EMPLOYEE BENEFITS DEVELOPMENTS MARCH 2009

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Practices & Industries

Employee Benefits

DOL Issues Model Notices Relating to COBRA Continuation Assistance

Meeting the March 19, 2009 deadline established in the American Recovery and Reinvestment Act of 2009 (the Act), the Department of Labor (DOL) has posted at its website a series of model notices relating to the subsidy for COBRA continuation health care coverage and the special extended election rights provided under the Act. (www.dol.gov/ebsa/ COBRAmodelnotice.html)

New Group Health Plan Special Enrollment Rights Effective April 1, 2009

The Children's Health Insurance Program Reauthorization Act of 2009, which became law on February 4, 2009, reauthorizes and expands the Children's Health Insurance Program (CHIP). CHIP, as amended, provides for new special enrollment rights for employees and dependents in two situations. The new special enrollment rights become effective April 1, 2009.

Under the amended CHIP, an employee and dependent who is eligible for (but not enrolled) in an employer's group health plan must be extended the right to enroll in a group health plan (a) if the employee's or dependent's Medicaid or a state-sponsored children's health insurance program ("State Plan") coverage is terminated as a result of loss of eligibility, or (b) the employee or dependent becomes eligible for a subsidy under Medicaid or a State Plan. An eligible employee or dependent has 60 days (not the usual 30) from the date on which the individual gains (or loses) coverage to request coverage.

Cafeteria plans and ERISA welfare plans will need to be amended to reflect these new special enrollment rights. In particular, while some plans may be worded broadly enough to accommodate the special enrollment rights prescribed by the new law, most will not reflect the 60-day election time frame. Amendments to summary plan descriptions and other employee communications will be needed as well. Specifically, plan sponsors will need to update their enrollment materials to communicate the new special enrollment rights.

The amendments to CHIP may also make it easier for states to provide premium subsidies under employer group health plans. If a state offers premium subsidies, a new notice providing information on the subsidy will need to be provided by the employer.

New Guidance on Offshore Deferred Compensation Subject to IRC § 457A

Interim guidance affecting new Internal Revenue Code (IRC) § 457A was issued by the Internal Revenue Service. Added to the tax code in October, 2008 as part of the Emergency Economic Stabilization Act of 2008, IRC § 457A generally provides that compensation deferred under nonqualified deferred compensation arrangements of certain partnerships and corporations (defined as "nonqualified entities") is subject to immediate taxation, unless it is subject to a substantial risk of forfeiture. As the new guidance makes clear, IRC § 457A applies to a broader range of entities and taxpayers than just those associated with offshore hedge funds. A nonqualified entity is defined under IRC § 457A as any foreign corporation, unless substantially all of the corporation's income is effectively connected with the conduct of a U.S. trade or business, or the corporation is subject to a "comprehensive foreign income tax." Foreign and domestic partnerships may also be nonqualified entities if more than 20 percent of their income is allocated to tax-exempt organizations or to foreign persons whose income is not subject to a comprehensive foreign income tax. Issued in question-and-answer format, IRS Notice 2009-8 provides key guidance on identifying nonqualified entities and those employees and other service providers who are covered by IRC § 457A. Guidance is also provided on the calculation of amounts includible in income and on the coordination of IRC § 457A with IRC § 409A. In certain cases where the amount is not "determinable" at vesting, it is taxed at a later date but is subject to an additional 20 percent tax, plus interest. Although the notice cautions that coverage under IRC § 457A may be expanded in future guidance, any expansion of coverage will be prospective only.

DOL Provides Guidance Regarding Funding Notices Required by April 30, 2009

Effective for plan years that begin in 2008 and later, defined benefit plans which are covered by the Pension Benefit Guaranty Corporation's (PBGC) insurance program are required to provide annual funding notices. Provision of this annual funding notice will replace the summary annual report previously required for single-employer defined benefit plans. The notice must be provided no later than 120 days following the close of the plan year. Thus, for calendar year plans, the first notice is required to be given by no later than April 30, 2009. For plans with 100 participants or less, the notice must be provided by the earlier of the due date for the Form 5500 filing or the actual filing date of the Form 5500.

