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January 2009 Employee Benefits Update

POSTED:

Dec 31, 2008

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SELECT COMPLIANCE DEADLINES AND REMINDERS

Cycle D Individually Designed Plans' Submission Period Opens February 1, 2009

Effective February 1, 2009 the Internal Revenue Service (IRS) will begin accepting determination letter applications for Remedial Amendment Period Cycle D individually designed plans. In general, Cycle D plans must be submitted for a determination letter before February 1, 2010 to rely on the extended period during which qualification amendments may be retroactively adopted. Cycle D plans include those sponsored by employers with identification numbers (EINs) ending in a four or nine, as well as multiemployer plans. As an alternative to submitting a plan in Cycle D, the IRS recently provided that a plan sponsor of a Cycle D plan whose first plan year beginning on or after January 1, 2009 ends after January 31, 2010, may defer submission of its plan until Cycle E (February 1, 2010 through January 31, 2011).

Review Compliance with 2009 Benefit Limits and Factors

In the fourth quarter of 2008, the IRS announced the cost-of-living adjustments to benefit limits for 2009, such as the increase in maximum annual elective deferrals to a 401(k), 403(b) or 457(b) plan from $15,500 for 2008 to $16,500 for 2009. Employee benefit plan sponsors and administrators should become familiar with the 2009 limits and make any necessary changes to reflect the new limits. In addition, defined benefit plan sponsors and administrators should confirm that the factors used to adjust lump sum benefits and other accelerated payment forms under Internal Revenue Code (the "Code) section 417(e)(3) reflect the plan's method for incorporating the Pension Protection Act of 2006 (PPA) assumptions.

Medicare Part D Creditable Coverage Disclosure to CMS Is Due by March 1, 2009 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, 2009 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.

DOL Form M-1 Filing Deadline is March 2, 2009

The deadline for filing the 2008 Form M-1 with the Department of Labor (DOL) is March 2, 2009, with an extension until May 1, 2009 available. Form M-1 filers generally include multiple employer welfare arrangements (MEWAs) that provide health benefits and certain entities that claim they are not MEWAs because of the exception for plans maintained under a collective bargaining agreement. The 2008 Form M-1 is substantially identical to the 2007 Form M-1. As in past years, the form's instructions include self-compliance checklists that are useful for all group health plans, not just Form M-1 filers. The checklists include numerous examples and practical tips to help group health plans comply with HIPAA's portability requirements, the Mental Health Parity Act, the Newborns' and Mothers' Health Protection Act and the Women's Health and Cancer Rights Act. Copies of Form M-1 (and related instructions) are available on the DOL website.

RETIREMENT PLAN DEVELOPMENTS

Worker, Retiree and Employer Recovery Act of 2008

On December 23, 2008, President Bush signed into law the Worker, Retiree and Employer Recovery Act of 2008 (the "Recovery Act"). The Recovery Act includes technical corrections to the PPA and relief provisions related to the current economic crisis. The paragraphs below highlight some key provisions of the Recovery Act.

PPA Technical Corrections. The Recovery Act's technical corrections to the PPA include the following:

- "*Smoothing" of Plan Assets*. The averaging method for determining the value of assets in a single-employer defined benefit plan must take into account expected earnings in addition to contributions and distributions, resulting in "asset smoothing," effective for plan years beginning after December 31, 2007. (The Recovery Act does not expand the "corridor" around fair market value. Under the current "corridor," the smoothed value of plan assets must be between 90% and 110% of the fair market value of plan assets.)

- *Deduction Limit*. The overall deduction limit for defined contribution and defined benefit plans only applies to the extent that defined contribution plan

contributions exceed six percent of compensation. Effective for contributions for tax years beginning after 2005, if the defined contributions are less than six percent of compensation, the defined benefit plan is not subject to the overall deduction limit. If defined contributions exceed six percent of compensation, only defined contributions in excess of six percent of compensation are counted toward the overall deduction limit.

