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WEB's ***Benefits Insider*** is a member exclusive publication providing the latest developments from the Nation's Capital on matters of interest to benefits professionals. The content of this newsletter is being provided as a result of a partnership with the American Benefits Council, a premier benefits advocacy organization, which provides its core content, and is edited by Corinne M. Tyler, Employee Benefits attorney and Senior Associate in the Cleveland Office of Baker & Hostetler LLP; ctyler@bakerlaw.com.

## Articles in this Edition

## RECENT LEGISLATIVE ACTIVITY

### Senate Delayed Action on Tax Bill with Benefits-Related Provisions Previously Approved by House and Ways and Means Committee, Including Nonqualified Deferred Compensation

In mid-November, the Senate failed to reach agreement on a tax "extenders" bill (legislation extending expiring tax provisions), based on the House of Representatives-passed Temporary Tax Relief Act (H.R. 3996), leaving the issue to be resolved in late December. Both the Senate and the House (as well as the House Ways and Means Committee) had previously approved the bill. However, on December 19, 2007, the Tax Increase Prevention Act of 2007 was approved by the House of Representatives following passage by the Senate. This Act provides a one-year patch to AMT for 2007 without offsetting the revenue cost of the measure with revenue raising pensions. Stay tuned for future Benefits Insiders for additional information on the Tax Increase Prevention Act of 2007.

Materials are available about the Temporary Tax Relief Act, including the text of the bill as passed by the House, the estimated revenue costs for the bill and the Joint Committee on Taxation's description of H.R. 3996's provisions.

The Temporary Tax Relief Act was largely intended to extend (or "patch") the alternative minimum tax (AMT) to relieve many taxpayers of the AMT obligation for another year. The bill also contained numerous benefits-related provisions, including tax-free distributions from IRAs to certain charities from individuals age 70½ or older (with the amount capped at $100,000 per taxpayer), penalty-free withdrawals from retirement plans for individuals called to active duty, the tuition tax deduction, and the mental health parity excise tax.

The cost to the federal treasury of the one-year AMT "patch" would have been $51 billion, while the package that extends the expiring tax provisions would cost another $21 billion. The legislation originally contained a number of provisions affecting nonqualified deferred compensation as a means of offsetting the federal revenue cost, including:

- taxation of "carried interest" (income to fund managers derived from the profits of the investment partnership) as ordinary income;
- current taxation of deferred compensation paid by certain offshore entities that meet specified conditions;
- modification of unrelated business income tax rules for certain investment partnerships (such as pension plans, universities and other tax-exempt entities); and
- a change in the tax code requiring U.S. employers to withhold income tax at a 30 percent rate on any distributions from pension or deferred compensation for an expatriate.

The bill also contained a provision identical to the AMT Credit Fairness and Relief Act (H.R.3861 in the House, bill number pending in the Senate) that would resolve the unintended application of the AMT tax as applied to incentive stock options (ISOs).

Senate Democrats and Republicans had differed on the necessity of offsetting the cost of the AMT patch, with Republicans preferring outright repeal of the AMT and no additional taxes. The Bush Administration released a Statement of Administration Policy (SAP) supporting AMT relief but opposing the tax changes that offset the proposal. The SAP argued that such changes would undermine the competitiveness of U.S. businesses in the global economy and could have adverse effects on the U.S. economy.

**Ways and Means Committee Approves Tax Bills with Employer Benefit Plan, Deferred Compensation Provisions**

On November 1, the House of Representatives Ways and Means Committee (Committee) approved two separate bills, each with implications for employer-sponsored benefit plans.

The Heroes Earnings Assistance and Relief Tax (HEART) Act (H.R. 3997), approved by the committee by voice vote, makes a number of tax code changes for military families and service volunteers. Provisions affecting employer-sponsored benefit plans would:

- Modify the Uniformed Services Employment and Reemployment Rights Act (USERRA) to allow the day prior to the date of death to be treated as the date the employee returned to work for purposes of triggering payment of benefits under a qualified plan;
- Permit an employer to make certain contributions to a qualified plan on behalf of an employee who was killed or disabled in combat;
- Include differential wages paid by an employer to an employee who becomes active duty military in the calculation of wages for retirement plan purposes;
- Make permanent the expiring Internal Revenue Code provision that permits active duty reservists to make penalty-free withdrawals from retirement plans; and
- Permit recipients of military death benefit gratuities to roll over the amounts received, tax-free, to a Roth IRA or an Education Savings Account.

**House Approves COBRA Coverage Expansion and Tax Credit for Employees Displaced Due to Adverse Trade Impact**

The House of Representatives recently approved legislation to expand COBRA coverage and a federal health care tax credit for employees whose jobs have been lost due to the effects of import competition or shifts in production to other countries.

