



CASH-OUT RULES CHANGE ON MARCH 28, 2005

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An amendment will be necessary for most qualified retirement plans, and must be executed no later than the last day of the plan year that overlaps March 28, 2005 (i.e. by December 31, 2005 for calendar year plans). The amendment will be retroactive to March 28, 2005, so you need to think through the issues before that earlier date. Because the amendment will be fairly straightforward, you may as well adopt it by March 28, 2005, rather than waiting until the end of the year deadline.

The background is that a law was passed several years ago (EGTRRA) which affects "cash-out" payments. Most plans permit forced "cash-out" payments to any terminated participant with a balance of \$5,000 or less (disregarding rollover accounts), even if he or she does not consent to the distribution. The law allows this so that plans can eliminate small accounts of terminated employees for administrative convenience.

As a practical matter, most terminating employees want their money if they leave employment, so many plans will never have to make a forced cash-out payment. But it is a helpful feature in the rare instance when a terminated employee cannot be found or will not sign distribution paperwork.

As happens to many good things, Washington decided to make cash-outs more complicated. EGTRRA says that if a cash-out exceeds \$1,000, it has to be deposited into an IRA in that person's name. Although a plan could select other qualified rollover vehicles, such as individual retirement annuities, most plan administrators will use IRA's as the default payment choice, simply because IRA's are readily available and the cost structure for the participant will generally be less than with an individual retirement annuity.

Setting up and administering small IRAs, usually for people who cannot be located or who will not sign paperwork, is no picnic. And there are fiduciary judgments involved. Before transferring money to an IRA, the plan administrator must be sure the IRA fee structure passes muster under Department of Labor regulations.

As a practical matter, there are two ways to comply with this new law:

- 1. THE EASY CHOICE IS JUST TO REDUCE YOUR PLAN'S CASH-OUT LIMIT FROM \$5,000 TO \$1,000.**

The new law does not apply to very small cash-outs (\$1,000 or less). That means if a terminated employee with more than \$1,000 does not consent to a distribution, you must keep it in the plan until the retirement date. But that's not such a big deal for most plans. As noted, terminated employees usually want their money, so having to keep it in the plan for many years is a somewhat academic concern.

2. THE OTHER CHOICE IS TO ADMINISTER YOUR PLAN UNDER THE NEW RULE, WHICH REQUIRES YOU TO ROLL OVER CASH-OUTS THAT EXCEED \$1,000, EVEN IF THE PARTICIPANT IS NOT COOPERATIVE IN SIGNING PAPERWORK TO OPEN UP THE IRA ACCOUNT.

With Choice 2, the main factors to consider will be:

- A. Will your fund sponsor be willing to set up these IRAs for terminated persons who are not cooperating in completing forms? If your plan is administered exclusively with a large mutual fund company or insurance company, they will usually accommodate this new feature.
- B. What is the cost structure? Generally, these IRAs can be administered so that the cost is charged to the IRA, without additional charge to your company or plan. The Department of Labor regulations do not provide a bright-line standard, but you must exercise fiduciary discretion when selecting the rollover IRA for these types of mandatory payments.
- C. Will the IRA sponsor accept cash-outs of \$1,000 or less? Even though the law does not require rollovers of cash-outs this small, this might make plan administration more simple if you intend to use this procedure for cash-outs greater than \$1,000. Why not get rid of the smallest balances, if the IRA sponsor is willing to take them?

Although the IRS has suggested plan language for the required amendment in IRS Notice 2005-5, you will probably want to modify this to fit with your plan's terms. Also, the IRS suggested language only addresses Choice 2, so a more tailored amendment will be needed if you prefer Choice 1.

Finally, Notice 2005-5 is of great interest to sponsors of plans who don't really think of themselves as having to comply with all of the qualified plan rules. The Notice is clear that this change applies to 403(b) plans and to plans of churches and governments. The deadlines for church and government plans may be extended for such entities, as described in the [Notice, which may be accessed at this link.](#)

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