

# June 2006 Employee Benefits Update

## SELECT COMPLIANCE DEADLINES

### **409A Performance-Based Compensation Deferral Election Deadline is June 30, 2006**

Internal Revenue Code ("Code") section 409A permits executives to make deferral elections of "performance-based compensation" for up to six months before the end of a service period. For performance-based compensation earned during the 2006 calendar year and paid in 2007, executives have until June 30, 2006 to elect to defer compensation.

### **Mandatory Electronic Filing of PBGC Premiums Begins July 1, 2006**

The Pension Benefit Guaranty Corporation ("PBGC") requires sponsors of large insured defined benefit plans (500 or more participants) to submit premium filings electronically beginning on July 1, 2006. This new requirement is discussed in detail below.

### **Form 5500 Deadline for Calendar Year Plans is July 31, 2006**

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, 2005, the deadline for filing the Form 5500 is July 31, 2006. Plan sponsors who extended their corporate federal income tax return may receive an automatic extension until September 15, 2006. Otherwise, plan administrators can apply for an extension until October 15, 2006 by filing a Form 5558 on or before July 31, 2006 (the plan's regular filing deadline).

## LEGISLATIVE DEVELOPMENTS

### **Hero Act Treats Combat Pay as Compensation for IRA Contribution Rules**

On May 29, 2006, President Bush signed the Heroes Earned Retirement Opportunities Act ("Hero Act"), creating a three-year window for individuals to make IRA contributions based on excludable combat pay for the 2004 and 2005 tax years. Prior to the Hero Act, military personnel who received only combat pay that was excludable from gross income under the Code could not make IRA contributions. The Hero Act treats excluded combat pay received in 2004 and 2005 as compensation for determining IRA contribution limits and gives

## POSTED:

Jun 29, 2006

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individuals three years to make contributions to a traditional IRA or Roth IRA based on excluded combat pay for 2004 and 2005.

**President Bush Signs \$70 Billion Tax Reconciliation Bill** The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA"), signed into law by President Bush on May 17, 2006, extends favorable capital gains and dividend rates until 2010 and provides alternative minimum tax ("AMT") relief for 2006. Specifically, TIPRA provides a two-year extension (from 2008 to 2010) of the reduced 15% tax rate on long-term capital gains and dividends. In addition, TIPRA increases the AMT exemption amount for taxpayers in 2006 and permits taxpayers to claim nonrefundable personal tax credits to the full extent of the individual's regular and alternative minimum tax.

To partially offset the revenue loss from extensions and other tax breaks, lawmakers eliminated the adjusted gross income ("AGI") limit on conversions from traditional IRAs to Roth IRAs beginning in 2010. Under prior law, only taxpayers with an AGI of \$100,000 or less were eligible to convert traditional IRAs to Roth IRAs. Beginning in 2010, any taxpayer may convert a traditional IRA to a Roth IRA, regardless of his or her AGI.

TIPRA provides further relief for taxpayers who convert traditional IRAs to Roth IRAs in 2010. Unless the taxpayer elects otherwise, none of the gross income from the conversion will be included in the taxpayer's income for 2010. Instead, half of the income attributable to the conversion will be included in the taxpayer's income in 2011 and the remaining half in 2012. For conversions in 2011 and beyond, the entire amount of the conversion will be included in the taxpayer's income for the year of the conversion.

## **PENSION PLAN DEVELOPMENTS**

**PBGC Issues Final Rule Requiring Electronic Filing of PBGC Premiums** On June 1, 2006, the PBGC issued a final rule requiring sponsors of insured defined benefit plans to submit premium filings to the PBGC electronically. The final rule requires sponsors of large plans (500 or more participants) to submit premium filings electronically starting on July 1, 2006, for plan years beginning in 2006. The final rule requires sponsors of small plans (fewer than 500 participants) to start submitting premium filings electronically for plan years beginning in 2007.

While the final rules require the electronic submission of premium filings, the rules do not require the electronic payment of premiums. Plan sponsors may pay premiums electronically via credit card, electronic check or Automated Clearing

House (ACH) transfer. Alternatively, plan sponsors may pay premiums via check or wire transfer.

The PBGC has offered voluntary electronic submission of premium filings and payments through PBGC's online application, My Plan Administration Account ("My PAA"), since 2004. My PAA permits sponsors to enter information into online forms or prepare premium filing information using private-sector software.

Detailed information on electronic filing of PBGC premiums and setting up a My PAA account is available on the [PBGC website](#).