- *Nonspouse Beneficiary Rollovers*. Effective for plan years beginning after December 31, 2009 (i.e., January 1, 2010 for calendar-year plans), plans will be required to provide direct rollovers for nonspouse beneficiaries, generally subject to the same rules as other eligible rollovers (*e.g.*, mandatory withholding and rollover notice rules).

- *Designated Roth Rollovers*. Effective for distributions made after December 31, 2007, rollovers from designated Roth accounts under qualified plans to Roth IRAs are not subject to the gross income inclusion and adjusted gross income conditions.

- *Gap-Period Income*. Effective for plan years beginning after December 31, 2007, the requirement to distribute gap-period income (gains and losses from the following January 1 to the actual date of distribution) with excess deferrals is eliminated. (The PPA eliminated the requirement to distribute gap-period income with actual deferral percentage (ADP) and actual contribution percentage (ACP) corrective distributions, effective for 2008 plan years.)

Relief Provisions—Current Economic Crisis. The Recovery Act's relief provisions relating to the current economic crisis include the following:

- *Required Minimum Distributions*. No minimum distributions under Code section 401(a)(9) are required from IRAs and employer-sponsored defined contribution plans (i.e., 401(k), 403(b) and certain 457(b) plans) for 2009. If a beneficiary is receiving distributions over a five-year period, he or she can waive the distribution for 2009, effectively lengthening the distribution period to six years. If a withdrawal is taken in 2009 (other than a required minimum distribution for 2008), the withdrawal may be an eligible rollover distribution. Because the Recovery Act only provides relief for 2009, individuals who attained age 70 ½ in 2008 must receive their first required minimum distribution payment by April 1, 2009. (The suspension of required minimum distributions for 2009 does not apply to defined benefit plans.)

- *Multiemployer Defined Benefit Plans*. Additional funding rules apply to a multiemployer defined benefit plan that is in endangered or critical status, including the adoption of a funding improvement or rehabilitation plan. For the first plan year beginning on or after October 1, 2008, a multiemployer plan sponsor may elect to treat the plan's funded status the same as the plan's status for the preceding plan year. If a plan sponsor elects to retain the plan's endangered or critical status from the preceding plan year, the plan is not required to update its funding improvement or rehabilitation plan until the following plan year. Also, after taking into consideration any election to treat the plan's funded status the same as the plan's status for the preceding plan year, the sponsor of a multiemployer plan in endangered or critical status may elect for a 2008 or 2009 plan year to extend the plan's funding improvement or rehabilitation plan by three years.

- *Single-Employer Defined Benefit Plans*. Under a PPA transition rule, a shortfall amortization base does not have to be established for a plan year during the transition period if the value of a plan's assets for a plan year is at least equal to the applicable percentage of the plan's funding target for the year 2008 (92%), 2009 (94%) and 2010 (96%). The Recovery Act revises the minimum funding rules by allowing plans to use the transition rule, as opposed to funding at 100%, regardless of whether the plan's shortfall amortization base was zero for each preceding plan year after 2007. In addition, for the first plan year beginning on or after October 1, 2008, the future benefit accrual limitation of Code section 436 is determined by substituting the preceding year's adjusted funding target attainment percentage (AFTAP) for the current year's AFTAP, provided the preceding year's AFTAP is greater.

Deadline Extension for 403(b) Plan Documents

On December 11, 2008, the IRS issued Notice 2009-3 extending the deadline for 403(b) plan sponsors to adopt written plan documents (or amend existing plans) until the end of 2009. As background, the IRS published final regulations under Code section 403(b) in July 2007 implementing numerous changes for 403(b) plans and reflecting the growing similarities between 403(b) and 401(k) plans. The IRS's final 403(b) regulations generally apply for tax years beginning on or after January 1, 2009. One of the most significant changes made by the final regulations is that all 403(b) plan sponsors must maintain a written plan document that satisfies the final regulations in both form and operation. Notice 2009-3 states that the IRS will consider 403(b) plans as meeting the requirements of Code

section 403(b) and the final regulations for 2009 if the plan sponsor does all of the following:

- Adopts or amends a written plan document by December 31, 2009 that is intended to satisfy Code section 403(b) and the final regulations effective January 1, 2009;
- Operates the plan during 2009 under a "reasonable interpretation" of Code section 403(b) and the final regulations; and
- Makes its "best effort" to retroactively correct by the end of 2009 any operational failure to conform to the written plan, based on general correction principles of the IRS's Employee Plans Compliance Resolution System (EPCRS).

