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I. Washington Update

The Obama Administration recently released its fiscal year (FY) 2013 budget proposal [158KB, 2 pages]. Although budget proposals do not include legislative language, they identify the Administration’s priorities and may lead to legislative action. The proposals that may impact retirement programs include the following:

**Itemized Deductions and Tax Rates** – One of the new proposals in this year’s budget is to limit to 28% the rate at which taxpayers in the top two brackets can claim tax expenditures. Under this proposal, this would affect filers with 2012 adjusted gross income (AGI) exceeding $250,000 (married joint) or $200,000 (joint/single).

Although the President has called since the FY 2009 budget proposal to limit itemized deductions to 28%, he has gradually expanded this provision to – for the first time – apply to employee contributions to defined contribution retirement plans as well as deposits to individual retirement arrangements (IRAs).

Text of White House’s proposal on this issue can be found at [http://benefitslink.com/src/misc/2013_budget_proposal_reducing_dc_contribution_limit.pdf](http://benefitslink.com/src/misc/2013_budget_proposal_reducing_dc_contribution_limit.pdf) [158KB, 2 pages].

**Auto IRA** – The Automatic IRA remains the centerpiece of the Obama Administration’s retirement policy.

As in prior years, the President proposes to require all private sector employers with 10 or more employees that do not already offer a qualified plan to establish a payroll deduction IRA known as the “Automatic IRA.” All covered employees would be automatically enrolled (but could affirmatively opt out), at an initial deferral
rate of 3%. As under his FY 2012 Budget Proposal, the President would default these IRAs to a Roth characterization.

As discussed below, Representative Neal (D-MA) has reintroduced legislation to create automatic IRAs.

**Required Minimum Distributions** – The proposal would exempt small IRA accounts from required minimum distribution (RMD) requirements under Section 401(a)(9) of the Internal Revenue Code (IRC).

The proposal would exempt a taxpayer from the RMD requirements if the aggregate value of the individual’s IRA and tax-favored retirement plan accumulations does not exceed $75,000 on the “measurement date” (i.e., beginning of the year in which the individual turns 70½ or, if earlier, the year in which the individual dies); the requirement would phase in ratably for individuals with retirement benefits between $75,000 and $85,000.

While Roth IRAs are exempt from the pre-death RMD rules, Roth IRA balances would be taken into account in measuring retirement assets against the threshold (but annuitized defined benefit plan payments would not be taken into account).

**“Sense of the Congress” Resolution**

On February 16, 2012, 107 bipartisan members of the House of Representatives introduced a Sense of the Congress resolution in support of current tax incentives for retirement plan savings. Although nonbinding, the resolution provides an important marker in response to deficit and tax reform proposals that would undermine these public policies.

**Automatic IRA Legislation Introduced**

Representative Neal (D-MA) reintroduced legislation, **H.R. 4049** [190KB, 40 pages], requiring all private sector employers (other than certain new and small employers) that do not sponsor a qualified retirement plan to offer automatic IRA payroll deductions to their employees. This legislation is similar to the **Automatic IRA Act of 2011** [208KB, 50 pages], which Senators Bingaman (D-NM) and Kerry (D-MA) introduced in November 2011.

Although the Automatic IRA remains the centerpiece of the President’s retirement policy agenda, there does not appear to be bipartisan support for this concept. Given the bill’s revenue cost and the fact that it creates an employer mandate, it is not expected to advance in the current legislative climate.

**Retirement Plan Simplification and Enhancement Act**

Representative Neal (D-MA) introduced **H.R. 4050** [142KB, 67 pages], the “Retirement Plan Simplification and Enhancement Act.” This legislation will:

- Permit all required ERISA disclosures to be made available electronically (following advanced notice and with the right to opt out).
- Modify the automatic enrollment safe harbor to remove the existing 10% cap on employee deferrals.
- Amend top-heavy rules to allow employers to test participants that have not met the minimum statutory age and service requirements separately for determining required top heavy contribution requirements.
• Triple the qualified plan start-up credit.
• Direct Treasury and DOL to issue administrative guidance for Multiple Employer Plans.
• Exclude retirement savings under $100,000 from minimum required distribution rules.
• Expand the IRS’s Voluntary Correction Program (EPCRS).
• Consolidate various employee notices.

A copy of this bill can be found at [www.acli.com/Newsroom/News%20Releases/Documents/Annuities_NealBill_021412.pdf](http://www.acli.com/Newsroom/News%20Releases/Documents/Annuities_NealBill_021412.pdf) [142KB, 67 pages].

