July 2007 Employee Benefits Update

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SELECT COMPLIANCE DEADLINES

Plan administrators have seven months after the end of a plan year to file a Form 5500 Annual Report/Return. For plan years ending December 31, 2006, the deadline for filing the Form 5500 is July 31, 2007. Plan sponsors who extended their corporate federal income tax return may receive an automatic extension until September 17, 2007 if certain criteria are satisfied. Otherwise, plan administrators may apply for an extension until October 15, 2007 by filing Form 5558 on or before July 31, 2007 (the plan's regular filing deadline).

According to IRS Announcement 2007-63, in an effort to streamline Form 5500 reporting for electronic submissions, Schedule P is eliminated for Form 5500 series filers, effective beginning with the 2006 plan year. Schedule P was the annual return of an employee benefits trust. The submission of Schedule P started the running of the statute of limitations for income tax assessments under section 6501 of the Internal Revenue Code. With the elimination of Schedule P, the IRS will treat the filing date of Form 5500, or Form 5500-EZ, as the starting date for the statute of limitations period.

Annual Multiemployer Funding Notice for Defined Benefit Plans Due September 30, 2007 for Calendar Year Plans

Plan administrators of multiemployer defined benefit plans must annually provide participants with a notice on the plan's basic financial information. Calendar year plans must furnish the notice by September 30, 2007, or within two months after the close of the plan's extended period for filing Form 5500 (if applicable). The Pension Benefit Guaranty Corporation ("PBGC") model notice remains available. Note that the Pension Protection Act of 2006 replaces this notice requirement with a new funding notice that will need to be provided within 120 days after the end of each plan year beginning with the 2008 plan year.

Medicare Part D Drug Subsidy Applications Due October 2, 2007 for Calendar Year Plans

Group health plan sponsors applying for the Medicare Part D retiree drug subsidy

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for a plan year ending in 2007 must apply no later than 90 days prior to the start of the plan year. For calendar year plans, the 2007 application must be submitted by October 2, 2007. Plan sponsors may request a 30-day application extension, provided the extension request is submitted no later than 90 days prior to the start of the plan year, (i.e., October 2, 2007 for calendar year plans.) The subsidy application and extension should be submitted to the Centers for Medicare and Medicaid Services ("CMS") through the Retiree Drug Subsidy Center website.

Massachusetts Health Care Coverage Deadline Is July 1, 2007; Cafeteria Plan Document Submission Deadline Extended to October 1, 2007

The Massachusetts Health Care Reform Law requires certain employers with employees in Massachusetts to take actions to provide health care coverage to their employees. See the discussion in the "Health and Welfare Plan Developments" section of the *June 2007 edition of the Employee Benefits Update* for more information. Recently, guidance and forms to help employers comply with the new law have been posted on the Web site of the Commonwealth Health Insurance Connector Authority (the "Connector), i.e., the independent state agency administering the program. Although covered employers must comply with the new law by July 1, 2007, the Connector is postponing the filing deadline for section 125 cafeteria plan documents that must contain provisions to comply with the new law from July 1, 2007 until October 1, 2007. Further, the Connector will not accept section 125 cafeteria plan documents prior to September 1, 2007. Information for employers is available on the *Connector Web site*.

National Provider Identifiers

As reported in our prior Employee Benefits Updates, the Health Insurance Portability and Accountability Act ("HIPAA") requires health plans to use a new National Provider Identifier ("NPI") when electronically conducting certain HIPAA standard transactions, such as billing. As an update, the CMS recently announced that certain data under the National Plan and Provider Enumeration System ("NPPES") will not be available through the Internet until August 1, 2007.

RETIREMENT PLAN DEVELOPMENTS

IRS Updates Its Rulings and Determination Letter Program

The IRS has recently updated the rules for issuing opinion, advisory and determination letters for qualified retirement plans. Revenue Procedure 2007-44, effective on June 13, 2007, updates and supersedes Revenue Procedure 2005-66.

