December 2007 Employee Benefits Update

POSTED:

Dec 18, 2007

RELATED PRACTICES:

Employee Benefits

https://www.reinhartlaw.com/practices/employee-benefits

SELECT COMPLIANCE DEADLINES

• **Pension Protection Act of 2006 - Provisions Effective for 2008 Plan Years**. As detailed in Reinhart's November 2006 Employee Benefits Update, numerous retirement plan changes made by the Pension Protection Act of 2006 (PPA) are effective beginning with the 2008 plan year, or January 1, 2008 for calendar year plans. For calendar-year plans, these changes are effective beginning January 1, 2008. The changes made by the PPA that are effective for 2008 plan years generally include, but are not limited to, the following: revamping the minimum funding rules for single-employer defined benefit plans; specifying a new interest rate and mortality table for calculating lump sum distributions from defined benefit plans; providing rules for "at risk" defined benefit plans; requiring a "qualified optional survivor annuity" for plans subject to the qualified joint and survivor annuity rules for married participants; requiring a new funding notice for all defined benefit plans; new options for automatic contribution arrangements and a corresponding new safe harbor from ADP/ACP testing for 401(k) plans; and increasing the maximum fidelity bond requirement for plans invested in employer securities from $500,000 to $1 million.

• **Required Minimum Distributions**. Active participants who are 5% owners and terminated participants are required to take annual minimum distributions once they attain age 70-1/2. Employers should confirm compliance with this distribution requirement for 2007. Plan participants who received initial payments by April 1 of this year may need to collect second payments by December 31, 2007. The minimum required distribution rules apply to qualified plans as well as 403(b) and 457(b) plans. The age 70-1/2 distribution requirement does not apply to active participants who are not 5% owners, unless the plan opted to continue the requirement despite the tax code change.

• **Compliance Deadline for Final 415 Regulations**. As reported in Reinhart's May 2007 Employee Benefits Update, the Internal Revenue Service (IRS) issued final comprehensive regulations under Code section 415. The final regulations generally apply for limitation years beginning on or after July 1, 2007. Plans with calendar-year limitation years will need to comply with the final regulations as of January 1, 2008. Code section 415 imposes annual limits on benefits under defined benefit plans and on contributions and other annual additions under

defined contribution plans. To highlight, the final regulations make changes to the definition of "compensation" that plans may use for Code section 415 purposes, including new rules on when post-severance compensation may be included. The regulations also revise the methodology for converting certain alternative benefit forms to a straight life annuity under a defined benefit plan when applying the Code section 415 limits. The final 415 regulations also provide that 401(k) deferrals may only be made from pay that fits within the Code section 415(c)(3) definition of compensation.

• **Compliance Deadline for Final HIPAA Wellness and Nondiscrimination Regulations**. As reported in Reinhart's January 2007 Employee Benefits Update, the Department of Labor (DOL), Department of Health and Human Services (HHS) and the IRS collectively issued final regulations in late 2006 on HIPAA's nondiscrimination and wellness program requirements. The final regulations apply for plan years beginning on or after July 1, 2007. Calendar-year plans will need to comply with the final regulations as of January 1, 2008. The final regulations provide criteria that wellness programs with health standards must satisfy and clarify and add other nondiscrimination rules that generally prohibit group health plans from discriminating against individuals on the basis of health factors. Employers will want to review any wellness programs, in particular, for compliance with the final regulations. Frequently Asked Questions on these rules can be found on the DOL's website.

• **Cycle B Individually Designed Plan Submission Date**. Remedial Amendment Period Cycle B individually designed plans must be submitted for a favorable IRS determination letter no later than January 31, 2008 to rely on the extended period during which qualification amendments may be retroactively adopted. Cycle B plans include those sponsored by employers with tax identification numbers (EINs) ending in a two or seven, as well as multiple-employer plans.

