EMPLOYEE BENEFITS DEVELOPMENTS JULY 2009

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

Proposed Rules Would Allow Safe Harbor Nonelective Contributions to Be Reduced or Eliminated. In May, the Internal Revenue Service (IRS) published a set of proposed regulations that would permit an employer sponsoring a safe harbor 401 (k) or 403(b) plan that incurs a substantial business hardship to reduce or suspend safe harbor nonelective contributions during a plan year. The proposed regulations would provide an employer with an alternative to the option of terminating the employer's safe harbor plan when facing economic hardship, and would allow for the reduction or suspension of safe harbor nonelective contributions under rules generally comparable to the provisions relating to the reduction or suspension of safe harbor matching contributions.

Factors for determining if a substantial business hardship exists include whether the employer is operating at an economic loss, whether there is substantial unemployment or underemployment in the trade or business and in the industry concerned, whether the sales and profits of the industry concerned are depressed or declining, and whether it is reasonable to expect that the plan will be continued only if the waiver is granted.

Under these proposed rules, a plan that reduces or suspends safe harbor nonelective contributions will not fail to satisfy the nondiscrimination standards of Internal Revenue Code (IRC) § 401(k)(3) if certain conditions are satisfied, including (1) the delivery of a supplemental notice of the reduction or suspension to all eligible employees, (2) making the reduction or suspension of safe harbor nonelective contributions effective no earlier than the later of 30 days after eligible employees are provided the supplemental notice and the date the amendment is adopted, (3) giving eligible employees a reasonable opportunity (including a reasonable period after receipt of the supplemental notice) prior to the reduction or suspension of the safe harbor nonelective contributions to change their cash or deferred elections and, if applicable, their employee contribution elections, (4) amending the plan to provide that the ADP test will be satisfied for the entire plan year in which the reduction or suspension occurs, using the current year testing method, and (5) satisfying the safe harbor nonelective contribution requirement with respect to safe harbor compensation paid through the effective date of the amendment.

These regulations are proposed to be effective for amendments adopted after May 18, 2009. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If the final regulations are more restrictive than the guidance in these proposed regulations, the more restrictive provisions will be applied without retroactive effect. (74 Fed. Reg. 23134)

IRS Provides Additional Guidance on Employer Owned Life Insurance. The rules governing the taxation of employer owned life insurance contracts were modified by the Pension Protection Act of 2006. Under new IRC §101(j), only the amount of the death benefit equal to the premiums paid by the employer is exempt from tax on the insured's death. However, certain exceptions apply. If certain notice and consent requirements are satisfied, the amounts are not includable in income if the insured was employed at any time during the 12-month period before death or if the insured was a director or a highly compensated employee at the time the contact was issued. Additionally, IRC §101(j) would not apply to any amounts paid or used to purchase an equity interest from a family member, trust, or estate of the deceased insured employee. Amounts paid to a member of the family of the insured, a designated beneficiary under the contract, or a trust for the benefit of such individuals are also excluded. The IRS in Notice 2009-48 provides additional guidance regarding the treatment of employer owned insurance contracts and certain definitional rules necessary to apply these exemptions. Further, Notice 2009-48 provides guidance under IRC §6039I regarding reporting requirements that every policy holder must comply with regarding employer owned life insurance contract issued after August 17, 2006. Any employer having contracts that could potentially be employer owned life insurance arrangements (including certain split dollar arrangements) should take steps to determine whether the restrictions from the exemption from income under IRC §101(j) apply and whether they must satisfy reporting requirements by filing Form 8925. (IRS Notice 2009-48, http://www.irs.gov/irb/2009-24_IRB/ar11.html)

Appeals of COBRA Subsidy Denials: New Q&As. The Department of Labor (DOL) and IRS continue to issue guidance and model forms related to COBRA premium subsidies for group health plan continuation coverage. Under the American Recovery and Reinvestment Act of 2009, certain employees who are involuntarily terminated between September 1, 2008 and December 31, 2009 are required to pay only 35 percent of the COBRA premium for nine months of health care continuation coverage. The employer is then reimbursed by the federal government for the remaining 65 percent of the premium. Individuals who are denied premium subsidies following termination may appeal the denial to the DOL, which must review and make a determination on the appeal within 15 business days. To aid applicants in the process, the DOL recently posted an application for an appeal on its Website. The application form leads the applicant through a series of questions designed to help the DOL determine whether or not the individual is eligible for the subsidy. The application also requires the applicant to provide contact information for the affected parties and attach documents supporting the individual's claim. Among the documents recommended for possible submission with the application are the individual's COBRA election notice, his or her insurance card, the original request for a premium reduction, documents describing the date and circumstances of the termination of employment, and documentation of the plan administrator's denial of the premium subsidy request. If necessary, the DOL may contact plan administrators for additional information regarding an individual's appeal. A similar application has been posted by the Centers for Medicare and Medicaid Services to handle subsidy denial appeals from individuals covered by public sector government plans and state mini-COBRA laws.

