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April 2010 Employee Benefits Update

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SELECT COMPLIANCE DEADLINES AND REMINDERS

Defined Benefit Funding Notice is Due by April 30, 2010

All defined benefit plans covered by the Pension Benefit Guaranty Corporation (PBGC) must provide an annual funding notice to the PBGC, plan participants and beneficiaries, labor organizations representing plan participants and beneficiaries and, for multiemployer plans, contributing employers. The funding notice generally must be provided within 120 days following the end of the plan year (*i.e.*, April 30, 2010 for calendar-year plans). Small plans (*i.e.*, plans with 100 or fewer participants) generally have until the Form 5500 filing date to provide the funding notice. The Department of Labor (DOL) previously issued guidance on complying with the funding notice, including two model notices (one for single-employer plans and one for multiemployer plans).

COBRA Premium Subsidy Extended - Special Notices Required

The Temporary Extension Act of 2010 (the Act) extended the COBRA premium subsidy created by the American Recovery and Reinvestment Act of 2009 (ARRA). Under ARRA, individuals who were involuntarily terminated between September 1, 2008 and December 31, 2009 may qualify for a 65% subsidy of their COBRA premiums for up to nine months. The 2010 Department of Defense Appropriations Act previously extended eligibility for the COBRA subsidy to individuals who were involuntarily terminated on or before February 28, 2010. The Act extends eligibility for the COBRA subsidy to individuals who were involuntarily terminated on or before March 31, 2010.

The Act also provides that individuals who experience a reduction in hours on or after September 1, 2008 that results in a loss of coverage and who then experience an involuntary termination of employment occurring between March 2, 2010 and March 31, 2010 are eligible for the subsidy. This provision applies to the first period of coverage beginning on or after March 31, 2010. If the qualified beneficiary did not elect COBRA at the time he or she experienced the reduction in hours (or elected COBRA and then discontinued coverage), the qualified beneficiary is entitled to a new election period. The plan administrator must provide a new election notice within 60 days of the involuntary termination of employment. The qualified beneficiary may elect COBRA coverage prospectively

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from the involuntary termination of employment; however, his or her 18-month maximum period of coverage is calculated from the date of the reduction in hours.

Plan sponsors will need to take the following actions with respect to the COBRA subsidy:

- Identify any individual who previously lost coverage due to a reduction in hours on or after September 1, 2008 and who is then involuntarily terminated by his or her employer between March 2, 2010 and March 31, 2010. Plan sponsors should provide a notice of the new election period to such individuals within 60 days of the termination of employment. The DOL issued new model notices that reflect the extension of the COBRA subsidy. The model notices are available through the DOL website.
- Revise all COBRA election notices by replacing "February 28, 2010" with "March 31, 2010." Plan sponsors should provide the updated COBRA election notice to all qualified beneficiaries who experience a qualifying event any time from September 1, 2008 through March 31, 2010, and who have not yet been provided a COBRA election notice. Plan sponsors should also provide the updated notice to qualified beneficiaries who experienced an involuntary termination on or after March 1, 2010 even if they have previously received a notice because these individuals may not have been provided with a proper notice. These individuals must be given the full 60 days from the date the updated notice is provided to make a COBRA election.
- Retain all supporting documentation for each subsidy application that was approved. The supporting documentation should be retained for at least as long as other payroll records.

The DOL posted new "frequently asked questions" (FAQs) on its Web site that address the changes made by the Act. The FAQs address when coverage begins and how long COBRA and the subsidy last when a reduction in hours is followed by an involuntary termination. The FAQs also provide that an extended election period under the Act does not count towards the 63-day break in coverage period for purposes of HIPAA's preexisting condition exclusion requirements.

Deadline for Adopting and Filing EGTRRA Pre-Approved Plans is April 30, 2010

Employers using a pre-approved master and prototype plan or volume submitter plan, such as Reinhart's EGTRRA volume submitter document, must adopt the EGTRRA-approved plan document by April 30, 2010. Plan sponsors who wish to receive determination letters from the Internal Revenue Service (IRS) must submit

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their applications for EGTRRA pre-approved plans to the IRS on or before April 30, 2010.

Mental Health Parity Regulations Become Effective on April 3, 2010

As we previously reported in Reinhart's February 2010 Employee Benefits Update, the DOL, IRS and Department of Health and Human Services (HHS) jointly released interim final regulations implementing provisions of the Mental Health Parity and Addiction Equity Act of 2008 (MHPAEA) on February 2, 2010. These regulations are effective April 3, 2010 and apply to non-collectively bargained group health plans for plan years beginning on or after July 1, 2010. The regulations apply to collectively bargained group health plans as of the first day of the first plan year beginning on or after the later of: (a) the date on which the last of the collective bargaining agreements in effect on October 3, 2008 (without extensions) terminates or (b) July 1, 2010.

