Reinhart

May 2008 Employee Benefits Update

SELECT COMPLIANCE DEADLINES

• **Annual Report/Return Deadline for Calendar Year Plans**. Plan administrators generally have seven months after the end of a plan year to file a Form 5500 (Annual Return/Report of Employee Benefit Plan). For plan years ending December 31, 2007, the deadline for filing the Form 5500 is July 31, 2008. Plan sponsors that extended their corporate federal income tax return deadline may receive an automatic extension until September 15, 2008 if certain criteria are satisfied. Otherwise, plan administrators may apply for a deadline extension until October 15, 2008 by filing Form 5558 on or before July 31, 2008 (the plan's regular filing deadline). The 2007 Instructions for Form 5500 detail changes made to the annual return/report, including the voluntary alternative reporting option created by the Pension Protection Act of 2006 (PPA) for certain retirement plans with fewer than 25 participants.

• **Annual Benefit Statement Deadline for Defined Contribution Plans with Plan- Directed Investments**. Generally effective for plan years beginning after December 31, 2006, the PPA requires administrators of defined contribution plans that do not permit participant investment direction to automatically furnish annual benefit statements to participants and beneficiaries. As summarized in Reinhart's November 2007 Employee Benefits Update, the Department of Labor (DOL) extended the safe harbor deadline for providing the annual benefit statement to the date on which the Form 5500 is filed by the plan (but in no event later than the due date, including extensions, for filing the Form 5500) for the plan year to which the benefit statement relates. For a calendar year plan, the first annual benefit statement is due by the earlier of: (1) the actual filing date of the 2007 Form 5500; or (2) July 31, 2008 (the plan's regular filing deadline), unless a Form 5500 deadline extension applies.

• **FMLA Compliance Reminder**. As reported in Reinhart's February 2008 Employee Benefits Update, the President signed the National Defense Authorization Act of 2008 (the Act) into law in January 2008 expanding the Family and Medical Leave Act (FMLA) to provide broader leave protections for military families. Some of the Act's FMLA provisions go into effect immediately, while others are effective upon the release of DOL guidance. Also, as noted in Reinhart's March 2008 Employee Benefits Update, the DOL issued long-awaited

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proposed regulations under the FMLA. The proposed regulations clarify employers' and employees' respective rights and responsibilities under the FMLA and do not address the new military family leave provisions. In light of these developments, employers should examine their FMLA compliance. This compliance review should include determining whether the DOL Military Family Leave Notice has been posted in a conspicuous location where employees are employed, as required by the FMLA.

• **Compliance Reminder for Dependent Care Assistance Plans**. Under a dependent care assistance plan (DCAP), an employer may only pay for "employment-related expenses" as defined under Internal Revenue Code (the Code) section 21. Code section 21 provides that expenses are employment-related only if the employee incurs the expenses in order to be gainfully employed. The Internal Revenue Service (IRS) issued regulations under Code section 21 addressing employment-related expenses, effective for taxable years ending after August 14, 2007. Among other changes and clarifications, the regulations provide that the determination of whether someone is gainfully employed is made on a daily basis, with new exceptions for certain short, temporary absences (e.g., absences for vacation or sickness) when the caregiver requires payment for the absence. DCAP sponsors and administrators should confirm compliance with the regulations' requirements, particularly the new guidance on how to handle short, temporary absences.

RETIREMENT PLAN DEVELOPMENTS

Additional IRS Proposed Guidance on Minimum Funding Requirements

The IRS issued proposed regulations under Code sections 430 and 4971 providing sponsors of single-employer defined benefit plans with guidance on determining minimum required contributions under the PPA's new funding rules. As background, Code section 412 contains the minimum funding requirements for pension plans. The PPA added Code section 430, which specifies the minimum funding requirements that apply to single employer defined benefit plans (including multiple-employer plans) pursuant to Code section 412. Code section 430's new funding rules are generally effective for plan years beginning on or after January 1, 2008. The proposed regulations are the fourth in a series of IRS proposed regulations under Code section 430. The IRS previously issued proposed minimum funding regulations addressing: (1) mortality assumptions; (2) prefunding and funding standard carryover balances; and (3) plan asset and liabilities measurements. These previously issued proposed regulations are

addressed in Reinhart's June 2007, September 2007 and January 2008 Employee Benefits Updates, respectively.