The Department of Labor (DOL) has issued Field Assistance Bulletin 2009-01, which provides guidance on the notice requirement in question and answer format. The Bulletin also provides a model notice for single-employer plans and for multiemployer plans. Use of the model notices and compliance with the guidance set out in the Bulletin will be deemed to be compliance with the requirements to provide these notices. The notice must be provided to each plan participant and beneficiary, each labor organization which represents employees participating in the plan, and, for multiemployer plans, to each employer obligated to contribute to the plan. The notice must also be given to the PBGC, but failure to provide the notice to the PBGC will not result in enforcement actions if plan liabilities do not exceed assets by more than $50 million and the latest available funding notice is provided to the PBGC within 30 days of receiving the request from PBGC.

Sponsors of defined benefit plans, particularly those with calendar plan years, should immediately contact their plan actuary for assistance in preparation of the notice.

New Tax Reporting Requirements for 2009 Waivers of Minimum Required Distributions

On December 23, 2008, President Bush signed the Worker, Retiree, and Employer Recovery Act of 2008 (the Act) into law. The act generally waives any required 2009 required minimum distributions (RMDs) from individual account retirement plans, such as 401(k) plans, 403(b) plans, and certain 457(b) plans. The act also generally waives any 2009 RMDs from Individual Retirement Arrangements (IRAs). Beneficiaries receiving distributions over a five-year period are also able to waive the distribution for 2009, effectively taking distributions over a six-year period instead of a five-year period. Note, however, that the act does not waive 2009 RMDs for defined benefit pension plans.

In January, the IRS published Notice 2009-9, which provides guidance to financial institutions on reporting required minimum distributions for 2009 in the wake of the Act. A financial institution that issued a 2008 Form 5498 IRA Contribution Information should not have put a check in Box 11. However, in recognition of the short amount of time financial institutions were given to make programming changes, if a financial institution issued a 2008 Form 5498 with a check in Box 11 the IRS will not consider such form issued incorrectly solely because of the check, provided the IRA owner is notified by the financial institution no later than March 31, 2009, that no RMD is required for 2009. In addition, the RMD information required under IRS Notice 2002-27 need not be sent to IRA owners for 2009. If a financial institution sends a separate RMD statement to an IRA owner, either initially or in response to the owner's request for the financial institution to calculate the RMD for 2009, the financial institution must show the RMD for 2009 as zero. Alternatively, the financial institution may send the IRA owner a statement showing the RMD that would have been required but for the waiver of RMDs for 2009, along with an explanation of the waiver for 2009. Finally, the IRS encourages all financial institutions to inform IRA owners who delayed taking their 2008 RMD until April 1, 2009, that they are still required to take that distribution.

DOL Publishes Final Rules for Assessing Penalties for Failures to Satisfy Post-PPA Notice and Disclosure Requirements

The Pension Protection Act of 2006 (PPA) established new notice and disclosure requirements relating to the various aspects of retirement plan operation they cover. They include funding-based limits on benefit accruals and certain forms of benefit distributions, plan actuarial and financial reports, multiemployer plan withdrawal liability of contributing employers, and participants' rights and obligations under automatic contribution arrangements. The PPA gives the Department of Labor (DOL) authority to assess civil monetary penalties of up to $1,000 per day against plan administrators for violations of the new notice and disclosure requirements. On December 31, 2008, the DOL released a final regulation for assessing civil penalties against plan administrators who fail to provide required disclosures or notices under the PPA. The final regulation is basically identical to the proposed regulation issued in December 2007, and sets forth the administrative procedures for assessing and contesting such penalties; those procedures are similar to the procedures used by the DOL to assess penalties for failure to file an annual Form 5500. The regulation, however, does not address substantive provisions of the new disclosure requirements. The final regulation is effective March 3, 2009. (DOL Reg. § 2560.502c-4)

Beneficiary Designation Survives Despite Conflicting Provision in Divorce Decree

In *Kennedy v. Dupont Savings and Investment Plan*, the U.S. Supreme Court held that a beneficiary designation filed in accordance with the terms of an ERISA plan must be honored even when it directly conflicts with the terms of a divorce decree that does not qualify as a QDRO.