In late October the House of Representatives approved the Trade and Globalization Assistance Act (H.R. 3920), which significantly expands the COBRA coverage period for individuals who are eligible for trade adjustment assistance (TAA) due to a job loss resulting from adverse trade-related conditions specified in the Trade Act of 2002. Currently, individuals whose jobs are lost due to a qualified trade-related reason may elect COBRA coverage for up to 18 months as long as the individual elects COBRA within six months of termination. Under the new legislation approved by the House, individuals who are eligible under the TAA program would be permitted to continue on COBRA coverage until the later of 18 months from their date of termination or until they no longer meet the definition of an Eligible TAA Recipient, generally no longer than 30 months.

The legislation also authorizes a much longer COBRA coverage period for individuals who have attained age 55 or have completed 10 years of service with the employer as of the date of termination. These individuals would be entitled to remain on COBRA until the earlier of becoming eligible for benefits under Medicare or under another group health plan (unless the employer's plan is terminated or the individual fails to pay premiums). There is no provision that terminates the extended COBRA coverage period at the point the individual ceases to be eligible for other TAA benefits, although this may have been a drafting error in the legislation. Therefore, as drafted, for an individual who is age 55 at the time of being qualified under the TAA program, the legislation would permit up to 10 years of COBRA coverage and even longer for a younger individual with 10 years of service. The provisions would be effective for plan years beginning on or after January 1, 2008.

The bill also extends the COBRA coverage period for individuals who are eligible for the TAA and are PBGC recipients. Eligible PBGC recipients who are also eligible under the TAA program would be permitted to retain COBRA coverage to the date of their death and their surviving spouse would be permitted to continue COBRA coverage for an additional 36 months after the recipient's date of death.

The House-approved bill also increases from 65 percent to 85 percent the health care tax credit for health insurance premiums paid by individuals who are eligible for trade adjustment assistance. Beginning January 1, 2008, the increased tax credit would be available for qualified individuals to receive retroactively to their date of separation from employment. The legislation also permits qualifying family members of a TAA recipient to continue to receive the tax credit for an additional 36 months after the TAA recipient becomes entitled to Medicare or in the event of the divorce or death of the TAA recipient. The tax credit provisions would be effective for taxable years beginning on or after January 1, 2008.

**House Subcommittee Hears Testimony on Retirement Coverage**

The House of Representatives Health, Employment, Labor and Pensions (HELP) Subcommittee of the Education and Labor Committee recently held a hearing on securing retirement coverage for future generations featuring several expert testimony proposing specific goals for improving retirement coverage and savings and the responsibilities of key stakeholders.

Testifying before the subcommittee were:

- Lynn Dudley, American Benefits Council (Council) vice president, retirement policy, targeted the 75 million working Americans who currently do not participate in tax-preferred retirement savings plans, and described what the Counsel perceives as five priority issues for lawmakers to consider, including: (1) raising financial literacy at the high school and college level, (2) having lawmakers focus on improvements to existing employer-sponsored systems and not turn attention only to new and additional forms of retirement savings vehicles, (3) end unproductive time spent debating whether defined benefit or defined contribution plans are preferable, as both types serve a valuable purpose; (4) health care costs and personal financial security are connected and health care costs will strongly influence retirement security; and )5) policymakers should not allow federal tax revenue projections to dictate retirement policy.

- Michael Calabrese, vice president of the New America Foundation, who described the organization's Universal 401(k) plan that would expand the Saver's Credit and then directly refund this amount into an "individual career account."

- J. Mark Iwry, nonresident senior fellow at the Brookings Institution, and David John, senior research fellow at the Heritage Foundation, who presented joint testimony in support of the "Automatic IRA" proposal introduced by representatives Richard Neal (D-MA) and Phil English (R-PA) in H.R. 2167, and by senators Jeff Bingaman (D-NM) and Gordon Smith (R-OR) in S. 1141. Iwry and John described the Automatic IRA as in initial savings step that would motivate currently non-participating workers through automatic payroll deduction and automatic enrollment to eventually join their employer-sponsored retirement savings plan. The Automatic IRA would also make use of a contribution limit that would intentionally be set lower than the 401(k) limit and no employer matching contributions would be permitted, to inspire savers to move into an employer-sponsored plan and to reduce the likelihood that employers might opt to drop their current plans in favor of the new proposal. Employers would be mandated to offer, at a minimum, access through payroll deduction to a worker's individual IRA and offered temporary tax incentives to introduce new employer-sponsored retirement savings plans.