• **Form 5500 Disaster Relief for Victims of Californian Wildfires**. The DOL announced a deadline extension for filing Forms 5500 and 5500-EZ due to damages caused by the recent Californian wildfires. The DOL is providing an extension to January 31, 2008 for Form 5500 series filings required to be filed between October 21, 2007 and January 31, 2008. The extension applies to plan administrators, employers and other entities who are located within the designated "disaster area" or who are unable to obtain required information from service providers, banks or insurance companies whose operations were directly affected by the fires.

Likewise, the IRS announced tax relief for Form 5500 series returns due between October 21, 2007 and January 31, 2008 that are filed by January 31, 2008. The IRS's tax relief applies to affected taxpayers located within the designated "disaster area" or who are not located within the disaster area but whose books, records or tax professional's offices are in the disaster area.

• **Disaster Relief from the PBGC for Victims of Californian Wildfires**. The Pension Benefit Guaranty Corporation (PBGC) issued Disaster Relief Announcement 07-26, which waives certain penalties and extends certain deadlines in response to the recent Californian wildfires. Subject to certain parameters and limitations, the PBGC provided penalty relief for late premium filings and extended deadlines for filing plan termination reports, sending participant notices, filing reportable event post-event notices, requesting reconsideration of appeals and complying with certain multiemployer plan deadlines. Person or entities located within the designated "disaster area" or who are unable to obtain required information or assistance from service providers due to the disaster may be eligible for the PBGC's disaster relief.

RETIREMENT PLAN DEVELOPMENTS

Additional IRS Guidance on Lump-Sum Payments from Defined Benefit Plans The IRS issued Revenue Ruling 2007-67 (the Ruling) providing additional guidance on the present value determination factors applicable to lump-sum distributions and other accelerated payment forms from defined benefit plans. The new factors generally apply for plan years beginning on or after January 1, 2008. Most significantly, the Ruling identifies the applicable mortality table. The Ruling also expands on the guidance issued by the IRS in October regarding the applicable interest rate, which is summarized in Reinhart's November 2007 Employee Benefits Update. As noted in Reinhart's November 2007 Employee Benefits Update, plan sponsors can now make decisions on how to implement the new assumptions and revise a plan's relative value notice.

As background, the PPA revised the applicable interest rate and mortality table under Code section 417(e)(3) for calculating lump-sum distributions and other accelerated payment forms from defined benefit plans. The interest and mortality assumptions under a defined benefit plan may not result in an amount less than the amount determined under the factors prescribed by Code section 417(e)(3).

To highlight, the IRS provides the following guidance in the Ruling:

- The required mortality table under Code section 417(e)(3) is the "2008

Applicable Mortality Table" identified in the Ruling. The table is a 50/50 blend of the male and female mortality rates. The table is available as an appendix to the Ruling. The applicable mortality table for subsequent years will be published by the IRS annually.

- The look back month and stability period described in current IRS regulations under Code section 417(e)(3) will continue to apply for 2008 and later plan years when determining the applicable interest rate.
- Plans may incorporate the applicable mortality table by reference, and plan sponsors have until the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 for governmental plans), to adopt a conforming plan amendment.
- Amendments to a plan to substitute the currently required interest rate and mortality table for the PPA's required interest rate and mortality table for plan years beginning on or after January 1, 2008, will not violate the anti-cutback rules of the Code or ERISA, even if the new factors result in a smaller distribution.

The IRS also issued Notice 2007-101, setting forth the following minimum present value segment rates (based in part on the November 2007 30-year Treasury rate of 4.52%) for plan years beginning in 2008:

	First Segment ≤ 5 Years	Second Segment 6-20 Years	Third Segment 20+ Years
November 2007	4.60%	4.82%	4.91%

The above segment rates for November 2007 would be the applicable interest rate for lump-sum distributions payable in 2008 for a calendar-year plan and stability period and a look back month of November. Plan sponsors will have to wait for the IRS to publish the segment rates for December 2007 in order to determine the effect of the PPA changes on lump-sum distributions payable in 2008 from calendar-year plans with December look back months.