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The new procedures retain the five-year remedial amendment cycle for individually designed plans and the six-year remedial amendment cycle for preapproved plans with additional details and clarifications. The remedial amendment cycle is the period during which a qualified plan must be submitted for a favorable IRS determination in order to rely on the extended period during which qualification amendments may be retroactively adopted. Revenue Procedure 2007-44 also provides special rules that apply for amendments to reflect the Pension Protection Act of 2006 ("PPA") and the procedures to submit those amendments.

As highlights, Revenue Procedure 2007-44:

- Clarifies that plans may delay becoming PPA amendments (including interim discretionary amendments) until the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 in the case of governmental plans).
- Provides that the IRS will not consider PPA amendments in review of applications for determination letters for upcoming Cycle B or Cycle C submissions for individually designed or multiple employer plans. While these plans may be amended for PPA provisions, the plan cannot rely on the determination letter issued with respect to PPA amendments. These review limitations on PPA amendments do not apply to determination letter submissions for terminating plans or to opinion and advisory letter applications for pre-approved defined benefit plans.
- Identifies the types of off-cycle applications for determination letters that will be given the same priority as on-cycle applications, e.g., applications for determination letters for terminating plans, certain new plans and applications due to urgent business need.
- Adds details on adoption deadlines for interim and discretionary amendments including special deadlines for governmental and tax-exempt employers.
- Expands and clarifies exceptions to the general rule for determining a plan's five-year remedial amendment cycle for governmental employers, joint boards of trustees, members of controlled or affiliated service groups and certain tax-exempt organizations.
- Expands the definition of cycle changing events to address changes involving plan sponsorship due to mergers and acquisitions and changes in multiemployer and multiple employer status.

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- Effective as of July 9, 2007, eliminates the use of Form 6406 (Short Form Application for Determination for Minor Amendment of Employee Benefit Plan) for determination letter applications.
- Adds details on when an employer's plan is treated as a preapproved plan and is eligible for a six-year remedial amendment cycle. The Revenue Procedure clarifies definitions of prior adopter, new adopter, intended adopter, and existing and interim plans as well as rules on when an employer is entitled to remain in the six-year cycle after becoming an individually designed plan.
- Provides new rules under which a master and prototype sponsor has authority to amend on behalf of an adopting employer.
- Allows relief for plan sponsors who determined that their plan was not required to be filed under Cycle A based on a good faith and reasonable interpretation of Revenue Procedure 2005-66 prior to the issuance of Revenue Procedure 2007-44. Under such circumstances, the plan sponsor will have six months from July 9, 2007 to submit the plan to the IRS.

IRS Issues New Sample Plan Provisions for Master and Prototype ("M&P") Defined Benefit Plans

The IRS has issued sample plan provisions for M&P defined benefit plans as a Listing of Required Modifications ("LRMs"). The provisions reflect language the IRS has found to be acceptable to satisfy certain specific requirements of the Internal Revenue Code as amended through the Gulf Opportunity Zone Act of 2005, as well as certain law changes under the PPA. The last LRMs for M&P defined benefit plans were published in 2000. The LRMs are available on the *IRS Web site*.

IRS Adopts 20 % Rule in Revenue Ruling on Partial Plan Terminations

The IRS has issued new guidance in Revenue Ruling 2007-43 on what constitutes a partial termination of a qualified retirement plan under the Internal Revenue Code. A partial termination generally occurs when there is a reduction in participants under the plan due to an employer's lay off a portion of its work force.

According to the Revenue Ruling, if there is a turnover rate of at least 20% in the number of participating employees under the plan, there is a rebuttable presumption that a partial termination of the plan has occurred. To remain qualified, a plan that experiences a partial termination must fully vest the benefits

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of all participating employees who had an employer-initiated severance from employment during the applicable period regardless of the vesting schedule that otherwise applies under the plan. In general, the applicable period is a plan year or a longer period if there are a series of related severances from employment.

All participating employees who have an employer-initiated severance from employment must be taken into account in calculation the turnover rate, including vested as well as nonvested participating employees. An employer-initiated severance from employment generally includes any severance (unless voluntary) other than death, disability or retirement on or after normal retirement age. If an employee is transferred to another controlled group of the employer, there is no severance from employment for purposes of calculating the turnover rate if those employees continue to be covered under a qualified plan. The employer may be able to verify that an employee's severance was purely voluntary through items such as information from personnel files, employee statements and other corporate records.

