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EMPLOYEE BENEFITS DEVELOPMENTS NOVEMBER 2006

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

IRS issues final regulations on the use of electronic notices and elections
The Internal Revenue Service (IRS) issued final regulations providing standards for retirement plans, employee benefit plans, and individual retirement plans to use electronic media to provide notices to participants. The regulations allow participants to make plan elections and file consents using electronic media. The regulations, codified in Treasury Regulations 1.401(a)-21, became effective October 20, 2006, and apply to electronic notices and elections made after 2006.

These regulations apply to a wide range of plans, including qualified plans under Internal Revenue Code (Code) §§ 401(a), 403(a), 403(b); Code § 457(b) government plans; and Code §§ 408A and 408(q) individual retirement plans. Unlike the 2005 proposed regulations, the final regulations apply to employee benefit programs such as Code § 223 health savings accounts, Code § 125 cafeteria plans, and accident and health plans under Code §§ 104(a)(3) or 105.

Under the rules, notices and elections that are required to be in writing are permitted to use electronic means. These include Code § 204(h) reduction in future accrual notices, Code § 402(f) rollover rights notices, Code § 411(a)(11) benefit commencement rights notices, and Code § 417(a)(2) spousal consents. The Department of Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC) have separate regulations dealing with electronic delivery of notices under their jurisdiction, such as Consolidated Omnibus Budget Reconciliation Act (COBRA) rights notices, notices of benefit suspensions, summary plan descriptions (SPDs), and summary annual reports.

The IRS regulations permit two methods for the electronic distribution of notices. Under the first method, the participant must consent to the electronic delivery. Before consent, however, the participant must receive a disclosure statement describing the scope of the consent, the participant's right to withdraw consent, the hardware and software required to access the electronic media, and procedures for updating the participant's current contact information. The second method requires that the participant must be "effectively able" to access the electronic medium used to provide the notice and must be advised that he or she may request and receive a paper version of the notice at no charge.

The regulations contain general provisions, such as requiring that the electronic notice alert the participant to the significance of the information, be at least as understandable as a paper notice, provide instruction on access, and be in a form that can be retained and reproduced for later reference. The electronic notice must be provided in a timely manner and include the same information that would have been provided in a paper notice.

If a plan allows its participants to use electronic media to consent and make elections, the regulations require that the system be secure; that the participants have a reasonable opportunity to review, confirm, modify, or rescind their elections; and that the system provide the participants with a written or electronic confirmation. Plans are not required to offer an alternative to electronic elections as long as participants are "effectively able" to access the electronic medium used to make the elections. (T.D. 9294)

Update from IRS on per diem business expenses for lodging, meals, and incidental expenses

The IRS has issued Revenue Procedure 2006-41 to update earlier guidance on deductible business expenses for lodging, meals, and incidentals while traveling away from home. Code § 274 generally requires substantiation for any of these expenses to be deductible but allows a taxpayer to avoid some of the substantiation requirements if the expenses do not exceed an amount prescribed by regulation. This revenue procedure may be used in those circumstances where an employer provides the employee with a per diem allowance. The updated procedure applies to expenses paid after September 30, 2006. The procedure establishes a per diem rate of $246 for travel to any of the "high-cost localities" located in 14 states and $148 for travel to other locations. The meal expense daily allowance is $58 for the high-cost localities and $45 for other locations. The revenue procedure, published October 23, 2006, may be used by employers, employees, and their tax accountants in determining the extent of deductible expenses for employers, itemized deductions that may be claimed by employees, and the portion of any excess amounts paid to employees that is reportable as W-2 compensation income.

