EMPLOYEE BENEFITS

Legal News[SM]

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 March 2008

Qualified Retirement Plans

The Internal Revenue Service (IRS) announced that it expects to issue opinion and advisory letters for pre-approved master and prototype and volume submitter defined contribution plans by March 31, 2008. This is of special interest to employers who have adopted prototype plans. Once the sponsor of the updated prototype plan document (e.g., Fidelity, T. Rowe Price, etc.) has received this approval letter from the IRS, each employer who previously adopted the prototype plan will have until April 30, 2010 to adopt the restated prototype plan. Adopting employers will receive extensive information from the sponsor of the restated prototype plan in the next 24 months and will be asked to review and sign the prototype plan's restatement documents. The information should be reviewed with care.

The use of prototype plans has increased greatly in recent years and many adopters of such plans may find the restatement process confusing, including deciding whether or not to file for a separate IRS determination letter for the employer's individual plan. This decision will depend on the facts and circumstances of the individual plan, including whether or not any special amendments have been adopted that supplement or change the prototype plan documentation.

Rollovers to Roth IRAs are explained in IRS Notice 2008-30. Effective for distributions made after December 31, 2007, distributions from a tax-qualified retirement plan may be rolled over to a Roth IRA through a direct rollover from the plan to the Roth IRA or an amount can be distributed from the plan and contributed (rolled over) to the Roth IRA within 60 days. A Roth IRA is an IRA that can receive only after-tax contributions, in contrast to traditional IRAs, which can receive only pretax contributions. The amount rolled over to a Roth IRA still must be a qualified rollover distribution and an amount must be included in the income of the person making the rollover that would be includible if the distribution were not rolled over. In addition, for taxable years beginning before January 1, 2010, an individual cannot make a rollover to a Roth IRA if, for the year in which the rollover would be made, the individual has modified adjusted gross income exceeding $100,000 or is married and files a separate return.

The new Roth IRA rollover rules also are available to rollover amounts from Code Section 403(a) and 403(b) plans and from eligible governmental plans under Code Section 457(b).

The 10 percent premature distribution penalty tax under Code Section 72(t) does not apply to rollovers from an eligible retirement plan to a Roth IRA, even though the amount rolled over is taken into income at the time it is rolled over to the Roth IRA.

A qualified plan must permit a distributee of an eligible rollover distribution to elect a direct rollover to a Roth IRA. The plan administrator is not responsible for assuring that the distributee is eligible to make the rollover to the Roth IRA. An eligible rollover distribution paid directly to a participant or the participant's spouse generally is subject to 20 percent mandatory withholding; however, if there is an election to make a direct rollover to a Roth IRA, no withholding is required (even though the entire amount may be includible in income). A distribution directly rolled over to a Roth IRA by a nonspouse beneficiary also is not subject to mandatory withholding. Voluntary withholding is allowed.

Beginning in 2007, retirement plans have the opportunity to choose to allow nonspouse beneficiaries to make rollovers. If permitted, then rollovers to Roth IRAs also must be allowed. Nonspouse rollovers may only be made in direct trustee-to-trustee transfers.

Certain plans must offer a qualified optional survivor annuity (QOSA) in plan years beginning after December 31, 2007. (IRS Notice 2008-30) Code Section 401(a)(11) applies to defined benefit plans and defined contribution money purchase pension plans. Plans subject to Code Section 401(a)(11) must provide that benefits are payable in the form of a Qualified Joint and Survivor Annuity (QJSA). A QJSA for a married participant means an annuity for the life of the participant with a survivor annuity for the life of the participant's spouse that is not less than 50 percent and not more than 100 percent of the amount of annuity payable during the joint lives of the participant and spouse. A participant is required to be able to waive payment in the QJSA form, with spousal consent, and elect any available optional form of payment.

Beginning in 2008, plans required to pay benefits in the QJSA form also must offer a specified optional form of benefit as an alternative to the QJSA. The specified alternative is the QOSA, an annuity for the life of the participant with a survivor annuity for the life of the participant's spouse that is equal to a specified percentage of the amount of the annuity that is payable during the joint lives of the participant and the spouse. A QOSA must have an actuarial equivalent that is not less than the single life annuity payable for the life of the participant that would be the normal form of benefit for the participant if the participant were not married. The QOSA is not required to be actuarially equivalent in value to the QJSA.