The minimum present value segment rates for August 2007, September 2007 and October 2007 are listed in Reinhart's November 2007 Employee Benefits Update.

No 204(h) Notice Required in 2007 for Certain PPA Changes

Under ERISA section 204(h) and Code section 4980F, a 45-day (15-day for multiemployer plans) advance notice to participants is generally required when a plan is amended to significantly reduce the rate of future benefit accruals. This notice is commonly referred to as a "204(h) Notice." On a posting on its website, the IRS addressed whether certain amendments to defined benefit plans required by the PPA trigger a requirement to provide a 204(h) notice. The IRS website provides that:

- The notice required under ERISA section 101(j) for amendments restricting benefits for defined benefit plans in "at-risk" status under the PPA's funding rules will satisfy both the timing and content requirements for a 204(h) notice.
- As noted in Reinhart's November 2007 Employee Benefits Update, a reduced single-sum benefit resulting from an amendment to a traditional defined benefit plan to substitute the PPA's required interest rate and mortality table under Code section 417(e)(3) for the pre-PPA applicable factors does not require a 204(h) notice.

The IRS also announced that it intends to issue proposed regulations under Code section 4980F in the near future.

IRS Proposed Regulations on Automatic Contribution Arrangements

The IRS issued proposed regulations regarding automatic contribution arrangements in 401(k), 403(b) and 457(b) governmental plans. While automatic contribution arrangements have been approved by the IRS and used by plan sponsors for many years, the PPA includes several significant changes encouraging eligible plan sponsors to implement an automatic contribution arrangement effective for plan years beginning on or after January 1, 2008. Under an automatic contribution arrangement, an employee is automatically enrolled to make deferrals absent an affirmative election to the contrary.

The PPA provides that a 401(k) plan with an automatic contribution arrangement may escape ADP/ACP nondiscrimination testing by incorporating design features that satisfy new safe harbor requirements. This type of safe harbor arrangement is called a qualified automatic contribution arrangement (QACA). The PPA also provides for another type of automatic contribution arrangement called an eligible automatic contribution arrangement (EACA). An EACA has up to six months after the end of a plan year to make corrective ADP/ACP distributions

without incurring an excise tax. (The PPA also provides that ADP/ACP corrective distributions are taxable to participants in the year distributed instead of the year of deferral, effective for plan years beginning in 2008.)

The IRS's regulations are proposed to be effective for plan years beginning on or after January 1, 2008, and may be relied upon pending the issuance of final regulations. Comments on the proposed regulations must be received by the IRS by February 6, 2008. The following paragraphs explain some key provisions of the regulations:

- To satisfy the QACA safe harbor requirements, plan amendments adopting the QACA must generally be adopted before the first day of the plan year and must remain in effect for an entire 12-month plan year.

- A QACA must uniformly apply the "qualified percentage" (the minimum applicable automatic deferral) to all employees eligible to make a cash or deferred election. The regulations provide that a QACA will not violate the uniformity requirement if the plan varies the elective deferral percentage based on the number of years an employee has participated in the automatic contribution arrangement or limits the amounts of elective deferrals so as not to exceed the Code's limits on compensation, elective deferrals or benefits and compensation. A plan will also not violate the uniformity requirement if it suspends employees from making elective deferrals for six months following a hardship distribution.

- Code section 401(k)(13)(C) provides an exception from the default election under a QACA for eligible employees who have a deferral election in effect on the QACA's effective date. The proposed regulations provide that an election in effect means an affirmative election that remains in effect to have the employer make contributions on the employee's behalf or an election not to have such contributions made. The regulations indicate that a prior election to not make deferrals must be an affirmative 0% election to qualify for the exception, and not just a failure to return the election form.

- To satisfy the requirements for a QACA or an EACA, an annual participant notice is required. The regulations provide that the notice is timely if provided at least 30 days (and not more than 90 days) before the beginning of each plan year. As noted below, the IRS now provides on its website a sample participant notice for an automatic contribution arrangement.