- Pamela Perun, policy director for the Aspen Institute, who detailed her organization's "America's IRA," as similar to current individual retirement savings accounts, but which encourages workers earning less than $30,000 and who are not saving to start doing so through a government-provided "starter" contribution.

- Michael Stapley, president and CEO of Deseret Mutual, who summarized the ERISA Industry Committee's "New Benefit Platform for Life Security" proposal. Stapley testified that this plan would expand opportunities for employers and employees to participate in retirement savings programs facilitate competition and establish a more equitable and fair tax structure to support the revised benefits system.

- Norman Stein, professor at the University of Alabama School of Law, who represented the Pension Rights Center and reviewed the final report of the Conversation on Coverage. The Conversation on Coverage was a six-year project that brought many benefits policy stakeholders together to propose means by which small- and medium-sized employers could more readily adopt retirement savings plans with features similar to those of defined benefit plans; encourage more individuals to save more for retirement through a new portable Retirement Investment Account plan administered by a government-authorized clearinghouse; and design a low-cost, simplified multiple-employer plan to be sold to small employers by financial institutions.

Questions from the subcommittee focused on the differences among the retirement savings plan proposals in cost, contribution limits, impact of lost tax revenue to the federal government, and use of mandates versus voluntary adoption. Subcommittee Chairman Rob Andrews (D-NJ) noted that the panel agreed unanimously on the benefits of using automatic means of plan enrollment, payroll deduction, contribution acceleration, default investment allocation, asset reallocation, and disbursement of a guaranteed stream of payment through the details of each proposal. He and Ranking Member John Kline (R-MN) both remarked that, as they are gathering information in this series of hearings with the aim of introducing bipartisan legislation, they remain concerned about the possible costs of such programs for employers and in lost federal revenue.

Chairman Andrews closed the hearing by stating that he and Kline admired the previous long-term, bipartisan work of former representative Rob Portman (R-OH) and current Senator Ben Cardin (D-MD) and are working in a similar bipartisan vein toward legislation to further encourage retirement savings.

## RECENT REGULATORY ACTIVITY

### IRS Issues Guidance Includes Model Amendments for 403(b) Plans

In late November the Internal Revenue Service (IRS) issued Revenue Procedure 2007-71, providing follow-up guidance in connection with the final regulations on Code Section 403(b) annuities. While the guidance focuses on model amendments for 403(b) plans of public school systems, the language can be used by other 403(b) plans, where appropriate.

Specifically, the revenue procedure provides (1) additional transition guidance relating to the application of the final regulations to certain 403(b) contracts issued before the January 1, 2009, general effective date of the regulations, (2) model plan language that may be used to adopt a written plan reflecting the requirements of Section 403(b) and the final regulations, or to amend a Section 403(b) plan to reflect these requirements, and (3) rules for when plan amendments or a written plan are required to be adopted to comply with the final regulations.

Notes in the appendix identify the principal provisions which require modification for use by an eligible employer maintaining a Section 403(b) arrangement that is not a public school. If such an eligible employer uses the model language in the appendix, additional or revised provisions may be necessary or appropriate in order to comply with the 2007 regulations and ERISA.

The IRS requests comments on the model language and on any other model language that interested parties believe should be added to this revenue procedure. The due date for these comments is March 16, 2008.

### SEC Releases Proposed Rule on Mutual Fund Disclosure

In mid-November, the Securities & Exchange Commission (SEC) held an open meeting during which the agency's Division of Investment Management presented its proposal regarding the improvement of mutual fund disclosure and subsequently released its proposed rule on simplified mutual fund disclosure. The proposal provides guidelines for furnishing investors with a summary prospectus in lieu of a full prospectus and enhancing investors' access to more detailed information. Pages 138 to 140 of the document provide a hypothetical summary prospectus. Comments will be due 90 days from publication in the Federal Register.

Officials at the DOL have previously indicated that the agency will seriously consider the SEC's proposal in formulating its own rules for disclosure of fees and related information about plan investments to defined contribution plan participants.

**IRS Releases Covered Compensation Tables**
Also included in the IRS Revenue Ruling 2007-71, are covered compensation tables for 2008. These tables are for use in determining employer contributions to defined benefit plans and permitted disparity (the method for integration of Social Security benefits with private pension distributions). Plan sponsors may find this information useful as they review their plans and participant communications for next year.

**DOL Releases Final Regulations Revisions to Form 5500 Annual Return/Report**
The DOL recently released final regulations and revisions to the 2007 Form 5500 Annual Return/Report [Part One | Part Two]. This is the first of the three regulatory projects often mentioned by DOL officials in recent hearings on the topic of defined contribution plan fees.

