ROBINSON & COLE LLP
Employee Benefits & Compensation

IRS Issues Comprehensive Proposed Regulations Affecting Retirement Plans

The IRS has issued Proposed Regulations under Section 415 of the Internal Revenue Code. The regulations incorporate administrative guidance and legislative changes issued since regulations were last updated in 1981. The regulations include two significant clarifications that plan sponsors can rely upon immediately:

• Certain types of compensation paid within two and one-half months following an employee's severance from employment are Section 415 compensation and can deferred by the employee. The types of compensation that are subject to this special rule are: (1) amounts that would have been payable to the employee if he had remained employed, and (2) payments for accrued sick, vacation, or other leave, provided that the employee would have been able to use the leave if he had not terminated employment. Any other type of compensation, including severance payments, paid after an employee's severance from employment are not treated as compensation for Section 415 purposes.

• Payments made to employees who are engaged in qualified military service constitute Section 415 compensation if they do not exceed the amount of compensation that the employee would have received if the employee had remained actively employed. These employees will be able to continue to make deferrals from such amounts while on leave.

The regulations include other notable provisions that will apply to limitation years beginning on or after January 1, 2007:

• New rules are provided for determining annual benefits under a defined benefit plan when there is more than one annuity starting date, such as when benefits have been aggregated with benefits under another plan under which distributions have previously commenced.

• The regulations clarify that social security supplements and rollover contributions made to a defined benefit plan are not included in determining a participant's annual benefit for purposes of the limit on annual benefit.

• The Section 415 corrective measures were previously addressed in the regulations. Now, any payment required to correct a Section 415 violation will be eligible for correction under EPCRS (the IRS's correction program).

• Payments made under the DOL's Voluntary Fiduciary Correction Program to correct a loss incurred as a result of a breach of fiduciary duty are restorative payments, and the allocation of such a payment to a participant's account will not result in an annual addition for 415 purposes.

Court finds that Employee was not Prejudiced by Employer's Failure to Distribute SPD

In Weinreb v. Hospital for Joint Diseases Orthopaedic Institute, the widow of a former employee sued the employer for life insurance benefits. The widow alleged that the employer had failed to provide the employee with a Summary Plan Description which would have set forth the enrollment rules, and that, as a result of that failure, the employee did not enroll in life insurance coverage. The employer established that although it had not timely provided a Summary Plan Description for the life insurance program, the employee had actual knowledge of the enrollment requirements. The employee had completed enrollment forms for other benefits; however, he failed to complete the enrollment form for life insurance, despite the fact that the employer had informed the employee on numerous occasions that the necessary enrollment forms had not yet been completed.

The Second Circuit Court of Appeals ruled in favor of the plan sponsor, finding that the widow's ineligibility for life insurance benefits resulted not from the plan sponsor's failure to distribute the Summary Plan Description, but rather, from the employee's failure to enroll for benefits. Consistent with its previous rulings, the court stated that in order for a plan sponsor to be liable for a deficiency in a Summary Plan Description, the claimant must show that he or she was prejudiced as a result of such deficiency.

DOL Provides Guidance on Handling Settlement Proceeds

The DOL has provided guidance on the appropriate handling of litigation settlement proceeds received by an employer's group health plan. In Advisory Opinion 2005-08A, the DOL stated that to the extent any portion of settlement proceeds is considered to be a plan asset, it becomes subject to ERISA and the fiduciary responsibility rules and prohibited transaction provisions of ERISA will apply. If a plan or trust is the policyholder, or if the premium is paid entirely from trust assets, the entire amount received constitutes a plan asset. Otherwise, absent a specific plan provision governing the receipt of such proceeds, the portion of the award that is attributable to employee contributions constitutes plan assets and must be used to provide enhanced benefits or must be applied towards future participant premium payments. The Advisory Opinion suggests that the best method for calculating the employee portion of the settlement proceeds is to multiply the amount of the award by the participant contribution percentage.

Settlement proceeds that constitute plan assets should be placed in the plan's trust. If no trust is maintained for the plan, the plan assets must be held in an interest-bearing bank account in the name of the plan for no more than 12 months.

Court Approves Plan Sponsor's Early Retirement Reduction Rate

A U.S. District Court for the District of Connecticut ruled in the case McCarthy v. Dun & Bradstreet Corp. that a plan sponsor's selection of a discount rate of 6.75% for calculating early retirement benefits did not violate ERISA. Dun & Bradstreet's plan permitted retirees to commence pension distributions at age 55. If an individual was no longer employed by Dun & Bradstreet at the time he turned age 55, the pension benefit would be reduced by 6.75% per year for each year the benefit commenced prior to age 65. A group of retirees brought suit against Dun & Bradstreet alleging that it had underpaid pension benefits by

using an unreasonably high discount rate in calculating early retirement benefits. The court ruled in favor of Dun & Bradstreet, concluding that Dun & Bradstreet's methodology satisfied ERISA's requirements and that the 6.75% rate was reasonable.

IRS Issues Regulations On Anti-Cutback Rules

The IRS has issued proposed regulations intended to reflect the United States Supreme Court's ruling in Central Laborers Pension Fund v. Hines. In that case, the Court ruled that ERISA's anti-cutback rule was violated by a plan amendment that expanded the categories of post-retirement employment that resulted in the suspension of payment of accrued early retirement benefits. The Court found that the anti-cutback rule protects the suspension of benefit payments and held that a qualified retirement plan cannot impose a new condition on a participant's right to benefits that had already accrued.

The proposed regulations reflect this ruling and provide a utilization test under which a plan sponsor can amend a plan to eliminate or reduce an early retirement benefit, a retirement type subsidy, or an optional form of benefit. The proposed regulations clarify that a plan amendment that adds a restriction that is permitted under the suspension of benefits provisions is still considered to be a prohibited cutback and thus, any restriction can only apply to benefits accruing after the amendment date.

Proposed Regulations Issued Regarding Electronic Transmission of Employee Benefits Information

The IRS has issued proposed regulations relating to the use of electronic technology to provide employee benefit plan information. The proposed regulations consolidate existing guidance on the use of electronic media to provide certain communications to participants and beneficiaries under employee benefit plans, including qualified plans, SEPs, eligible governmental plans, health plans, cafeteria plans, and educational assistance plans.

In an expansion of a provision from prior guidance, electronic media can be used to satisfy the qualified joint and survivor annuity notice and election requirements. The guidance does not extend to communications, such as summary plan descriptions and COBRA notices, over which the Department of Labor has authority.

The proposed regulations require that the content of the electronic notices and the manner in which they are delivered be reasonably designed to provide information that is as understandable as it would b if provided in written form. Participants must consent to receiving plan information electronically after being provided with a disclosure statement relating to the electronic communication. If the regulations are finalized in their current form, plan sponsors that use automated telephone response systems, email, the internet or an intranet to provide notices and communications in accordance with these regulations would be deemed to satisfy the requirements that written communication be provided to participants.

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