RETIREMENT PLAN DEVELOPMENTS

DOL Issues Proposed Regulations on Investment Advice

On February 26, 2010, the DOL issued proposed regulations on the provision of investment advice to participants in individual account plans, such as 401(k) plans, and to owners of IRAs. The proposed regulations replace a prior set of regulations that were issued in January 2009 but never became effective. The proposed regulations are substantially the same as the prior regulations, except for two major differences related to fee-leveling and computer modeling.

- *Fee-Leveling*. The proposed regulations do not include the prohibited transaction class exemption that was included in the prior regulations. Thus, the proposed regulations would not provide relief for: (i) individualized advice provided after a participant has been given recommendations generated by a computer model or for asset allocation advice given to IRA beneficiaries for whom a computer model may not be available, or (ii) an arrangement whereby the fiduciary advisor receives different fees or compensation for different investment products selected by a plan participant but the compensation received by employees, agents or registered representatives of the fiduciary advisor do not vary. This significantly narrows the scope of exemptive relief that was provided under the prior regulations. In addition, the proposed regulations would not permit a fiduciary advisor or its employees, agents and registered representatives to receive, directly or indirectly, any fee or other form of compensation that varies based on the selection of an investment option by a

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participant or beneficiary. The proposed regulations would also prohibit a fiduciary advisor from receiving economic incentives from its affiliates or any other party to recommend certain investments.

- *Computer Modeling*. The proposed regulations would impose the same requirements for computer modeling that were imposed under the prior regulations, except that the DOL added a new condition. Specifically, the proposed regulations would prohibit computer models from using factors that are not expected to persist in the future to distinguish among investment options within a single asset class. In the preamble to the proposed regulation, the DOL noted that certain differences such as fees, expenses and management style will likely persist in the future, while a factor, such as historical performance, is less predictable and thus would not typically constitute appropriate criteria for asset allocation within the same asset class.
- *Additional Requirements*. The proposed regulations would require a fiduciary advisor to satisfy several additional restrictions. For example, a plan fiduciary other than the fiduciary advisor would need to expressly authorize the investment advice arrangement. In addition, the proposed regulations would require an annual independent audit to determine that the investment advice arrangement complies with the statutory requirements. The proposed regulations would also require fiduciary advisors to make certain written disclosures and retain certain records for at least six years.
- *Public Comments and Effective Date*. The DOL is seeking public comments on the proposed regulations until May 5, 2010. The proposed regulations would become effective 60 days after publication in final form in the *Federal Register*.

DOL Publishes Final Regulations on Participant-Requested Documents from Multiemployer Plans

On February 26, 2010, the DOL issued final regulations on the obligation of multiemployer plans to disclose certain actuarial and financial information to participants and others upon request. Under the final regulations, which are effective April 1, 2010, multiemployer pension plan administrators are obligated to provide to participants, beneficiaries, employee representatives and contributing employers the following documentation, if requested:

- Periodic actuarial reports for any plan year that have been in the plan's possession for at least 30 days prior to the date of the written request. "Periodic actuarial report" means any actuarial report prepared by the plan actuary and received by the plan at regularly scheduled recurring intervals. It also includes studies, test documents, analysis or other information received by

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a plan from an actuary depicting alternative funding scenarios based on a range of alternative actuarial assumptions whether or not received at regularly scheduled recurring intervals.
- Quarterly, semiannual or annual financial reports prepared for the plan by any plan investment manager or advisor or other fiduciary that have been in the plan's possession for at least 30 days prior to the date of the written request.
- Any request to the IRS for an extension of the amortization periods under the multiemployer minimum funding standards and the resulting IRS decision.

The final regulations clarify that copies of the requested documents must be furnished by the plan administrator no later than 30 days after the date the written request is received, and the administrator is not required to furnish the requestor more than one copy of the same document within a 12-month period. The administrator is also permitted to charge the reasonable cost of providing the requested documents, which means the lesser of: (i) the actual cost to the plan for the least expensive means of acceptable document reproduction or (ii) 25¢ per page plus the cost of mailing or delivering the document.

The final regulations do not require disclosure of information that a plan administrator reasonably determines to be either: (i) individually identifiable information with regard to a participant, beneficiary, employee fiduciary or contributing employer or (ii) proprietary information regarding the plan, any contributing employer or entity providing services to the plan.

