EMPLOYEE BENEFITS DEVELOPMENTS APRIL 2011

Hodgson Russ Newsletter
April 15, 2011

Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

IRS Issues Important Reminders for Retirement Plans

The Internal Revenue Service (IRS) recently issued three reminders addressing the new submission period for determination letter and other rulings, fee changes, and certain corrections through the IRS's Voluntary Correction Program (VCP).

New Determination Letter Submission Period and Increased User Fees. A new submission period began February 1, 2011, for individually designed plans on Cycle A to apply for determination letters and for most pre-approved defined contributions plans to apply for opinion or advisory letters. The submission period ends January 31, 2012. Also, new user fees for applications for determination letters and other rulings (which we reported on in last month's newsletter) became effective February 1, 2011. The IRS noted in its reminder that although the user fee form (Form 8717) has not been updated yet, plans should start submitting the new fees with their applications. The reminder can be found at http://www.irs.gov/pub/irs-tege/epn_2011_2.pdf.

Discounted VCP Fees for Certain Pre-Approved Plan Nonamenders Ending. Certain small-plan sponsors of pre-approved 401(k), profit-sharing, money purchase, or other defined contribution plans can currently benefit from a discounted fee to correct a failure to adopt a pre-approved Economic Growth and Tax Relief Reconciliation Act (EGTRRA) plan by April 30, 2010, through VCP. The discounted fee, $375 instead of the regular fee of $750, will only be in place until April 30, 2011. The reminder issued by the IRS explains that the discounted fee applies to plan sponsors who (1) have 20 or less participants in their plan, (2) have no other plan qualification failures, and (3) file their VCP applications with a postmarked date of May 2, 2011 at the latest (the April 30 deadline is on a Saturday). After April 30, 2011, such plans will be subject to the regular $750 VCP fee.

Correction of 403(b) Eligibility Failures Through VCP. An "eligibility failure" may occur if an organization that is neither a tax-exempt organization (under Code Section 501(c)(3)) or an educational organization (under Code Section 170(b)(1)(A)(ii)) adopts or operates a 403(b) plan. The IRS recently issued a reminder for plan sponsors who may have such an eligibility failure that they can correct the failure through VCP. The IRS explained that in order to make the correction, plan sponsors will need to complete and submit all parts of Appendix F, Streamlined VCP Submission, and Schedule 6, Employer Eligibility Failure (401(k) and 403(b) Plans only), and must include the applicable amount of fees from the Appendix F instructions.

DOL Extends Financial Disclosure Deadline for Service Providers

One of the major initiatives of the U.S. Department of Labor (DOL) and its Employee Benefit Security Administration (EBSA) has been to develop regulations imposing increased fee disclosure information for retirement plans. One set of regulations imposes disclosure requirements on service providers that will require financial institutions, recordkeepers and other service providers to detail the direct and indirect fees charged for various plan administrative and recordkeeping services as well as investment expenses. These disclosures will be an important part of the information available to plan fiduciaries to assess the reasonableness of servicing arrangements and contracts and to detect conflicts of interest. Without these disclosures, a plan fiduciary would be deemed to violate the statutory mandate to maintain only reasonable contracts for plan services. The regulations introduce a significant change in industry practices and are related to a second set of regulations requiring plans to provide enhanced fee and cost reporting to participants. The service provider regulations were initially scheduled to go into effect on July 1, 2011, with the plan participant reporting rules effective for calendar year plans beginning January 1, 2012. In an announcement issued in February, the DOL has postponed the effective date for the service provider disclosures until January 1, 2012. Plan administrators should continue to keep tuned to the issuance of guidance in this area and the effects on communications with participants as the rules evolve. (EBSA News Release, February 11, 2011)

IRS Provides Some Guidance on 403(b) Plan Terminations

Prior to the issuance of the final regulations for Internal Revenue Code Section 403(b) plans in 2007, there had been a question whether it was possible to terminate a 403(b) plan such that the sponsoring employer had no further administrative or other filing obligations. With the publication of the final 403(b) regulations, the IRS clarified that a 403 (b) plan may be terminated. However, the provisions set out in the final regulations left many questions open, and many practitioners questioned whether it would not be possible to comply with the requirements set out in the regulations in order that it may be positively determined that the 403(b) plan had been terminated. In response to these concerns, the IRS recently issued Rev. Rul. 2011-7 providing additional guidance on the requirements for a plan sponsor to terminate a 403(b) plan. The revenue ruling described several fact patterns and describes whether the actions taken result in termination of the 403(b) plan and describe the tax consequences to the participant of such actions. Under the revenue ruling the IRS has indicated that the following requirements must be met to terminate a 403(b) plan:

- The termination of the 403(b) plan must be approved by formal action of the governing body of the sponsor.

