

New Guidance from the IRS for the New Year

WHO'S AFFECTED This guidance applies to qualified defined benefit and defined contribution plans, including multiemployer plans, governmental plans and non-electing church plans. Some of the guidance also applies to sponsors of and participants in 403(b) programs and section 457 governmental plans.

BACKGROUND AND SUMMARY In late 2002, and early 2003, the IRS issued a number of pieces of regulatory guidance relating to the operation of qualified plans.

In particular, the IRS published:

- Procedures for obtaining waivers of the standard 60-day rollover deadline ([Rev. Proc. 2003-16](#));
- An extension for the adoption of plan amendments where an employer provides for certain types of automatic health plan enrollment ([Rev. Proc. 2002-73](#));
- Guidance for offering “deemed IRAs” under qualified plans ([Rev. Proc. 2003-13](#));
- Special transition rules for the adoption of the final minimum required distribution (MRD) rules by defined benefit plans ([Notice 2003-2](#));
- An extension of the MRD amendment deadline for defined benefit plans ([Rev. Proc. 2003-10](#)); and
- Guidance for permitting retroactive increases in the compensation limit for former employees ([Rev. Rul. 2003-11](#)).

Not to be outdone, the Department of Labor (DOL) published some important pieces of guidance regarding fiduciary responsibilities during the same timeframe. The DOL guidance is discussed in detail in a separate Prudential's *Pension Analyst* titled “[DOL Provides Fiduciary Guidance](#).”

ACTION AND NEXT STEPS Plan sponsors should review the information contained in this publication to determine which items apply to their plans. In some situations, additional plan amendments may be needed or desired.

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

IN THIS ISSUE

[IRS Rollover Guidance for Plan Participants](#)

[Delayed Deadline for "Deemed Section 125 Compensation" Plan Amendments](#)

[Plans May Offer "Deemed IRAs"](#)

[Special Minimum Distribution Guidance for Sponsors of Defined Benefit Plans](#)

[Defined Benefit Plans May Increase the Compensation Limit Applied to Former Employees](#)

IRS Rollover Guidance for Plan Participants

Individuals who receive eligible rollover distributions from a qualified plan, 403(b) program, or section 457 governmental plan may roll over those distributions to an eligible retirement plan within 60 days of receipt, to avoid federal taxation of those amounts. In the past, the IRS has made very few exceptions to this 60-day rule, saying that they simply did not have the authority to do so. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) included a provision that gives the IRS this authority.

Distributions occurring after December 31, 2001, may be eligible for a waiver of the 60-day rollover period. Two types of waivers are now available: an "automatic" waiver and an "application" waiver.

An automatic waiver is provided if:

- A financial institution receives funds on behalf of the taxpayer before the end of the 60-day rollover period;
- The taxpayer depositing the funds follows all of the financial institution's procedures for making the deposit;
- The 60-day period is exceeded solely due to an error made by the financial institution;
- The funds are deposited into the eligible retirement plan within one year from the beginning of the original 60-day rollover period; and
- If the financial institution had deposited the distribution as instructed, it would have been a valid rollover.

If an automatic waiver does not apply to a payee's situation, he may apply to the IRS for an application waiver. To apply for a waiver, the individual must submit a request to the IRS for a Private Letter Ruling, along with a \$90 User Fee. The IRS will issue a waiver in situations such as casualty, disaster, or other events beyond the reasonable control of the payee. In making its decision, the IRS will consider all relevant facts and circumstances, including:

- Errors committed by a financial institution, other than those covered by the automatic waiver;
- Inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error;
- The use of the amount distributed (for example, if payment was made by check, whether the check was cashed); and
- The time elapsed since the distribution occurred.

Instructions for requesting a Private Letter Ruling can be found in IRS Revenue Procedure 2003-4, published in [Internal Revenue Bulletin 2003-1](#). An individual who is interested in obtaining an application waiver of the 60-day rollover period should consult legal counsel for assistance.

Delayed Deadline for “Deemed Section 125 Compensation” Plan Amendments

In 2002, the IRS approved certain automatic enrollment health plan designs. One of these designs did not allow employees to elect cash in place of employee-only coverage; unless they could certify that they had other health insurance coverage. In the situation where an employee could not elect cash due to this certification rule, the IRS ruled that the section 125 cafeteria plan rules did not apply. Therefore, the employee’s health insurance premiums had to be paid with post-tax dollars, rather than pre-tax dollars.

Surprisingly, this ruling had a downstream impact on qualified plans, especially 401(k) plans. Starting with years beginning after December 31, 1997, the definition of “compensation” used in determining the annual additions limits, maximum annual benefits under a defined benefit plan, identifying HCEs, and identifying key employees, has included section 125 plan deferrals. It was now not clear if these post-tax health insurance premium payments should be considered “compensation” for purposes of the annual additions limit and other plan provisions.