**Government Plan Definition: IRS and Treasury Events**

The Internal Revenue Service (IRS) and Department of the Treasury will be holding town halls in various locations around the country to discuss potential standards for designating retirement plans as governmental plans under section 414(d) of the Internal Revenue Code.

Information about the anticipated guidance and the current direction can be found in the Proposed Rulemaking REG-157714-06: [www.irs.gov/retirement/article/0,,id=249178,00.html](http://www.irs.gov/retirement/article/0,,id=249178,00.html).

The town hall meetings have been scheduled as follows:

- Oakland, CA – March 15, 2012
- Cleveland, OH – May 3, 2012
- Phone forum – May 15, 2012

The IRS and Treasury are seeking written comments regarding this issue that are due by June 18, 2012. In addition, a public hearing is scheduled for July 9 in Washington, D.C. on the proposed rulemaking effort. The announcement on these events can be found here: [www.irs.gov/newsroom/article/0,,id=254280,00.html](http://www.irs.gov/newsroom/article/0,,id=254280,00.html).

A separate telephone forum is being held to discuss the determination of Indian Tribal Governments as governmental plans [under Section 414(d)] on April 24, 2012.

The proposed standards for this determination can be found in the notice of Proposed Rulemaking REG-133223-08, [www.irs.gov/pub/irs-tege/reg_133223_08.pdf](http://www.irs.gov/pub/irs-tege/reg_133223_08.pdf) [137KB, 42 pages].

Information about these forums can be found at [www.irs.gov/retirement/article/0,,id=218995,00.html](http://www.irs.gov/retirement/article/0,,id=218995,00.html).
II. IRS, Treasury Release Proposed Defined Contribution Plan Annuity Guidance

The Internal Revenue Service (IRS) and Treasury have released proposed regulations and Revenue Ruling 2012-4 [25KB, 8 pages], designed to facilitate the use of annuities to provide a lifetime stream of income for defined contribution plan participants.

Revenue Ruling 2012-4

This ruling describes how full or partial rollovers from a qualified defined contribution plan to the same employer’s defined benefit plan can be converted to provide an additional annuity under the employer’s defined benefit plan. This ruling also discusses the effect on plan qualification if the defined benefit plan applies different conversion factors for calculating the additional annuity attributed to the direct rollover from a defined contribution plan.

To retain its status as a qualified plan under IRC 401(a) the defined benefit plan must not provide benefits in excess of the annual limitation on benefits (the lesser of $200,000 as indexed or 100% of the average of compensation for a participant’s highest three years of service). The rollover from the defined contribution plan will not affect the annual benefit limits in the defined benefit plan provided the rollover distribution:

- Is directly rolled over to the same employer’s defined benefit plan,
- Is used to provide an immediate annuity in the defined benefit plan, and
- The immediate annuity derived from the rollover is determined using the applicable interest rate and mortality tables found in IRC 417(e)

Example (from Revenue Ruling 2012-4)

Employer X sponsors Plan A, a profit sharing plan that is exempt from the qualified joint and survivor rules that apply to some ERISA covered plans. Plan A does not permit employee after tax contributions.

Employer X also sponsors a defined benefit plan, Plan B, which permits benefits to begin at any time after separation of service and offers several forms of annuity payments. Upon the death of the participant, the defined benefit plan is subject to the qualified joint and survivor rules resulting in the forfeiture of a portion of the accrued benefit attributed to employer contributions. Any amounts attributed to employee contributions are not subject to forfeiture.

Plan B accepts direct rollovers from Plan A for any employee or former employee who separates service after age 55 with 10 years of service and elects to receive a benefit as an additional annuity from the defined benefit plan. A participant may elect to have his profit sharing account balance directly rolled into Employer X’s defined benefit plan and select an annuity option under the defined benefit plan for the rollover amount from Plan A. The amount of the additional annuity under Plan B is determined by actuarial equivalence using interest rates and mortality tables described in IRC 417(e). Plan B requires married participants to obtain spousal consent for distributions that are not paid as a qualified joint and survivor annuity.

Thus, the amounts rolled from Plan A to Plan B:
• Are not subject to the limits that apply to benefits from the defined benefit plan because the defined benefit plan uses the IRS actuarial equivalency rules found in IRC 417(e), thus
• Plan B maintains its status as a qualified retirement plan under IRC section 401(a).

But a defined benefit plan would not satisfy the qualification requirements if the additional benefit attributed to the direct rollover is determined by a method, that produces either a larger or smaller benefit than would have been produced using the interest and mortality factors described IRC 417(e).

**Effective date**

This revenue ruling will apply to rollovers made on or after January 1, 2013, but plan sponsor can rely on this ruling for rollovers before then.

