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EMPLOYEE BENEFITS DEVELOPMENTS MARCH 2010

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

DOL Publishes Final Safe Harbor Rule for Depositing Participant Contributions

In January, the Department of Labor (DOL) published a final regulation that establishes a safe harbor period for determining when amounts an employer receives from employees or withholds from wages as contributions to certain plans (e.g., 401(k) plans) must be treated as "plan assets" and, therefore, must be deposited in the plan's trust. The regulation is intended to enhance the clarity and certainty as to when participant contributions under certain plans will be treated as contributed in a timely manner.

The general contribution timing rule is that an employer must deposit participant contributions (e.g., 401(k) salary reduction contributions) with the employer's plan on the earliest date the contributions can be reasonably segregated from the employer's general assets, but in any event no later than the 15th business day of the month following the month in which the employer receives or withholds the contributions. For small plans, the final regulation establishes a safe harbor period of seven business days within which an employer may deposit participant contributions. Deposits of participant contributions made within the seven-day safe harbor are deemed to comply with the general contribution timing rule. The seven-business day safe harbor also is available to loan repayments. The safe harbor rule is available only to plan sponsors of small plans (i.e., plans that have fewer than 100 participants at the beginning of the plan year) — large plans will still be required to comply with the general contribution timing rule. The final regulation also includes a new paragraph clarifying that the safe harbor is not the exclusive means by which employers can discharge their obligation to deposit participant contributions or loan repayments on the earliest date on which such contributions and payments can reasonably be segregated from the employer's general assets. The final regulation is effective January 14, 2010. (75 Fed. Reg. 2068, January 14, 2010)

Mandatory Electronic Filing of Form 5500: Recent Guidance on Delinquent or Amended Form 5500s

Form 5500 filers beware! The EFAST2 online filing system is now operational, and it is ready to receive and process Form 5500 filings. All pension and welfare plans that are required to submit an annual return/report on a Form 5500 or Form 5500-SF ***must*** do so electronically for plan years beginning on or after January 1, 2009. Beginning January 2010, the all-electronic EFAST2 system started to receive the electronic annual returns/reports. Plan administrators who have not yet done so will need to familiarize themselves with the EFAST2 system. For more information, go to www.efast.dol.gov.

In January, the DOL provided new guidance on how to submit delinquent or amended Form 5500s for plan years prior to 2009 now that the all-electronic system is in place. Beginning January 1, 2010, delinquent and amended filings of Title I plans must be submitted electronically through EFAST2 and may not be submitted on paper. A limited exception is available, however, for delinquent and amended 2008 plan year filings. Specifically, while a plan may submit a delinquent or amended 2008 plan year filing electronically through EFAST2 beginning January 1, 2010, the plan also has the option to submit it through the original EFAST on paper until October 15, 2010, or electronically through June 30, 2010. After October 15, 2010, even 2008 plan year filings must be submitted electronically through EFAST2. For more information, see www.dol.gov/ebsa/faqs/faq-EFAST2.html at Q4.

IRS Issues Guidance on HEART Act Provisions

In Notice 2010-15, the Internal Revenue Service (IRS) provides much-needed guidance on certain provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act). Signed into law in 2008, the HEART Act provides benefits-related requirements for returning military personnel and their beneficiaries. Notice 2010-15 provides guidance in a question-and-answer format on survivor and disability benefits for qualified military service, differential wage payments, retirement plan distributions to individuals called to active duty, and contributions of military death gratuities to Roth IRA accounts and Coverdell education savings accounts. The HEART Act requires retirement plans to provide that the survivors of a participant who dies while in qualified military service are entitled to any additional benefits (other than benefits accrued during the service) that would have been provided under the plan had the participant resumed employment and then terminated employment on account of death. The new notice clarifies the types of benefits subject to this requirement and specifies the service credit limitations and requirements for vesting for participants who die or become disabled while on military service. The notice also clarifies the treatment of differential wage payments (voluntary payments by an employer of all or a portion of the regular wages of a service member while on active duty) for various benefits purposes, and provides guidance on the employer tax credit for differential wage payments made to qualified employees who are on active duty for more than 30 days. Finally, the notice clarifies the rules for calculating the amount of military death gratuities that may be contributed to Roth IRAs or Coverdell accounts and addresses the remedial amendment period for amending plans to comply with certain sections of the HEART Act. Plans generally must be amended by the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012 for governmental plans).