The IRS's latest set of proposed regulations on the PPA's new minimum funding requirements provide rules for calculating and paying the minimum required contribution (including the payment of quarterly contributions and liquidity requirements) and rules for applying excise taxes for failures to meet the minimum funding requirements. For example, the proposed regulations provide the following guidance on quarterly contributions:

- If a plan has a funding shortfall for the preceding year, the plan sponsor must make quarterly installments. The amount of each quarterly installment is equal to 25% of the required annual payment. For this purpose, the required annual payment is equal to the lesser of: (1) 90% of the minimum required contribution under Code section 430(a) for the plan year; or (2) 100% of the minimum required contribution under Code section 430(a) (determined without regard to any funding waiver under Code section 412) for the prior plan year. The minimum required contribution is determined without regard to the prefunding balance or funding standard carryover balance in the current or any prior year.
- Quarterly contributions are generally due on the 15th day: (1) of the fourth plan month; (2) of the seventh plan month; (3) of the tenth plan month; and (4) following the end of the plan year. If a plan sponsor fails to timely pay the full installment, the underpayment is adjusted for the period between the due date and the payment date using the effective interest rate for that plan year (determined under IRS proposed regulations) plus 5 percentage points. However, the increased interest rate applies only to installments that are due after the valuation date for the plan year.
- Consistent with prior IRS guidance, a plan sponsor is generally allowed to elect to use the plan's funding balances to satisfy quarterly contribution requirements, subject to certain limitations.
- A plan (other than a small plan under Code section 430(g)(2)(B)) is generally treated as failing to pay the full amount of a quarterly installment to the extent that the value of liquid assets contributed after the close of that quarter and by the due date for the installment is less than the liquidity shortfall for that quarter. The use of funding balances or the contribution of illiquid assets cannot remedy a liquidity shortfall.

The regulations are proposed to be effective for plan years beginning on or after January 1, 2009. However, plan sponsors can rely on the proposed regulations for purposes of satisfying the minimum funding rules for plan years beginning in 2008. Comments on the proposed regulations are due by July 14, 2008.

Additional DOL Guidance on QDIAs

The DOL issued Field Assistance Bulletin 2008-03 (the FAB) to supplement its final regulations on qualified default investment alternatives (QDIAs) by providing guidance on frequently asked questions. The DOL's final QDIA regulations are summarized in Reinhart's November 14, 2007 E-Alert. ERISA section 404(c) generally provides plan fiduciaries with protection from liability for investment decisions made by a plan participant who "exercises control" over his or her account. Prior to the final QDIA regulations, no protection was available when an employer invested an account in a default fund because a participant failed to make an investment decision. The DOL's QDIA regulations aim to encourage plan fiduciaries to choose more profitable investment alternatives by releasing them from liability if the default fund satisfies the regulations' requirements for a QDIA.

The FAB provides guidance on: (1) the scope of the QDIA regulations; (2) the participant notice requirements; (3) the 90-day limitation on fees and restrictions; (4) the management and asset allocation for QDIAs; (5) the 120-day capital preservation QDIA; and (6) grandfather-type relief for stable value funds. To highlight a few key points, the FAB provides as follows:

- •The fiduciary relief under the QDIA regulations is available for assets invested in a default investment prior to the effective date of the final QDIA regulations (December 24, 2007) if all conditions of the QDIA regulations are satisfied with respect to such assets. Relief is not available, however, for fiduciary decisions made before the effective date of the final QDIA regulations (e.g., decision to invest assets in a default investment).

- In the absence of further guidance, the DOL specifies the following information regarding QDIA fees and expenses that generally must be provided in the participant notice: (1) the amount and a description of any shareholder-type fees, such as sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, purchase fees, and mortality and expense fees; and (2) for investments with respect to which performance may vary over the term of the investment, the total annual operating expenses of the investment expressed as a percentage (e.g., expense

ratio).

- The payment of a fee or expense (e.g., redemption fee) by a plan sponsor or service provider that would otherwise be assessed to a participant's account during the initial 90- day period would not violate the QDIA regulations' restriction on charging fees and expenses to a participant's account within the first 90 days of his or her investment in the QDIA.
- To qualify as a permanent, long-term QDIA, an investment alternative must offer a mix of equity and fixed income exposures. An investment fund or product with zero fixed income (or zero equity) would not qualify as a permanent, long-term QDIA.
- The 120-day capital preservation QDIA described in the DOL's final regulations is available only for plans that include an eligible automatic contribution arrangement (EACA).

