for rollovers to “eligible retirement plans” including individual retirement arrangements (“IRAs”), qualified plans and 403(b) annuity plans.

Background

Currently, if an individual receives a distribution from an eligible retirement plan and does not roll the funds into another eligible retirement plan within 60 days of the distribution date, the individual must include the amount of the distribution as taxable income. For distributions after December 31, 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 provided that, in certain cases, the IRS could waive the 60-day deadline “where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster or other events beyond the reasonable control of the individual subject to such

In some cases, individuals will not need to apply for an IRS waiver of the 60-day deadline.

requirement.” Conference committee reports on EGTRRA provided examples of such situations, including errors committed by financial institutions and failure to complete the rollover because of death, disability, hospitalization, incarceration or postal error. The new IRS guidance sets out the administrative requirements for the waivers.

Waiver Applications

To take advantage of the new waiver, individuals generally will need to file an application for a waiver with the IRS using the same procedure outlined in Revenue Procedure 2003-4 which is used for obtaining IRS letter rulings. There is a \$90 fee for the filing. The IRS may then issue a ruling waiving the 60-day rollover deadline, taking into account all relevant facts and circumstances including:

- ⊙ whether the inability to complete a rollover was due to an error committed by a financial institution (see also Automatic Waivers below);
- ⊙ whether the inability to complete a rollover was due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error;
- ⊙ whether the amount distributed was used (for example, whether the check was cashed); and
- ⊙ how much time has elapsed since the distribution.

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Employee Plans — New Law Action Checklist

401(k) PLANS — BLACKOUT PERIOD RESTRICTIONS

The Department of Labor recently finalized guidance on blackout restrictions under individual account plans, such as 401(k) plans. These restrictions apply to both public and private companies and became effective January 26, 2003. See page 4.

HEALTH PLANS — HIPAA PRIVACY RULES

Beginning April 14, 2003, new privacy rules under the Health Insurance Portability and Accountability Act of 1996 take effect for most health plans. The new HIPAA privacy rules are designed to protect individuals against disclosure of personal health information to unnecessary parties. Sponsors of health plans subject to the new privacy rules must take action to insure that the privacy rights of participants are protected. These actions include, for example, (1) updating contracts with “business associates” (such as claims processors, attorneys and recordkeepers) to insure that participant privacy is protected, (2) providing notice to health plan participants of their privacy rights under HIPAA, (3) preparing written participant authorization forms to allow necessary disclosures of private information to certain parties, (4) amending plan documents, (5) providing certifications to plans and insurers, (6) training employees and (7) providing records and compliance reports to the Secretary of Health and Human Services. Many of these actions are time consuming and must be taken in advance of April 14, 2003, to ensure compliance with HIPAA regulations.

Rollover Waivers

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Automatic Waivers

In some cases, individuals will not need to apply for an IRS waiver of the 60-day deadline. An automatic waiver may be granted if:

- ⊙ a financial institution receives funds on behalf of an individual before the expiration of the 60-day rollover;
- ⊙ the individual follows all procedures required by the financial institution including giving instructions to deposit the amounts into an eligible retirement plan; and

- ⊙ the funds are not deposited within the 60-day period because of an error by the financial institution.

Automatic approval is only granted, however, if:

- ⊙ the funds are deposited to an eligible retirement plan within one year of the beginning of the 60-day rollover period; and
- ⊙ if the financial institution had deposited the funds as instructed, the rollover would have been a valid rollover.

