ROBINSON & COLE LLP

Employee Benefits & Compensation

IRS Extends Year End Deadline for FSAs

This week the IRS announced a significant modification to the year end "use-it-or-lose-it" rule that applies to Flexible Spending Accounts (FSAs). Under existing law, any FSA contributions remaining at the end of a plan year are forfeited. The IRS introduced a grace period of two and half months immediately following the end of a plan year during which an employee can incur qualified expenses and obtain reimbursement from unused contributions.

Employers can amend their cafeteria plan document before the end of the current plan year to extend the deadline for participants to obtain reimbursements for up to two and half months after the end of the plan year. A plan can permit expenses for qualified benefits incurred during the grace period to be reimbursed from contributions remaining unused from the immediately preceding plan year. A participant who has a remaining account balance in an FSA at the end of a year and who incurs expenses during the grace period can be reimbursed for those expenses from the remaining balance as if the expenses had been incurred in the immediately preceding plan year. This major modification to the cafeteria plan rules essentially extends from 12 months to 14 months and 15 days the period during which participants can incur qualified expenses that are eligible to be reimbursed through the FSA.

Connecticut's New Civil Union Law Impacts Employee Benefits

Effective October 1, 2005, the State of Connecticut will recognize civil unions between same sex partners if such civil unions meet certain requirements. Under the new civil union law, civil union partners are entitled to receive the same benefits, protections and responsibilities as are granted to spouses under Connecticut law. This requirement may impact many employee benefit plans and programs. It is possible that there will be judicial challenges involving the rights of civil union partners and it is impossible to predict how those challenges will be resolved. In order to avoid risks associated with impacted benefits, employer should analyze how this new law impacts its benefit plans and its employees.

ERISA, the federal law that governs employee benefit plans, generally preempts state laws that relate to ERISA plans. Unless there is an express exemption from ERISA preemption, a state cannot require an ERISA plan to provide benefits to a civil union partner. State insurance laws are one major exemption from ERISA preemption. Thus, the State of Connecticut Insurance Department could require that if a Connecticut employer offers an insured benefit, such as a medical or dental insurance plan, those insured benefits must be offered to civil union partners on the same terms as they are offered to spouses. Self-insured plans are governed solely by federal law and are not subject to state insurance laws. Since federal law does not recognize civil union partners, sponsors of self-insured plans may take

the position that they are not required to provide benefits to civil union partners. Self-insured plan sponsors can of course extend such coverage under the terms of their plan on a voluntary basis.

Other non-ERISA benefits may be impacted, as well. For example, it may be necessary to extend family leave benefits that are required under Connecticut state law to civil union partners. Employers may be required to extend other non-ERISA benefits, such as discount programs, to civil union partners if they provide such benefits to spouses.

Insured plans may be required to extend Connecticut COBRA coverage to civil union partners. Civil union partners may be entitled to federal COBRA coverage if they qualify as a "dependent" of an employee under federal law.

Employers may encounter the following issues with Connecticut's civil union law:

• Since many employee benefit plans define the term "spouse" in general terms, or by reference to state law, if the terms of an employer's plan document can be interpreted as extending benefits to parties to a civil union, ERISA may not override the plan document or Summary Plan Description and civil union partners could assert that they are entitled to the same benefits as spouses under the terms of a plan. Accordingly, employers may wish to consider whether or not they wish to extend benefits to civil union partners, and to review ERISA plan documents and other employee communication materials to ensure that those materials clearly reflect the employer's choice as to who is entitled to benefits. The new law defines "marriage" as the union of one man and one woman. Although historically Connecticut has honored marriages validly entered into in other states, this provision could pose issues for individuals who have entered into a same sex marriage in another state (for example, Massachusetts), but who later move to Connecticut. If an employer wishes to provide benefits to same sex spouses, the plan document should reflect that decision.

• Many Connecticut employers offer domestic partner benefits. Employers that currently offer domestic partner benefits may want to review their domestic partner policy to see whether they wish to update that policy to reflect civil unions.

• Unless a civil union partner is a tax dependent, the value of employer provided benefits, such as medical insurance, will be taxable income to the employee for purposes of federal income tax, but will not be subject to Connecticut income tax under the new law. Employers will have to update their payroll system to handle the bifurcated income tax treatment.

At this time Connecticut employers may need to consider changes to insured plans and non-ERISA plans and update payroll systems to comply with the new law. Employers should determine whether or not it is in the best interest of the employer and its workforce to extend all benefits to civil union parties when not required by law. All plan documents and employee communication materials should reflect any decision. It is probably advisable for employers to address these issues before the law becomes effective in October in order to

avoid confusion over benefit plan offerings.

District Court Prevents EEOC from Publishing Retiree Medical Benefits Rule

In AARP v. EEOC, a Federal District Court in Pennsylvania blocked the EEOC from publishing a final rule permitting employers to coordinate retiree medical benefits with Medicare. The court stated that the EEOC did not have the authority to adopt the rule and effectively delayed, and perhaps prevented, the rule from becoming effective.