The Revenue Ruling also provides that a partial termination of a qualified plan may occur for reasons other than a turnover of employees. For example, a partial termination can be caused by a plan amendment that adversely affect the rights of employees to vest in benefits under the plan, a plan amendment that exclude a group of employees who have previously been covered under the plan or a reduction or cessation of future benefit accruals resulting in a potential reversion to the employer.

IRS Project Targets Public School Districts to Ensure Compliance With Coverage Rules for 403(b) Plans

The IRS is expanding an outreach effort to ensure that public schools throughout the United States are complying with the universal availability requirement for 403(b) plans. Under the universal availability rule, all employees who are normally expected to work 20 hours or more per week must be offered the opportunity to participate in a school or district sponsored 403(b) plan. A pilot project began in June 2006 with questionnaires to public schools and districts in New Jersey, Missouri and Washington. The IRS is now contacting school districts in Alaska, Florida, Hawaii, Illinois, Nevada, Pennsylvania, Tennessee and Virginia. School districts in the remaining states will be contacted as part of the project through 2008. More details on the program are provided on the *IRS Web site*.

"Greater Of" Formulas in Cash Balance Plans May Violate Accrual Rules for

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Qualified Plans

The IRS is challenging the qualified status of cash balance plans that use a "greater of" formula. With the passage of the PPA, the IRS recently resumed after an eight-year moratorium the review of determination letter applications of cash balance plans which had been converted from a traditional defined benefit plan.

According to the IRS, when participants receive the greatest benefit determined under the cash balance formula and one or more other formulas, the plan may violate accrual rules for qualified plans. The accrual rules are intended to prevent a plan from backloading benefits.

As a result of the IRS position, a sponsor of a cash balance plan may need to demonstrate that the plan's "greater of" formula does not result in backloading.

U.S. Supreme Court to Review ERISA Remedies Case

The U.S. Supreme Court agreed to review a decision of the U.S. Court of Appeals for the Fourth Circuit with respect to remedies under the Employee Retirement Income Security Act ("ERISA") available to a participant of a 401(k) plan. Under the lawsuit, participant James LaRue alleged the plan breached its fiduciary duty by not following his strategy for the investment of his plan account and this breach resulted in a loss of approximately $150,000. In confirming the ruling of the district court, the Fourth Circuit found that ERISA does not provide a remedy for the participant's alleged losses. The Supreme Court has scheduled review of the case during its 2007-2008 term. *LaRue v. DeWolff*, 2007 WL 1730445 (U.S. June 18, 2007).

The ruling of the Supreme Court will be important for employers. At issue is whether a participant in a defined contribution plan may sue under ERISA to recover losses due to a breach of fiduciary duty when the losses to the plan affect only the participant's account and whether equitable relief can be interpreted as encompassing the recovery of losses caused by a breach of fiduciary duty. The Solicitor General of the Department of Labor has filed an amicus brief in favor of the plaintiff.

District Court Dismisses Class Action 401(k) Fee Case

The U.S. District Court for the Western District Court of Wisconsin dismissed participants' complaints in a lawsuit which alleged that the plan sponsor and its service providers violated ERISA disclosure and fiduciary requirements with

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respect to 401(k) plan fees. Participants alleged that investment fees were being incorrectly disclosed because the plan's investment advisor shared some of its asset-based fees with the plan's trustee, under an undisclosed revenue sharing agreement. They also alleged that the plan sponsor selected investments that had unreasonably high fees. *Hecker v. Deere and Co. et al.*, Case No. 06-C-719-S (W.D. Wis. June 20, 2007). This case is one of the many class action lawsuits that have been filed against major corporate retirement plans and service providers regarding investment fees in 401(k) plans.

