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COMPENSATION AND BENEFITS
Benefits e-News
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Benefits e-News: A value added service from Robinson & Cole LLP

Benefits e-News is a a monthly electronic newsletter reporting on recent changes in the law affecting employee benefits and other developments affecting plan sponsors and their employees. Benefits e-News provides web links to the Internal Revenue Service, the United States Department of Labor, the United States Department of Health and Human Services HIP HIPAA web site, and the Pension Benefit Guaranty Corporation. Benefits e-News is easy to navigate. To access a web link, position your cursor on the link and click your mouse. To return to Benefits e-News, click the back button on your browser.

We hope that you find Benefits e-News to be informational and helpful. If you know of others who would like to receive this online newsletter (or if you would like to discontinue receiving Benefits e-News), please click here and send us an email message. If there are certain topics that you would like covered in future issues, please let us know.

New Health Reimbursement Arrangements Permitted by IRS

The IRS has issued guidance on a new type of health reimbursement arrangement (HRA) – a significant victory for consumer-driven health care advocates. A number of employers had adopted these arrangements, but the tax consequences had not yet been blessed by the IRS. Under the guidance, an HRA can be used to reimburse employees for qualified medical expenses and the employees do not have income. In order to qualify the plan must be funded solely by the employer. A maximum dollar amount must be provided for a coverage period (generally $2,000 to $3,000 per family) and any unused amount at the end of a coverage period must be carried forward to the next year. Under such an arrangment, the HRA will not be subject to the flexible spending arrangement limitations imposed under the cafeteria plan rules.

An HRA is considered to be a group health plan, and is consequently subject to COBRA's continuation requirements and HIPAA's creditable coverage requirements. An employer usually offers an HRA in conjunction with a high deductible health insurance program. The arrangement is intended to promote awareness of the cost of medical care and encourage

wise health care decisions. Employees are encouraged to plan for major foreseeable medical expenses by building up the account in years leading up to when the expenses are anticipated. The guidance is welcomed by employers who have already adopted such programs and is expected to result in an increase in the number of employers sponsoring HSAs.

Moratorium Extended for Employment Taxes on Statutory Stock Options

In 2001, the IRS advised that FICA and FUTA taxes and income tax withholding would be required with respect to Section 422/423 statutory stock options effective as of January 1, 2003. Those notices and the proposed regulations published thereafter were intended to provide rules of administrative convenience for employers and employees and to clarify employers' income tax withholding and reporting obligations. In June, the IRS announced that under Notice 2002-47, it would continue its moratorium on assessing FICA or FUTA taxes or imposing federal income tax withholding on the exercise of any statutory stock option or the disposition of any stock acquired by exercising a statutory stock option. This moratorium will remain in place until Treasury and IRS complete their review of comments on the proposed regulations. Future guidance will be issued by the IRS, but will apply only on a prospective basis. Notice 2002-47 said that individuals still must include any compensation in income on a disqualifying disposition of stock acquired by exercising a statutory stock option. The notice does not relieve employers of their reporting obligations. Nonqualified or nonstatutory options are not affected by the notice. These options have always been, and continue to be, subject to FICA and FUTA taxes and income tax withholding at exercise.

IRS Provides Guidance on "Restorative Payments" to Qualified Plans

Generally, an employer's payments to a qualified plan are treated as contributions, subject to annual addition limits and deductibility limits, as well as nondiscrimination standards. The IRS has released guidance clarifying when certain "restorative payments" can be made to a plan without regard to those rules. A sponsor of a defined contribution plan can make a payment to restore losses to the plan resulting from actions by a fiduciary if there is a reasonable risk of liability for breach of fiduciary duty as a result of those actions. Similarly situated participants must be treated similarly with respect to the payment in order for the payment to constitute a "restorative payment" exempt from ERISA's contribution rules. Payments to a plan to make up for losses that result simply from market fluctuations and that are not due to a fiduciary breach may not be treated as restorative payments. Payments made under the EPCRS correction program also may not be treated as restorative payments.