This case continues the legal conflict over the ability of employers to coordinate retiree medical benefits with Medicare eligibility that began in Erie County Retiree Ass'n v. County of Erie. In Erie County, the Third Circuit Court of Appeals ruled that an employer's practice of reducing medical benefits for retirees once they became eligible for Medicare violated the ADEA. The EEOC subsequently established the final rule creating an ADEA exemption for retiree medical benefits, rendering the Erie County decision obsolete. Under the proposed rule, employers who reduce or eliminate medical benefits for Medicare eligible retirees would not violate the ADEA's restriction on age discrimination. In AARP v. EEOC, the AARP successfully challenged the ability of the EEOC to issue this rule.

Since the EEOC will likely appeal this decision, employers who sponsor retiree medical programs should continue to monitor the developments in this case, which could impact plan design.

IRS Issues Revenue Procedure Regarding Suspension of Benefits Rules

Last year in Benefits e-News we reported on the case Central Laborers' Pension Fund v. Heinz. In that case, the United States Supreme 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. In Heinz, certain employees, including Mr. Heinz, accrued enough pension credits to satisfy the plan's requirements for an unreduced early retirement benefit and had elected to retire and begin receiving benefit payments. At the time of Mr. Heinz's retirement, the plan provided that benefit payments would be suspended if a participant worked in "disqualifying employment", which was then defined as any job as a union or nonunion construction worker. Employment in a supervisory capacity was not considered to be disqualifying employment. After his retirement, Mr. Heinz became employed as a construction supervisor. He continued to receive benefit payments from the Central Laborers' Pension Fund. Later, the retirement plan was amended to expand the definition of "disqualifying employment" to include any job in any capacity in the construction industry. As a result of this amendment, Mr. Heinz's benefit payments were suspended due to his employment as a construction supervisor. Mr. Heinz sued to recover the suspended benefits, alleging that the plan had violated ERISA's anti-cutback rule. The Supreme Court found that the anti-cutback rule protects the suspension of benefit payments and held that a qualified plan cannot impose a new condition on a participant's right to benefits that have already accrued. The Supreme Court stated that new conditions can be attached to benefits only if the conditions apply to benefits that are associated with future employment.

The IRS recently issued Revenue Procedure 2005-23 which give guidance to plan sponsors on the retroactive application of the Heinz ruling. Under the Revenue Procedure, a plan will not be disqualified if it adopted an amendment before June 7, 2004 that added or expanded a suspension of benefits provision, provided that the plan adopts a reforming amendment, effective June 7, 2004, that provides that the amendment regarding the suspension of benefits does not apply with respect to benefits accrued as of the date the original amendment was adopted or became effective. Benefits accrued after the impermissible amendment can continue to be suspended. A participant must be allowed to elect retroactively to have payments commence as of the reforming amendment's effective date or the date the participant was eligible to commence payments if their benefits were suspended pursuant to an impermissible amendment.

Any plan sponsor that may have adopted an impermissible amendment prior to June 7, 2004, should consider the impact of this Revenue Procedure. Plans must be operated in compliance with the reforming amendment no later than January 1, 2006. Eligible participants must be provided notice on or before January 1, 2006 that explains the opportunity to elect to commence benefits retroactive to the first date on which the reforming amendment is made effective.

Bankruptcy Act Impacts Employee Benefit Plans

President Bush recently signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Act). The Act contains many provisions that affect employee benefits:

- Any amount that an employer has withheld from an employee's wages for a contribution to an employee benefit plan is not included in an individual's bankruptcy estate.
- Although many states, including Connecticut, protect an individual's IRA from creditors, under the Bankruptcy Code, only qualified plans have been protected. In April, the U.S. Supreme Court ruled in the case Rousey v. Jacoway that where a debtor is not using state exemptions, IRA assets that are reasonably necessary for support are entitled to the same protection as qualified plan assets. The Act codifies the protection of IRAs and Roth IRAs under federal bankruptcy law, up to one million dollars. Any amount that has been rolled over from a qualified plan is not counted for purposes of the one million dollar limit.
- Plan loans are not dischargeable in individual bankruptcy. A qualified plan sponsor can continue to withhold plan loan repayments from a bankrupt employee's wages.
- The dollar limit on priority claims for an employer's unpaid employee benefit plan contributions has been increased. The amount of the priority claim is based on a formula and can now be as high as $10,000 per participant. These claims have priority over most other unsecured claims.
- In the event that an employer in bankruptcy attempts to modify or refuses to pay retiree benefits, such as medical coverage, the Act provides for a committee of retired employees to be appointed to negotiate with the employer.
- If an employer in bankruptcy is a plan administrator, it must continue to perform those duties during bankruptcy unless the bankruptcy trustee assumes the obligations of plan

administrator.

- Retention bonuses designed to induce executives to stay on during the bankruptcy are only permitted if numerous conditions are satisfied.
- Severance payments to insiders during an employer's bankruptcy are only permissible if the severance payments are part of a program that provides payments to all full-time employees and the amount of the payment is limited.

The Act is generally effective for bankruptcy filings after October 17, 2005.

This is an archive of past issues. As a result, it may contain information that is not current.