This updated form reflects changes to the Form 5500 proposed by DOL in the proposed regulations (issued in July 2006) and the additional proposed revisions (issued in December 2006).

The final regulations will take effect 60 days after their publication in the Federal Register. Some of the form's revisions will apply on a transitional basis for the 2008 reporting year before all of the form's revisions are fully implemented for the 2009 reporting year. This will coincide with the switch from the ERISA Filing Acceptance System (EFAST) to the wholly electronic EFAST2.

**Treasury Issues Sample Automatic Enrollment Notice**
In conjunction with the proposed automatic enrollment regulations released by the U.S. Treasury Department and Internal Revenue Service (collectively Treasury) in early November and final regulations on qualified default investment alternatives (QDIA) released by the DOL in October, Treasury has issued a sample notice for employers to use to satisfy the various notification requirements. Under the Treasury regulations, the automatic enrollment notice and default investment notices can be provided in the same notice if all of the requirements including timing are met.

**PBGC Announces Lower Deficit**
On November 15, the Pension Benefit Guaranty Corporation (PBGC) reported in its Fiscal Year 2007 Annual Management Report that the agency's deficit for 2007 has fallen to $13.1 billion, an improvement over the $18.1 billion deficit in 2006. The agency previously reported deficits of $22.8 million deficit reported in 2005 and the $23.3 billion deficit reported in 2004. An accompanying PBGC press release attributed the improvement to "a robust economy, strong investment returns and higher valuation interest factors."

**Treasury, IRS Release Proposed Regulations on Automatic Enrollment**
In early November, the Treasury released proposed regulations designed to implement the automatic enrollment provisions (Section 902) in the Pension Protection Act of 2006 (PPA). Under automatic enrollment arrangements, an employee is treated as having elected to make salary reduction contributions at a stated level unless the employee affirmatively elects otherwise.

The PPA provision added new sections to the Code. Specifically, they are Sections 401(k)(13) and 401(m)(12) (which created a design-based automatic enrollment plan safe harbor) and 414(w) (which provides for withdrawals within 90 days of eligibility if certain requirements are met). The statutory provision is effective for plan years beginning on or after January 1, 2008 and plan sponsors can rely on the proposed regulations pending issuance of final regulations.

Key points covered by the regulations include:

*Timing*

- The plan provision implementing a safe harbor Qualified Automatic Contribution Arrangement (QACA) for an existing 401(k) plan is required to be adopted prior to the first day of the plan year and remain in effect for an entire 12-month plan year.

- Notices are generally required 30 to 90 days before the beginning of the plan year (deemed to be within a reasonable period of time before the plan year).

- In the case of an employee who does not receive the notice within the 30-90 day period described above because the employee becomes eligible after the 90th day before the beginning of the plan year, the notice generally must be provided no more than 90 days before the employee becomes eligible and no later than the date the employee becomes eligible.

- Language in the preamble may allow immediate notice (notice up to the first day of eligibility) for the first year the QACA is in place but language is not explicitly clear. (This will be discussed during the Council's Benefits Briefing.)

- For plans with immediate eligibility, new employees generally are required to receive notice on the first day of employment.

*Notices*

- Notice requirements for the QACA are essentially the same as notice requirements for non-safe harbor Eligible Automatic Contribution Arrangements (EACA).

- The automatic enrollment notice and default investment notices can be provided in the same notice if all of the requirements including timing are met.

*90-day Withdrawals*

- Employers are permitted but not required to allow the 90-day withdrawals (the time period in which participants automatically enrolled can elect to withdraw contributions without penalty).

- Withdrawals are adjusted for gains and losses and may be reduced by any generally applicable fees.

- Matching contributions must be forfeited and cannot be returned to the employer or distributed to the employee (must be treated in the same manner as other forfeitures).

- The employer may not condition the right to take the withdrawal on an election to have no future elective contributions (but the withdrawal election form can make cessation of contributions the default unless the employee makes an affirmative election).

- The 90-day window for making the withdrawal election begins on the date the compensation would otherwise have been included in gross income.

- The effective date of the election must be no later than the last day of the payroll period that begins after the date of the election.

- 90-day withdrawals are reported on 1099-R but not subject to premature distribution penalty and not eligible for rollover.

*Uniform Application in QACA*

- Generally, the qualified percentage used for the QACA must be uniform for all employees.

- Exceptions include (1) variations based on the number of years an eligible employee has participated in the QACA, (2) higher election percentages in effect on the effective date of the QACA, or (3) amounts reduced so as not to exceed statutory limits on compensation, deferrals or overall contributions.

- Suspensions for hardship distributions are another exception.

