



Important Information

Distributions and Withdrawals

March 1999*

IRS Issues Cash-Out and Consent Rules For Defined Benefit Plans

WHO'S AFFECTED These rules apply to qualified defined benefit plans. They do not apply to governmental plans or to nonelecting church plans.

BACKGROUND AND SUMMARY The Taxpayer Relief Act of 1997 (TRA'97) increased the involuntary cash-out threshold from \$3,500 to \$5,000 for plan years beginning after August 5, 1997. However, TRA'97 did not address explicitly whether or not plan sponsors could apply the new limit retroactively. On December 21, 1998, the IRS published temporary rules confirming that plan sponsors could apply the increased limit retroactively in certain situations.

On December 18, 1998, the IRS also published final rules concerning the timing requirements for certain distribution and consent notices. Under these rules, a participant must receive a notice describing his payment options and, if applicable, his spouse must receive notification about the qualified joint and survivor form of payment no less than 30 days and no more than 90 days before the participant's annuity starting date. However, the 30-day minimum notice rule is waived if the participant, with applicable spousal consent, makes an affirmative election to begin receiving payments and payments do not begin before the eighth day following the date the notices were received. In addition, the final rules permit plans to provide the notices after the annuity starting date and then make retroactive annuity payments.

ACTION AND NEXT STEPS Plan sponsors should review these changes and determine the appropriate involuntary cash-out limit for their plans. Increasing a plan's cash-out limit to \$5,000 will reduce Pension Benefit Guaranty Corporation (PBGC) premiums and decrease administrative expenses. On the other hand, cashing-out a group of participants can cause financial difficulties for a plan if its current cashflow is not adequate to sustain a sudden loss of assets. If you want to change your plan's cash-out limit, please contact your Prudential Retirement representative.

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

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IRS Issues Cash-Out and Consent Rules For Defined Benefit Plans

In December 1998, the IRS published rules regarding qualified plan distributions. One set of rules provides guidance regarding involuntary plan cash-outs and the new \$5,000 threshold set by the Taxpayer Relief Act of 1997 (TRA'97). The other rules finalize the timing requirements for providing distribution and consent notices to plan participants who take voluntary distributions.

TRA'97 Involuntary Cash-Out Rules

On December 21, 1998, the IRS published temporary rules regarding involuntary cash-outs from qualified plans. TRA'97 increased the involuntary cash-out threshold from \$3,500 to \$5,000 for plan years beginning after August 5, 1997. However, the law did not address explicitly whether a plan sponsor, upon amending its plan to reflect the \$5,000 limit, could apply the increased limit retroactively. That is, could a plan now cash-out a participant whose present value of his vested accrued benefit at the time he terminated employment exceeded the plan's cash-out limit but was less than the new \$5,000 limit? The IRS has now provided guidance on this issue and other related concerns.

Applying the New Cash-Out Limit Retroactively

The new IRS rules allow plan sponsors to apply the new limit retroactively. Plans that adopt the new limit may now automatically cash-out a terminated participant whose vested accrued benefit at the time of termination was greater than \$3,500, but is now \$5,000 or less. In general, a terminated participant's vested accrued benefit may be cashed-out even if the value of that benefit at the time of termination exceeded \$5,000, if the value is now \$5,000 or less.

For example: In 1997, John Doe terminated employment with XYZ Company. At that time, the present value of John's vested accrued benefit in the XYZ Company Defined Benefit Plan was \$4,200. Since the Plan applied the \$3,500 cash-out threshold, it could not force John to take a distribution. Effective as of the first day of the 1998 plan year, XYZ Company amends the Plan to increase the plan's cash-out limit to \$5,000. The present value of John's vested accrued benefit is now \$4,800, so the XYZ Company Plan may cash-out John's vested accrued benefit without his consent or his spouse's consent. However, the Plan must still provide John with the eligible rollover distribution notice.

These retroactive cash-out rules are modified slightly if a participant is currently receiving annuity payments. A plan may cash-out remaining annuity payments only if the present value of the participant's vested accrued benefit at the time distributions began was \$5,000 or less. In addition, when considering the cash-out of remaining annuity payments under these rules, plan sponsors need to consider any limitations imposed by underlying group annuity contracts.

A decision to apply the increased cash-out limit retroactively must apply to all similarly-situated participants and should ultimately be reflected in the plan document.

Changing Interest Assumptions for Determining Present Value

The IRS has also addressed how to apply the cash-out limit when a plan is amended to reflect a new interest rate assumption for calculating the present value of accrued benefits. This is of particular concern as many plan sponsors are now, or soon will be, amending their plans to adopt the new interest rate assumptions required by the Uruguay Round Agreements Act (GATT). Under these new rules, if the present value of a participant's vested accrued benefit exceeded \$5,000 under the plan's old interest assumption when he terminated employment, but is \$5,000 or less using the new interest assumption, the plan may now cash-out the participant.

For example: On March 1, 1998, Jane Doe terminated employment with XYZ Company. Using the interest rate assumptions defined, at that time, in XYZ Company's Defined Benefit Plan, the present value of Jane's accrued benefit exceeded \$5,000. Therefore, the Plan could not cash-out Jane's benefit without her consent. On January 1, 2000, XYZ Company amends this Plan to adopt GATT interest rates for calculating single sum benefits. Using these new interest assumptions, the Plan recalculates the present value of Jane's vested accrued benefit to be less than \$5,000. The XYZ Company Plan may cash-out Jane's vested accrued benefit without her consent or her spouse's consent. However, the Plan must still provide Jane with the eligible rollover distribution notice.