The IRS's proposed regulations also address permissible withdrawals of automatic contributions and the additional time for making corrective ADP/ACP distributions applicable to EACAs. For example, the proposed regulations provide that a plan sponsor is not required to offer the permissible withdrawal feature to all employees eligible under the EACA, but also may not condition an employee's right to receive a withdrawal on whether or not he or she elects future plan deferrals.

Sample Notice to Participants for Automatic Contribution Arrangements

The IRS recently updated its website to include a sample notice that plan sponsors may use to inform participants about their rights and obligations under a QACA or an EACA. The sample notice is based on a hypothetical QACA that allows for permissible withdrawals of automatic contributions, and will need to be modified to the extent needed to reflect a plan's actual operation. The sample notice also contains language that, according to the IRS, will satisfy the information requirement for participant notices under the DOL's final rule on qualified default investment alternatives (QDIAs). Please see Reinhart's November 14, 2007 mailing for more information on the DOL's final rule on QDIAs.

IRS Guidance for 403(b) Plans

The IRS issued the following two pieces of guidance for 403(b) plans:

• **Final Regulations Defining "Salary Reduction Agreement" for FICA Tax Purposes**. The IRS issued final regulations describing the parameters of a "salary reduction agreement" under a 403(b) plan for FICA tax purposes. The regulation finalizes the temporary and proposed regulations without change, and applies to contributions to 403(b) plans made on or after November 15, 2007. The temporary and proposed regulations were applicable to contributions to 403(b) plans made on or after November 16, 2004.

As background, Code section 3121(a) defines wages for FICA tax purposes as all remuneration for employment unless otherwise excepted. Code section 3121(a)(5)(D) generally excepts from wages payments made by an employer for the purchase of a 403(b) annuity contract, but not payments made by reason of a salary reduction agreement. In the final regulations, the IRS broadly defines the term "salary reduction agreement" to include: (1) a cash or deferred arrangement under which an employee elects to reduce his or her compensation; (2) an arrangement under which an employee elects to reduce his or her compensation pursuant to a one-time irrevocable election made at or before the time of initial

eligibility; or (3) an arrangement under which the employee agrees as a condition of employment to make a contribution that reduces the employee's compensation.

• **Model Plan Documents/Amendments for Public School Sponsors and Additional Guidance for 403(b) Sponsors**. The IRS issued Revenue Procedure 2007-71 (the Procedure) containing model 403(b) plan language that may be used by public school sponsors to adopt a written plan document or amend an existing plan document. The model language contained in the Procedure reflects the requirements of the Code and the final 403(b) regulations issued by the IRS earlier this year. (Reinhart's August 2007 Employee Benefits Update describes the final 403(b) regulations.) The final regulations generally apply for tax years beginning on or after January 1, 2009 and require that all 403(b) plans be maintained pursuant to a written document.

The Procedure provides that an eligible employer that is not a public school may use the model 403(b) language as sample language to comply with the requirements of the final regulations. However, the IRS cautions that a non-public school employer may need to modify certain provisions of the model language due to differences in applicable tax or ERISA rules. The IRS also reminds 403(b) plan sponsors that the Procedure only addresses the requirement for a written plan document, and that a 403(b) plan must also satisfy the final regulations in operation.

The Procedure also addresses the deadline for amending plans to reflect the final 403(b) regulations. Sponsors of 403(b) plans must make amendments to comply with the final regulations no later than the first day of the first tax year beginning after December 31, 2008. This means most 403(b) plans will need to be amended no later than January 1, 2009. Further, the Procedure provides some transitional relief to the written plan and information sharing requirements of the final 403(b) regulations for certain contracts or custodial accounts that were issued or exchanged before January 1, 2009. The IRS is seeking comments on the model language. Comments are due by March 16, 2008.

