Reinhart

February 2008 Employee Benefits Update

SELECT COMPLIANCE DEADLINES

Qualified Retirement Plans

• **Cycle C Individually Designed Plans' Submission Period Opened February 1, 2008**. Effective February 1, 2008, the Internal Revenue Service (IRS) began accepting determination letter applications for Remedial Amendment Period Cycle C individually designed plans. Cycle C plans must be submitted for a determination letter before February 1, 2009 to rely on the extended period during which qualification amendments may be retroactively adopted. Cycle C plans include those sponsored by employers with identification numbers (EINs) ending in a three or eight as well as governmental plans. Determination letter applications for Cycle C plans will be reviewed for the requirements of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and other changes in qualification requirements and guidance contained in the IRS's 2007 Cumulative List.

• **PBGC Form 1-ES (Estimated Premium Payment) for Calendar Year Plans Is Due by February 29, 2008**. Sponsors of defined benefit plans with 500 or more participants must file Form 1-ES (Estimated Premium Payment) and make an estimated flat-rate premium payment with the Pension Benefit Guaranty Corporation (PBGC) by the end of the second full month of the plan year (i.e., February 29, 2008 for calendar year plans). The PBGC recently announced the availability of its 2008 electronic estimated premium payment system for filers of Form 1-ES. Except for limited exemptions, all premium filings must now be made electronically.

• **Deadline for Making Corrective Distributions of Failed ADP/ACP Tests Without Excise Tax is March 15, 2008 for Calendar Year Plans**. Sponsors of calendar year plans that failed the actual deferral percentage (ADP) test and/or actual contribution percentage (ACP) test for 2007 must make any corrective distributions by March 15, 2008 (*i.e.*, 2 ½ months after the end of the plan year) to avoid a 10% excise tax. Also, any ADP/ACP corrective distributions must be distributed with gap period income (gains and losses from January 1, 2008 to the actual date of distribution). The final 401(k) regulations require the distribution of gap period income for 2006 and 2007 plan years. The Pension Protection Act of 2006 (PPA) repeals the requirement that plans distribute gap period income with

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ADP/ACP corrective distributions effective for the 2008 plan year.

• **Annual Certification of Multiemployer Plan Status is Due by March 30, 2008 for Calendar Year Plans**. Effective for plan years beginning after 2007, the PPA requires actuaries of multiemployer plans to certify to the IRS and to the plan sponsor (1) whether or not the plan is in endangered status or is (or will be) in critical status for that plan year and (2) for a plan that is in a funding improvement or rehabilitation period, whether or not the plan is making scheduled progress toward meeting the requirements of its funding improvement or rehabilitation plan. This certification is due no later than the 90th day of each plan year (i.e., March 30, 2008 for calendar year plans). Sponsors and administrators of multiemployer plans should confirm their actuaries have the necessary information to complete the certification by the deadline.

Health and Welfare Plans

• **Medicare Part D Creditable Coverage Disclosure to CMS Is Due by March 1, 2008 for Calendar Year Plans**. Under Medicare Part D regulations, most group health plans offering prescription drug coverage to Part D eligible individuals must annually disclose to the Centers for Medicare & Medicaid Services (CMS) whether the coverage is creditable or non-creditable. Group health plan sponsors comply with the CMS disclosure requirement by completing a disclosure form on the CMS website and filing the form electronically. The annual filing deadline is 60 days after the first day of the plan year (i.e., March 1, 2008 for calendar year plans). In addition, disclosure forms must be filed within 30 days after the termination of a plan's prescription drug coverage or a change in its creditable coverage status.

• **Deadline for Complying with HIPAA's National Provider Identifier Rules Is May 23, 2008**. Effective May 23, 2008, HIPAA requires small heath plans ($5 million or less in annual receipts) to use a new National Provider Identifier (NPI) when electronically conducting certain HIPAA standard transactions. The NPI rules applied to large health plans (more than $5 million in annual receipts) effective May 23, 2007. In addition, as reported in Reinhart's May 2007 Employee Benefits Update, CMS provided one-year enforcement relief for large health plans that implement a contingency plan and make reasonable and diligent good-faith efforts to comply with the NPI rules. The enforcement relief for large health plans is set to expire on May 23, 2008.