PBGC Reporting Waiver for Small Employers' Missed Quarterly Contributions

The Pension Benefit Guaranty Corporation (PBGC) issued Technical Update 08-2 waiving the reporting of missed quarterly contributions for plan years beginning in 2008 for certain small employers. As background, ERISA section 4043 generally requires plan administrators of single-employer defined benefit plans to notify the PBGC within 30 days after specified 4 reportable events (i.e., post-event reporting). However, the PBGC has waived the post-event reporting requirement for certain events. Under Technical Update 08-2, post-event reporting for failing to make required quarterly contributions for 2008 plan years is waived if: (1) the employer had 100 or fewer participants in its defined benefit plans for the 2007 plan year; or (2) the employer had 500 or fewer participants in its defined benefit plans for the 2007 plan year and a Participant Notice for the plan would not be required for the 2007 plan year under ERISA section 4011 regulations in effect as of December 31, 2006.

DOL Advisory Opinion on Offshore Custody of Pooled Plan Assets

The DOL issued Advisory Opinion 2008-04A (the Opinion) providing guidance on the indicia of ownership requirements of ERISA section 404(b) and the use of multinational cross-border pooling products (MCBPPs) designed by a U.S. bank (the Bank) for multinational businesses. ERISA section 404(b) provides that no fiduciary may maintain the indicia of ownership of any plan assets outside the jurisdiction of the U.S. district courts, except as authorized in DOL regulations.

According to the Bank, the assets of any MCBPP subfund, in which one or more ERISA plans invest, are considered "plan assets" subject to ERISA's fiduciary responsibilities and prohibited transaction rules. In the Opinion, the DOL favorably opined on the application of ERISA section 404(b) to the custody of U.S. securities and foreign securities and currencies under the MCBPP structure. For example, the DOL advised that, with respect to U.S. securities, the requirements of ERISA section 404(b) are satisfied because the indicia of ownership would be held by the Bank, within the jurisdiction of U.S. district courts, or held in the U.S. by appropriate domestic clearing agencies, the Federal Reserve Bank or other appropriate entities acting as agent for the Bank.

Seventh Circuit Allows Fiduciary Breach Suit to Proceed Based on LaRue Decision

The Seventh Circuit Court of Appeals, following the U.S. Supreme Court's LaRue decision, allowed participants in a defined contribution plan to proceed with their fiduciary breach lawsuit. Rogers v. Baxter Intern., Inc., 2008 WL 867741. As briefly discussed in Reinhart's March 2008 Employee Benefits Update, the Supreme Court unanimously held in LaRue that an individual participant in a 401(k) plan can sue under ERISA for losses to his own plan account resulting from an alleged fiduciary breach. In Rogers, participants in a defined contribution plan brought a class action lawsuit alleging that the plan's trustees violated ERISA by encouraging the investment of retirement funds in company stock when they allegedly knew that the stock's value was inflated. The trustees argued that the plaintiffs' claims should be dismissed because there was no loss to the plan as an entity. Based on the Supreme Court's LaRue holding, the Seventh Circuit rejected the trustees' argument and allowed the lawsuit to proceed. The Seventh Circuit's decision highlights LaRue's expansion of the right of recovery under ERISA for participants in 401(k) and other individual account plans.

Seventh Circuit Holds Fiduciaries Were Not Obligated to Diversify ESOP Holdings

The Seventh Circuit Court of Appeals held that plan fiduciaries had no duty to diversify ESOP investments based on the fraudulent overstatement of circulation figures because there were no "red flags" alerting the fiduciaries of the misconduct. Pugh v. Tribune Company, 2008 WL 867739. Beginning in 2001, employees of a Tribune Company (Tribune) subsidiary falsely boosted the circulation figures of two newspapers, increasing the amount the newspapers were able to charge advertisers and inflating revenues. Starting in February 2004,

advertisers filed lawsuits over the false circulation figures. After the lawsuits began, Tribune promptly began its own internal investigation and learned of the fraud. Tribune publicly disclosed the fraud, which resulted in a charge of $90- $95 million against earnings (representing less than 2% of one year's revenues for Tribune). After Tribune's public disclosure of the fraud, its stock price fell from approximately $42 per share to approximately $40 per share. However, the stock's price increased to $43 per share the following month. Tribune sponsored two defined contribution plans (collectively, the Plan), each of which had an ESOP component invested almost completely in Tribune stock. Based on the discovered fraud, a class of participants sued Plan fiduciaries for breach of fiduciary duty under ERISA.