Case Provides Guidance on Conversion of Terminated Participants' ESOP Accounts

Recent developments indicate that the controversy over mandatory conversion of a terminated participant's ESOP account may reach a positive conclusion for plan sponsors of ESOPs. The U.S. District Court for the District of North Dakota ruled that an amendment to the Tharaldson Motor Hotels, Inc. ESOP (TMI ESOP) that required a terminated employee to convert his or her shares of Tharaldson Motels Inc. stock to cash was permitted under the terms of the plan and ERISA. *Hoffman v. Tharaldson Motels Inc*. Employee Stock Ownership Plan, 2010 WL 4749788 (D.N.D., February 26, 2010).

The Plan was amended in 2005 to allow participants to retain their accounts in employer stock after termination of employment. In 2006, the Plan was amended to repeal the 2005 amendment and require conversion of employer securities held in ESOP accounts. It is common for an ESOP to include a provision requiring that the employer securities held in the ESOP account of a terminated participant

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be converted to cash for distribution. The court determined that the 2006 amendment was not a violation of the "anti-cutback" rule, which prohibits amendments to a retirement plan that reduce a participant's accrued benefit. The court relied in part on IRS regulations that provide that a right to a particular form of investment is generally not a protected benefit under the anti-cutback rule.

This case and recent IRS commentary indicate that ESOPs should be able to retain the right to convert a terminated participant's ESOP account when certain requirements are satisfied.

Senate Passes Pension Funding Relief

On March 9, 2010, the Senate passed the American Workers, State and Business Relief Bill (the Bill). Congress must now reconcile the Senate bill with the bill passed by the House of Representatives. In addition to extending various tax provisions that expired at the end of 2009, the Bill includes pension funding relief.

The Bill would allow the plan sponsor of a single-employer defined benefit plan to elect one of two special amortization schedules. A plan sponsor would be able to elect, for any two plan years during the period starting with the first plan year beginning in 2008 and ending with the first plan year beginning in 2011, either: (i) a 2 and 7 rule; or (ii) a 15 year rule. Under the 2 and 7 rule, a defined benefit plan's shortfall amortization base for the year in question would be amortized over seven years, but the seven-year amortization would start two years later. During the first two years the employer would only owe interest on the shortfall. Under the 15 year rule, a defined benefit plan's shortfall amortization base for the year in question would be amortized over 15 years.

For a defined benefit plan to qualify for this pension funding relief, the plan sponsor would be required to satisfy a "cash flow rule." Under the cash flow rule, the plan sponsor would be required to make a contribution to the plan equal to the sum of: (i) the aggregate excess employee compensation over $1 million; or (ii) the aggregate amount of extraordinary dividends and redemptions for the plan year.

Under the Bill, multiemployer defined benefit plans would be able to amortize net investment experience losses for the first two plan years ending after August 31, 2008 over 30 years. In addition, when determining the actuarial value of assets, a multiemployer plan would be able to spread the difference between actual and expected investment return for the first two plan years ending after August 31, 2008 over 10 years.

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The Bill would also provide limited relief to 401(k) plan participants. Participants experiencing a distributable event would be allowed to directly roll over the distribution to a Roth 401(k) account maintained under the 401(k) plan for the benefit of the individual to whom the distribution is being made.

IRS Provides Guidance on Pension Distribution Reporting Changes for 2010

The IRS recently released the 2010 instructions for the Form 1099 R. The instructions explain the reporting treatment for certain changes in the law that became effective January 1, 2010. For example, the instructions explain the reporting requirements for participants who roll over non-Roth amounts in a qualified plan to a Roth IRA (known as Roth Conversions).

In addition, the instructions address the 20% mandatory withholding on eligible rollover distributions from a plan paid directly to a nonspouse beneficiary. The instructions also clarify the new "truncated social security number" option, which provides that a recipient's Form 1099-R may include only the last four digits of the recipient's social security number. The instructions discuss issues relating to loss reporting and corrections under the IRS's Employee Plans Compliance Resolution System.

HEALTH AND WELFARE PLAN DEVELOPMENTS

Health Care Reform Legislation Signed into Law

On March 23, 2010, President Obama signed into law comprehensive health reform legislation, the Patient Protection and Affordable Health Care Act (PPACA). On March 25, 2010, Congress approved the Health Care and Education Affordability Reconciliation Act, which reconciled the health reform bill passed by the Senate with the health reform bill passed by the House of Representatives. PPACA has significant implications for plan sponsors. Although many provisions will not become effective for several years, several provisions are effective immediately and several others are effective for the first plan year beginning six months after the date of enactment. Reinhart will provide Client e-alerts that describe specific provisions of PPACA.

HHS Announces Delay in Enforcement of HITECH and Intent to Issue Regulations

On March 15, 2010, HHS announced its plans for enforcement of certain provisions of the Health Information Technology for Economic and Clinical Heath Act (HITECH) and its intent to publish rules related to HITECH requirements that

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became effective February 17, 2010.