In 1974, a DuPont employee and participant in Dupont's ERISA-covered savings and investment plan signed a beneficiary designation naming his then spouse as his beneficiary. The participant and his spouse divorced in 1994, subject to a divorce decree that divested the spouse of her interest in the participant's savings and investment plan benefit. The participant did not, however, change his beneficiary designation. On the participant's death in 2001, the plan administrator paid the participant's account balance to the ex-spouse in accordance with the participant's beneficiary designation. The participant's estate sued, claiming that the plan violated ERISA by paying the benefit in contravention of the divorce decree which, as noted, explicitly divested the spouse of any rights to plan benefits. The estate argued that the divorce decree amounted to a waiver of her rights.

The Supreme Court ruled against the estate, holding that the plan administrator complied with ERISA by paying the participant's savings and investment plan account to his ex-spouse. According to the court, the plan administrator was obligated to honor the participant's designation, which was filed in accordance with the terms of the plan. In so holding, the court made it clear that ERISA provides no exception to a plan administrator's duty to act in accordance with ERISA plan documents.

The Supreme Court's decision in *Kennedy* resolves a split among the courts of appeals and state supreme courts over whether a beneficiary's federal common-law waiver of plan benefits is effective when that waiver is inconsistent with plan documents. As such, the decision gives plan administrators some comfort in following the terms of an ERISA plan in situations where one or more documents generated outside of the plan conflict with plan terms. *Kennedy* also highlights the importance of ensuring the terms of a plan contain clear and unambiguous provisions regarding beneficiary designations, and that these provisions are communicated completely (and accurately) to participants. (*Kennedy v. Dupont Savings and Investment Plan*, U.S. Sup. Ct., 2009)

Court Rules Common-Law Spouse Has Right to Pension Assets Through QDRO

The U.S. Court of Appeals for the Ninth Circuit recently held that a woman who was in a "quasi-marital relationship" with a man for more than 30 years was entitled to half his pension benefits. Although they were never legally married, the couple raised two children, purchased a home together, filed joint tax returns, and otherwise held themselves out to their friends and the public as a married couple. The circuit court affirmed a lower court ruling that the qualified domestic relations order (QDRO) assigning the woman 50 percent of the pension benefit was valid. The circuit court held that the state court's order was a valid QDRO because (i) it related to "marital property rights" and (ii) it recognized the existence of an "alternate payee."

Generally, the ERISA protects a plan participant's benefit from being assigned to another party. This is known as the anti-alienation rule. A limited exception to this rule provides that benefits accrued by a participant may be paid to another person provided such person meets the definition of an alternate payee, and the order issuing such payment meets the criteria of a QDRO. ERISA's anti-alienation provision allows for the assignment of a participant's benefit to comply with a court order for child support, alimony, or marital property rights.

The court held "marital property rights" existed despite the fact that the couple was not legally married. Noting that ERISA does not explicitly define "marital property rights," the court looked to Washington State domestic relations law to determine the meaning of the term. Washington recognizes quasi-marital relationships for purposes of property division.

Because the participant's pension benefits would be characterized as community property under state law, the pension benefits qualified as "marital property" that could be validly assigned by a QDRO.

