EMPLOYEE BENEFITS

Legal News[SM]

FOLEY
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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 February 2008

Qualified Retirement Plans

The U.S. Supreme Court held that a defined contribution plan participant may seek recovery under Section 502(a)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended for fiduciary breaches by plan fiduciaries that caused a reduction in the value of the participant's account. *LaRue v. DeWolff Boberg & Associates,* 2008 W.L. 440748 (February, 20, 2008). Although most plan sponsors probably already assumed that this was the law, there was a substantial argument under ERISA and prior case law that only the entire plan, not individuals, could seek recovery under Section 502(a)(2), which provides broad recovery rights, including the right to recover lost profits. Justice Stevens, writing for a unanimous court, held that individual participants in defined contribution plans such as 401(k) plans, could seek recovery under this section of the law, even where the damage done is to the account of just one participant.

The *LaRue* case is an excellent reminder for plan sponsors to review periodically their own fiduciary responsibilities under ERISA plans and how well other plan fiduciaries are fulfilling their responsibilities. Fiduciary self-audits, including reviews of policies, fee arrangements, procedures, disclosures, liability insurance, and documentation such as trust agreements, investment manager agreements, investment policy statements, investment consultant contracts, and service provider agreements, may help to ensure proper accountability for any errors or omissions and avoid expensive litigation.

The U.S. Department of Labor (DOL) issued guidance stating that a plan's legal claims for delinquent contributions must be assigned by plan documentation to a plan trustee with discretion over plan assets, a directed trustee subject to the directions of a named fiduciary, or an investment manager. Field Assistance Bulletin No. 2008-01. Many, if not all institutional trust documents currently provide that the trustee has no responsibility to pursue recovery of delinquent contributions, which may be inconsistent with this guidance unless the responsibility is assigned to another plan fiduciary. Delinquent employer contributions for this purpose include employer contributions that are due and owing to the plan in accordance with plan documents but have not been transmitted to the plan in a timely manner (e.g., amounts withheld from payroll as 401(k) contributions).

Plan sponsors should review plan and trust documents to ensure that the duty to pursue collection of delinquent employer contributions has been assigned properly and that the assigned duty is being carried out properly. Otherwise, the board of directors or other body appointing the trustee may have ultimate responsibility for any delinquent contributions.

The DOL proposed rules that would establish a seven-day safe harbor period for employee contributions to small plans. Proposed revision to Labor Reg. 2510.3-102(a) and (f). The current rule for all employers is that employee contributions to retirement plans (such as 401(k) contributions) must be transmitted to the plan as soon as they can reasonably be segregated from the employer's general assets, but no later than the 15th day of the month following the month in which the contributions are withheld by the employer. If contributions are not timely transferred, a prohibited transaction occurs. The proposed rule would provide that, for plans with fewer than 100 participants, participant contributions for both retirement and welfare benefit plans would be deemed to be made in compliance with ERISA if they are deposited with the plan within seven business days of being withheld by the employer. This safe harbor also would apply to amounts paid to the employer or withheld for purposes of repaying a participant's loan regardless of plan size. During the safe harbor period described above, amounts in transit would not be considered to be plan assets. The DOL advised that it would consider extending the safe harbor to larger plans if comments on the proposed regulations indicated that this would be beneficial to the sponsors of the larger plans.

Welfare Plans

The DOL issued guidance on the final Health Insurance Portability and Accountability Act of 1996 (HIPAA) wellness plan regulations in the form of a Wellness Program Checklist. Field Assistance Bulletin No. 2008-2. According to the DOL, the checklist helps answer questions concerning the types of health promotion or disease prevention programs offered by a group health plan that must comply with the HIPAA wellness plan regulations as well as how to determine if the programs comply with the rules. The checklist is available on the DOL's Web site at: http://www.dol.gov/ebsa/regs/fab2008-2.html.

Executive Compensation

The Internal Revenue Service (IRS) issued a Private Letter Ruling (PLR) followed by a published Revenue Ruling regarding qualified performance-based compensation under Internal Revenue Code (Code) Section 162(m). Section 162(m) of the Code limits the tax deduction for compensation paid to each covered executive of public corporations to $1 million per year. An exception to this $1-million limitation applies for "qualified performance-based compensation." Qualified performance-based compensation has a number of requirements such as shareholder approval of possible performance goals and objective quantification of those goals in advance. Additionally, Treasury Regulation (Treas. Reg.) § 1.162-27(e)(2)(v) provides that an award does not qualify as performance-based compensation if the facts and circumstances indicate the award would be paid out regardless of whether the performance goal is attained. The regulation further provides that an award will not fail to be qualified performance-based compensation merely because the plan allows for payments upon death, disability, or change of control irrespective of satisfaction of the performance goals (though if any such death, disability, or change-in-control event occurred, the resulting payment itself would not be performance-based compensation).

Previously, the IRS has issued PLRs indicating that the entitlement to payment of award amounts in the event of termination of the executive without cause or by the executive with good reason were similar to death, disability, and change of control. As a result, the rulings concluded that the existence of such provisions in plans would not taint awards actually made based on the performance goals.

The IRS reached the opposite conclusion in a recent PLR. In PLR 200804004, the IRS concluded that permitting the executive to receive incentive awards upon involuntary termination without cause or by the executive with good reason, regardless of satisfaction of the performance goals, does not meet the exception in Treas. Reg. § 1.162-27(e)(2)(v) described above and taints the entire award. Consequently, such awards cannot be qualified performance-based compensation even if no termination of the employment of the executive occurs. PLRs may not be used or cited as precedent. Many groups requested that the IRS provide more definitive guidance and transitional relief.

Three weeks after issuing PLR 200804004, the IRS issued Revenue Ruling (Rev. Rul.) 2008-13, addressing qualified performance-based compensation. Rev. Rul. 2008-13 does not change the conclusion reached in the recent PLR. However, it does provide that the new position applies prospectively and that it will not be applied to disallow a deduction for any compensation that otherwise satisfies the requirements for qualified performance-based compensation under Code Section 162(m)(4)(C) and Treas. Reg. 1.162-27(e) and that is paid under a plan, agreement, or contract that has payment terms similar to the terms described in the Revenue Ruling if either (i) the performance period for such compensation begins on or before January 1, 2009 or (ii) the compensation is paid pursuant to the terms of an employment contract as in effect on February 21, 2008, but not including any period of extension or renewal of the contract, including automatic renewals that occur absent specific actions of one or more parties to the contract.

This new position of the IRS on qualified performance-based compensation appears to have been reached at the executive level of the IRS, perhaps suggesting that it may not be reversed or rescinded, despite its unpopularity with public companies and their tax advisors.

Reminder: All nonqualified deferred compensation arrangements should be updated for Code Section 409A compliance by December 31, 2008. This compliance deadline has been extended three times and there is little hope for any further extensions. The adverse income tax consequences to an individual with deferred compensation that is includible in income under Code Section 409A are significant.

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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