## **WELFARE AND FRINGE BENEFIT PLAN DEVELOPMENTS**

### **IRS Issues Proposed Regulations on Dependent Care Expenses**

On May 24, 2006, the Internal Revenue Service ("IRS") issued proposed regulations under Code section 21 on the dependent care tax credit. Code section 21 also governs which benefits employers can reimburse under a Dependent Care Assistance Program ("DCAP"). Under a DCAP, employees can elect to contribute a portion of pay on a pre-tax basis that the employer reimburses tax-free as the employee incurs employment-related dependent care expenses. Employment-related expenses must be incurred to enable the taxpayer to be gainfully employed. The proposed regulations provided guidance on the following expenses:

- Nursery School and Kindergarten - Expenses of preschool or similar programs below the kindergarten level may be employment-related expenses, but expenses for kindergarten and above, which the IRS views as primarily for education and not for care, will not qualify as employment-related expenses.
- Day Camps and Overnight Camps - Expenses for day camps may be employment-related, even if the camp specializes in a particular activity, such as soccer or computers. Expenses for overnight camps are not employment-related.
- Transportation - Expenses for transportation furnished by a dependent care provider may be an employment-related expense.
- Other Expenses - Expenses for a care provider's employment taxes and room and board may be employment-related expenses. Indirect expenses such as application and agency fees may be employment-related expenses, but only if such expenses are necessary to obtain care.

The proposed regulations also provide guidance on qualifying individuals, temporary absences from work, part-time employment, and divorced or separated parents. The IRS guidance includes many helpful examples as well. Although the proposed regulations will not become effective until finalized, DCAP sponsors with plans that define eligible dependent care expenses as employment-related expenses under Code section 21 can rely on this guidance immediately.

**Reinhart Action Note:** The proposed regulations both confirm and expand on previous guidance regarding deductible dependent care expenses. DCAP sponsors should consider whether to incorporate the proposed rules at this time. Amendments may be required to DCAPs and DCAP sponsors may want to provide plan participants with updated information regarding covered expenses. In addition, the publication of the proposed regulations may constitute a "significant change in coverage," so the plan sponsor should consider whether to permit DCAP participants to make a mid-year election change to increase their DCAP contributions.

## **First Circuit Rejects Presumption in Favor of Vesting of Retiree Welfare Benefits**

The First Circuit Court of Appeals refused to adopt a presumption in favor of or against the vesting of retiree welfare benefits in two companion cases decided May 31, 2006. *Senior et al. v. NStar Electric and Gas Co. et al.*, No. 05-2015 (1st Cir. May 31, 2006); *Balestracci et al. v. NStar Electric and Gas Co.*, No. 05-1894 (1st Cir. May 31, 2006).

The company offered two early retirement programs ("ERPs") that included retiree dental benefits. Years later, the company decided to terminate retiree dental benefits for all retirees when they reached age 65. In response, plan participants sued the company claiming they were entitled to lifetime benefits. Participants filed one suit under the Labor Management Relations Act ("LMRA") and another suit under the Employee Retirement Income Security Act ("ERISA"). In both cases, the participants claimed they received documents promising their dental benefits would last "for life." However, the summary plan descriptions and plan documents in both cases expressly reserved the company's right to terminate, amend, modify or cancel existing retiree welfare benefits.

In the LMRA case, the First Circuit rejected the district court's test that ERISA welfare benefits do not vest, unless the labor agreement contains a "clear and

express statement" of vesting. Instead, the court surveyed the split in federal circuit courts and held that federal labor law does not create a presumption for or against the vesting of retiree welfare benefits.

In the ERISA case, the First Circuit also rejected the district court's conclusion that retiree welfare benefits never vest absent a "clear and express statement" of vesting. The court noted that while ERISA does not create any entitlement to welfare benefits, an employer may contractually agree to have such benefits vest.

In both cases, the court reviewed the ERP documents, benefit summaries, plan documents and summary plan descriptions and found that the company had expressly reserved its right to change benefits. The court concluded that the company had intended to provide lifetime benefits to retirees, but had reserved the right to modify, alter or terminate coverage in the future. Hence, the court affirmed the district court's holdings that the participants were not entitled to lifetime benefits.

**Reinhart Comment:** The reservation of rights provisions in the plan documents and summary plan description were crucial to the employer's success in both these cases. Accordingly, plan sponsors are reminded to check benefit summaries and plan documents for a reservation of the sponsor's right to terminate, amend, modify or cancel welfare benefits.

## **Medicare Publishes Prices for Common Elective Procedures**

The Centers for Medicaid and Medicare Services ("CMS") posted on its website the costs CMS pays hospitals for the 30 most common elective inpatient procedures and selected other procedures. The information includes the national average payment for procedures, a range of prices paid by state and county, and the number of procedures performed in each hospital.

As part of President Bush's health care initiatives, CMS was directed to make price and quality information available on the internet in an effort to increase transparency in the health care industry. CMS expects to post payment information on outpatient surgical procedures and physician services later this year. The reports are available on the [CMS website](#).

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