Although this transition relief provides 403(b) plan sponsors with additional time to adopt or amend written plans, 403(b) plans must still operate under a "reasonable interpretation" of the final regulations effective January 1, 2009. The IRS intends to issue further guidance on 403(b) plans, including a prototype plan program and a determination letter program. According to the IRS, these programs will allow 403(b) plans to correct plan document failures for years after 2009 by making remedial amendments. The IRS also intends to modify EPCRS to include additional 403(b) issues.

PBGC Final Rules on Multiemployer Plan Withdrawal Liability

The Pension Benefit Guaranty Corporation (PBGC) issued final regulations implementing PPA changes to ERISA's withdrawal liability rules and amending the current regulations' provisions on allocating unfunded vested benefits (UVBs). Under ERISA section 4201, an employer that withdraws from a multiemployer defined benefit plan may incur withdrawal liability to the plan. Withdrawal liability represents the employer's allocable share of the plan's UVBs determined under ERISA section 4211, as adjusted under other ERISA provisions. ERISA section 4211 prescribes four general methods that a plan may use to allocate UVBs to a withdrawing employer: (1) the presumptive method; (2) the modified presumptive method; (3) the rolling-5 method; and (4) the direct attribution method.

The presumptive and modified presumptive methods are based in part on the plan's UVBs as of the end of the last plan year ending before September 26, 1980. The PPA modified ERISA's withdrawal liability rules to permit a plan to apply the presumptive method by substituting a different plan year for the plan year ending before September 26, 1980. The PPA also amended ERISA to provide that benefit

adjustments and employer surcharges applicable to plans in critical funding status are disregarded in determining a plan's UVBs and allocating withdrawal liability to employers.

The final regulations implement the above-described PPA changes to ERISA's withdrawal liability rules. The final regulations also make non-PPA related changes to the presumptive and modified presumptive methods for allocating UVBs. For example, the regulations permit plans using the modified presumptive method to designate a plan year that would substitute for the last plan year ending before September 26, 1980. The regulations also revise the rules under ERISA section 4219 for reallocating liability when a multiemployer plan terminates because of mass withdrawal. The regulations are generally effective for withdrawals occurring on or after January 29, 2009, with some exceptions for provisions incorporating PPA changes.

HEALTH AND WELFARE PLAN DEVELOPMENTS

Mental Health Parity – Effective Date Clarification for Collectively Bargained Plans
President Bush signed into law the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 (the "Act") in early October 2008. The Mental Health Parity Act of 1996 (MHPA) prohibits group health plans from imposing a lower annual or lifetime dollar limit on mental health benefits than the limit it imposes on medical or surgical benefits. MHPA does not restrict other types of limits on mental health benefits, such outpatient visit limits. The Act goes further than MHPA in terms of requiring parity for mental health benefits.

The Act makes permanent MHPA's parity requirements, which were scheduled to sunset at the end of 2008. The Act also amends ERISA, the Code and the Public Health Service Act to require group health plans providing mental health or substance abuse benefits to provide such coverage at the same level as the coverage for medical or surgical benefits. With respect to group health plans' mental health or substance abuse benefits, the Act's expanded parity rules prohibit inequity in financial requirements (*e.g.*, deductibles, copayments, coinsurance and out-of-pocket expenses), treatment limits (*e.g.*, limits on frequency or number of visits) and out-of-network coverage.

