



Alert

Employee Benefits & Executive Compensation Client Service Group

To: Our Clients and Friends

November 30, 2010

Qualified Retirement Plans: Year-End Compliance

Although 2010 has been dominated by new healthcare-related laws and regulations requiring significant design changes to group health plans, as discussed in our [prior alert](#), qualified retirement plans are not immune to new requirements that must be addressed by the end of 2010.

The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART"), Pension Protection Act of 2006 ("PPA"), and Worker, Retiree, and Employer Recovery Act ("WRERA") included provisions affecting both defined benefit and defined contribution plans which require plan amendments by December 31, 2010, for calendar year plans. This bulletin summarizes the mandatory and optional amendments for tax-qualified plans to comply with these laws.

In addition, reminders about annual notices, "Cycle E" determination letter filings that are due on January 31, 2011, and the upcoming deadline for transferring assets to Puerto Rico trusts are included at the end of the bulletin.

I. Required Amendments for 2010

Except as otherwise noted, the deadline for adopting plan amendments implementing the changes described below is the last day of the first plan year beginning on or after January 1, 2010. (Governmental plans have later effective dates.) For calendar-year plans, this deadline is December 31, 2010. However, as noted below, some of the provisions were required to be effective prior to December 31, 2010. Plan sponsors should carefully review the effective dates to ensure that plans have been operated in compliance with these provisions.

A. Defined Benefit and Defined Contribution Plans

- **Military Differential Pay.** Tax-qualified retirement plans must include any differential wage payments made by the plan sponsor after December 31, 2008 as plan compensation for purposes of applying statutory limitations and other plan qualification requirements, such as the limitations on annual contributions or benefit accruals under Section 415 of the

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Internal Revenue Code (the “Code”) or nondiscrimination testing requirements under Code Sections 401(a)(4), 401(k), and 401(m).

****Note:** HEART amended the Code so that differential wage payments are included in the definition of wages within Code Section 3401(a). If a plan defines “compensation” as wages within the meaning of Code Section 3401(a), differential wage payments are automatically included and no amendment is necessary if that definition is used for purposes of Code Section 415 and other tax-qualification requirements.

- Military Death Benefits. Effective retroactive to January 1, 2007, tax-qualified retirement plans must provide beneficiaries of a plan participant who dies while performing qualified military service with the same death benefits that would have been available to the beneficiaries (other than benefit accruals relating to the period of qualified military service) had the participant been employed by the plan sponsor on his or her date of death.
- Direct Rollovers by Non-spouse Beneficiaries. Prior to 2010, plan sponsors previously had the option of allowing non-spouse beneficiaries to make direct rollovers of eligible rollover distributions to an individual retirement plan. This provision is no longer optional and is now mandatory for all tax-qualified retirement plans for plan years beginning after December 31, 2009. Amendments incorporating this change must be adopted by the later of the last day of the first plan year beginning after December 31, 2009, or the due date (plus extensions) for the plan sponsor’s federal tax return for the year that includes the first day of such plan year.

B. Defined Contribution Plans

- Diversification of Publicly Traded Employer Stock. Publicly traded companies maintaining defined contribution plans that invest in company stock must provide participants with the ability to diversify the portion of their account invested in company stock into other investment options, subject to certain requirements. Under these diversification rules, participants must generally be given at least three investment options in which they can elect to invest their elective deferrals and their employee contributions currently invested in employer securities. The diversification rights also apply to the portion of a Participant’s account consisting of employer contributions invested in employer stock if the participant has at least three years of service. These diversification rights are effective for plan years commencing after December 31, 2006.
- Waiver of Required Minimum Distributions. WRERA modified the required minimum distribution rules for 2009 by waiving any required minimum distribution for 2009. Although amendments implementing the waiver are not required until the last day of the 2011 plan year (2012 plan year for governmental plans), plan sponsors may consider amending their plans this year while adopting required amendments for 2010.

II. Optional Amendments

In addition to the mandatory plan amendments discussed above, the HEART Act permitted plan sponsors to implement certain optional design changes that must also be documented by year-end. These optional design changes include the following:

- Differential Wage Payments. Plan sponsors of defined contribution and defined benefit plans have the option of including differential wage payments in the plan's definition of "compensation" for purposes of determining contributions and benefits under the plan.

****Note:** As discussed above, differential wage payments are now included in the definition of wages within the meaning of Code Section 3401(a). If a plan uses this definition for purposes of determining contributions and benefits under the plan, then differential wage payments will be automatically included unless the plan sponsor amends the definition of "compensation" to exclude such differential wage payments.

- Qualified Military Service. Defined benefit and defined contribution plans may provide additional benefit accruals or contributions to employees who become disabled or die while performing qualified military service.
- Deemed Severance from Employment. A defined contribution plan may treat an employee on active duty for more than 30 days as having terminated employment for purposes of taking a distribution of any elective deferrals from a 401(k) plan. If an employee takes such a distribution, the employee is not allowed to make elective deferrals or after-tax contributions under the plan for six months after the distribution.
- Qualified Reservist Distributions. A 401(k) plan may provide for distributions to a reservist called to active duty for a period of 180 days or more, or for an indefinite period. Qualified reservist distributions are not subject to the 10% tax on early distributions from a plan and are considered eligible rollover distributions.