IRS Updates Qualified Plan Compliance Programs

The IRS Employee Plans Compliance Resolution System (EPCRS) is a series of programs

designed by the IRS to encourage qualified plan sponsors to correct operational failures. In June the IRS issued a Revenue Procedure improving the correction procedures.

The IRS has clarified that terminated plans can take advantage of EPCRS. The John Doe anonymous submission procedures, which allow for the submission of a plan to the IRS for correction without initially identifying the plan or plan sponsor, have been expanded and extended indefinitely. In cases where a plan sponsor assumes a plan or plan assets in connection with a corporate transaction, there is an extended period for correction. In such cases, operational defects can be corrected through the self correction program through the end of the plan year after the corporate merger, acquisition or other transaction. The de minimis correction rules have been liberalized. If correction would involve a distribution to a participant of $50 or less, the distribution is not required if the processing and delivery costs would exceed the amount to be distributed. If the operational failure involved overpayment to a participant of $100 or less, the plan sponsor does not need to seek return of the overpayment. These changes, as well as other minor changes to EPCRS will enable plan sponsors to take advantage of the correction program.

EGTRRA Amendments

Last summer EGTRRA was passed, enabling employers and employees to make larger contributions to qualified plans. Many of EGTRRA's provisions came into effect in 2002. A qualified plan can only take advantage of an EGTRRA optional provision (such as catch-up contributions) if the plan is amended. Any plans that have been administered to take advantage of these new provisions must be amended before the end of the 2002 plan year.

Cafeteria Plan Amendments May be Needed

A series of regulations and rulings relating to cafeteria plans issued over the past couple of years has changed some of the specific rules relating to cafeteria plans and reimbursement accounts. Although most of the changes are minor in nature, cafeteria plan documents and SPDs may require amendment if they contain provisions contrary to the new rules.

There are now more liberal standards for determining when a change in status occurs, providing increased opportunities for employees to change elections. Elections can be changed mid-year if there is a significant increase or decrease in the cost of coverage. In the case of dependent care reimbursement accounts, this is particularly favorable as elections can now be changed if day care costs unexpectedly increase. Also, if a dependent care reimbursement plan document includes the deemed earned income rule, amendment will be necessary to reflect recent changes to the legal definition of "earned income." Additionally, if a plan document or SPD details which medical expenses are reimbursable, amendment may be necessary to reflect the fact that smoking cessation programs and weight loss programs are now reimbursable expenses. A thorough review of all cafeteria plan documents should be made to determine whether amendment is necessary as a result of these new rules.

HIPAA and the October 16, 2002 Deadline

Along with mandating requirements for protecting the privacy of health information, HIPAA also requires covered entities to use national electronic standards and codes when conducting certain electronic transactions. These standards, called the Electronic Transaction and Code Set Standards, apply to health plans (such as medical, dental, and flexible spending accounts), as well as to health care providers who transmit health information electronically.

When these entities engage in a transaction related to

- health care claims or similar encounter information,
- health plan enrollment and disenrollment,
- health plan eligibility,
- health care payment and remittance advice,
- health plan premium payments,
- health care claim status,
- referral certification and authorization, or
- coordination of benefits

then the covered entity must transmit such information using the national standard adopted for that transaction. Two additional transactions, first report of injury and health claims attachment, will be added to the list of transactions covered by the standards when those transaction rules are finalized. In many instances, a TPA performs these functions on behalf of a plan, but the plan is responsible for ensuring that the TPA complies with these standards.

The compliance date for covered entities is October 16, 2002. However, covered entities may have an additional year to comply, so long as they submit a compliance plan by October 15, 2002. Covered entities wishing to submit a compliance plan can use the model compliance plan put out by the Department of Health and Human Services (DHHS). This is simply a form that the covered entity must complete detailing the steps it is taking to become compliant and can be found at DHHS's website.

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