- The termination must satisfy all applicable laws including the final 403(b) regulations, must provide for 100 percent vesting, and must satisfy any other requirements imposed by the funding vehicles used in the 403(b) plan.
- Plan assets must be distributed as soon as possible following plan termination.
- If plan participants are allowed to roll over the benefits to another plan or qualified retirement vehicle, they must be provided with appropriate notice of their rights.
- Neither the plan sponsor nor any control group member may make contributions within 12 months of the termination of the 403(b) plan to another 403(b) plan which covers more than 2 percent of the employees under the terminating plan.

Under the revenue ruling while additional guidance is provided, many issues will remain with respect to distributing plan assets, especially given the various provisions contained in multiple 403(b) funding vehicles. Thus, while this revenue ruling provides additional guidance, many practical problems will remain in terminating a 403(b) plan. For plan sponsors looking to terminate a plan, this revenue ruling must be reviewed carefully.

MEWA Held to Be Not Fully Insured Under ERISA

When unrelated employers join together in an association or other group to purchase or arrange for health insurance, the association is defined as a “multiple employer welfare arrangement” or “MEWA” under the law. MEWAs are unusual under the Employee Retirement Income Security Act (ERISA) preemption rules. The preemption provision of ERISA generally prohibits states from regulating employee benefit plans. Because of preemption, employee benefit plans are usually required to conform to the same rules across the country regardless of which state the plan is in. ERISA preemption does not apply to state insurance laws. Thus, if the benefits under a MEWA are fully insured, the insurance contracts that provide the benefits will be regulated by state insurance laws, insurance commissioners, and other protections established for individuals covered under insurance policies. If a MEWA is not fully insured, however, a special ERISA rule allows states to regulate the MEWA even though the state is not then regulating “insurance.” In many states, a self-insured MEWA will have to register as an insurer and meet state compliance and reserve requirements if it is to operate legally. Sometimes the complexity of the arrangements invented for programs established by a business association can raise the question of whether a MEWA is fully insured or not. In a recent advisory option, the DOL ruled that a complex arrangement set up for an association of railroad employers did not qualify as fully insured and thus was subject to state regulation as a self-insured MEWA. Any employer participating in or contemplating joining an association of employers in order to jointly purchase health or other welfare benefits is well-advised to make sure the association is meeting all insurance or state self-insurance rules as a MEWA. (DOL Advisory Opinion 2011-OIA)

CASES

Legal Challenges to Health Care Reform Continue to Work Through the Courts

In late January, a district court in Florida ruled that the Patient Protection and Affordable Care Act (PPACA) is unconstitutional. While the constitutionality of PPACA is an issue that likely will have to be resolved by the Supreme Court (perhaps in 2012), the ruling in Florida adds further uncertainty as to whether PPACA can stand up to constitutional scrutiny. Four district courts have ruled in cases on PPACA to date. Two have upheld the individual mandate and two have ruled that it is unconstitutional. In the meantime, until these legal challenges are fully resolved, employers, insurers, and providers are left with little choice but to continue their efforts to comply with PPACA's mandates and deadlines. (*State of Florida, et al. v. United States Department of Health and Human Services, et al.*, N. D. Fla. 2011)

Plan Sponsor Liable for Failure to Transmit Investment Directions

An important reminder for plan sponsors – if you promise to collect and transmit investment directions on behalf of your plan participants, then it is critical that procedures are in place to ensure that those investment directions are processed properly and timely. A district court in Oklahoma ruled that a plan sponsor breached its fiduciary responsibility by failing to pass along a plan participant's instructions to the plan trustee for how her plan account was to be invested. Because of the oversight, the participant's plan account was invested in the plan's default investment, and she asserted that her account lost approximately $100,000 while it was invested in that default fund. The court held that the plan sponsor assumed a fiduciary duty for insuring that the plan trustee would be able to follow the participant's investment direction when it offered participants the option of submitting investment directions to the plan sponsor. Summary judgment was granted against the plan sponsor, and a non-jury trial to resolve the matter of damages is to follow. (*Womack v. Orchids Paper Products Co. 401(k) Savings Plan*, N.D. Okla. 2011)

Court Upholds Plan Decision That Stock Options Not a Bonus

A former executive of a corporation challenged a supplemental executive retirement plan's (SERP) determination of whether income from stock options and other stock-linked payments was a "bonus". Under the terms of the SERP the executive would have received an annual pension worth about 45 percent of his compensation. The SERP defined compensation to exclude amounts paid as a bonus. The committee administering the SERP determined that income resulting from the exercise of stock options or other stock-linked compensation amounts were a bonus and were therefore excluded from the calculation. This reduced the benefit by approximately $2.5 million. The executive challenged the committee's determination that the stock options and stock-linked compensation payments were a bonus. The Seventh Circuit upheld the district court's decision that the SERP committee's determination to exclude the amounts because they represented a bonus was not arbitrary or capricious and, therefore, the committee's decision to exclude these amounts from the calculation was upheld. While the corporation sponsoring the plan was successful in this case, it again points out that careful drafting of plan documents could have avoided this dispute by clearly stating that income resulting from stock

options and other stock related compensation was excluded from the benefit calculation. (*Comrie v. IPSCO Inc.*, 7th Cir., 2011)