The court also supported the legitimacy of the QDRO by concluding that the woman qualified as an "alternate payee." ERISA defines an alternate payee as a spouse, former spouse, child, or other dependent. In this context, the term "other dependent" is defined as an individual "other than … the spouse … who, for the taxable year of the taxpayer, has the same principal place of abode as the taxpayer and is a member of the taxpayer's household." Because the couple resided in the same house and the participant provided the majority of the financial support for the family, the woman qualified as a dependent and therefore as an alternate payee. (*Owens v. Automotive Machinists Pension Trust*, 9th Cir., 2009)

Fiduciary Litigation Proceeds in Participant Lawsuit

Plan participants in a 401(k) plan survived a summary judgment motion based in part on the U.S. Supreme Court decision in 2008 (*LaRue v. DeWolff, Bobery & Associates Inc.*) that allows individual participants to maintain lawsuits seeking recovery for individual losses resulting from fiduciary breaches. In this case, the plaintiffs/plan participants were part of a 401(k) plan where a bank trustee handled the investment of plan assets as the plan fiduciary. After a decision was made in 2003 to change the plan investments from trustee-directed investments to participant-directed choices, there was a transition period of about eight months. During most of this transition period, plan assets were held in a money market account pending completion of the conversion. The participants sued the bank trustee and its representative, claiming that the handling of plan assets, as well as other acts or omissions, constituted breaches of fiduciary responsibility, negligence, and common-law fraud. The suit was filed in state court. The bank defendant removed the case to federal court on the basis of federal law. The federal district court held that the claims were preempted by ERISA and dismissed the state and common law claims as well as a claim for compensatory damages. In allowing the case to proceed on the ERISA claims that seek recovery to individual accounts based on an alleged fiduciary breach, the courtroom door remains open for claims of this nature from individual participants. While the plaintiffs must still prove their case, fiduciaries must be ever alert to the possibility of participant claims arising in the context of harm to individual accounts resulting from fiduciary decisions. (*Marks Construction Co. v. Huntington National Bank*, N.D. W. Va., 2009)

Eighth Circuit Holds Payments Made by ESOP Sponsor to Redeem Stock Not Deductible as a Dividend Paid

Reversing a lower court decision (see *Employee Benefit Developments*, March 2008), the Eighth Circuit has denied a tax deduction for shares General Mills redeemed from its employee stock ownership plan (ESOP) in order to pay terminating employees cash distributions from the ESOP. Under the lower court holding, General Mills was allowed to receive a deduction not only for its contributions it had to the ESOP but also a deduction for amounts paid to redeem the stock when the employee is paid his or her benefit in cash. The Eighth Circuit overturned the lower court decision and refused to follow the decision of *Boise Cascade* in the Ninth Circuit in 2003 (see *Employee Benefit Developments*, May 13, 2003 — May 20, 2003). The Eighth Circuit disagreed with the Ninth Circuit's analysis, which concluded that IRC § 162(k)(1) did not disallow a deduction under IRC § 404(k)(1). Unlike the Ninth circuit, which separated the transaction into two distinct steps (a dividend contribution to the ESOP followed by a pass-through distribution from the ESOP, which was then deductible under IRC § 404(k)(1)), the Eighth Circuit found that the dividend payment was "in connection" with a redemption and that therefore both steps of the transaction were "in connection" with General Mills redemption of stock and a deduction was barred by the provisions of IRC § 162(k)(1). (*General Mills Inc. v. United States*, 8th Cir., 2009)

Cash Balance Plan Again Held Not Age Discriminatory

In a recent case, the District Court for the Southern District of Texas held a cash balance pension plan sponsored by the United Way of Greater Houston did not to discriminate against older workers. The court decided to follow the decisions of five U.S. circuit courts that have held that cash balance plans are not inherently age discriminatory under ERISA. The district court also held that the plaintiff's related claim under the Age Discrimination and Employment Act (ADEA) was also precluded because ADEA contains similar language to that found in ERISA and that Congressional intent was that both provisions were to be interpreted similar manner. (*Rosenblatt v. United Way of Greater Houston*, S.D. Tex., 2008)