**Reference Material**

Revenue Ruling 2012-4  
III. Treasury, IRS Propose Regulations Amending RMD rules for Longevity Annuities

The Department of Treasury and Internal Revenue Service (IRS), concluded that modifying the required minimum distribution (RMD) rules will encourage plan participants to invest in a longevity annuity if it is offered under their defined contribution plan, have issued proposed regulations amending RMD rules.

These regulations, when finalized, will apply to longevity annuities purchased under 401(a) defined contribution plans, 403(b)plans, governmental 457(b) plans and IRAs.

These regulations will not apply to defined benefit plans, as such plans already provide annuity distributions.

Background

Under the RMD rules each retirement plan participant must begin taking minimum distributions from his or her retirement plan by April 1 of the calendar year following the later of age 70½ or retirement. Private sector participants who are more than 5% owners of the business sponsoring the plan and traditional IRA account holders must begin taking minimum distributions by April 1 of the calendar year following attainment of age 70½.

RMDs may be distributed over the life of the participant or lives of the participant and a designated beneficiary (defined benefit plan) or over a period not extending beyond the life expectancy of the participant or the life of participant and a designated beneficiary (defined contribution plan).

The minimum distribution rules also apply to an annuity contract held by a defined contribution plan. If an annuity contract held under a defined contribution has not yet been annuitized, its value is included in the account balance used to determine the RMD from the participant/beneficiary’s account. Under the proposed regulations participants/ beneficiaries could exclude the value of certain qualified longevity annuity contracts (QLACs) from their account balances when calculating their RMD if certain requirements are met.

QLAC Requirements

Contribution Limit

Under the proposed regulations, QLACs must be limited to the lesser of 25% of a participant’s account balance on the date of payment or $100,000. Both limits are reduced by any premiums paid for any QLAC purchased under the employer’s plan and other plans, accounts or annuities in which the employee

Definition: Qualified Longevity annuities

Longevity annuities are qualified deferred annuities:

- Purchased under defined contribution plans, including governmental 457(b) plans, and
- Begin making annuity payments at a later age – usually between 80-85.

Longevity annuities, in general, are designed to hedge the risk of outliving retirement savings or having a lower standard of living during retirement to avoid outliving retirement savings.
participates or owns, such as a traditional IRA. The plan administrator may rely on participant representations about a participant’s QLAC’s outside of the plan unless, the administrator has knowledge to the contrary.

If a premium payment causes the total premiums paid to exceed either of these limits, the contract would no longer be a QLAC on the date excess premiums were paid and the value of the QLAC would be included in the defined contribution account balance to determine the participant’s RMD. For calendar years beginning on January 1, 2014, the $100,000 limit may be adjusted for cost of living increases in $25,000 increments. If a contract failed to be a QLAC immediately before an adjustment to the dollar limit because of excess premium, the contract would still not be a QLAC because of this adjustment.

**Maximum Age**

Payments from the QLAC begin no later than age 85. The QLAC may, but is not required to, permit an earlier starting date than that specified in the contract. The maximum age requirement may be increased by the IRS in the future to reflect future improvement in mortality.

**Death Benefits**

The only benefit payable to a designated beneficiary after the death of the employee is a life annuity. Payments to a sole surviving spouse could not be greater than 100% of the amount paid to the employee. Special rules apply to QLACs distributions for non spouse beneficiaries that may reduce their distributions.

**Other Requirements**

A QLAC must also:

- State that it is intended to be a qualified longevity contract when issued,
- Be a life-only annuity contract and not a variable contract, equity indexed contract, or similar contract because these types of contracts would not provide a participant with a predictable stream of lifetime income,
- Not provide for period certain distributions, a refund of premiums feature, any commutation benefit, cash surrender value, or other similar feature,
- Satisfy the RMD requirements after distributions begin from the QLAC, and
- Meet certain disclosure and annual reporting requirements.

**Disclosure and Annual Reporting Requirements**

QLAC issuers must provide participants with both an initial disclosure prior to, or when the QLAC is purchased for them and annual disclosures thereafter. Issuers must also file annual reports with the IRS.

The initial disclosure report to participants, which is not filed with the IRS, must:

- State that the contract is intended to be a QLAC;
- Provide a plain-language description of the dollar and percentage limitations on premiums;
- Include the annuity starting date under the contract, and, if applicable, a description of the employee’s ability to choose to begin payments before the annuity starting date;
• State the amount (or estimated amount) of the periodic annuity payment that is payable after the annuity starting date as a single life annuity. If annuity payment is estimated, the assumed interest rate or rates used in making this determination must be included.
• Include a statement that there is no commutation benefit or right to surrender the contract for its cash value; and
• Describe any death benefit payable under the contract, including any differences between benefits payable before, on or after the annuity starting date in the event of the employee’s death; and
• Any other information the IRS may require.

