■ EMPLOYEE BENEFITS

Legal News™

FOLEY

FOLEY & LARDNER LLP

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Legal News is part of our ongoing commitment to providing legal insight to our Employee Benefits clients and colleagues. If you have any questions about or would like to discuss these topics further, please contact your Foley attorney or any of the following individuals:

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Employee Benefits Developments for July and August 2007

Executive Compensation

The Code Section 409A compliance deadline is still December 31, 2007. Nearly 100 prominent law firms have asked the Internal Revenue Service (IRS) for a one-year delay in the effective date for compliance with the new rules in Section 409A applicable to nonqualified deferred compensation, but there has been no response to date. Practitioners expressed concern that clients will not have the needed time to do a good job to ensure compliance in the time available. The sweep of Section 409A is so broad and so deep that it has a foundational effect on the compensation structures of many companies, according to one commentator, and it takes substantial time to work through those problems. ***We would add that it is not too soon to start on 409A compliance efforts even if the deadline is extended. Work already underway for clients is proving to be complex and the issues presented for employers are sometimes difficult to resolve.***

The IRS announced plans to issue guidance under Code Section 457 on what constitutes a ''substantial risk of forfeiture.'' (Notice 2007-62). This announcement pertains mainly to tax-exempt employers who offer deferred compensation arrangements to "top-hat" employees under Code Section 457(f). A Section 457(f) plan's deferred compensation becomes taxable to the participant when the compensation that is deferred is no longer subject to a substantial risk of forfeiture. The IRS announced that its forthcoming guidance would be similar in many respects to the final regulations issued in April 2007 under Code Section 409A.

Under the final Section 409A rules, a substantial risk of forfeiture exists if entitlement to the deferred compensation is conditioned on the performance of substantial future services or the occurrence of a condition that is related to a purpose of the compensation and the potential for forfeiture is substantial. The IRS said that (i) conditioning payment on involuntary separation from service without cause might be a substantial risk of forfeiture if the possibility of forfeiture is substantial and (ii) that an amount is not subject to a substantial risk of forfeiture merely because the right to the amount is conditioned, directly or indirectly, on refraining from the performance of services (i.e., refraining from competing with the employer after leaving its employment). The IRS also noted that adding a risk of forfeiture after the right to compensation arises — sometimes referred to as a "rolling risk of forfeiture" — is generally disregarded for purposes of determining whether there is a substantial risk of forfeiture.

In Notice 2007-62, the IRS stated that its new Section 457(f) guidance would be prospectively effective. Many tax-exempt employers' Section 457(f) plans will be significantly affected by this guidance when it becomes effective.

Qualified Retirement Plans

The U.S. Department of Labor has published a new rule, to be effective October 9, 2007, that provides for a $100 per person per day penalty for failure by a plan administrator to notify participants of their right to sell company stock. (72 Fed. Reg. 44,970, 44,991, 8/10/07). Employee Retirement Income Security Act (ERISA) Section 101(m), created by the Pension Protection Act of 2006, requires plan administrators of individual account plans to notify participants and beneficiaries of their right to sell the company stock in their account and reinvest in other investment options available under the Plan. The notice is required by law to point out the advantages of diversification of investment of retirement funds. The notice is required to be provided not later than 30 days before the first date on which the individuals are eligible to exercise their rights. A Model Notice was published in IRS Notice 2006-107 in December 2006. The penalty is to be assessed in a manner similar to the penalty for failure to provide a required "black out notice." The Department may determine that all or part of the penalty will not be assessed based upon a showing that the administrator complied with the applicable requirements or on a showing by the administrator of mitigating circumstances.

The IRS finalized regulations on Section 403(b) plans and "tax-sheltered annuities (TSAs)." (TD 9340). The rules were initially proposed in 2004 and are not significantly changed in their final form. They retain the requirement of a written plan document for these types of plans. Section 403(b) plans cover employees of organizations exempt under Code Section 501(c)(3) and employees of public schools. They may be funded only by annuity contracts or custodial accounts invested in mutual funds. Plans for Section 501(c)(3) organizations must meet many requirements that are now very similar to those of plans that are qualified under Code Section 401(a). The rules are effective July 26, 2007, but are not required to be applied until the taxable year beginning after December 31, 2008. There are transition rules for collectively bargained plans, and a special provision makes the rules effective for church plans with the plan year commencing in 2010.

