

IRS Issues New Versions of Section 402(f) Tax Notices for Qualified Plan Distributions

by Bradley A. Benedict

The Internal Revenue Service has issued two new safe harbor tax notices for qualified plans to provide to participants, which explain their rollover options and tax treatment when receiving an eligible distribution of plan benefits. The new notices are updated to account for changes in the law under the Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”), the Pension Protection Act (“PPA”) and other recent legislation. One notice covers distributions from designated Roth accounts and the second applies to all other kinds of distributions. Plan administrators who timely provide the safe harbor notices will be deemed to have satisfied the requirement under Section 402(f) of the Internal Revenue Code of 1986, as amended (the “Code”) to provide participants with written explanations of the tax treatment of eligible rollover distributions.

Background

Section 402(f) of the Code requires administrators of qualified plans that permit non-annuity benefit distributions (“eligible rollover distributions”) to provide participants with a written explanation of their rights to roll over such amounts to another tax-preferred plan or account. Similar notice obligations apply to a plan described in Code Section 457(b) (a “Government Plan”) and an annuity plan described in Code Sections 403(a) or (b) (an “Annuity Plan”). In 2002, the IRS provided a model safe harbor tax notice for use by plan administrators to facilitate compliance with these requirements. (See IRS Notice 2002-3.) As a result of changes in the law under EGTRRA, the PPA and other recent pension legislation, the 2002 model tax notice has become stale and can no longer be relied upon as a safe harbor. The new safe harbor tax notices, which can be found in Notice 2009-68, update the 2002 safe harbor notice to reflect the changes in the law over the last seven years.

Contents of the Updated Safe Harbor Tax Notices

Participants receiving “eligible rollover distributions” from a qualified plan or other types of plans noted above may elect to roll over all or a portion of such distributions to an eligible retirement plan, including an individual retirement account or individual retirement annuity (an “IRA”) or another qualified plan, Government Plan or Annuity Plan. Amounts rolled over may continue to receive favorable tax treatment. Only certain distributions are eligible for rollover.

The updated safe harbor tax notices explain the tax consequences of the rollover decision, the types of accounts and plans that may receive a rollover, payments that are eligible for rollover, situations in which the 10% early withdrawal penalty may apply, applicable employer withholding obligations, and a number of special rules that may pertain to certain distributees (e.g., individuals whose eligible rollover distribution includes employer stock, beneficiaries of plan participants, resident aliens, etc.).

The updated notices also explain new rules stemming from recent changes to the tax law. For example, one of the modifications under EGTRRA was to permit retirement plans to accept contributions of after-tax money as designated Roth contributions, which are maintained in a separate account. Distributions from these dedicated Roth accounts are treated differently under the Code because the contributions have already been taxed. Rollovers from Roth accounts may only be made to another designated Roth account or to a Roth IRA. In order to simplify the required Section 402(f) tax explanation provided to participants, the IRS issued two versions of the updated safe harbor notice, one for distributions from designated Roth accounts and the other for non-Roth distributions. Plan administrators should only use the Roth notice when applicable.

In addition to the rules pertaining to Roth accounts, the following recent changes in the tax law are reflected in the new safe harbor notices:

- a requirement that the plan automatically roll over to an IRA any mandatory cashout distributions exceeding \$1,000, but less than \$5,000, absent a contrary election by the participant;
- the ability for a participant to roll over amounts to a Roth IRA from an eligible employer plan (subject to an applicable income limitation);
- relief from the early withdrawal penalty for a qualified reservist distribution or a distribution from a government plan to a qualified public safety employee;
- the ability for a plan to allow a beneficiary other than the participant’s spouse to roll over a distribution (required for all qualified plans for plan years beginning on or after January 1, 2010, under the Worker, Retiree, and Employer Recovery Act);
- an exclusion allowance from the includible income of an eligible retired public safety officer for distributions used to pay health or long-term care insurance premiums for the individual or his or her spouse and dependents; and
- special treatment for “permissible withdrawals” from certain employer plans having an automatic contribution arrangement, including qualified plans, Government Plans and some Annuity Plans.

Plan administrators may appropriately customize the safe harbor notices to the plan design. For example, any inapplicable information may be omitted from the notice without jeopardizing reliance on the safe harbor. Plan administrators, however, will not be able to rely on the safe harbor notices to the extent that the

information no longer accurately describes the relevant law. Accordingly, plan administrators will need to update the notices for any amendments to the laws governing the tax treatment of distributions occurring after September 28, 2009 in order to continue to comply with Code Section 402(f).

Section 402(f) Notice Requirements

The plan administrator must provide the Section 402(f) tax notice to a plan participant no more than 180 days before the date an eligible rollover distribution is to occur and no sooner than 30 days before such date, absent a waiver by the participant. The notice may be provided by electronic means, in accordance with regulations issued by the Treasury Department. The IRS will be publishing a Spanish translation of the safe harbor tax notices shortly.

Further information is available on the IRS web page, *Retirement Topics—Rollovers of Retirement Plan Distributions*.

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