The Act is generally effective for plan years beginning after October 3, 2009 (January 1, 2010 for calendar-year plans). A special effective date applies to collectively bargained plans. On December 23, 2008, President Bush signed legislation clarifying that, for collectively bargained plans, the Act's provisions will

not apply to plan years beginning before the later of: (1) January 1, 2010 (January 1, 2009 in the original legislation); or (2) the date the last collective bargaining agreement related to the plan terminates (determined without regard to any extension agreed to after October 3, 2008).

Post-*Glenn* Standard of Review for Discretionary Benefit Claim Determinations

The Second and Fourth Circuits recently addressed whether their standard of judicial review for discretionary benefit claim determinations survived the Supreme Court's decision in *Metropolitan Life Insurance Company v. Glenn*. The U.S. Supreme Court decided *Glenn* in 2008 to settle a dispute among the circuit courts regarding the impact of a conflict of interest on the standard of judicial review for discretionary benefit claim determinations. In 1989, the Supreme Court decided *Firestone Tire & Rubber Co. v. Bruch* holding that where an employer is responsible for deciding eligibility for claims and making claims payment, the employer acts under a conflict of interest that is a relevant factor in determining whether the employer abused its discretion. In Glenn, the Supreme Court concluded that this rule extends to an insurer that administers the plan and pays benefits. The *Glenn* court clarified that the existence of a conflict of interest does not change the standard of judicial review for discretionary benefit claim determinations, but should be weighed as a factor in determining whether there was an abuse of discretion.

- *Second Circuit – McCauley v. First UNUM Life Insurance Company, 2008 U.S*. App. LEXIS 26094 (2nd Cir. 2008). Under the Second Circuit's pre-*Glenn* analysis, an arbitrary and capricious standard of judicial review applied to a discretionary benefit claim determination, unless the claimant could show that a conflict of interest both existed and affected the reasonableness of the administrator's decision. Upon a showing that the conflict affected the reasonableness of the administrator's decision, the court applied a *de novo* standard of judicial review. In *McCauley*, the Second Circuit recognized held that a conflict of interest exists when a plan administrator both evaluates and pays benefit claims. The Second Circuit held that this conflict of interest must be weighed as a factor in determining whether there was an abuse of discretion, but the conflict does not make *de novo* review appropriate. The *McCauley* court also echoed the Supreme Court's *Glenn* holding by recognizing that an administrator's history of biased claims administration should give additional weight to the existence of the conflict of interest. The court pointed out First UNUM's well-documented history of abusive tactics and deception in holding that its benefit denial was

arbitrary and capricious.

- *Fourth Circuit – Champion v. Black & Decker, 2008 U.S. App. LEXIS 25741 (4th Cir. 2008)*. Under the Fourth Circuit's pre-*Glenn* analysis, an employer with a self-funded benefit plan was not, per se, operating under a conflict of interest when deciding benefit claims. If the court concluded that a conflict of interest existed, the court's pre-*Glenn* analysis called for a modified abuse-of-discretion standard of judicial review intended to neutralize any effect of the conflict of interest. In *Champion*, the Fourth Circuit relied on the Supreme Court's *Glenn* decision and recognized that a conflict of interest is "readily determinable" by a plan administrator's or other fiduciary's dual role. The *Champion* court also rejected its modified abuse-of-discretion standard of judicial review and held that, when a conflict of interest exists, a benefit denial should be reviewed under an abuse-of-discretion standard of judicial review with any conflict of interest being taken into account merely as "one factor" in the court's decision.

Health FSA and HRA Debit Card Transition Relief for Drug Stores and Pharmacies

The IRS issued Notice 2008-104, extending by six months the transition relief for using health flexible spending account (FSA) and health reimbursement arrangement (HRA) debit cards at stores with the drug stores and pharmacies merchant category code (MCC). In Notice 2007-2, the IRS provided that, effective January 1, 2009, health FSA and HRA debit cards may not be used at stores with the drug stores and pharmacies MCC unless: (1) the store participates in the inventory information approval system or (2) 90% of the store's gross receipts during the prior taxable year (determined on a store-location-by-store-location basis) consisted of items qualifying as Code section 213(d) medical expenses. Notice 2008-104 extends the compliance deadline from January 1, 2009 until July 1, 2009.

