Employee Benefits E-news

December 30, 2008

Recovery Act of 2008 Changes to Employee Benefit Law

On December 23, 2008, the Worker, Retiree, and Employer Recovery Act of 2008 (the "Act") was signed into law. Many of the provisions of the Act provide technical corrections to the Pension Protection Act of 2006, and thus are of primary interest to plan actuaries and administrators. The following provisions will have a practical impact on plan sponsors, employers, and retirees.

Required Minimum Distribution Relief for 2009

Under existing law, retirees with an individual account retirement plan, including a 401(k) plan, 403(b) plan, 457 plan, or Individual Retirement Account or Annuity ("IRA"), must take a required minimum distribution ("RMD") from the plan. Under most plans, distributions must begin on the April 1st of the calendar year following the year the retiree turns 70 and a half, or if later, the April 1st after retirement. Under a traditional IRA, and for those who own 5% or more of the retirement plan's sponsor, distributions must begin as of April 1st following the year the individual turns 70 and a half, even if they have not yet retired. If the full RMD is not made, a 50% excise tax applies. The Act waives the RMD requirement for defined contribution plans for the 2009 calendar year. At the time of this publication, for 2008 the regular RMD rules apply, meaning generally that RMDs must be taken by December 31, 2008. Similar RMD relief for 2008 is under discussion. Sponsors should consider providing a notice to retirees regarding this relief. Sponsors may also want to amend their defined contribution plans, if necessary, to allow retirees to roll over the 2009 RMD distribution amount to an IRA, thus reducing the account balance before for 2010.

Employer's Deduction Limit

Employers are generally prohibited from deducting contributions they make to qualified plans to the extent the employer's combined contributions to all defined benefit and defined contribution plans exceed the greater of 25% of the annual compensation to the plan participants, or the amount contributed to the defined benefit pension plans, to the extent these contributions do not exceed the annual minimum funding standard amount. The Act clarifies this provision, so that the combined deduction limit only applies if the employer's contributions to defined contribution plans exceed 6% of participants' annual compensation. This effectively allows the employer to take a deduction for all amounts contributed to a defined benefit pension plan, without running afoul of the combined plan deduction limit, as long as contributions to defined contribution plans do not exceed 6%. If contributions to defined contribution plans exceed 6%, then the only the excess amount above 6% is counted toward the combined deduction limit.

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Non-Spouse Rollovers

Currently, qualified plans may allow a beneficiary who is not a spouse to rollover their inherited account balance from a tax-qualified plan, a 403(b) plan, or a 457 plan, into an inherited IRA. The Act makes this a mandatory plan provision, rather than permissive. A plan must also provide the beneficiary with a notice of this rollover right. This means that plans that did not previously allow these rollovers will need to be amended and will have to ensure that rollover notices are provided for plan years beginning after December 31, 2009.

Eligible Automatic Enrollment Arrangements

Under existing law, an employer can adopt an automatic enrollment provision, through which a portion of an employee's pay will be automatically deferred into a 401(k) plan, 457(b) plan, or 403(b) plan, unless the employee affirmatively elects to opt out of the arrangement. Where the automatic enrollment provision meets certain requirements, the arrangement is know as an Eligible Automatic Enrollment Arrangement ("EACA"). The advantages to meeting the EACA requirements are that EACA deferrals are not subject to state laws regarding employee wage reduction, and a plan can allow amounts contributed through an EACA to be withdrawn by a participant within the first 90 days ("permissive withdrawals"). A requirement for being an EACA is that, if the participant fails to make an investment election, the deferred amounts must be invested in a qualified default investment alternative ("QDIA"). A QDIA is generally an investment vehicle that provides a balance of equity and fixed income investments, and includes investments such as target-retirement date or life-cycle funds, individually managed accounts, and other balanced funds. The Act has now eliminated the QDIA requirement, meaning EACAs no longer must invest the deferred amounts in a QDIA if the plan participant fails to make an affirmative election. This change will be ease the rules for sponsors that do not want to invest automatically deferred amounts into a QDIA, and for EACA investments that were intended to be placed into a QDIA but the investment failed to meet the technical QDIA requirements. Since a plan using an EACA can allow permissive withdrawals, this change also broadens the circumstances under which an automatically-enrolled participant can withdraw deferred amounts from a plan. The Act further expanded the types of plans that may offer participants permissive withdrawals to include SIMPLE IRAs and SARSEPs, and clarified that permissive withdrawals are disregarded for purposes of applying the annual dollar limit on elective deferrals.

For more information about these issues, or for questions regarding any aspect of your company's retirement plans, contact your regular Butzel Long attorney, a member of the Butzel Long Employee Benefits Practice Group, or the author of this bulletin.

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