- *Enforcement*. HHS will not enforce HITECH provisions that become effective February 17, 2010, and for which the rulemaking process is not complete. This enforcement exemption applies to the following HITECH requirements: (i) business associate liability; (ii) limits on the sale of protected health information (PHI), marketing and fundraising communications; and (iii) individual rights to access electronic medical records and restrict the disclosure of certain information. HHS will enforce HITECH requirements related to breach notification and increased civil monetary penalties. Regulations implementing these HITECH provisions have been issued.
- *Regulations*. HHS announced its intent to issue regulations on the HITECH requirements that became effective February 17, 2010 including the increased responsibilities and liability for business associates, the right to request a restriction, access to PHI maintained in electronic health records and the use or disclosure of PHI for marketing and fundraising. The regulations will address when compliance is expected and when enforcement will begin. HHS did not indicate an expected publication date for these regulations.

GENERAL DEVELOPMENTS

DOL Clarifies EFAST2 Filing Requirements

The DOL posted additional FAQs on its Web site about EFAST2, the electronic filing system that must be used for 2009 Form 5500 filings, which are due in 2010 for most plans. A new Q/A-16a addresses what EFAST2 users should do if they complete the online registration process for electronic credentials but do not receive an email from EFAST2 to complete their registration. In this situation, the DOL instructs the user to check for the email in their spam or junk mail folders and, if it is not there, call the EFAST2 Help Line.

In addition, Q/A-35a addresses timely filing requirements. The DOL provides that timely returns must be received by EFAST2 by midnight in the plan administrator's time zone, which is determined by the plan administrator's address specified on line 3a of the Form 5500. Q/A-35a also addresses instances where a filer attempts to submit a return on time but it is not successfully received by EFAST2 prior to the deadline. In this case, the DOL instructs the filer to print the unsuccessful submission notice and include it with the resubmitted return as another attachment. However, based upon the facts and circumstances surrounding the original unprocessable submission and the subsequent resubmission, the DOL

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may still assess penalties from the original due date if EFAST2 receives the subsequent resubmission after the deadline.

Court Holds that Severance Payments Are Not "Wages" Subject to FICA

The U.S. District Court for the Western District of Michigan held that severance payments were not wages subject to FICA taxes. *U.S. v. Quality Stores, Inc*., 2010 U.S. Dist. LEXIS 15825 (W.D. Mich. 2010). Quality Stores closed several stores and distribution centers and terminated numerous employees prior to filing for bankruptcy. Quality Stores made severance payments to terminated employees pursuant to a severance plan. Quality Stores reported the severance payments as wages on the Forms W-2 issued to the employees and withheld federal income tax and the employees' shares of FICA. Quality Stores then filed several refund claims with the IRS, seeking to recover alleged overpayments of FICA.

The court held that the severance payments were "supplemental unemployment compensation benefits" and were a form of wage-replacement benefits as opposed to remuneration for services. The court's decision departs from IRS guidance under Revenue Ruling 90-72 and the decision of the U.S. Court of Appeals for the Federal Circuit in *CSX Corp. v. U.S.*, 518 F.3d 1328 (Fed. Cir. 2008). Both Revenue Ruling 90-72, and the court in CSX Corporation held that such severance benefits were wages subject to FICA taxation. Employers may wish to file a protective refund request to preserve their ability to obtain a refund of FICA taxes. However, since the court's decision is not generally accepted, employers should continue to pay FICA taxes unless and until the court's decision becomes settled law.

IRS Finds that Accrual-Basis Taxpayers Cannot Take Bonuses into Account Until Paid

The IRS released a chief counsel advice memorandum that addresses the deduction of bonuses. *IRS Chief Counsel Memorandum* 200929040. In general, an employer may deduct bonuses it awards in Year 1 and pays in Year 2 if the bonuses are paid within the first 2 1/2 months of Year 2 and the "all events" test is satisfied. The "all events" test generally provides that, for accrual-basis taxpayers, a liability is incurred in the taxable year in which: (i) all the events have occurred that establish the fact of the liability; (ii) the amount of the liability can be determined with reasonable accuracy; and (iii) economic performance has occurred with respect to the liability.

The IRS concluded that the employer did not satisfy the "all events test" for Year 1

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because, if the employee was not employed in Year 2, the employer did not pay the bonus to the employee. The IRS found that the requirement of employment in Year 2 precluded economic performance from occurring until the bonus was paid in Year 2.

Employers whose bonus plans require employees to continue their service until the date the bonuses are paid should review the proper year of deduction of such bonus payments.

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