DOL Fact Sheet Proposes Expanded Fiduciary Definition

The Employee Retirement Income Security Act (ERISA) was adopted in 1974, and in 1975 the DOL issued a regulation dealing with the definition of a "fiduciary" under the statute. This definition has been the basis for many pension consultants, financial advisors, and brokers to avoid being treated as fiduciaries under ERISA. In many of these circumstances the consultant or advisor has no discretionary control over investment decisions, may receive only brokerage commissions or otherwise avoid the regulatory definition of a "fiduciary" while providing consultations and recommendations to plans. Many new and different business models in the field of investment advice and financial consulting have arisen in the 35 years since the DOL regulation was adopted. A fact sheet issued by the DOL's Employee Benefit Security Administration has announced the DOL intention to issue an amended definition of a "fiduciary" for plan investment advisors to include more persons, such as consultants, as ERISA fiduciaries. This anticipated expansion of who will be treated as an ERISA fiduciary will continue the current scrutiny on fiduciary responsibilities and appropriate plan procedures. (*EBSA Fact Sheet*, 01/2010)

Requirement of Employment on Date of Payment Defeats Accrual of Bonus Payment

In a chief counsel advice memorandum, the IRS reviewed the proper treatment of accrual of a bonus payment. Under the taxpayer's bonus program, an employee would not be paid the bonus unless he or she remained employed through the date of payment. A requirement of the "all events" test taking a deduction under the accrual method of accounting under Internal Revenue Code Section 461(a) is that "economic performance" must have occurred within the tax period. The IRS concluded that the requirement of employment into the subsequent tax year precluded economic performance from occurring until such time as the bonus was paid. Therefore, even though the bonus was paid within the first two and a half months of the subsequent tax year, the amount could not be deducted as an accrued expense for the prior year. Employers that impose such restrictions on bonus plans should be careful in reviewing the proper year of deduction of such bonus payments. (IRS Chief Counsel Advice Memorandum 200949040)

IRS Rules That Delay in Awarding Performance Units Does Not Result in Loss of Deduction Under Section 162(m)

In a private letter ruling (PLR), the IRS examined the provisions of a bonus plan intending to qualify for the "performance-based compensation" exemption of Internal Revenue Code §162(m). Section 162(m) generally provides that a publicly traded company may not deduct compensation with respect to "covered employees" to the extent that the compensation exceeds $1 million, unless the compensation meets certain exceptions such as "performance-based compensation." A requirement for performance-based compensation is that it must meet a pre-established objective performance criteria that is established not later than 90 days after the commencement of the period to which the goal relates. Under the program at issue in the PLR, the performance-based goals were established within the first 90 days of the performance period. The program also set the maximum number of performance units that could be awarded to an individual. However, under the terms of the program, the number of units to be awarded to an individual would be determined after the initial 90 days of the performance period. The IRS, without setting forth any explanation, determined that the ability to determine the number of units after the initial 90-day period did not result in a failure to be performance-based compensation. It would appear that the reason for this conclusion is that the underlying effect of the program terms only allowed the compensation committee discretion to reduce the amount of compensation payable (by awarding fewer units than the established

individual maximum limitation). Given recent IRS attention to limiting the ability to qualify amounts as performance-based compensation, this favorable determination by the IRS, like all PLRs that are not binding on the IRS, should not necessarily be relied upon. (PLR 200949005)