This initial participant report should also include:
• A description of the administrative procedures associated with an employee’s elections under the contract including deadlines;
• Information about obtaining forms, and where to file them; and
• The name and contact information of the person who can provide the employee with additional information about the contract.

The report would not have to include information that the issuer has already provided to the employee to satisfy any applicable state disclosure law.

The annual report to the IRS, at a minimum, must include:
• Name, address and identifying number of the contract issuer plus contact information for more information about the contract;
• The name address, and identifying number of the person in whose name the contract has been purchased;
• If the contract was purchased under a plan, the name of the plan, the plan number and EIN of the plan sponsor;
• If payments have not begun, the annuity starting date, the amount of the periodic annuity payments and whether the date may be accelerated; and
• The amount of each premium paid for the contract and the date of the payment

A copy of the report provided to the IRS has to be given to the participant by January 31 of the calendar year following each calendar beginning with the first year premiums are paid and for each year until the participant reaches age 85 or, dies, if earlier. The IRS annual report must continue if the spouse is the sole beneficiary, until the date the benefit to the surviving spouse begins or if earlier, the death of the surviving spouse. The participant or surviving spouse would receive a copy of the report or statement that “This information is being furnished to the Internal Revenue Service.” The IRS will provide filing deadline information for annual reports to be with the IRS.

Effective date

The proposed regulations regarding disclosure and reporting will be effective upon publication in the Federal Register of the Treasury decision adopting these rules as final regulations. Otherwise, these regulations are proposed to be effective for contracts purchased on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register and for determining required minimum distributions for distribution calendar years beginning on or after January 1, 2013. Until regulations finalizing
these proposed regulations are issued, taxpayers may not rely on the rules set forth in these proposed regulations (and the existing rules under section 401(a)(9) continue to apply). These proposed regulations cannot be relied on as a basis for the final regulations meaning that the current RMD rules continue to apply.

Comments Requested

Before these regulations are finalized, the IRS would like to have written or electronic comments from the public on topics listed in the proposed regulations as well as any other comments. Comments must be received by May 3, 2012. Outlines of topics to be discussed at the public hearing scheduled for June 1 2012 must be received by May 11, 2012.

Send submissions to:

CC:PA:LPD:PR (Reg–115809–11), room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington DC 20044


Reference Material

Proposed Regulation as Published in the Federal Register
http://www.gpo.gov/fdsys/pkg/FR-2012-02-03/pdf/2012-2340.pdf [193KB, 8 pages]
IV. Court Rules Fiduciary Liable For Rollover Failure

Under ERISA, a plan fiduciary who prevents or interferes with participants receiving the benefits that they are entitled to breaches his fiduciary duty. Plan participants may go to court to recover benefits due to them under the terms of their plan, to enforce their rights under the terms of the plan, or to clarify their rights to future benefits under the terms of the plan.

Edward Klepeis, a former employee of J & R Equipment, went to the United States Federal District Court for Southern New York because his former employer refused to roll over his 401(k) account balance to an IRA of his choosing after he terminated employment. After numerous requests to have his 401(k) account balance rolled over to an IRA, Klepeis asked the court for a ruling to find his former employer had breached his fiduciary duty, restore lost earnings on his account and award attorney’s fees and costs.

Background

Klepeis began working for J & R Equipment in 1998. In 2004, Joseph Falanga, J & R’s sole owner established the J & R Equipment 401(k) plan and was the plan’s sole trustee. Klepeis enrolled in the plan as soon as he was eligible and J & R began making contributions to his account.

When Klepeis resigned from J&R in January, 2005, he asked Falanga, to roll over his 401(k) balance into an IRA that Klepeis had selected. Under J & R’s plan, participants who resign may elect to receive a distribution of their vested balance payable on or after the plan anniversary date (December 31) which coincides with or next follows termination of employment without the having to make a formal written claim for benefits. Mr. Falanga did not respond claiming that the distribution request was not the submitted properly. On December 31, 2005 Klepeis’ account balance was $63,936.41.