RETIREMENT PLAN DEVELOPMENTS

DOL Guidance on Proxy Voting by Fiduciaries

The Department of Labor (DOL) issued Advisory Opinion 2007-07A providing guidance for ERISA plan fiduciaries on proxy activity. As background, ERISA section 404 requires a plan fiduciary to act prudently, solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of paying benefits and defraying reasonable administrative expenses. Consistent with prior DOL guidance on proxy voting, the DOL states in Advisory Opinion 2007-07A that ERISA's prudence and exclusive purpose requirements are violated when pension plan fiduciaries use plan assets to further public policy or political issues through proxy resolutions that have no connection to enhancing the value of the plan's investment in a corporation. For example, the DOL provides that a proxy resolution requiring corporate directors and officers to disclose their personal political contributions appears sufficiently remote from the enhancement of shareholder value to raise ERISA fiduciary compliance issues.

Additional IRS Guidance on Lump Sum Distributions from Defined Benefit Plans

As discussed in Reinhart's November 2007 Employee Benefits Update and December 2007 Employee Benefits Update, the PPA revised the applicable interest rate and mortality table under Internal Revenue Code (the 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). The IRS has now issued Notice 2008-17, setting forth the following minimum present value segment rates (based in part on the December 2007 30-year Treasury rate of 4.53) for plan years beginning in 2008:

	First Segment ≤ 5 Years	Second Segment 6-20 Years	Third Segment 20+ Years
December 2007	4.61	4.85	4.96

The above segment rates for December 2007 would be the applicable interest rate for lump sum distributions payable in 2008 for a calendar plan year and

stability period and a look-back month of December. The minimum present value segment rates for August 2007, September 2007, October 2007 and November 2007 are listed in Reinhart's November 2007 Employee Benefits Update and December 2007 Employee Benefits Update.

Tax Technical Corrections Act of 2007 - Designated Roth Contribution Clarifications

The Tax Technical Corrections Act of 2007 (the Act) was passed by Congress and signed by the President in late December 2007. Among other tax provisions, the Act makes the following clarifications for designated Roth contributions:

- *Application of Special Deferral Limit*. Code section 402(g)(7) provides a special rule allowing certain employees to make additional elective deferrals to a tax-sheltered 403(b) annuity, subject to (1) an annual limit of $3,000 and (2) a cumulative limit of $15,000 minus the amount of additional elective deferrals made in previous years under the special rule. The Act clarifies that the $15,000 cumulative amount is reduced only by additional designated Roth contributions made under the special rule.
- *FICA Tax Application*. The Act clarifies that designated Roth contributions are included in wages for purposes of Social Security and Medicare taxes.

IRS Transitional Guidance on PPA's New Funding Rules

The IRS issued Notice 2008-21 (the Notice) announcing a later effective date for applying certain proposed regulations under the PPA's new funding rules and providing transitional guidance for 2008 plan years under Code section 436 for small plans with end-of-year valuation dates. As background, Code section 412 provides minimum funding rules that generally apply to defined benefit plans. The PPA added Code section 430 specifying the minimum funding requirements that apply to single employer defined benefit plans (including multiple employer plans) pursuant to Code section 412. The PPA also added Code section 436 setting forth a series of limitations on the accrual and payment of benefits from an underfunded plan. The PPA's funding changes are generally effective for plan years beginning after December 31, 2007.

In 2007, the IRS issued: (1) proposed regulations under Code section 430(h) regarding substitute mortality tables; (2) proposed regulations under Code section 430(f) regarding maintenance of certain funding balances; and (3) proposed regulations under Code section 436 regarding limits on benefit accruals

and payments. These regulations were originally proposed to be effective for 2008 plan years. To provide a uniform effective date with other PPA funding guidance, the Notice provides that, when the above-described regulations are finalized, they will not apply to plan years beginning before January 1, 2009. For 2008 plan years, plan sponsors must follow a reasonable interpretation of Code sections 430 and 436 and may rely on the proposed regulations. The Notice also lists certain restrictions on complying with the PPA's new funding rules for 2008. For example, substitute mortality tables may be used for 2008 plan years only if they are approved by the IRS under the procedures of Revenue Procedure 2007-37. In addition, the Notice contains a 2008 transition rule for applying the benefit limitations of Code section 436 to small plans with end-of-year valuation dates. Comments on this transition rule and related suggestions are requested and must be submitted by April 21, 2008.

Early Retirement Payments Are "Wages" Subject to FICA Tax

The Third Circuit Court of Appeals ruled that early retirement payments made by the University of Pittsburgh (the University) to its tenured faculty are "wages" subject to FICA tax. *University of Pittsburgh v. United States*., 507 F.3d 165 (3rd Cir. 2007). To qualify for the early retirement payments, faculty members were required to relinquish their tenure rights. From 1996 to 2001, the University paid over $2 million in FICA taxes on early retirement payments. In 2001, the University sought a refund from the IRS on the ground that the early retirement payments were not "wages" but buyouts of tenured status not subject to FICA. The IRS denied the refund, and the University initiated a lawsuit.

