EMPLOYEE BENEFITS

Legal News™

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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 September 2007

Executive Compensation

The latest Code Section 409A transition relief DOES NOT mean that we can wait another year. Our September 11, 2007 Alert summarized the recent Internal Revenue Service (IRS) transition relief. It remains absolutely necessary for employers to:

- Identify changes that must be made in programs or arrangements subject to Section 409A by January 1, 2008
- Prepare necessary documentation (such as election forms) that may need to be in place by that date
- Obtain any formal actions or approvals in a timely manner

Many practitioners and the Taxation Section of the American Bar Association have asked the IRS to broaden its recently granted limited transitional relief. There is no assurance that this will occur.

The chief of the IRS' Executive Compensation Branch recently provided an overview of issues which may arise in an executive compensation audit. The list is not surprising: nonqualified deferred compensation; the $1 million compensation limit under Code Section 162(m); golden parachute payments under Code Section 280G; fringe benefits; transactions such as transfers of nonstatutory options to related persons; and split-dollar insurance.

The nonqualified deferred compensation audits have all involved pre-Section 409A years thus far. The issues in these audits include: employers deducting deferred compensation before it is taken into income by the employee; compensation taxable under the constructive receipt and economic benefit rules; failure to follow the rules on when to pay Federal Insurance Contributions Act (FICA) taxes; and deferred compensation that is made available early — such as in the form of loans.

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The pitfalls for Code Section 162(m) audits include: changes in performance goals midstream; use of goals set by fewer than two outside directors; failure to obtain shareholder approval of the goals; and payment of the compensation even though the goals were not met.

Qualified Retirement Plans

IRS has issued a list of "interim and discretionary" amendments for 2007. Retirement plan sponsors must make interim amendments to keep their written plan documents up-to-date between a plan's five-year determination letter submission cycle under the new IRS procedures for issuing determination letters. Discretionary amendments also must be adopted in the first year during which they are applied. The list is helpful to review whether any plan changes are needed, or whether any opportunities to make discretionary changes are available. The list is available at http://www.irs.gov/retirement/article/0%2C%2Cid=173372%2C00.html.

The U.S. Department of Labor's (DOL) Employee Benefits Security Administration has released proposed regulations offering guidance to defined contribution plan fiduciaries who must select an annuity provider for benefit distributions. The previous guidance (Labor Department Interpretive Bulletin 95-1) indicated that retirement plan fiduciaries were supposed to select the "safest available annuity provider." The Pension Protection Act of 2006 provided that defined contribution plans were not subject to the "safest available" rule and directed the DOL to issue new guidance. The proposed safe harbor provides that a fiduciary will have acted prudently in selecting an annuity provider and annuity contract if an extensive list of conditions is met. These conditions, stated generally, are that the fiduciary must engage in a thorough search for the annuity provider while avoiding self-dealing and, when feasible, consider competing providers. If the fiduciary does not have the expertise to do the search, then an independent expert should be engaged to do so. *Proposed Labor Reg. 2550.404a-4; 72 Fed. Reg. 52021.* The proposed regulations do not comment on how, if at all, having the individual participant for whom the annuity is being purchased select the annuity to be purchased affects the plan fiduciary's duties with respect to the purchase.

The Sixth Circuit Court of Appeals has joined the Seventh and Third Circuits in holding that cash balance plans' interest crediting provisions do not discriminate on the basis of age. Consistent with the Seventh Circuit's decision in Cooper and the Third Circuit's decision in Register, the Sixth Circuit has held that cash balance plans do not discriminate against older workers solely due to their interest-crediting provisions. This means that all three federal appellate courts that have ruled on this issue have reached similar conclusions. *Drutis v. Rand McNally & Co.* (2007, CA6) 2007 WL 2409762.

Welfare Plans

Labeling a short-term disability plan an Employee Retirement Income Security Act (ERISA) plan in the summary plan description does not make the plan subject to ERISA. The issue in the case was whether or not a short-term disability plan was subject to ERISA. The Sixth Circuit held that "mere labeling by a plan

sponsor or administrator is not determinative on whether a plan is governed by ERISA." What did make a difference was that the employer paid benefits out of its general corporate assets and did not treat the plan as subject to ERISA in its governmental filings. *Langley v. DaimlerChrysler (2007, CA6) WL 2701091.* This decision, and similar ones in the First and Eleventh Circuits, may be of interest to employers who prefer ERISA preemption of state laws that would otherwise impact short-term disability benefits — such as state family leave acts — but who continue to pay short-term disability benefits out of general corporate assets.

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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