Additional guidance on complying with the premium subsidy rules was also provided by the IRS in the form of 19 new Q&As addressing a number of difficult subsidy issues. For example, the new Q&As reassure employers that the IRS will not challenge the employer's determination that a termination was involuntary for purposes of the employer's entitlement to a payroll tax credit for the subsidy, so long as the determination "is consistent with a reasonable interpretation of the applicable statutory provisions and IRS guidance." The employer must, however, maintain supporting documentation of its determination that the termination was involuntary. Other clarifications include confirmation that an employer's failure to renew the contract of an employee hired for a limited period of time, such as a seasonal worker or a teacher working on a one-year contract, may be considered an involuntary termination if the employee was willing and able to renew the contract and continue providing the services on substantially similar terms. The new Q&As also clarify that an involuntary termination of employment occurs if a reservist or National Guard member is called to active duty, regardless of whether the civilian employer otherwise treats the employee's absence as a termination of employment or leave of absence. Other Q&As address church plans, coverage for elected officials, supporting documentation for insurers and multiemployer plans requesting payroll tax credits, information reporting, multiple employer plans, and reimbursements for controlled group members.

Mandatory Health Risk Assessments and the EEOC. ABC, Inc. maintains a self-funded health plan. To qualify for plan participation, employees must participate in a health risk assessment program that includes answering a short health-related questionnaire, taking a blood pressure test, and providing blood for use in a blood panel screen. The assessment includes questions regarding disabilities. The results of the assessment are given only to the employees; ABC receives only de-identified, aggregate information. Employees who refuse to take the assessment and their dependents are not permitted to enroll in the plan.

Does ABC's health and risk assessment program violate the Americans With Disabilities Act (ADA)? In a recent opinion letter, the Equal Employment Opportunity Commission (EEOC) says "yes."

Under the ADA, disability related inquiries and medical examinations must be job related and consistent with business necessity or part of a voluntary wellness program. A wellness program is voluntary if employees are neither required to participate nor penalized for non-participation. In its opinion letter, the EEOC expressed the view that requiring employees to participate in a health risk assessment program as a condition of continuing health coverage "does not appear" to be job related and consistent with business necessity. Furthermore, the EEOC noted, participation in the program, even if part of a wellness plan, would not be voluntary because employees who refused to participate are denied a benefit (i.e., penalized for non-participation).

The EEOC's opinion as expressed in this letter is not definitive guidance and applies only to mandatory health risk programs of the type described in the opinion. The EEOC has not issued formal guidance in this area, and we are not aware of any ADA litigation involving mandatory health risk assessments. Nevertheless, employers are well advised to consult legal counsel before implementing a health risk assessment program with characteristics similar to the program described in the letter.

HSA Inflation Adjusted Limits. The IRS released the 2010 inflation adjusted contribution limits for Health Savings Accounts (HSAs). For taxable years beginning in 2010, the annual limitation on contributions for an individual with self-only coverage under a high deductible health plan is $3,050 ($6,150 with family coverage). For calendar year 2010, an

HSA-eligible high deductible health plan cannot have a deductible that is less than $1,200 for self-only coverage ($2,400 for family coverage). In addition, the annual out-of-pocket expense limits (deductibles, co-payments, and other amounts, but not premiums) cannot exceed $5,950 for self-only coverage ($11,900 for family coverage).

CASES

Pension Plan Eliminates Post-Retirement Increases. In circumstances where underfunded pension plans are attempting to reduce or otherwise manage plan liabilities, benefits counsel are careful to consider the statutory prohibition against reducing accrued benefits in a plan amendment. A frequent legal challenge is to decide what elements of a plan are part of the protected "accrued benefit." This challenge was recently met in the case of a defined benefit plan that had granted post-retirement benefit increases to its retirees in years of plenty (1997, 1998, and 1999) and later found itself in a stressed financial position in 2003. A decision to amend the plan to eliminate the post-retirement increases was challenged by a group of retirees, claiming that the amendment violated the "anti-cutback" rule prohibiting amendments reducing accrued benefits. The retirees seemed to be aided by an IRS regulation issued in 2005 stating in part that the accrued benefit protected by the anti-cutback rule includes increases in monthly benefits adopted after a participant's severance from employment. While the IRS has generally maintained that cost-of-living adjustments (COLAs) and other post-retirement increases, including ad hoc increases, are part of the protected accrued benefit, the basis for this has not been crystal clear. As recently as December, 2008, the IRS abandoned its initial audit position that the elimination of a pension COLA violated the anti-cutback rule where the COLA was eliminated prior to the 2005 regulation. The statutory language had not changed, but its interpretation obviously has. In the case at hand, the 6th Circuit Court of Appeals ruled that the 2003 amendment eliminating ad hoc retiree benefits was permissible. The court concluded that the post-retirement benefit increases were not part of the retirees' accrued benefits, at least as the rule is applied by the court prior to the 2005 regulation. With more plans facing difficult financial situations after 2008, the scope of the protected "accrued benefit" may be tested further by plans seeking to reduce liabilities. *Thornton v. Graphic Communications Conference of International Brotherhood of Teamsters Supplemental Retirement and Disability Fund* (6th Cir. 2009)