IRS Guidance on Deduction Timing for Payments under a Self-Insured Health Plan

In Technical Advice Memorandum 200846021 (TAM), the IRS concluded that an accrual method taxpayer providing medical and dental services to employees under a self-insured health plan and paying service providers more than 2 ½ months after the end of the taxable year in which the services were provided, may deduct payments in the taxable year during which the medical and dental services were provided. Under the TAM's facts, the employer was an accrual

method taxpayer maintaining a self-insured medical and dental plan for its eligible employees. The plan's third-party administrator (TPA) generally paid claims within 30 days of receiving a billing from a service provider. However, in certain circumstances, there was a billing delay by the service provider and the TPA paid the service provider more than 2 ½ months after the end of the taxable year in which the services were provided. The IRS separately analyzed the employer's deduction timing issue under the rules of Code sections 404 and 461. In either case, the IRS ruled that the employer may deduct the payments in the taxable year in which the services were provided.

New HIPAA Privacy and Security Guidance on Electronic Exchange of Health Information through a Network

The Department of Health and Human Services (HHS) issued the Nationwide Privacy and Security Framework for Electronic Exchange of Individually Identifiable Health Information (the "Framework"). According to HHS, the Framework's principles establish a single, consistent approach to address the privacy and security challenges when health information is electronically exchanged through a network. Although the HIPAA Privacy and Security Rules address electronic health information, HHS provides that the current landscape of electronic health information exchange poses new issues and involves additional organizations that were not contemplated when the Privacy and Security Rules were issued.

The Framework is composed of the following eight principles: (1) individual access; (2) correction; (3) openness and transparency; (4) individual choice; (5) collection, use and disclosure limitation; (6) data quality and integrity; (7) safeguards; and (8) accountability. The Framework contains a "toolkit" with fact sheets covering the eight principles described above. The toolkit addresses common issues associated with the electronic exchange of health information in a networked environment, including disclosures to and through separate entities called health information organizations (HIOs). (For purposes of this guidance and HIO is an organization that oversees and governs the exchange of health care related information among organizations according to nationally recognized standards.)

NONQUALIFIED DEFERRED COMPENSATION

Proposed 409A Regulations on Income Inclusion and Additional Taxes The IRS issued proposed regulations regarding the calculation of amounts includible in

income due to a violation of Code section 409A and the additional taxes triggered by the violation. The regulations are proposed to be applicable for taxable years beginning on or after the issuance of final regulations. Comments on the proposed regulations are due by March 9, 2009.

As background, Code section 409A generally provides that if certain requirements are not met at any time during a taxable year, amounts deferred under a nonqualified deferred compensation plan for that year and all previous taxable years are immediately includible in income, unless the amounts are subject to a substantial risk of forfeiture (i.e., nonvested) or were previously included in gross income. The amount includible in income under Code section 409A is increased by an additional 20% tax and a premium interest tax. The IRS's proposed regulations describe in detail how to calculate the amounts includible in income under Code section 409A, as well as the calculation of the additional taxes. For example, the proposed regulations provide the following guidance:

- Adverse tax consequences that result from Code section 409A noncompliance would apply only to amounts deferred under a plan in the year the noncompliance occurred and all previous taxable years, to the extent such amounts are not subject to a substantial risk of forfeiture and have not previously been included in income. A failure to comply with Code section 409A during a service provider's taxable year generally would not affect the taxation of amounts deferred under the plan for a subsequent taxable year in which the plan complies with Code section 409A.
- The amount includible in income would be the present value of all amounts payable calculated as of the last day of the taxable year during which the violation occurred, plus amounts paid to the service provider during the taxable year.
- A service provider who is required to include an amount in income under Code section 409A with respect to a deferred amount is entitled to a tax deduction at the time the service provider's legally binding right to all deferred compensation under the plan is permanently forfeited under the plan's terms or the right to such compensation is otherwise permanently lost (*e.g.*, the service recipient may be insolvent, bankrupt or have ceased to exist at the time payment is due).