Reducing volatility of plan investments may be part of prudent investment strategy

In light of defined benefit pension funding reforms and revised financial statement reporting, some plan sponsors may prefer that investment managers adopt a strategy that makes asset values less volatile. (In any event, a fiduciary must act in the interest of plan participants and not for the benefit of the plan sponsor.) In the past, many plans have heavily weighted their asset allocations to equities, where investment performance can be volatile. Fixed income securities generally have lower volatility but may produce lower long-term returns. DOL Advisory Opinion 2006-08A (October 3, 2006) provides support for an asset allocation strategy that may have less volatility than traditionally used. In the Advisory Opinion Request, the DOL was asked if a plan fiduciary could adopt an approach of matching assets to expected payments of liabilities by the plan. The question posed was whether a plan fiduciary could manage plan assets by matching the risks of a plan's investment portfolio with the risks associated with its benefit liabilities. The goal of the investment strategy is to increase the likelihood that assets will match liabilities by investing in a portfolio of fixed-income securities with durations that coincide with the benefit obligations. The DOL concluded that there is nothing in the Employee Retirement Income Security Act (ERISA) or the DOL regulations that would limit a plan fiduciary's ability to take into account the risks associated with benefit liabilities or how those risks relate to portfolio management. The DOL points out, however, that whether an investment strategy is prudent always "depends on all of the facts and circumstances involved."

DOL guidance on health savings accounts: Are HSAs subject to ERISA?
The DOL has issued further guidance for employers who establish or contribute to health savings accounts (HSAs) for their employees. Guidance issued in 2004 through Field Assistance Bulletin (FAB) 2004-01 provides rules under which an employer may select a single HSA provider in establishing these arrangements.

Following the issuance of FAB 2004-01, the DOL received a number of recurring questions concerning whether specific employer activities in connection with an HSA would cause the HSA to be subject to ERISA. FAB 2006-2 responds to these questions. Specifically, FAB 2006-02 permits an employer to:

Unilaterally open an HSA for an employee and deposit employer funds into the account, provided employee contributions are voluntary and the employer does not limit or restrict an employee's access to the funds

Offer HSA investment options that replicate the investment options available under the employer's 401(k) plan, provided employees are afforded a reasonable choice of investment options and employees are not limited in moving their funds to another HSA provider

Pay an employee's HSA fees

In the DOL's view, the selection of a single HSA provider that offers a single investment option does not offer employees a "reasonable choice of investment options."

The FAB instructs employers to ensure that employee HSA contributions are promptly remitted to the HSA provider and indicates that employers may not receive discounts on other products offered from an HSA vendor selected by the employer.

In our view, most employers would be well advised to avoid any activity that could cause an HSA to be subject to ERISA. Following the guidance outlined in the FABs ensures an employer that the DOL will not bring an enforcement action against the employer for failure to file an annual report (5500), provide an SPD, or comply with COBRA in connection with the HSA. This exemption does not apply to any related high-deductible health plan otherwise subject to ERISA.

CASES

Immaterial omission does not invalidate beneficiary designation
An employee participating in the 401(k) plan sponsored by Alliant Techsystems, Inc. (Alliant) filled out a new beneficiary designation form in 2002 in which he named his former stepdaughter, Tracy, as his primary beneficiary. The new beneficiary designation was intended to replace an existing beneficiary designation that had named the employee's mother, Rose, as the primary beneficiary. When the employee filled out the new beneficiary designation form, he failed to fill in information requested on the form that identified the relationship between Tracy and himself. The form was returned to the employee so that the missing information could be filled in. The employee died before the completed form was ever filed with the plan administrator, but there were telephone communications between the employee and the plan administrator in which he confirmed his wish to name Tracy as his beneficiary. Following the employee's death, Tracy and Rose submitted competing claims for the death benefit payable under the 401(k) plan. Alliant initially ruled in favor of Tracy's claim on the basis that the employee's failure to fill in the relationship line was "not a material omission" and that the plan was "on notice" of the

employee's relationship to Tracy from two prior beneficiary designations. The matter ended up in the courts, and a federal district court found in favor of Rose. The federal appeals court reversed the district court's ruling and concluded that Alliant did not abuse its discretion in determining that the employee's 2002 beneficiary designation was valid. Accordingly, Tracy was found to be the rightful beneficiary of the employee's 401(k) account, absent a showing by Rose proving that the employee lacked capacity when he executed the change of beneficiary form or that the form was the product of undue influence by Tracy.

Regardless of where your sympathy may lie, this case is another reminder that a disputed beneficiary designation can lead to costly litigation. This type of dispute, however, can be avoided or minimized by plans that maintain, communicate, and follow clear procedures for accepting and rejecting beneficiary designations. (*Alliant Techsystems, Inc. v. Marks*, 8th Cir. 2006)