Code section 3121 broadly defines FICA wages as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." In Revenue Ruling 2004-110, the IRS provides that a separation payment does not constitute FICA wages if the employee provides clear, separate and adequate consideration for the employer's payment that is not dependent upon the employee-employer relationship and its component terms and conditions. The Third Circuit concluded that the relinquishment of tenure rights, although a necessary component to receiving the early retirement payments, did not alter the payments' character as compensation for past services. Thus, the court ruled in favor of the government and held that the early retirement payments are FICA wages.

Comment: The law on this issue is unsettled. Two other circuit courts have addressed the FICA tax treatment of similar early retirement payments with

differing rulings. Consistent with the Third Circuit, the Sixth Circuit held that early retirement payments made to public school teachers who relinquished their tenure rights were wages subject to FICA tax. Appoloni v. United States, 450 F.3d 185 (6th Cir. 2006). In contrast, the Eighth Circuit held that early retirement payments made to university faculty who gave up their tenure rights were not wages subject to FICA. North Dakota State Univ. v. United States, 255 F.3d 599 (8th Cir. 2001).

HEALTH AND WELFARE PLAN DEVELOPMENTS

Medicare, Medicaid and SCHIP Extension Act of 2007 - New Medicare Secondary Payer Reporting Requirement

The Medicare, Medicaid and SCHIP Extension Act of 2007 (the Act) was signed into law in late 2007. Among other provisions, the Act contains a new Medicare secondary payer reporting requirement effective January 1, 2009. The Act requires group health plan insurers, administrators and fiduciaries to gather information and identify situations where the group health plan is or should be primary to Medicare and to submit the information to the Department of Health and Human Services (HHS). The Act authorizes HHS to specify the exact information that must be reported as well as the form and manner for providing the information. The Act authorizes a civil penalty of $1,000 for each day of noncompliance for each individual for whom information was required to be submitted. The scope of this new reporting requirement will be more ascertainable once HHS releases its required guidance.

No COBRA Qualifying Event Following Leave of Absence Without Medical Coverage

The Sixth Circuit Court of Appeals held that an employee's termination of employment following a medical leave of absence was not a COBRA qualifying event because the employee was not covered under the employer's health plan during his leave. Jordan v. Tyson Foods, Inc., 2007 WL 4455435 (6th Cir. 2007). This case demonstrates the complexities of coordinating COBRA rights with employee leaves of absence, and highlights the importance of understanding which events trigger COBRA rights. Also, although the court ruled in favor of the employer in this case, other courts may reach a different conclusion.

The plaintiff was covered under his employer's group health plan (the Plan) until he took a six-month leave of absence. The first twelve weeks of the plaintiff's leave were covered by the Family and Medical Leave Act (FMLA). Although he

remained eligible for plan coverage during his leave, the plaintiff did not pay any of the required premiums during this time. The plaintiff was fired when he did not return to employment at the end of his leave. The plaintiff sued his employer for failure to provide COBRA coverage under the plan.

The Sixth Circuit affirmed the trial court and entered judgment in favor of the plaintiff's employer. The court held that the plaintiff's termination of employment was not a COBRA qualifying event because his termination did not result in a loss of plan coverage. The court also rejected the plaintiff's argument that the FMLA required his employer to provide him with COBRA coverage. The court noted that COBRA provides that an FMLA leave can result in a COBRA qualifying event if an employee who does not return from an FMLA leave (1) was covered under his employer's health plan the day before taking the FMLA leave, (2) does not return to employment at the end of the FMLA leave, and (3) would lose health coverage in the absence of COBRA. The court noted that the third element was not met by the plaintiff because the plaintiff would have remained covered under the plan if he had paid his premiums. Thus, the court ruled that the plaintiff was not entitled to COBRA coverage.

IRS Guidance on "Qualifying Relative" under the Definition of "Dependent"

The IRS issued Notice 2008-5 providing guidance on when a child is a "qualifying relative " under the Code section 152 definition of "dependent." As background, an employer may provide nontaxable health coverage to an employee's "dependent" as defined under Code section 152. For this purpose, Code section 152 defines "dependent" to include a "qualifying child" or "qualifying relative." Code section 152 provides that a child is not a qualifying relative of the taxpayer if he or she is a qualifying child of any other taxpayer. Notice 2008-5 clarifies that an individual is not a qualifying child of any other taxpayer if the individual's parent (or other person with respect to whom the individual is defined as a qualifying child) is not required to file an income tax return under Code section 6012 and (1) does not file an income tax return or (2) files an income tax return solely to obtain a refund of withheld income taxes. Notice 2008-5 applies to taxable years beginning after December 31, 2004.