In its decision to dismiss, the court found that the plan fiduciaries had met the disclosure requirements under ERISA by disclosing fee information in the plan's summary plan description and in each fund prospectus. The court concluded existing regulations under ERISA do not require disclosure of revenue sharing, only the amount of the fees. It also concluded that knowing about the revenue sharing is not material to the investment decisions of participants.

Because the participants could choose to invest in over 2,500 other mutual funds in addition to plan selected funds through a mutual fund brokerage account offered under the plan, the court found they had exercised control over their accounts. Because of the Department of Labor's and Congress' growing concern about fees charged to participants in 401(k) plans, it is unclear whether other courts deciding 401(k) fee cases will adopt the positions related in this decision. Also uncertain is whether the decision will be appealed.

HEALTH AND WELFARE PLAN DEVELOPMENTS

2008 Cost Threshold and Limit Adjustments for Medicare Part D

CMS recently announced the 2008 adjusted cost threshold and cost limit amounts that apply to group health plan sponsors who participate in the Medicare Part D Retiree Drug Subsidy program. Under this program, employers who offer retiree prescription drug coverage may qualify for a tax free subsidy provided for allowable prescription drug costs incurred by qualified retired employees. For plan years that end in 2008, subsidy payments to a plan sponsor for each qualifying covered retiree will generally equal 28% of allowable retiree prescription drug costs, attributable to gross retiree costs between $275 and $5,600, up from $265 and $5,350 in 2007. Medicare Part D benefit parameters (e.g., deductible and out-of-pocket threshold) have also been adjusted for 2008. These parameters will help a group health plan offering prescription drug coverage to Medicare Part D eligible individuals to determine whether it is

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creditable or non-creditable with Medicare Part D. More information on Medicare Part D adjustments for 2008 can be found on the *CMS Web site*.

New "How To" Documents for Medicare Part D Subsidy Reconciliation Available on CMS Web Site

Group health plan sponsors receiving payments under the Medicare Part D retiree drug subsidy for a plan year must go through a mandatory reconciliation process. This process entails matching enrollment and member eligibility with CMS records in order to qualify for the Medicare Part D retiree subsidy. The CMS recently posted new information on "How To Complete Reconciliation" on its *Retiree Drug Subsidy Center Web*. The new document includes questions, answers, general instructions and information about the 12-step process of the Medicare Part D retiree subsidy reconciliation process. Reconciliation for a given application must generally be completed by the last day of the fifteenth month following the last day of the retiree drug subsidy plan year specified in the application.

CMS Issues Proposed Medicare Part D Regulations

The CMS recently issued new proposed regulations for the Medicare Part D Program. 72 Fed. Reg. 29403 (May 25, 2007). The proposed regulations make certain technical corrections to previously issued final regulations, codify previous guidance on Medicare Part D policies and propose clarification of these policies. Of particular interest to sponsors of group health plans are proposed clarifications on deadlines affecting employers who apply for the retiree drug subsidy and proposed changes to coordination of benefit requirements that affect procedures to correct mistaken payments as a primary payer.

Third Circuit Ruling Lifts Injunction on EEOC Rule Allowing Retiree Health Plans to Coordinate Coverage With Medicare

The U.S. Court of Appeals for the Third Circuit recently issued an opinion that supports employers who choose to coordinate coverage under their retiree medical plans with Medicare or a comparable state health benefit plan. *AARP v. EEOC*, 2007 WL 154385 (June 4, 2007). Under the much awaited ruling, the court unanimously found that the proposed exemption issued by the U.S. Equal Employment Opportunity Commission ("EEOC") in 2003 allowing carve outs for retiree health benefits does not violate the Age Discrimination in Employment Act ("ADEA") or the Administrative Procedure Act ("APA") with respect to the EEOC's decision making authority and process. As a result, the Third Circuit lifted the injunction on the implementation of a final rule by the EEOC, finding that the

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exemption was reasonable and in the public interest.

The ruling paves the way for the EEOC to finalize and publish its exemption so that employers may coordinate their retiree medical plans with Medicare or a comparable state health benefit plan. However, the uncertainty could continue if AARP decides to seek review of the decision by the U.S. Supreme Court.

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