ERISA section 404 imposes a fiduciary duty to diversify investments, but generally exempts ESOPs from this obligation. However, the Seventh Circuit recognized that the duty of prudence may require diversification of an ESOP's holdings in some situations. The thrust of the plaintiffs' allegations was that the defendants breached their fiduciary duties by continuing to offer and maintain Tribune stock in the Plan's ESOP component at a time when it was imprudent to do so. The plaintiffs argued that the defendants had a duty to investigate and uncover the circulation fraud at an earlier time. The Seventh Circuit noted that ERISA imposes no duty on plan fiduciaries to continuously audit operational affairs. Rather, a duty to investigate only arises when there is some reason to suspect that investing in company stock may be imprudent (e.g., a "red flag" of misconduct). The court held that the plaintiffs failed to show any such red flags. The court also held that the plaintiffs failed to show that the individual fiduciaries knew or should have known about the circulation overstatements merely because of their positions. Finally, the court indicated that the financial implications of the circulation overstatements did not support the diversification claim.

HEALTH AND WELFARE PLAN DEVELOPMENTS

Final IRS Regulations on HSA Comparability Requirement

The IRS issued final regulations under Code section 4980G providing guidance on how the health savings account (HSA) comparability requirement applies when: (1) an employee has not established an HSA by December 31st (or fails to notify the employer of his or her HSA by year end); or (2) an employer opts to accelerate HSA contributions for employees who have incurred qualified medical expenses exceeding the employer's cumulative HSA contributions for the year. As background, if an employer decides to make HSA contributions outside of a

cafeteria plan, the employer must make comparable contributions to the HSAs of all comparable participating employees. If an employer does not satisfy the HSA comparability requirement, Code section 4980G imposes an excise tax. As reported in Reinhart's June 2007 Employee Benefits Update, the IRS issued proposed regulations addressing how the HSA comparability requirement applies to the two scenarios listed above. According to the IRS, the final regulations adopt the proposed regulations without substantive revision.

To highlight, the final regulations provide the following guidance:

- When an employee does not establish an HSA by December 31st (or fails to notify the employer of his or her HSA by year end), an employer can satisfy the HSA comparability requirement by complying with a notice and contribution requirement. Specifically, no earlier than 90 days before the first employer contribution for the calendar year and no later than January 15th of the following year, the employer must provide written notice explaining that each eligible employee who, by the last day of February, both establishes an HSA and notifies the employer will receive a comparable contribution to the HSA. The notice may be provided electronically. The regulations provide sample notice language that employers may use. The HSA comparable contribution (plus reasonable interest) must be made by April 15th.
- An employer may accelerate all or part of its HSA contributions for a calendar year to the HSAs of employees who have incurred qualified medical expenses during that year exceeding the employer's year-to-date HSA contributions. Accelerated contributions must be available on an equal and uniform basis to all eligible employees throughout the calendar year and employers must establish reasonable uniform methods and requirements for accelerating contributions and determining medical expenses. Employers are not required to contribute interest on either accelerated or unaccelerated HSA contributions. The final regulations apply to employer contributions made for calendar years beginning on or after January 1, 2009. However, employers may rely on the final regulations in the interim.

DOL Advisory Opinion on Medicaid Reimbursement Requirements

The DOL issued Advisory Opinion 2008-03A (the "Opinion") providing guidance on whether a private health plan must comply with state laws requiring it to reimburse a Medicaid agency despite a participant's failure to obtain prior authorization for covered health care items or services. The Opinion addresses a

fact scenario where a participant fails to notify the provider that he or she has private health care coverage, and the provider submits the claim to Medicaid. When Medicaid discovers the private health care coverage and seeks reimbursement, the health plan claims that it is not legally required to pay because the participant failed to follow the plan's preauthorization procedures. As background, ERISA section 609(b)(3) states that, to the extent payment has been made by a state Medicaid agency in any case in which a group health plan has a legal liability to pay, a group health plan must comply with any state law requiring it to reimburse Medicaid for the payment.

In the Opinion, the DOL concludes that under the fact scenario explained above, the health plan is required to reimburse Medicaid if the procedure would have been covered if the participant had obtained preauthorization. The DOL states that a plan that requires prior authorization for health care items or services, but that makes no provision for reimbursing a state Medicaid agency for payment of those items or services in cases where prior authorization was not obtained, would not comply with ERISA section 609(b)(3). The DOL distinguishes this fact scenario from other scenarios where the health plan does not have legal liability for the claim, such as when the plan's terms require a participant to seek an alternative treatment. The DOL also notes that, if before seeking to have Medicaid pay for an item or service, the participant or provider had filed a claim with the health plan and the plan had issued a final denial based on the participant's failure to obtain preauthorization, the DOL would not recognize the plan as having a legal liability to pay for the item or service.