IRS 2007 Cumulative List of Changes in Plan Qualification Requirements

The IRS issued the "2007 Cumulative List of Changes in Plan Qualification Requirements," as Notice 2007-94. The 2007 Cumulative List details the plan qualification requirements that must be adopted by plan sponsors submitting IRS determination letter requests during Cycle C of the EGTRRA remedial amendment

cycle. Cycle C runs from February 1, 2008 through January 31, 2009. Generally, a plan falls into Cycle C if it is an individually designed plan and the last digit of the plan sponsor's EIN is a 3 or an 8 or it is a Code section 414(d) governmental plans (including a governmental multiemployer plan or a governmental multiple-employer plan). The 2007 Cumulative List reflects many of the qualification requirements described in the 2004, 2005 and 2006 Cumulative Lists and updates the list for more recent guidance, such as guidance relating to the PPA. As a reminder, the IRS points out in Notice 2007-94 that a plan must comply with all relevant qualification requirements, not just those that appear on the 2007 Cumulative List, to remain qualified.

HEALTH AND WELFARE PLAN DEVELOPMENTS

Temporary IRS Regulations on Reporting Employer-Owned Life Insurance Contracts

The IRS issued temporary regulations regarding information reporting on employer-owned life insurance contracts under Code section 6039I. The temporary regulations, which also serve as proposed regulations, are effective November 13, 2007 and apply to tax years ending after the effective date. As background, the PPA added Code sections 101(j) and 6039I establishing income exclusion rules and reporting requirements applicable to an employer that is a direct or indirect beneficiary of a life insurance contract covering one or more of its employees. Code section 101(j) and 6039I generally apply to life insurance contracts issued after August 17, 2006. The temporary regulations merely provide that the IRS may prescribe the form and manner of satisfying the reporting requirements of Code section 6039I. The IRS will likely provide more information on the reporting requirements in less formal guidance, such as in a revenue procedure or IRS forms and instructions. The regulations also solicit comments on the need for guidance on specific reporting issues. Comments are due by January 14, 2008.

No Restitution under ERISA for Fiduciary Misrepresentations

The Fifth Circuit Court of Appeals held that ERISA section 502(a)(3) provides no remedy to a life insurance plan beneficiary for an employer's fiduciary misrepresentations about the life insurance plan's eligibility criteria. Amschwand v. Spherion Corp., 2007 WL 3027072 (5th Cir. 2007). Although the court in this case concluded that the plaintiff was not entitled to "make-whole" damages despite the employer's fiduciary misrepresentations, plan sponsors should be

careful to follow their ERISA fiduciary duties when communicating a plan's terms and operation to employees.

Thomas Amschwand was an employee of Spherion Corporation (Spherion). After Amschwand took a medical leave, Spherion switched providers for its group life insurance plan (the Plan). The new Plan contained an "actively-at-work" rule, which provided that the effective date of an employee's coverage would be the date he or she returned to active work. Spherion failed to tell Amschwand about the actively-at-work rule and repeatedly assured him that he had nearly $400,000 in coverage. Amschwand paid the premiums on the policy while on medical leave until his death in February 2001. After Amschwand died, his wife's claim for life insurance benefits under the Plan was rejected by the insurer. The insurer rejected the claim because Amschwand was ineligible to participate in the Plan due to the actively-at-work rule. Amschwand's widow sued Spherion, arguing that it violated its ERISA fiduciary duties by misleading Amschwand and requesting the approximately $400,000 she would have received if Amschwand had been covered by the Plan.

The Fifth Circuit affirmed the trial court and held that the relief requested by Amschwand's widow did not qualify as "appropriate equitable relief" under ERISA section 502(a)(3). The court relied on the Supreme Court's precedent in the *Great-West Life* and *Sereboff* cases regarding equitable relief and reasoned that the widow's claim failed because Spherion never took possession of the life insurance proceeds she was requesting. Without this element of possession, the widow was not requesting the type of equitable relief available under ERISA.