- The default election does not apply to employees who have made an affirmative election that remains in effect – the preamble indicates that this would generally require that the employee have completed an election form and chosen an amount or percentage (including zero) of the employee's compensation to be deferred.

*Miscellaneous*

- The regulations confirm that the initial period for a participant in a QACA (with a minimum of 3 percent automatic deferrals) could be as long as two full plan years (it begins when the employee first participates and ends on the last day of the following plan year).

- The requirement that automatic contributions must be invested in accordance with the Department of Labor's default investment guidance does not apply if the plan is not subject to Title I of ERISA.

- The regulations include modifications of rules related to corrective distributions made in the PPA.

**IRS Issues Updated Mortality Tables for Calculating Lump Sum Distributions, News Flash on 204(h) Notices**

The IRS recently issued Revenue Ruling 2007-67, providing guidance on applicable interest and mortality assumptions under Section 417(e) of the Code, as amended by the PPA. These mortality tables are to be used for calculating lump sum distributions as well as determining the present value of plan benefits for purposes of minimum survivor annuity distributions. The guidance is effective for plan years that begin on or after January 1, 2008.

In addition to providing the updated mortality tables, the guidance attempts to address specific issues with regard to tax code Section 417(e):

- Whether the timing rules for the determination of the applicable interest rate continue to apply for distributions with annuity starting dates occurring during plan years beginning on or after January 1, 2008;

- Which mortality table is applicable for distributions with annuity starting dates occurring during plan years beginning on or after January 1, 2008; and

- Whether an amendment that implements the new interest rates and mortality table under tax code Section 417(e)(3) violates the requirements of code Section 411(d)(6) (the anti-cutback rules).

The IRS also released an Employee Plans News Flash announcing that the agency will soon issue proposed regulations under tax code Section 4980F (Section 204(h) of ERISA) addressing advance notice requirements for amendments required under the PPA. Advance notice to participants of 45 days (or 15 days in the case of a multiemployer plan) – often referred to as a "section 204(h) notice" – is generally required when a plan is amended to significantly reduce the rate of future benefit accrual.

In addition to other guidance, the proposed regulations will provide that:

- The notice required under Section 101(j) of ERISA (regarding blackout periods) for amendments restricting benefits in accordance with tax code Section 436 will satisfy both the timing and content requirements for a section 204(h) notice; and

- A reduced single-sum benefit resulting from an amendment to a traditional defined benefit plan to substitute the PPA-prescribed actuarial assumptions under tax code Section 417(e)(3) for the pre-PPA actuarial assumptions under tax code section 417(e)(3) does not require a section 204(h) notice.

**Agreement Reached Between New York Attorney General and CIGNA on Physician Quality and Cost Rankings**

In late October, New York State Attorney General Andrew Cuomo announced an agreement with CIGNA HealthCare on standards for programs reporting health plan physician quality and cost-effectiveness information. Employers and consumers have identified access to performance measurement as a vital tool for making informed health care decisions and for improving health care quality. The design and use of physician performance ranking systems came under scrutiny in July when the New York attorney general's office initiated an inquiry expressing concerns that health plan rating systems contain flawed methodology or designs that could detrimentally impact consumers. CIGNA and several other health plans received letters from Cuomo asking the plans to refrain from introducing the programs pending its investigation.

The agreement between the Cuomo and CIGNA will allow quality and cost measurement of physician performance measurement to proceed in New York under a framework that relies on nationally recognized measurement standards and enhances transparency. The agreement also has the potential to become a national model for standards for the validity and transparency of health plan reporting of physician cost and quality information. In crafting the agreement, the attorney general's office worked closely with the Consumer-Purchaser Disclosure Project, a collaboration of consumer, labor and employer organizations dedicated to ensuring access to sound, reliable, publicly reported health performance information about physicians, hospitals and medical treatments.

The agreement incorporates core principles of accuracy, transparency of information and oversight of process and fairness by requiring:

- Transparency of ranking systems, including the degree to which any ranking is based on cost;
- Use of established national standards to measure quality, including measures endorsed by the National Quality Forum (NQF) and other generally accepted national standards;
- Employment of measures to foster more accurate physician comparisons, including risk adjustment and valid sampling;
- Disclosure to consumers of how the program is designed and how doctors are ranked, and provide a process for consumers to register complaints;
- Disclosure to physicians of how rankings are designed, and provide a process to appeal incorrect ratings; and
- An oversight monitor known as a Ratings Examiner who will oversee compliance with all aspects of the agreement and will report to the Attorney General every six months. This Ratings Examiner must be a "national standard setting organization" and will be national in scope, independent, and an Internal Revenue Code Section 501(c)(3) organization.

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