

## Retirement and Savings Initiatives

In a recent flurry of activity, the Internal Revenue Service has issued a series of notices and revenue rulings designed to promote retirement savings and address technical issues related to certain plan distributions. These initiatives are intended to: (i) encourage employers to add automatic enrollment features to their 401(k) plans; (ii) enable employees to convert unused vacation into additional retirement savings; and (iii) assist both employers and employees to better understand the available options for distributions from tax-favored retirement savings. A brief summary of the various pronouncements is set forth below.

### Expand Automatic Enrollment

Automatic enrollment 401(k) plans allow employers, in the absence of an employee's affirmative election, to withhold a specific percentage of each paycheck and make elective contributions to the plan on the employee's behalf. The employer must provide notice of the automatic enrollment feature to employees at least 30, but no more than 90 days, before the beginning of each plan year. In addition, employees must be given ample opportunity to opt out of the plan and to contribute at a different percentage. The evidence indicates that automatic enrollment boosts average participation in 401(k) plans from approximately 70 percent to 90 percent. Automatic enrollment 401(k) plans are particularly effective at increasing the participation of lower-income employees.

In Notice 2009-65, the Internal Revenue Service, intending to streamline the process of adding an automatic enrollment feature to a 401(k) plan, has provided two sample plan amendments that employers may utilize without the need for IRS approval. Adoption of either amendment (including any modification necessary to conform with the plan's terms or administrative procedures) will not affect the status of any pre-approved master or prototype

plan document, or jeopardize reliance on a favorable determination letter or opinion letter. The first sample amendment may be used to add a basic automatic contribution arrangement to a 401(k) plan. The second sample amendment may be used to add an eligible automatic contribution arrangement that permits participants to withdraw amounts automatically contributed within 90 days of the first contribution. Both sample amendments also include the option to automatically increase the plan's default contribution percentage each plan year.

An employer wishing to utilize one of the sample amendments must adopt the amendment by the later of (i) the end of the plan year in which the amendment is effective (in accordance with the IRS deadline for adopting discretionary amendments); or (ii) the deadline for adopting amendments made pursuant to the Pension Protection Act of 2006 (i.e., the last day of the first plan year beginning on or after January 1, 2009). Timely adoption of the amendment must be evidenced by a written document that is signed and dated by the employer. In addition, affected employees must be provided notice of the amendment within a reasonable period *before* the amendment is effective.

## Automatic Contribution Increases

In Revenue Ruling 2009-30, the Internal Revenue Service explains how automatic enrollment 401(k) plans may permit automatic increases in an eligible employee's default contribution percentage (i.e., so called "escalator" features). The Revenue Ruling provides two examples of how a 401(k) plan may structure these increases. The examples indicate that the scheduled increases may be based, in part, on increases in the employee's compensation, and may occur on a date other than the first day of a plan year. The examples further indicate that simple automatic contribution arrangements (i.e., arrangements not intended to comply with the designed-based discrimination safe harbor or permissible withdrawal rules) have greater flexibility to implement an escalator feature because such arrangements are not subject to the uniformity requirements.

## Contributions of Unused Vacation

Each year many employees do not use all of their paid-time-off ("PTO") benefit and many others terminate employment and receive a cash-out of their unused PTO benefit. In a pair of related rulings, Revenue Rulings 2009-31 and 2009-32, the IRS describes how employers may amend their 401(k) plans to allow the cash value of unused PTO benefits to be contributed to such plans. The first ruling describes an annual contribution of unused PTO and, subject to the normal Internal Revenue Code limits and nondiscrimination requirements, explains how such contribution may be made on an elective or non-elective basis. The second ruling provides similar guidance in the context of an employee's termination of employment. Under both rulings, the PTO contributions are not includible in the participant's taxable compensation until distributed from the applicable 401(k) plan.

## Rollover Explanation

Internal Revenue Code section 402(f) requires qualified retirement plans to provide a written explanation of the tax consequences and rollover options to any individual receiving an "eligible rollover distribution" from the plan (a "rollover notice"). Although the IRS issued a safe harbor rollover notice in 2002, it has become substantially outdated due to numerous legislative changes.

In Notice 2009-68, the IRS has issued new safe harbor rollover notice language that is designed to comply with changes in the law, provide a simplified description of the rollover options available to plan participants, and to explain certain rules that apply in special circumstances (e.g., after-tax contributions and outstanding loans). Notice 2009-68 actually contains two "plain-English" safe harbor rollover notices: one pertaining to eligible rollover distributions from a Roth account; and the other notice applicable to all other types of eligible rollover distributions.

The new question and answer format provides a much more reader-friendly explanation of some very complex rules. Plans may customize the safe harbor notices by omitting any information that does not apply. Plans may continue to use the 2002 safe harbor notice, provided it has properly modified, until the end of 2009. However, we would strongly recommend that plans begin using the new safe harbor notices as soon as possible.

## Required Minimum Distributions

The Worker, Retiree, and Employer Recovery Act of 2009 ("WRERA") added new section 401(a)(9)(H) to the Internal Revenue Code to provide for a waiver of 2009 required minimum distributions ("2009 RMDs") from defined contribution plans and IRAs. There has been significant confusion on the part of retirement plan sponsors and administrators regarding the options available with respect to the implementation of the 2009 RMD waiver. In response to numerous questions, the IRS has issued Notice 2009-82, which includes sample amendments, transition relief, and additional guidance regarding the 2009 RMD waiver.

Notice 2009-82 provides two sample amendments that may be adopted by plan sponsors to reflect how the plan will administer the 2009 RMD waiver. Both sample amendments provide participants and beneficiaries the choice between receiving and not receiving 2009 RMDs. The first sample amendment provides that the plan default that applies in the absence of a participant's (or beneficiary's) election will be to pay out the 2009 RMD. The second sample amendment provides that the plan default that applies in the absence of a participant's (or beneficiary's) election will be to not pay out the 2009 RMD. Both sample amendments also provide direct rollover choices regarding 2009 RMDs. A plan may, but is not required, to offer a direct rollover option for 2009 RMDs. If the plan does wish to provide a direct rollover option for 2009 RMDs, it may either (1) treat all 2009

RMDs as eligible rollover distributions, or (2) limit the rollover of 2009 RMDs only to those 2009 RMDs that are paid as part of a larger eligible rollover distribution.

Notice 2009-82 also contains transitional relief for any operational non-compliance for the period January 1, 2009 through November 30, 2009. Under the relief, a plan will not be treated as failing to be operated in accordance with its terms (when finally amended) for such transition period regardless of whether: (i) 2009

RMDs were or were not paid; (ii) participants and beneficiaries were not given the option of receiving or not receiving 2009 RMDs; or (iii) a direct rollover option was or was not offered for 2009 RMDs.

Finally, Notice 2009-82 provides guidance, in question and answer format, regarding technical issues related to how Code section 401(a)(9)(H) will impact the timing of rollover elections and spousal consent.

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## Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at [www.dechert.com/employeebenefits](http://www.dechert.com/employeebenefits).

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