The Section 403(b) final rules contain guidance for determining who is the employer in tax-exempt controlled group situations (other than governments or churches). These rules are not limited to Section 403(b) plans, but are generally applicable for Code Section 414 purposes. Common control exists among tax-exempt organizations if at least 80 percent of the directors or trustees of one organization are controlled by the other.

The IRS has ruled that a qualified plan is "partially terminated" when 23 percent of participants are severed from employment. (Rev. Rul. 2007-43). Code Section 411(d)(3) requires a qualified plan to provide that on the plan's partial termination, the benefits accrued for affected employees (to the extent funded) or their account balances must become fully vested. In the ruling, the IRS reaffirmed the existing "rule of thumb" that a partial termination is presumed to occur if the turnover rate for employees leaving employment is at least 20 percent. Turnover rate (after years of litigation and many court decisions) is now described by the IRS as being determined by dividing the number of employees participating in the plan affected by the employer-initiated severance from employment by the number of all participating employees during a specific period. The period is usually a plan year but could be longer if there are a series of related severances. Employees who voluntarily leave during the period are not included in the numerator and are not entitled to full vesting due to partial plan termination. Partial terminations also may occur if a plan is amended to exclude a group of previously-covered employees or to reduce or stop accruals in a defined benefit plan resulting in a potential reversion of plan assets to the employer.

Schedule P to Form 5500 is eliminated for 2006 and subsequent years. (IRS Announcement 2007-63). Schedule P was previously required to be filed in order to start the statute of limitations period running for the assessment of taxes with respect to an employee benefit trust. The statute of limitations period generally ends three years after the date the plan administrator files a complete and accurate Form 5500 (including all required schedules). The IRS announcement confirms the elimination of the requirement to file Schedule P to Form 5500 effective for 2006 and later plan years. For plan years for which no Schedule P is required, the IRS will treat the plan's filing of Form 5500 as the necessary filing for statute of limitations purposes.

Welfare Plans

The IRS has proposed new rules for cafeteria plans under Code Section 125. (72-Fed. Reg. 43,938, 8/6/07). Code Section 125 allows employees to choose between taxable cash and non-taxable employee benefits (e. g. payment of medical premiums and flexible spending accounts). Previously issued temporary regulations have been removed. The proposed rules would generally be effective for plan years beginning on or after January 1, 2009, and may be relied on until the final rules are issued. According to the IRS description of the proposed rules, they "generally preserve the rules of the existing proposed regulations, while adding clarifications" relating to developments in the law and guidance issued after those rules were proposed. For anyone using the amalgam of Section 125 guidance, the issuance of a comprehensive package of rules will be a great relief.

Under the proposed rules, a Section 125 plan is a separate written plan that must describe all benefits, list their eligibility rules and the procedures for electing benefits, note the circumstances under which elections may be changed, describe how employer contributions are made, list the maximum amount of contributions, and give the plan year. Only employees and former employees may participate in a Section 125 plan, and the plan must uniformly apply to all participants. The proposed rules retain the "use it or lose it" rule for health flexible spending accounts (health FSAs) and provide for the two-and-a-half-month grace period recently adopted to soften that rule. Plan sponsors may use forfeited amounts to pay for plan administration or to allocate those amounts to Section 401(k) plan participants where the 401(k) plan is part of the cafeteria plan.

Nontaxable benefits available under Code Section 125 plans include group term life insurance on the life of an employee, employer-provided accident and health plans, dependent care assistance programs, adoption assistance plans, contributions to a Section 401(k) plan, contributions to certain plans maintained by educational organizations, and contributions to health savings accounts.

ABOUT FOLEY

The Employee Benefits attorneys of Foley & Lardner LLP counsel employers on employee benefits and executive compensation matters to reduce exposure to employee complaints, governmental agency actions, and union-related problems. We counsel on health, dental, disability, life insurance, severance, cafeteria, and flexible benefits plans. Our counsel also extends to Medicare and Social Security benefits, COBRA compliance, and post-retirement benefits issues. We also advise clients in resolving benefits issues arising in mergers and acquisitions. We work closely with Foley trial lawyers who represent corporations and their benefit plans in litigation involving employment benefits and other obligations under ERISA.

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