Effective Date

The waiver rules are effective for distributions made after December 31, 2001. ⊙

DOL Finalizes Rules on Blackout Period Notice Requirements

On January 24, 2003, the Department of Labor, Pension Welfare and Benefits Administration issued final rules relating to notice of blackout periods to participants and beneficiaries and the related civil penalties for failure to provide such notices. Although the final rules are nearly identical to the interim final regulations released late last year (see our December 2002 newsletter), there are a few changes:

- ⊙ The blackout period notice now must either specify the length of the blackout period by reference to the expected beginning and ending dates of the blackout period or the “calendar week” during which the blackout period is expected to begin and end. “Calendar week” means a seven-day period beginning on Sunday and ending on Saturday.
- ⊙ Plan administrators must provide all participants and beneficiaries with readily available, free access to information as to whether the blackout period has begun or ended, such as a toll-free number or access to a specific web site.
- ⊙ For purposes of the notices which must be furnished to an issuer of employer securities, if the issuer designates the plan administrator as the person for service of notice, the issuer will be deemed to have been furnished notice on the same date as notice is furnished to all affected participants and beneficiaries.
- ⊙ To satisfy the exclusion from coverage for these blackout period notice requirements for regularly-scheduled blackout periods, details of the regularly scheduled blackout period must be disclosed to all participants and beneficiaries in a summary plan description, summary of material

modifications, materials describing specific investment alternatives or other documents furnished to participants and beneficiaries.

- ⊙ The exclusion from the blackout notice requirements which applies to any suspension, limitation or restriction which occurs by reason of a qualified domestic relations order was expanded to exclude any restrictions imposed while a plan administrator, court or other party is determining whether an order is a QDRO.
- ⊙ Notice is not required for account restrictions triggered by individual participant actions or by reason of an action or claim by a party unrelated to the plan involving the individual participant's account.

The civil penalties for failure to timely provide the notice were essentially unchanged from those in the interim final rules, other than technical corrections related to inflation adjustments.

Please contact us if you have any questions about the final rules. ⊙

Benefits Briefs

✓ DOL Request for Comments on Automatic Rollovers

On January 7, 2003, the Department of Labor requested comments on “default IRAs” which will be required for qualified plans which have a mandatory cash-out feature. The Economic Growth and Tax Relief Reconciliation Act of 2001 added a requirement to qualified plans which provide for mandatory cash-outs of amounts of \$5,000 or less. Such plans must roll over the cashed-out amounts to a “default IRA” under the plan, unless the participant affirmatively elects otherwise. (No rollover to a default IRA is required if the cashed-out amount is \$1,000 or less). This mandatory rollover requirement will apply after the DOL issues final regulations on default IRAs. This request for comments will help the DOL draft these new regulations. The request for comments specified several key issues on which the DOL would like comments, including standards for selecting IRA custodians and trustees, standards for choosing initial investment allocations, establishment and termination costs, maintenance fees and surrender charges. The deadline for submitting comments to the DOL is March 10, 2003.

✓ DOL Issues Cost of Living Increases for Certain Penalties

The DOL has issued cost of living increases for certain monetary penalties under ERISA. Most of the Employee Retirement Income Security Act of 1974 penalties (which range from \$11 per day to \$1,100 per day) remain the same. However, the rules do increase the penalties for the following ERISA violations:

- ⊙ failure or refusal to furnish information under ERISA Section 101(g) relating to multiple employer welfare arrangements — penalties increased from \$100 to \$110 per day; and
- ⊙ failure to furnish information under ERISA Section 104(a)(6) relating to employee benefit documentation to the Secretary of Labor — penalties increased from \$100 to \$110 per day but not more than \$1,100 per request (increased from \$1,000 per request).

These increased penalties are effective for violations occurring after March 24, 2003.

✓ Cash Balance Plan Controversy Continues

As we reported in last month’s newsletter, the IRS issued proposed regulations regarding age discrimination in cash balance plans. Cash balance plans continue to be the subject of much controversy. Employee groups have spoken out against the proposed regulations and opposition to the proposed regulations has already reached Congress. Senators Harkin (D-IA) and Feingold (D-WI) offered an appropriations amendment that would have prohibited the IRS from finalizing the proposed cash balance regulations. The amendment is not included in either the House or Senate versions of the appropriations bill, but may get reintroduced when both versions are sent to the conference committee. Given the current controversy, many employers are continuing to take a wait-and-see approach in determining whether a cash balance plan will be the right option for their companies. ⊙

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Employee Benefits & Executive Compensation: Legal Perspectives

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