Lack of Interpretive Authority Resulted in Non-Deferential Standard of Review

The Ninth Circuit Court of Appeals held that because a medical review committee under a long-term disability plan (the Plan) had no formal delegation of authority to interpret the Plan's eligibility rules, the committee's decision to revoke benefits was subject to a de novo (non-deferential) standard of review. *Shane v. Albertson's Inc.*, 2007 WL 2983801 (9th Cir. 2007). As demonstrated by the outcome of this case, it is imperative to have in place proper and formal delegations of fiduciary authority under an employee benefit plan, such as when a separate benefits committee decides eligibility issues.

Stacey Shane was a participant in the Plan. After sustaining a knee injury, Shane began receiving Plan benefits in January 2000. In April 2003, Shane's Plan benefits

ceased because the Albertson's Inc. medical review committee determined that Shane no longer met the definition of "total disability" required under the Plan to receive benefits. Following the committee's denial of her administrative appeal, Shane filed suit.

The Ninth Circuit refused to apply the deferential "abuse of discretion" standard to the committee's determination because the committee had no discretionary authority to interpret the Plan's eligibility rules. The Plan provided that the Plan's trustees had the discretionary authority to review and evaluate benefit claims. While the Plan also provided that the trustees could delegate this discretionary authority, the court concluded that there was no documentary evidence of any formal delegation to the committee. The court applied a non-deferential standard of review to the committee's determination and concluded that Shane's Plan benefits should be reinstated.

GENERAL TOPICS

Joint Guidance on Form 5500 for 2009 Plan Years

The DOL, IRS and PBGC jointly published final Form 5500 regulations and issued final revisions to the 2009 Form 5500. Most significantly, the joint guidance delays the effective date of mandatory electronic filing of Form 5500 until plan years beginning on or after January 1, 2009. Under this new effective date, plan sponsors with calendar-year plans will have until at least July 2010 to comply with the electronic filing requirement. The following paragraphs highlight some other key provisions of the joint guidance:

- The PPA requires simplified reporting for small plans (*i.e.*, plans with fewer than 25 participants) for plan years beginning after December 31, 2006. The DOL has finalized a short form for small plans and certain other types of plans (Form 5500-SF). However, the short form will not be available until the fully electronic system is available for 2009 plan years. In the interim, the guidance offers these plans a simplified reporting option under the existing forms.

- The PPA changes the actuarial schedules required for defined benefit plans beginning with 2008 plan years. Although the DOL is revising its forms to reflect this PPA change, these forms will not apply until 2009 plan years. For 2008 plan years, defined benefit plans will need to file the actuarial schedules as a non-standard attachment to satisfy the PPA's requirements.

- The revised forms and instructions provide for increased transparency of plan-

related fees and expenses on Schedule C to the Form 5500, and contain new questions regarding the funding of defined benefit plans.

- The revised forms and instructions revise the reporting rules applicable to 403(b) plans to make them more compatible with the rules applicable to 401(k) plans.

NOTE: Effective for plan years beginning in 2008, plan administrators of defined benefit plans are not required to provide a Summary Annual Report (SAR). Instead, some of the information on the SAR will be included in the new funding notice required by the PPA.

Proposed Amendments to Prohibited Transaction Class Exemption for Litigation Settlements

The DOL announced proposed amendments to an existing class exemption from ERISA's and the Code's prohibited transaction restrictions. The existing class exemption is Prohibited Transaction Exemption (PTE) 2003-39. PTE 2003-39 deals with litigation settlement, and it currently requires that the consideration paid by related parties in settlement generally be in the form of cash. The proposed amendments would expand PTE 2003-39 to permit the receipt of non-cash consideration in settlement of a claim (such as future employer contributions and benefit enhancements) when the consideration can be objectively valued and also the receipt of non-qualifying employer securities (such as stock rights) in settlement of litigation. The proposed amendments would amend PTE 2003-39 to clarify the role of the independent plan fiduciary in evaluating the reasonableness of the entire settlement, including any award of attorney's fees. The proposed amendments will be effective upon publication in final form. Written comments on the proposed amendments must be submitted to the DOL before January 22, 2008.