CASES

401(k) Fees Held Reasonable in Illinois Lawsuit

A number of lawsuits have been filed alleging that fees paid by 401(k) plans to recordkeepers, trustees, or other service roviders are excessive and imprudent. For the most part, these lawsuits have found that standard practices in the industry did not violate ERISA's fiduciary standards. A recent decision in a federal district court in Illinois ruled in favor of the plan fiduciaries and recordkeeper after a careful review of the plan's process in selecting and retaining its service providers, and in operating a company stock fund within the plan's investment selections. In this case, the plan periodically reviewed its recordkeeping contract and at one point hired an outside consultant to review the arrangement and the fees paid. The plan included a company stock fund as an investment choice that was maintained as a "unitized" fund holding principally company stock but also cash and short-term fixed income assets. Participant investments in the company stock fund were held as units in the fund rather than in specific shares of company stock. The plan used a bank trustee who was compensated in part through short-term interest earned by the bank on plan assets in transit between investments and distributions or other transfers. The plaintiffs alleged that the unitized company stock fund as well as the compensation arrangement with the bank constituted breaches of fiduciary duty to plan participants and that the recordkeeping fees violated fiduciary standards. Defendants in the case included the employer, the plan's administrative committee (as an entity) and the individual members of that committee. The court granted summary judgment in favor of the defendants and concluded that the unitized company stock fund was prudent and consistent with industry practice, that the plan adequately advised participants of the risks of investment in company stock and the fees connected with all plan investments, that plan fees and expenses were regularly monitored and were consistent with industry averages, and that the arrangement with the bank was standard in the industry and did not result in excess fees to the bank. The defendants prevailed in this dispute largely based on their attention to good procedures and policies as well as regular documentation of their reviews of plan expenses and the performance of their service providers. Prudent plan administrators will minimize their risk and exposure by following similar practices. (*George v. Kraft Foods Global Inc.*, N.D. Ill., 2010)

SPD Error Does Not Result in Additional Benefits for Retired Employees

The U.S. District Court for the Central District of California held that former employees who received an inaccurate summary plan description (SPD) were not entitled to increased retirement benefits as a result of the error. The court ruled that the former employees were not entitled to additional benefits because they failed to prove that they "reasonably relied" on the terms of the faulty SPD. In this case, the employer acquired two companies, merged those companies' defined benefit plans into the employer's defined benefit plan, then converted the merged defined benefit plan to a cash balance plan. To harmonize the retirement benefits of the newly acquired employees, the cash balance plan included a transitional formula that incorporated an annuity equivalent offset provision in the retirement benefit calculation. This annuity equivalent

offset provision reduced participants' retirement benefits under the transitional benefit formula. However, the cash balance plan's SPD did not adequately reference the offset provision. In granting summary judgment in favor of the plan, the court reasoned that, absent a showing of reasonable reliance on the SPD error, the former employees were not entitled to increased retirement benefits. Although some circuit courts do not require a showing of reasonable reliance, the majority of circuit courts do. The Ninth Circuit has not ruled on the necessity of this requirement, but the district court reasoned that providing an additional benefit absent a showing of reasonable reliance would provide a windfall for the former employees and that is a "result abhorred by ERISA." (*Skinner v. Northrop Grumman Retirement Plan B*, C.D. Ca., 2010)

Divorce Settlement Does Not Trump Beneficiary Designation

A decedent's ex-wife, named as beneficiary under her decedent ex-husband's 401(k) plan, was entitled to his plan benefits, the U.S. District Court for the District of Massachusetts ruled. Although the terms of their divorce settlement provided that the decedent was entitled to "retain" his interest in the plan, the court explained that such language would not preclude him from naming his ex-spouse as a beneficiary. Further, the language in the divorce settlement should not be interpreted as a waiver of benefits by the ex-wife. Moreover, the plan administrator was informed by the decedent participant that it was his intention to keep his ex-spouse as the designated beneficiary. Although in this instance the participant intended to retain his ex-wife as a designated beneficiary, this case can serve as a reminder to plan administrators and participants of the importance of maintaining unambiguous and up-to-date beneficiary designation forms. (*Staelens v. Staelens*, D. Mass., 2010)

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