Same-Sex Domestic Partner Policy Does Not Discriminate Against Opposite-Sex Couples

Reversing a decision by the Westchester County Human Rights Commission, a New York appeals court recently held that a policy adopted by a local Board of Cooperative Educational Services (BOCES) to offer health care to same-sex domestic partners did not unlawfully discriminate against opposite-sex domestic partners. Among its services, BOCES offers health care benefits to employees of local school districts. In 2005 the board of the BOCES plan voted to extend dependent health care benefits to same-sex domestic partners of member employees. Following notification of the benefit change, a teacher sought health coverage for her long-term opposite-sex domestic partner. Denied coverage, the teacher filed a complaint with the commission, alleging that she had been unlawfully discriminated against on the basis of her sexual orientation and marital status, in violation of a local human rights law. Holding that BOCES had unlawfully discriminated against the teacher, the commission awarded damages and directed BOCES to make health care benefits available to the teacher's domestic partner and to all opposite-sex domestic partners on the same basis as to same-sex domestic partners. In overturning the commission's decision, the New York Supreme Court Appellate Division found that BOCES demonstrated a legitimate, nondiscriminatory reason for offering health care benefits only to same-sex domestic partners — that same-sex domestic partners cannot obtain the benefits offered to employees' spouses by becoming lawfully married In New York. Noting that the Domestic Partner Policy itself states that it may be rescinded in the event that same-sex marriage becomes legal in the state, the court found that the ability of same-sex couples to be married in other jurisdictions does not undermine the legitimate, nondiscriminatory basis for the decision to offer benefits only to same-sex couples, that is, the impediment to marrying in New York. The teacher's claim that she was discriminated against on the basis of marital status also failed in the eyes of the court, because eligibility for domestic partner health care benefits does not turn on the marital status of the employee. As the court pointed out, the same-sex domestic partners who were allegedly treated differently have the same marital status as the teacher — they are all unmarried. (*In re Putnam/N. Westchester Bd. of Coop. Educ. Servs. V. Westchester Cnty Human Rights Comm'n*, N.Y. App. Div., 2011)

Three Companies and Their Owners All Held Liable for One Company's Unpaid Benefits

The U.S. District Court for the Eastern District of New York recently issued a judgment in favor of the trustees of a multi-employer welfare and pension fund, holding three companies and their shared owners liable for unpaid fringe benefits. The multi-employer welfare and pension fund was established for covered employees of three local chapters of the International Union of Operating Engineers. All companies that had signed a collective bargaining agreement with the union were obligated to make fringe benefit contributions to the fund for covered employees. Only one of the three defendant companies in this case had actually signed the collective bargaining agreement. However, the three defendant companies were owned and operated by the same two individuals. The trustees were successful in obtaining judgment against all three

companies for unpaid contributions dating back to 2005 on the basis that the three companies constituted a "single employer/single unit." Analyzing the facts and circumstances, the court noted that the companies in this case were "separate companies in name only," and provided various reasons why the businesses should be treated as a single employer. For example, the companies had "interrelated" operations because they shared employees/staff, equipment, and customers, and they provided the same services for those customers. Additionally, there was "common management" because the two owner-defendants owned and managed all three of the companies. The court then found that the three companies constituted a "single appropriate bargaining unit" on the basis that their employees shared a "community of interests." Among the reasons the court cited were the companies' "integrated operations," the amount of "employee interchange" among the companies, the similarity of working conditions and requirements for the employees, the shared geographical location for worksites, and the shared customer base. In light of all of these circumstances, the court held that all three companies should be treated as a "single employer/single unit," and as a result held that they were all equally liable for the unpaid contributions. The court then ordered the companies to permit the trustees to audit their books and records to determine the amount of contributions due.

The court additionally ruled that the two owner-defendants were equally liable with the companies for the unpaid contributions, finding that the facts of the case warranted piercing the corporate veil to hold the owners personally liable. The court found that the owners exercised "complete domination" over the companies because of the overwhelming overlap in their control, management, and supervision of all three. Additionally, the court found that the owner-defendants "abused the corporate form to defraud" the trustees. The owners had the ultimate authority with regard to payments to creditors, they planned projects in such a way as to alter the amount of fringe benefit contributions owed to the union fund, and they used money that represented unpaid fringe benefit contributions for their own gain rather than remitting the contributions to the fund. This case demonstrates the serious liability that related companies can face for one company's failure to properly remit contributions to a multi-employer plan it participates in, and illustrates the type of circumstances that can result in personal liability for company owners. (*Duffy v. Modern Waste Services Corp*., EDNY. 2011)

Employee Benefits Practice Group

Peter K. Bradley
pbradley@hodgsonruss.com

Anita Costello Greer
anita_greer@hodgsonruss.com

Michael J. Flanagan
mflanagan@hodgsonruss.com

Richard W. Kaiser
rkaiser@hodgsonruss.com

Arthur A. Marrapese, III
Art_Marrapese@hodgsonruss.com