Interim Guidance on 409A Wage Withholding and Reporting

The IRS issued Notice 2008-115 (the “Notice”) providing interim guidance on reporting and wage withholding requirements under Code section 409A. The Notice generally extends the reporting and withholding relief for 2005, 2006 and 2007 to the 2008 calendar year. Some key aspects of the 409A reporting and wage withholding requirements are as follows:

Reporting. Employers are not required to report annual deferrals of compensation on Form W-2 (box 12, code Y) or Form 1099-MISC (box 15a) if such amounts were not includible in income under Code section 409A. Employers are required to report amounts includible in income due to violations of Code section 409A on Form W-2 (box 12, code Z). Employers must also report these amounts as wages paid on line 2 of Form 941, Employer's Quarterly Federal Tax Return. For nonemployees, payers must report amounts includible in income under Code section 409A on Form 1099-MISC in boxes 7 and 15b.

Withholding. For tax withholding purposes, amounts includible in income due to Code section 409A violations are treated as supplemental wages, regardless of whether the employer paid regular wages to the service provider in 2008. Additional income taxes imposed by Code section 409A, if any, do not increase the employer's withholding amount.

The Notice also addresses: (1) the calculation of amounts includible in income under Code section 409A, including 409A(b); (2) the wage payment date of amounts includible in income under Code section 409A; and (3) the service provider requirements for amounts includible in income under Code section 409A.

The Notice is effective for the 2008 calendar year and is expected to remain in effect until the IRS's proposed 409A regulations on income inclusion and taxes (described above) are finalized. The Notice provides that employers who comply with the reporting and withholding requirements outlined in the Notice will not be liable for additional income tax withholding or penalties, nor will employers will be required to file corrected information returns or payee statements, if future IRS guidance changes the reporting and withholding requirements under Code section 409A. The Notice also states that compliance with the IRS's proposed regulations with respect to the calculation of amount includible in income and additional taxes under Code section 409A will be treated as compliance with the Notice's requirements, provided the taxpayer complies with all the provisions of the proposed regulations.

Updated IRS Correction Program for 409A Operational Failures

The IRS issued Notice 2008-113 providing an updated correction program for inadvertent and unintentional operational violations of Code section 409A for tax years beginning after 2008. (As described in Reinhart's January 2008 Employee Benefits Update, the IRS previously issued Notice 2007-100 establishing a limited 409A correction program. The IRS's updated correction program described in Notice 2008-113 replaces this prior correction program.) If certain requirements are satisfied, the IRS correction program provides a way for taxpayers to avoid the full application of the income inclusion rules and additional taxes triggered by Code section 409A noncompliance. A few highlights of the updated 409A correction program are described below.

Eligibility. To be eligible for the 409A correction program, the error must be an inadvertent and unintentional failure to comply with Code section 409A in operation. In addition, the employer or service recipient must take commercially reasonable steps to avoid a recurrence of the operational failure. Certain corrections are not available during years in which the employer or service recipient experiences a substantial financial downturn, or otherwise experiences financial or other issues; if such downturn or other issue indicates a significant risk that the employer or service recipient will not be able to pay the amount deferred when due.

Correction Methods. Notice 2008-113 describes the specific types of operational failures that may be corrected under the 409A correction program and details the related correction requirements for each type of failure. The availability of the correction methods depends on the timing of the correction, the amount involved in the failure and the service provider's status as an "insider" (i.e., director, officer or 10% owner) with respect to the employer or service recipient.

Reporting Requirements. Like Notice 2007-100, the updated correction program requires an IRS filing by both the employer or service recipient and the service provider.

Comments on the IRS's 409A correction program are due by March 6, 2009. The IRS is considering whether to expand the 409A correction program to include plan document failures and specifically requests comments on this issue. (The deadline for amending nonqualified deferred compensation plans to comply with Code section 409A was December 31, 2008.)