III. Discretionary Amendments

Generally, plan amendments for discretionary changes (optional changes not required by law) must be adopted by the end of the plan year in which the amendment is effective. Therefore, calendar-year plans must adopt amendments by December 31, 2010, for discretionary changes to a plan's design that took effect in 2010. Examples of some discretionary changes that a plan sponsor may have made include the addition of Roth elective deferrals, automatic enrollment of participants, and automatic increases to participants' elective deferrals.

IV. 2010 Deadline for Amendments to Defined Benefit Plans Extended

On November 30, 2010, the IRS issued Notice 2010-77. This Notice extends the deadline for adopting plan amendments implementing the changes described below until the last day of the first plan year beginning on or after January 1, 2011. For calendar-year plans, this deadline is now December 31, 2011. Prior to this extension, these amendments were required to be adopted by the last day of the first plan year beginning on or after January 1, 2010.

- Funding-Based Benefit Restrictions. PPA added Code Section 436, which imposes restrictions on distribution and benefit accruals based on the funding status of a defined benefit plan. Plans that do not meet certain funding targets must limit benefit accruals and cannot be amended to increase benefit liabilities. In addition, plans failing to meet the funding targets must limit certain benefit payments. These rules are effective for plan years beginning after December 31, 2007.
- Cash Balance / Hybrid Plans. Cash balance and other hybrid pension plans must satisfy special vesting and benefit accrual rules. This includes the use of an interest crediting rate that does not exceed a market rate of return and providing that an employee with at least three (3) years of service is fully vested in his accrued benefit under the plan. These rules first became effective for plan years beginning after December 31, 2007.

V. Annual Notices

In addition to the plan amendments discussed above, if applicable plan sponsors should ensure that any required annual notices have been sent to participants. Below is a list of common annual notices that plan sponsors may be required to send:

- 401(k) Safe Harbor Notices. All plan participants in a 401(k) safe-harbor plan must receive an annual notice of the safe-harbor contribution and other material features of the plan. The safe-harbor notice must be provided by December 1, 2010 for calendar-year plans, or at least 30 days but no more than 90 days prior to the beginning of the plan year for non-calendar year plans.
- 401(k) Automatic Enrollment Notices. Plan sponsors that automatically enroll participants into a 401(k) plan must provide eligible employees with an annual notice describing the circumstances in which the eligible employees will be automatically enrolled and compensation automatically deferred to the plan. This notice must be provided by December 1, 2010 for calendar-year plans, or for non-calendar year plans, at least 30 days prior to the beginning of the plan year.
- Qualified Default Investment Alternative Notices. A participant-directed 401(k) plan may provide that participant contributions are invested in a qualified default investment alternative, or "QDIA," if a participant fails to provide an affirmative investment direction for the contributions. Plan sponsors must provide annual notice of such QDIA to all participants who have or may have their contributions invested by default in the QDIA by December 1, 2010, for calendar year plans, or for non-calendar year plans, at least 30 days prior to the beginning of the plan year.

****Note:** If applicable, the three notices described above (the Safe-Harbor Notice, 401(k) Automatic Enrollment Notice, and the QDIA Notice) may be combined into one notice to be provided to plan participants.

- Plan Funding Notice for Defined Benefit Plans. An annual notice describing a defined benefit plan's funding status for the previous two years, a statement of the plan's assets

and liabilities, and certain other information related to the plan's funding status must be provided to participants within 120 days after the end of the plan year. For calendar year plans, this deadline is April 30, 2011. However, the deadline for small plans that cover less than 100 participants to provide this annual notice is the filing due date for the plan's IRS Form 5500.

VI. "Cycle E" Determination Letter Filings

A plan sponsor of an individually designed tax-qualified plan with an employer identification number ("EIN") ending in 0 or 5 that wishes to obtain new a determination letter for its qualified plan(s) must file a determination letter application by January 31, 2011. Plans being submitted for a determination letter must be amended to include all items on the IRS's cumulative list, which is set out in IRS Notice 2009-98.

VII. Puerto Rico Trusts

Under guidance issued in 2008, the IRS took the position that the transfer of assets and liabilities from a plan qualified under both US and Puerto Rico law to a plan qualified under Puerto Rico law only is considered a transfer from a qualified plan to a nonqualified plan. Such a transfer could result in the disqualification of the plan qualified under US law. Because this was a reversal from the IRS's prior position as set forth in several private letter rulings, the IRS provided a transition period in which plan sponsors have until December 31, 2010 to transfer assets and liabilities from a plan qualified under both US and Puerto Rico law to a plan qualified under Puerto Rico law only.

If you have any questions regarding anything discussed in this Alert, the attorneys of the Employee Benefits and Executive Compensation group of Bryan Cave LLP are available to answer your questions.

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