Klepeis’ rollover request was denied in 2007, even though he submitted a formal written rollover request on forms Mr. Falanga supplied. Falanga claimed that Klepeis’ 2007 Rollover Request was impossible to fulfill because the rollover had to be requested by the end of the plan year, December 31, 2006. He admitted that he did not know if that requirement existed under the Plan but relied on what his third party administrator told him. But, neither the Plan Document, nor other plan documents require that such a request be made before the close of the valuation year – terms that were not used or defined in any of plan documents. Notice of this requirement was never provided to plan participants.

Klepeis again submitted another written rollover request in 2008, Falanga and the plan’s third party did not comply with or explain why the plan did not honor his rollover request. Falanga contended that since the plan was being terminated and awaiting a determination from the IRS, all plan assets were frozen and could not be distributed. By 2010, Klepeis account balance decreased to $57,346.76. In January, 2011, Klepeis was notified that $57,312.76 had been transferred to IRA selected by one of the plan’s service providers.

Klepeis asked the district Court to award him $63,936.41, plus prejudgment interest and attorneys’ fees and costs. Falanga and the other defendants asked the court to deny this request.
**Analysis**

In its analysis, the Court determined that Klepeis was entitled to have his vested balance in the Plan on December 31, 2005 rolled over when he first requested the rollover in January, 2005. Under the terms of the Plan, he was entitled to distribution on the next Anniversary Date – December 31, 2005 and that Falanga breached his fiduciary duty because:

- The Plan and other plan documents do not require a formal claims process for a participant to receive benefits and Falanga in his role as the Plan Fiduciary should have given his authorization, without unreasonable delay, for the rollover request;
- Falanga failed to timely execute any of the Klepeis’ rollover requests and did not notify Klepeis that the plan was being terminated and participant assets were being frozen.

Under the terms of the Plan, if the Plan is to be terminated, plan participants have to be notified and distribution of account balances made as soon as practicable. The Court explained that even if a plan is being terminated, a plan fiduciary cannot hang on to the participant’s assets before the termination occurs or where a participant has no notice that the plan is being terminated. Moreover, Falanga could not cite any authority in the Plan or ERISA regarding timing or freezing participant assets pending plan termination requests with the IRS.

**Conclusion**

The Court concluded that Klepeis was justified in expecting to have his Plan funds rolled over to an IRA as of December 31, 2005 under the terms of the Plan and in expecting Falanga to honor Klepeis rollover request no matter what form it took. Thus Klepeis was entitled to:

- A judgment for $63,936.41 against Falanga, which would be reduced by any amount Klepeis could recover from his current rollover account;
- Prejudgment interest on his balance unless his current balance would have been the same regardless of where it had been invested-- in the Plan or an IRA he had selected; and
- Attorney’s fees and costs.

This case was referred to a Magistrate for a determination of the appropriate amount of damages, prejudgment interest, attorneys' fees and costs.

**Reference Material**

http://law.justia.com/cases/federal/district-courts/new-york/nysdce/7:2010cv00363/357223/63

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V. Keeping watch

You can find the most recent information on issues affecting governmental defined contribution plans, plan sponsors and plan participants in the Employer page of our plan website, NRSforu.com. In addition, we report guidance on legislative and regulatory activity relevant to government sector plans through:

- **Federal Legislative and Regulatory Report** – distributed monthly and posted in the Plan Sponsor Corner on the home page of NRSforu.com. It’s available online and for download.
- **Plan Sponsor Alerts** – published as needed to announce breaking news, and distributed by email and posted in the Plan Sponsor Corner of NRSforu.com.
- **457 Guidebook** – which has just been revised to include information about the Pension Protection Act of 2006; The Heroes Earnings Assistance and Relief Tax Act of 2008; Worker, Retiree & Employer Recovery Act of 2008; and The Small Business Jobs Act of 2010.

About this report

**JOANN ALBRECHT**, CPC, QPA, Compliance Manager, authors this report.

Albrecht is a member of American Society of Pension Professionals and Actuaries (ASPPA), currently serving on its Government Affairs Committee, is past chair of the ASPPA Tax Exempt and Government Plans Subcommittee and is a subject matter expert (SME) for the ASPPA Education and Examinations Committee. She is a current contributor to Aspen Publisher’s “457 Answer Book.”

**BOB BEASLEY**, CRC, CIC, Communications Consultant, edits this report.

Beasley brings 22 years of financial services communications experience to your plan. He helped prepare the four most recent editions of the **457 Guidebook**, edits countless newsletters and plan sponsor communications, and in 2001 authored “What you should know about the Economic Growth and Tax Relief Reconciliation Act of 2001.” He often voices Nationwide online presentations and telephone greetings.

Beasley serves on the Education and Communication Committee for the Profit Sharing / 401k Council of America and is a member of the National Association of Government Defined Contribution Administrators.