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.

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Employee Benefits Developments for January 2008

Qualified Retirement Plans

The U.S. Department of Labor (DOL) issued proposed rules on service provider disclosures for retirement plans and health and welfare benefit plans. (DOL Reg. Sec. 2550.408b-2(c), 72 Fed. Reg. 7087, Dec. 13, 2007) As has been widely communicated in our Legal News: Employee Benefits newsletters and elsewhere, the DOL's Employee Benefits Security Administration (EBSA) has been focused on helping Employee Retirement Income Security Act (ERISA) plan fiduciaries understand how service providers are compensated and whether they have possible conflicts of interest that may affect their performance. Under ERISA, plan fiduciaries are obligated to act prudently in selecting service providers and ensure that no more than reasonable compensation is paid for services to plans. One of the most significant developments in ERISA in recent years has been the evolution of what constitutes "compensation" when analyzing whether compensation is reasonable. In these proposed rules, EBSA makes clear that compensation to a service provider includes indirect compensation, including amounts provided to the service provider by third parties.

The purpose of the proposed rules, according to EBSA, is to provide plan fiduciaries with sufficient information regarding (i) fees and compensation that the service provider receives, directly and indirectly, and (ii) whether there are relationships or interests on the part of the service provider that may call into question the objectivity of the service provider in providing services to the plan. The proposed rules apply to fiduciary service providers; providers of banking, consulting, custodial, insurance, investment advisory or management, recordkeeping, securities brokerage, or third-party administration services; and providers who receive indirect compensation for accounting, actuarial, appraisal, auditing, legal, or valuation services.

Disclosure is required of the terms of the services contract and all compensation to be received directly from the plan or plan sponsor, or indirectly from parties other than the plan or plan sponsor. Service providers also are required to disclose their conflicts of interest, including information about relationships or interests that may raise conflicts of interest for the service provider in performing plan services.

If a service provider fails to make the required disclosures, including required ongoing disclosures, the contract or arrangement would be a prohibited transaction for failing to be based on "reasonable" compensation. However, the DOL also has proposed a prohibited transaction class exemption (PTCE) that would provide relief to plan fiduciaries that unknowingly enter into deficient contracts due to a service provider's failure to comply with the disclosure requirements. To obtain relief under the PTCE, the plan fiduciary would be required to provide notice of the deficiency to the DOL. (72 Fed. Reg. 70893, Dec. 13, 2007)

Commentators note that the proposed regulation does not clearly address when a service provider is treated as providing services to a plan and thus subject to the disclosure requirements in cases where the service provider is not paid out of plan assets and provides services pursuant to an arrangement or contract with the plan sponsor. An example would be Foley, which typically provides legal services to the employer, rather than to the plan itself.

The Internal Revenue Service (IRS) issued proposed rules on diversification requirements for publicly traded employer securities in defined contribution retirement plans. (IRS Reg. Sec. 1.401(a)(35)-1, 73 Fed. Reg. 421, Jan. 3, 2008) The Pension Protection Act of 2006 (PPA) added new Internal Revenue Code Section 401(a)(35), providing diversification rights with respect to publicly traded employer securities held by certain defined contribution plans, including 401(k) plans, but not including standalone employee stock ownership plans (ESOPs), and one-person plans. Plan sponsors may rely on the proposed regulations or on the previously issued Notice 2006-107 on the same subject, pending issuance of final regulations. The proposed rules are more flexible in many respects than Notice 2006-107.

Cycle C is underway for the new IRS determination letter filing procedures. We have covered the new procedures for obtaining IRS determination letters in prior Legal News: Employee Benefits issues, but an update is in order. Under the revised procedures, new IRS determination letter requests for individually prepared qualified plans are to be filed in five-year cycles. Each cycle begins on February 1 and ends on the January 31 of the following year. Plans are assigned to cycles based on the last digit of the plan sponsor's employer identification number (EIN), with some exceptions. Cycle B just ended January 31, 2008. Multiple employer plans, and those plans whose sponsor's EIN ended in the numbers two or seven, were assigned to Cycle B. Plans whose sponsor's EIN ends in the numbers three or eight are assigned to Cycle C.

When Cycle C plans are filed for determination letters under this procedure, they are supposed to contain all of the updates on what is called the 2007 Cumulative List of Changes in Plan Qualification Requirements (IRS Notice 2007-94). Plans may contain additional changes for subsequent legal developments, but those must be identified in the determination letter request and will not be covered by the determination letter that is issued. They will be considered in the determination letter request that is made five years later.

Also, beginning in February 2008, the IRS will detail on the IRS Web site (www.irs.gov) a preliminary list of interim amendments that plans must adopt, and the list will be updated bimonthly through August 2008. In some cases, required interim amendments must be adopted by the end of the plan year, so the IRS is trying to give earlier notice of required amendments.

One consequence of the formality of the new IRS procedures is that plan documentation also will need to become even more formal. It will be important to execute periodic amendments on a regular basis and to restate plan documents at least once every five years. Attention to the details of the process of adopting plan amendments and maintaining records of their timely adoption will be very useful when it comes time to make these determination letter requests in the applicable five-year cycle.

The IRS issued retirement plan frequently asked questions (FAQs) on pre-approved and individually designed plan programs. These FAQs are found on the IRS Web site (http://www.irs.gov/retirement/article/0,,id=158688,00.html). These FAQs address a number of practical questions about how the new IRS determination letter procedures apply, for example, when an employer with an individually designed plan decides to adopt a pre-approved plan as its successor plan, or when a business transaction (e.g., merger or acquisition) results in a new EIN for the plan sponsor, which is a "cycle-changing event."

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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Welfare Plans

A final rule issued by the Equal Employment Opportunity Commission (EEOC) will allow employers that provide retiree health benefits to continue coordinating those benefits with Medicare without violating the Age Discrimination in Employment Act (ADEA). (29 CFR Part 1625, 72 Fed. Reg. 72938, Dec. 26, 2007) This is what most employers have been doing for years, but the Third Circuit decision in *Erie County Retirees Association v. County of Erie,* 220 F.3d 193 (CA3, 2000) (Cert. Den.) called this practice into question. According to EEOC Vice Chair Leslie E. Silverman, the *Erie County* decision would have made most existing retiree health plans unlawful. To correct the problem, the new regulation provides an exemption from ADEA coverage for this common and longstanding employer practice. The final rule was strenuously opposed by AARP, but the Third Circuit concluded that the then-proposed rule was “a reasonable, necessary and proper exercise” of EEOC’s authority. On November 20, 2007, AARP requested the U.S. Supreme Court to review the Third Circuit decision.

The IRS has issued Form 8925, Report of Employer-Owned Life Insurance Contracts. Form 8925 is to be used for the reporting requirement on employer-owned life insurance contracts under Internal Revenue Code Section 6039I. The PPA required employers to treat death benefits from such coverage in many cases as taxable income for contracts issued after August 17, 2006.

Executive Compensation

The IRS announces that it intends to issue proposed regulations on determining amounts included in income under Code Section 409A by the end of June 2008. The IRS spokesperson indicated that the proposed rules would focus on the method for calculating income to be included in taxable income when a violation of Section 409A occurs and in related matters. As noted in our last Legal News: Employee Benefits, the IRS also has issued Notice 2007-100, providing relief, which expires at the end of 2009, for some operational failures. The IRS spokesperson also indicated that the IRS is seeking comments on creating a more permanent correction program.

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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