EMPLOYEE BENEFITS

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Legal News: Employee Benefits is part of our ongoing commitment to providing legal insight to our clients and our colleagues.

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Thank you.

Harvey Kurtz
Managing Editor

Employee Benefits Developments for May and June 2007

Executive Compensation

Will the December 31, 2007 deadline for documentary compliance with the requirements of Code Section 409A, governing nonqualified deferred compensation, be extended? Dan Hogans, attorney adviser in the Treasury's office of Tax Policy, stated in a June 21 forum on Section 409A: "There is no movement to extend the deadline. We have a final regulation with an effective date of January 1, 2008."

How do you determine if your company or organization has nonqualified deferred compensation that must be reviewed for compliance with the requirements of Code Section 409A? Hogans said if you meet the threshold criteria—a legally binding right to taxable compensation earned in one year and payable in a future year — you have a Section 409A issue that needs to be resolved. (We recently reviewed one executive employment contract in which there were 10 different Section 409A arrangements. The time to focus on Section 409A compliance is now.)

The definition of ''covered employee'' for purposes of Code Section 162(m), which limits the deduction for compensation paid to certain employees of publicly held corporations, no longer incorporates the U.S. Securities Exchange Commission (SEC) executive compensation rules for ''named employees'' by reference. In Notice 2007-49, the IRS pointed out that the SEC's final rules on executive compensation disclosure, issued September 8, 2006, changed the number of executives who are named executive officers by virtue of their position from one to two, and reduced the number of executives who are named executive officers based on their compensation level from four to three. The Notice concludes that, since covered employees are determined by looking to the Exchange Act, a new interpretation of Code Section 162(m) is needed. Accordingly, the IRS will interpret the term "covered employee" for purposes of Code Section 162(m) to mean any employee of the company if, as of the close of the tax year:

- The employee is the company's principal executive officer (PEO) within the meaning of the amended SEC disclosure rules or an individual acting in that capacity; or

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- The employee's total compensation for that tax year is required to be reported to shareholders under the Exchange Act because such employee is among the three highest compensated officers for the taxable year (other than the PEO or the company's principal financial officer (PFO).

As a result of this change, the PFO will not be subject to Code Section 162(m).

Qualified Retirement Plans

The first IRS Private Letter Ruling (PLR) on the rollover to an IRA of a deceased participant's plan interest by a non-spouse beneficiary illustrates that the rules are extremely complex. PLR 200717023. The facts of this private letter ruling are too extensive to cover here, but they are fairly ordinary facts that raise an amazing number of complex issues. The point of this note is that this letter ruling makes it abundantly clear that any non-spouse beneficiary making such a rollover to an Individual Retirement Account (IRA), as permitted beginning in 2007 by Section 829 of the Pension Protection Act of 2006, needs to be extremely careful. Plan administrators should not provide personal tax advice in these situations, but should encourage such individuals to obtain professional assistance from a qualified tax professional.

A unanimous United States Supreme Court (Court) rules that Employee Retirement Income Security Act (ERISA) does not permit a qualified plan to terminate by merger into another plan. *Beck v. Pace International Union*, U.S. No. 05-1448, June 11, 2007. The Court held that a bankrupt employer did not breach its fiduciary duties when the employer annuitized all plan benefits rather than investigate whether it should merge its single employer plan into a multiemployer plan. In reversing the Ninth Circuit Court of Appeals, the Court noted that an "employer's decision *whether* to terminate an ERISA plan is a settlor function immune from ERISA's fiduciary obligations."

Roth contributions must be specified when they are made to 401(k) plans. According to a senior technical reviewer in the IRS Office of Division Counsel, if election forms do not specifically provide that a Roth contribution is being made, the transaction will be treated as if the participant did not make a Roth contribution (but rather made a traditional 401(k) pretax contribution). The tax benefits of making Roth contributions depend on whether five consecutive years have passed since the first Roth contribution was made. As a result, it is essential to be able to determine definitively when that occurred.

IRS rules that, to determine whether there has been a partial termination of a qualified retirement plan, a 20 percent or more reduction in the number of participating employees establishes a rebuttable presumption that a partial plan termination has occurred during the applicable period (generally the plan year). Revenue Ruling 2007-43. Employees affected by a partial plan termination must be given full vesting in their accrued plan benefits, which makes the timing of when a partial termination has occurred very important. This ruling adopts the decision of the Seventh Circuit in *Matz v. Household International Tax Reduction Plan*, 388 F3d 570 (7 Cir. 2004), in which the court considered all participants, vested and non-vested, who had an employer-initiated severance from employment during the applicable period, in determining the percentage of participants affected by the partial plan termination. The applicable period is the plan year or a longer period if there is a partial plan year or a series of related severances from employment. IRS also adopts for purposes of this ruling a rebuttable presumption that all severances from employment are employer-initiated other than severances due to death, disability, or retirement on or after normal retirement age. Partial plan terminations may occur, under the ruling, for reasons other than employee turnover. For example, plan amendments that adversely affect the right of participants to vest in plan benefits, plan amendments that exclude a group of previously-covered employees, or the reduction or cessation of future accruals may also give rise to a partial plan termination.

A plan sponsor did not breach its fiduciary duties when a Human Resources (HR) Department representative gave an employee an incorrect estimate of the employee's pension benefits. *Livick v. Gillette Co.*, D. Mass., No. 05-11094-JLT, June 12, 2007. The court concluded that the human resources representative was not a plan fiduciary and there was no breach of fiduciary duty by the plan sponsor in assigning this task to the HR Department. The court also

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found that, even if the employer had breached its fiduciary duty, the employee receiving the incorrect estimate was without remedy because the employee could not show that the employer was unjustly enriched by the alleged breach.

Welfare Plans

The Third Circuit has upheld the authority of the Equal Employment Opportunity Commission (EEOC) to implement its proposed regulation that provides an exemption from the Age Discrimination in Employment Act for private retiree health plans that coordinate benefits with Medicare or a state health insurance plan. *AARP v EEOC*, (2007, CA3) 2007 WL 1584385.

IRS provides 2008 inflation-adjusted amounts for Health Savings Accounts (HSAs). Revenue Procedure 2007-36. For calendar year 2008, a high deductible health plan is defined as a health plan with an annual deductible of at least $1,100 for self-only coverage with no more than $5,600 for annual out-of-pocket expenses; and $2,200 for family coverage with no more than $11,200 out-of-pocket expenses annually. The annual 2008 contribution limit to an HSA accompanied by a high deductible health plan increases (from $2,850 in 2007) to $2,900 for self-only coverage and (from $5,650 in 2007) to $5,800 for family coverage.

Massachusetts 151F employers have until October 1, 2007, to file copies of their Section 125 plans with the Massachusetts Connector. Employers with 11 or more full-time equivalent employees in Massachusetts during the initial determination period ending March 31, 2007, comprise the initial group of "151F employers" under the Massachusetts universal health care law. Section 151F employers are required to file a copy of their Code Section 125 cafeteria plan with the Massachusetts Connector in order to avoid certain financial sanctions under that law. The filing deadline has been extended from July 1, 2007, to October 1, 2007, and no filings of cafeteria plans will be accepted prior to September 1, 2007. Administrative Information Bulletin 02-07, June 29, 2007.

Internal Revenue Service regulations generally require that, for purposes of avoiding United States federal tax penalties, a taxpayer may only rely on formal written opinions meeting specific requirements described in those regulations. This newsletter does not meet those requirements. To the extent this newsletter contains written information relating to United States federal tax issues, the written information is not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal tax penalties, and it was not written to support the promotion or marketing of any transaction or matter discussed in the newsletter.

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