Tax Relief for Withdrawing Direct Deposits of 2008 Economic Stimulus Payments

The IRS issued Announcement 2008-44 providing that individuals who have Economic Stimulus Payments made by direct deposit to their HSAs may remove the payments without incurring adverse tax consequences. As background, taxpayers who indicated on their 2007 federal income tax return that refund amounts should be directly deposited into an account specified on the return will have their Economic Stimulus Payment directly deposited into that same account. Distributions from an HSA that are not used to pay for qualified medical expenses are generally subject to income tax and, depending on the taxpayer's age, an additional 10% penalty. To provide relief to taxpayers who had not intended to have their Economic Stimulus Payment directly deposited into an HSA, Announcement 2008-44 provides that an individual may withdraw from an HSA all or part of the Economic Stimulus Payment directly deposited into such account

without any adverse tax consequences. To qualify for this relief, the withdrawal must be made no later than the deadline for filing the individual's 2008 tax return (including extensions). If these requirements are satisfied, the amount withdrawn is treated as neither contributed nor distributed from the HSA, and it will not be subject to regular federal income tax or any additional tax or penalty under the Code.

Comment: Announcement 2008-44 provides that tax relief for withdrawing direct deposits of 2008 Economic Stimulus Payments applies to direct deposits made to other tax-favored accounts, such as an IRA, Archer MSA, Coverdell education savings account (CESA) or qualified tuition program account (QTP or section 529 program).

IRS Guidance on Modifications of Split-Dollar Life Insurance

The IRS issued Notice 2008-42 providing guidance on the application of Code sections 101(j) and 264(f) to life insurance contracts that are subject to split-dollar life insurance arrangements. In general, a split-dollar life insurance arrangement is an arrangement between two or more parties to allocate the policy benefits and, in some cases, the costs of a life insurance contract. In 2003, the IRS issued final regulations providing taxation rules for participants in split-dollar life insurance arrangements. The regulations generally apply to any split-dollar life insurance arrangement that is entered into or is materially modified after September 17, 2003. The PPA added Code section 101(j), which generally limits the tax exclusion for death benefits under an employer-owned life insurance contract to the premiums paid, unless an exception applies. Code section 101(j) applies to life insurance contracts issued or materially changed after August 17, 2006. Code section 264(f) generally disallows interest expense deductions allocable to unborrowed policy cash value with respect to a life insurance policy or an annuity or endowment contract. Code section 264(f) applies to life insurance contracts issued or materially changed after June 8, 1997.

In Notice 2008-42, the IRS explains that, if the parties to a split-dollar life insurance arrangement modify the terms of the arrangement but do not modify the terms of the underlying life insurance contract, the modification will not be treated as a material change in the life insurance contract for purposes of Code sections 101(j) and 264(f), even if the modification is treated as a material modification for purposes of applying the 2003 split-dollar life insurance regulations mentioned above.

Eighth Circuit Allows Former Employee's Interference Claim to Proceed The Eighth Circuit Court of Appeals rejected a health plan sponsor's request for summary judgment and allowed a former employee to proceed with his claim of interference with employee benefits. Fitzgerald v. Action, Inc., 2008 WL 899888. This case serves as a reminder of the protections afforded to participants under ERISA section 510. In particular, ERISA section 510 prohibits discharging an employee benefit plan participant for the purpose of interfering with the participant's rights under the plan. In Fitzgerald, the plaintiff was hired by Action, Inc. (Action) in November 2003 and was a participant in Action's health plan. Action fired the plaintiff in May 2005, shortly after he informed his supervisor that he required rotator cuff surgery. The plaintiff filed suit alleging that Action fired him because of his need for health plan coverage for shoulder surgery in violation of ERISA section 510. The Eighth Circuit rejected Action's request for summary judgment and concluded that the plaintiff presented sufficient evidence to raise genuine issues of material fact regarding Action's explanation for the termination. Specifically, the plaintiff pointed to: (1) Action's inconsistent explanations for his termination; (2) Action's failure to follow company policy; (3) Action's more lenient treatment of another employee; and (4) the temporal proximity between notifying Action of his surgery and his termination.

2009 Cost Threshold and Limit Adjustments for Medicare Part D

The Centers for Medicare & Medicaid Services (CMS) recently announced the 2009 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 2009, subsidy payments to a plan sponsor for each qualifying covered retiree will generally equal 28% of allowable retiree prescription drug costs attributable to gross prescription drug costs between $295 and $6,000, up from $275 and $5,600 in 2008. Medicare Part D benefit parameters (e.g., deductible and out-of-pocket threshold) have also been adjusted for 2009. These parameters will help a group health plan offering prescription drug coverage to Medicare Part D eligible individuals to determine whether it is creditable or non-creditable with Medicare Part D. More information on Medicare Part D adjustments for 2008 can be found on the CMS website.

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