If the plan's QJSA survivor's percentage is less than 75 percent of the amount payable during the joint lives of the participant and the spouse, then the QOSA must provide a spouse survivor annuity of 75 percent. If the QJSA survivor's percentage is greater than or equal to 75 percent of the amount payable during the joint lives of the participant and the spouse, then the QOSA must provide a spouse survivor percentage of 50 percent.

Whether the spouse's consent is required for a participant to select a QOSA, rather than receive payment in the QJSA form, depends on whether the QOSA is actuarially equivalent in value to the QJSA. If so, then spousal consent is not required. If however, the QOSA is not actuarially equivalent in value to the QJSA, then spousal consent is required.

A plan that is required to offer a QOSA also must provide to participants a written explanation of the terms and conditions of the QOSA, similar to that provided for the QJSA.

The interest rate and mortality assumptions used to determine the present value of lump-sum benefits paid by defined benefit plans under Code Section 417(e) are changing. (IRS Notice 2008-30) For plan years beginning after December 31, 2007, present value determinations of lump-sum benefits payable by defined benefit plans must be made using interest and mortality assumptions required by the Pension Protection Act of 2006 (PPA).

Gap-period earnings must be included with the distribution of excess deferrals in years beginning after December 31, 2007. (IRS Notice 2008-30) Final regulations under Code Section 402(g), published in April 2007, require that gap-period earnings must be repaid with the distribution of excess deferrals to the extent the employee is or would be credited with an allocable gain or loss on those excess deferrals for the gap period, if the total amount were to be distributed. Excess deferrals are amounts contributed in excess of the maximum amount permitted for the year for a participant ($15,500 for 2008, plus an additional $5,000 for persons age 50 or older). This rule applies to both pretax excess deferrals and excess deferrals that are designated Roth IRA contributions. Prior to this change, the return of gap-period earnings on excess deferrals was optional.

It is somewhat ironic to note that Section 902 of the PPA eliminated any requirement to refund gap-period earnings on amounts returned to participants on amounts refunded to participants to satisfy the nondiscrimination rules applicable to 401(k) plans (Actual Deferral Percentage test and the Actual Contribution Percentage test) after 2007.

Amendments implementing the changes described above, and in IRS Notice 2008-30, generally are required to be adopted by the last day of the plan year that begins on or after January 1, 2009. This extended due date for amendments includes the required gap-period income amendment, which would otherwise be required to be completed at an earlier date. Note that plans must still be administered in compliance with these changes as of their 2008 effective dates, even though the required plan amendment may be adopted later.

Welfare Plans

The U. S. Supreme Court denied an appeal by AARP challenging rules adopted by the Equal Employment Opportunity Commission (EEOC) that allows employers to reduce their health insurance expenses for retired workers once they turn age 65 and qualify for Medicare. The EEOC proposed its rules in response to a decision in 2000 by the United States Circuit Court of Appeals for the Third Circuit that held that the Age Discrimination in Employment Act requires employers to spend the same amount on health insurance benefits provided to Medicare-eligible retirees as those received by younger retirees.

Executive Compensation

In addition to getting documents providing for nonqualified deferred compensation into compliance with Code Section 409A (Section 409A) by December 31, 2008, companies also must implement plans and strategies for ongoing compliance. Employers should consider identifying the personnel who may create, enter into, and offer advice concerning documents likely to be governed by Section 409A. Section 409A affects a wide range of plans, programs, and contracts, and often does so in very complex and interrelated ways. A provision or change in one document may have a significant compliance impact on a completely separate document. It is going to be necessary to centralize and/or coordinate management of Section 409A sensitive documentation.

Another suggested compliance strategy for publicly traded companies is to establish a systematic means of identifying and tracking "specified employees." Specified employees are key employees under Code Section 416's "top-heavy plan" rules, which have not been an issue for most public companies. The rules are complicated and there are special rules that apply in merger and acquisitions.

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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