Modification of the "Two-Year Rule"

The final rules also modify the existing "two-year rule" for disregarding prior service when a participant's vested accrued benefit is cashed-out under the involuntary cash-out provisions and is later rehired. Under the standard two-year rule, any distribution made by the close of the second plan year following the plan year in which the participant terminated employment is deemed to be made on account of that termination.

Under the modified rule, after March 21, 1999, a plan may make an involuntary cash-out due to a participant's termination of employment that occurred more than two years earlier if the cash-out would have been made within the standard two-year period if the \$5,000 threshold had been in effect.

Plan Amendments

Plan sponsors may amend their plan documents to provide for the increased cash-out limit for plan years beginning after August 5, 1997. However, these amendments generally do not have to be made until the last day of the 1999 plan year. In the meantime, plans may operate under the new

rules, as long as the amended plan indicates the appropriate retroactive effective date for these provisions.

Consent Rules for Voluntary Distributions

On December 18, 1998, the IRS issued final rules regarding the timing requirements for providing distribution and consent notices to a participant and, if applicable, his spouse. Specifically, the IRS confirmed that distribution notices and qualified joint and survivor annuity notices must be provided to a participant and his spouse no less than 30 days and no more than 90 days before the annuity starting date. The 30-day minimum notice requirement may be waived by a participant's affirmative election to receive a distribution and a plan may make the distribution as soon as that election is received, as long as the distribution does not require spousal consent (e.g., the participant is not married). If spousal consent is needed, the plan may begin making distributions upon receiving the participant's election and the spouse's consent to that election within the 30-day period, but no earlier than the eighth day after the notices were provided.

If a distribution is going to be made in the form of an annuity, the final rules now permit notices to be provided after the official annuity starting date. This permits plans to make retroactive annuity payments in situations where a participant has retired and distribution of the appropriate election and consent notices is delayed until after that retirement date.

These final rules apply to distributions made after September 21, 1995.

Compliance Clips

Notifying Participants of Reductions in Future Benefit Accruals

The IRS recently published final rules regarding ERISA §204(h) Notices. These rules require a defined benefit plan sponsor to notify affected parties if it intends to significantly reduce future benefit accruals. This notice requirement *does not apply* to governmental plans or nonelecting church plans.

A plan amendment "significantly reduces future benefit accruals" if it is reasonably expected to change the amount of a participant's annual benefit beginning at normal retirement age. Changes made to vesting schedules and optional forms of benefit are not taken into account when making this determination.

In these situations, the plan administrator must notify affected plan participants, beneficiaries, and employee organizations. The §204(h) Notice must be provided after the plan amendment is adopted but at least 15 days *before* the amendment's effective date. The plan administrator may hand-deliver these notices or mail them via first class mail. If the notices are mailed, the date of the U.S. postmark is considered the notification date. Currently, these notices may *not* be provided electronically and it is not clear if a bulletin board posting would be acceptable. The §204(h) Notice may be provided along with other required notices, such as a notice to interested parties or Notice of Intent to Terminate.

The 204(h) Notice must contain a summary of the plan amendment and note its effective date. It does not need to include the actual amendment or explain how the individual participant will be affected.

Plan administrators need to be especially aware of the §204(h) Notice rules in plan merger and termination situations. For example, if a plan is being terminated, the plan administrator would be well-advised to provide the §204(h) Notice to fix a stated date for the cessation of benefit accruals, just in case the plan termination falls through.

The penalty for not complying with these rules is substantial. If a plan administrator does not provide §204(h) Notices on time, the amendment reducing the future accruals will not be effective. If notices are provided on time but are not provided to all affected parties, the amendment will generally apply as intended only to the individuals who received notices. However, if only a "de-minimis" percentage of affected parties did not receive notices, the amendment may still apply to all affected parties.

The final §204(h) Notice rules apply to plan amendments adopted after December 11, 1998. For more information regarding these rules, please contact your Prudential Retirement representative.

PBGC Changes Premium Filing Deadline

On December 14, 1998, the Pension Benefit Guaranty Corporation (PBGC) issued final rules that change the due date for PBGC premium payments. The new rules move the premium due date from eight and one-half months to nine and one-half months after the beginning of the plan year. The new premium filing date coincides with the date the plan's Form 5500 must be filed with the IRS. This change gives plan administrators more time to file their PBGC insurance premiums. The change is effective on February 12, 1999, and applies to premium payment years beginning after December 31, 1998.

For a calendar plan year, the new filing date will be October 15 instead of September 15. There are also similar changes for non-calendar-plans. For example, a plan year that begins on July 1 will now have the filing date moved from March 15 of the following year to April 15 of the following year. In addition, a plan that has a plan year beginning on a date other than the first day of the month gets a two-month extension to coincide with the Form 5500 due date. Therefore a plan that has a plan year beginning on January 2 will now have a November 15 filing date instead of a September 15 filing due date.

Pension Analyst by Prudential Retirement

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