The IRS eventually ruled that these health insurance premiums paid with post-tax dollars may be treated as “deemed section 125 compensation” for purposes of the qualified plan compensation definition. However, in order to use this special definition, the plan sponsor must amend the qualified plan. If the plan had already been treating these premium payments as compensation, it originally had to be amended to contain a definition of “deemed section 125 compensation” by the end of the 2002 plan year. The IRS has now extended this amendment deadline to the “GUST” amendment deadline. For many plans, this deadline is September 30, 2003. See our December 2002 Prudential's *Pension Analyst* titled [“IRS Extends GUST Amendment Deadline for Prototype and Volume Submitter Plans”](#) for more information about this deadline.

It is our understanding that the cafeteria plan design that causes this problem is relatively rare. If you sponsor a cafeteria plan and are not sure if you have this design, you should talk to your health care benefits provider. If your qualified plan does need a “deemed section 125 compensation” amendment, and we provide your document services, let us know as soon as possible so that we can provide the appropriate amendment for your signature.

Plans May Offer “Deemed IRAs”

Effective for plan years beginning after December 31, 2002, certain employer-sponsored retirement plans may allow employees to make voluntary employee contributions to a separate account under the plan that meets the Individual Retirement Account/Annuity (IRA) rules. These “deemed IRA” accounts may be offered under qualified defined benefit and defined contribution plans, 403(b) programs, and section 457 governmental plans.

To offer deemed IRA accounts, plan documents must contain specific provisions. In general, deemed IRA provisions must be included in plan documents before employees can make this type of contribution. However, if a plan sponsor wants to offer deemed IRAs during the 2003 plan year, the required plan provisions do not have to be adopted until the last day of the 2003 plan year.

While the IRS has not provided specific guidance regarding the operation of deemed IRA provisions, they have published a deemed IRA model amendment that plan sponsors may adopt, if

they want to offer these accounts. Employers who use Prudential's plan documents cannot adopt this amendment and cannot offer these accounts at this time.

In the absence of IRS guidance regarding the application of qualified plan rules to deemed IRA accounts, we are still assessing the recordkeeping needs for offering this feature. If you are interested in offering this type of account to your plan's participants, please contact your Prudential Retirement Relationship Manager to discuss the feasibility of doing so.

Special Minimum Distribution Guidance For Sponsors of Defined Benefit Plans

The final, temporary and proposed minimum required distribution (MRD) regulations that the IRS published in 2002, are generally effective for distributions made after December 31, 2002. However, to enable the IRS to fully consider all the comments made regarding the rules relating to defined benefit plans, the IRS has now provided special transition rules, which will apply at least through the end of the calendar year in which final regulations are published:

- **Nongovernmental defined benefit plans** may continue to determine MRDs under either the 1987 or the 2001 proposed regulations. Plan sponsors that want to apply the 2001 rules must timely adopt the appropriate plan amendment. See our March 2001 Prudential's *Pension Analyst* titled "[IRS Issues New Minimum Distribution Regulations](#)" for additional information about these amendments.
- If the governing body of a **governmental plan** does not meet continuously, the plan will not have to comply with final MRD regulations until the first calendar year starting more than 90 days after the opening of the first legislative session that begins on or after the publication of final regulations. Until then, the plan must make a good-faith compliance effort. Following the 1987, 2001, or 2002 regulations is considered a good-faith effort.

In addition to providing these transition rules, the IRS has extended the deadline for amending defined benefit plan to adopt the 2002 final and temporary rules. The original amendment deadline was the last day of the 2003 plan year. The new MRD amendment adoption deadline is the EGTRRA amendment deadline. Currently, this deadline is no earlier than the last day of the 2005 plan year.

As a result of this extension, IRS determination letters issued for defined benefit plans that request determinations on or after the first day of the 2003 plan year will not take into account the requirements of the temporary and final MRD regulations.

As noted in our November 2002 Prudential's *Pension Analyst* titled "[IRS Publishes Additional Rules for Required Payments From Defined Benefit Plans.](#)" which discusses the 2002 final and temporary regulations, plan sponsors should consult the plan's enrolled actuary before taking any amendment action with respect to these rules.

Defined Benefit Plans May Increase the Compensation Limit Applied to Former Employees

EGTRRA increased the annual limit on the amount of a participant's compensation that may be taken into account in determining benefits under a qualified plan. Effective for plan years beginning after December 31, 2001, this limit rose to \$200,000, as adjusted for cost-of-living increases. Under the previous rules, this limit had slowly risen to \$170,000 for plan years beginning in 2001, from the original \$150,000 limit that first took effect in 1994.

In 2001, the IRS published guidance permitting plans that take pre-2002 compensation into account in determining benefit accruals to apply the \$200,000 retroactively to pre-2002 compensation when calculating post-2001 accruals. The new IRS guidance allows plan sponsors to amend non-governmental defined benefit plans to apply the higher compensation limit to all former employees or to all former employees with vested plan benefits. This type of amendment will not violate nondiscrimination rules if, under all of the relevant facts and circumstances, the plan does not discriminate significantly in favor of former Highly Compensated Employees (HCEs).

Before making this type of plan amendment, plan sponsors should review their entire benefits packages. Special care should be taken if a plan sponsor also provides a nonqualified plan for HCEs to make up for benefits lost due to the application of the qualified plan compensation limit. In addition, such plan amendments should only be made after consulting the plan's enrolled actuary.

Pension Analyst by Prudential Retirement

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