Rejection of "Scrivener's Error" Theory to Retroactively Amend Life Insurance Policy

The Fourth Circuit Court of Appeals rejected an insurer's attempt to retroactively amend a life insurance policy to address a scrivener's or clerical error. *Blackshear*

v. Reliance Standard Life Ins. Co., 2007 WL 4277588 (4th Cir. 2007). This case demonstrates the general unwillingness of courts to recognize scrivener's error in the ERISA plan context, and underscores the importance of carefully reviewing plan provisions for accuracy.

Verdie Blackshear died shortly after she began working as a nurse at Duplin General (Duplin). Duplin maintained a group life insurance policy (the Policy) for its employees. Both the policy and its summary plan description (SPD) provided that nonexempt employees such as Blackshear were not subject to a waiting period, meaning that the policy's coverage took effect immediately upon Blackshear's employment. The plaintiff, Blackshear's named beneficiary under the policy, filed a claim for the life insurance proceeds following Blackshear's death. The plaintiff's claim was denied because, contrary to the Policy's and SPD's language, Duplin intended for a six-month waiting period to apply to all employees. The insurer then issued a new policy providing for the universal six-month waiting period.

The Fourth Circuit reversed the district court's decision and rejected both theories presented by the insurer for denying the plaintiff's claim. First, the court held that the plaintiff's right to the policy's benefits vested on Blackshear's death and the insurer could not rely on the "clerical errors" provision of the contract to divest benefits that were already due. Second, the court rejected the insurer's attempt to equitably reform the policy to correct the scrivener's error. The court stated that the doctrine of equitable reformation does not apply in the context of an administrator's interpretation of an ERISA plan and held that an administrator cannot "reform" a plan to correct what it unilaterally perceives to be a mistake or error contained in the plan's written terms.

San Francisco May Temporarily Enforce Its "Fair Share" Law

The Ninth Circuit Court of Appeals ruled that the City of San Francisco may temporarily enforce its fair share law while it appeals a lower court's ruling that the law is invalid on ERISA preemption grounds. *Golden Gate Restaurant Ass'n v. City and County of San Francisco*, 2008 WL 90078 (9th Cir. 2008). Among other requirements, the law requires covered employers with twenty or more employees to either pay a fee to the City or make certain health care expenditures at rates based on the size of the employer. Covered employers with fifty or more employees must comply with the employer spending requirements effective January 1, 2008, while covered employers with less than fifty employees have until April 1, 2008 to comply with the spending requirements. (More

information about the fair share law is available at Healthy San Francisco.) In making its ruling, the Ninth Circuit noted that the City has "a probability, even a strong likelihood, of success" in its argument that the fair share law is not preempted by ERISA.

Comment: At this point, the Ninth Circuit has only ruled on the City's motion to stay the lower court's decision. The Ninth Circuit still needs to rule on the merits of the ERISA preemption argument. Other courts have ruled that similar fair share laws are preempted by ERISA. For example, Reinhart's February 2007 Employee Benefits Update discusses the Fourth Circuit's holding that Maryland's fair share law is preempted by ERISA and thus unenforceable.

National Defense Authorization Act of 2008 - Expanded FMLA Leave

The President signed the National Defense Authorization Act of 2008 (NDAA) into law in late January 2008 expanding the FMLA for the first time since its enactment in 1993. The NDAA expands the FMLA to provide broader leave protections for military families. Group health plan sponsors subject to the FMLA should take note of this expansion as group health plan benefits generally must be maintained for employees on FMLA leave based on the same terms and conditions that would have applied if the employees continued to work. When employees return from FMLA leave, group health coverage must be restored.

The NDAA provides for the following two additional types of leave:

- *Qualifying Exigency Leave*. The NDAA provides that an eligible employee may take up to twelve weeks of FMLA leave because of any qualifying exigency arising because the employee's spouse, son, daughter or parent is on active duty or has been called to active duty in support of a contingency operation. The term "qualifying exigency" is to be defined under future DOL regulations. This portion of the NDAA is not effective until the DOL issues its guidance. On the DOL website, the DOL notes that it is working on its guidance, and encourages employers to provide this type of leave to eligible employees in the interim.

- *Leave to Care for Ill or Injured Servicemember*. The NDAA provides that an eligible employee who is the spouse, son, daughter, parent or next of kin of a covered servicemember may take up to 26 weeks of unpaid leave during a twelve-month period to care for the servicemember. A "covered servicemember" is a member of the armed forces who is undergoing medical treatment, recuperation or therapy, is an outpatient or is on the temporary disabled

retired list, for a serious injury or illness. This provision goes into effect immediately.