BENEFITS INSIDER
A Member Exclusive Publication

Volume 43, November 2008

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 Christopher M. Smith, Employee Benefits attorney and Principal of Flexible Benefits Systems, Inc., csmith@fbsi.com. Please note that because of the transition to a new editor, this edition covers select legislative, regulatory and judicial activity from July through October 2008.**

Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

President Bush Signs "Michelle's Law" Legislation

On October 9, President Bush signed Michelle's Law (H.R. 2851), legislation to amend ERISA's continuation-of-coverage provisions to allow ill or injured college students to maintain their health coverage during extended leaves of absence.

H.R. 2851 had been approved by the Senate by unanimous consent on September 25. The House approved the measure by voice vote by voice vote on July 30. The measure requires:

- that a plan covering college students provide up to 12 months covered medical leave to any student who takes a medical leave of absence;
- apply to students who are covered under their parent's health insurance plan; and
- define "medical leave" for purposes of the law as an absence from school or reduction in course load to part-time as a result of a serious health condition.

House Approves Economic Rescue Bill; President Signs

The U.S. House of Representatives approved economic rescue legislation by a vote of 263-171 on October 3. The Senate approved the measure by a 74-25 vote on October 1. President Bush signed the bill shortly thereafter.

The legislation is composed of three "divisions."

- The Emergency Economic Stabilization Act (Division A) provides up to $700 billion to the Secretary of the Treasury to buy mortgages and other troubled assets held by financial institutions (including pension plans) and establishes a federal program that would allow companies to insure their troubled assets. The legislation also limits "excessive" deferred and non-deferred compensation for CEOs and certain executives for companies participating in the program. The congressional Joint Tax Committee prepared a summary of the tax provisions of Division A .
- The Energy Improvement and Extension Act (Division B) establishes, expands or enhances certain tax credits, particularly for renewable energy initiatives.
- The Tax Extenders and Alternative Minimum Tax Relief (Division C) includes a wide number of provisions that extend expiring elements of the tax code (including relief from the Alternative Minimum Tax (AMT)), the mental health parity compromise legislation (see story below), an extension and modification of the AMT credit for incentive stock options (ISO), a modification of the tax treatment of offshore nonqualified deferred compensation and relief for certain disaster areas.

Congress Passes Mental Health Parity Legislation as Part of Economic Package

As part of the economic rescue package (see above story), Congress passed compromise legislation addressing mental health parity. This language is identical to the parity language contained in the Senate-passed H.R. 6049.

Key elements of the agreement are as follows:

- *Definition of mental health benefits subject to parity requirement:* mental health and substance abuse disorder benefits are defined under the terms of the plan and in accordance with applicable federal and state law. State law may continue to define what

benefits a fully insured plan may be required to cover, but not a self-insured plan. The requirement to use the DSM-IV (the compendium of mental health conditions) to determine what benefits must be covered is not included in the measure.

- *Protection of plan medical management practices:* there is no provision that prohibits plan medical management practices or mandates parity in medical management. The agreement includes a rule of construction that it does not affect "terms and conditions" of plans to the extent that they do not conflict with the parity requirements. This language should protect medical necessity provisions. The agreement requires plans to make available their criteria for medical necessity determinations and the reason for any denial of any reimbursement or payment for services for mental health or substance abuse benefits.

- *Out-of-network coverage:* a plan must provide out-of-network coverage for mental health and substance abuse disorders in a manner consistent with the parity requirement if out-of-network coverage is provided for medical and surgical benefits. Other applicable plan terms and conditions, such as those related to medical management, would continue to apply.

- *Relationship to state laws and remedies*: The agreement applies the current law "HIPAA standard" which establishes the federal requirements as a floor and permits states to enact more extensive requirements for insured plans, provided that such laws do not conflict with federal law. The agreement also applies the current law ERISA remedy framework to new mental health parity requirements.

House Panel Holds Hearing on Vesting of Retiree Health Benefits

The U.S. House of Representatives Education and Labor Committee held a September 25 hearing on the Emergency Retiree Health Benefits Protection Act (H.R. 1322), legislation sponsored by committee member John Tierney (D-MA). H.R. 1322 would require employers to maintain retiree health coverage, without regard to statements in plan documents that the benefits may be changed or terminated in the future.

The committee heard testimony from retiree advocates, who urged that Congress require employers to maintain, and in some cases retroactively restore, retiree health benefits, even if plan documents state that benefits could change in the future.

Providing the viewpoint of benefit plan sponsors, Scott Macey, senior vice president and director of government affairs for Aon Consulting, Inc., and Dale Yamamoto, president and founder of Red Quill Consulting (and former actuary for Hewitt Associates), testified on the factors that have caused many employers to restructure their retiree health benefits programs. Macey also explained that in instances where retiree benefits are terminated, the change often applies only to future retirees, other than in cases of companies experiencing serious financial distress which are unable to continue benefits for current retirees.

Congress will not consider H.R. 1322 this year. However, action on this issue is possible in 2009, separately or as part of comprehensive health reform legislation.

House Approves Breast Cancer Coverage Legislation

On September 25, the U.S. House of Representatives passed The Breast Cancer Patient Protection Act (H.R. 758), which a minimum coverage mandate for breast cancer patients (including a minimum of 48 hours of coverage for hospital stays for mastectomies and 24 hours

for lymph node procedures whenever a physician determines that a hospital stay is medically required).

RECENT REGULATORY ACTIVITY

DOL Releases Proposed Regulations on Participant-Level Retirement Plan Fee Disclosure

The U.S. Department of Labor has issued long-awaited proposed regulations addressing fiduciary requirements for fee disclosure to participants in participant-directed individual account plans such as 401(k) plans. This is the last of three defined contribution plan fee disclosure projects undertaken by DOL. (The first was the final regulations and revisions to the Form 5500 Annual Return/Report (disclosure or reporting to the government), and the second was proposed regulations and a proposed class exemption under ERISA Section 408(b)(2), which allows plans to contract for necessary services if the compensation paid for the services is reasonable (disclosure from the plan's service providers to plan fiduciaries.)

An official DOL fact sheet on the proposed participant disclosure regulation is also available. According to a DOL news release, the centerpiece of the proposed regulations is a requirement to provide investment-related information in a comparative chart or similar format (DOL has provided a model comparative chart for complying with this requirement, though plan fiduciaries have the flexibility to design their own charts or comparative formats). This chart would include specific performance data compared to benchmark performance data in addition to expense and fee information (operating expenses in the form of an expense ratio). The chart and other general and investment-related information about the plan and its investment options, such as what options are available under the plan, how to give investment instructions, and how to obtain more detailed information (including reference to Internet Web site addresses) must be provided on or before the date a participant becomes eligible for the plan and annually thereafter.

In addition, quarterly statements must be provided showing actual dollar amounts of transaction-related individual expenses and general administrative expenses (not including investment-related expenses) charged to plan participants (including a general description of the services to which the charge relates). Other information must be available upon request. The proposal allows use of other materials currently available (such as prospectuses and SPDs) to meet some of the requirements, and asks for comments in a number of areas regarding investments that may not be able to easily comply with the proposed regulations (for instance, investments that do not have readily available supplemental information or benchmarks).

DOL will attempt to finalize the regulations on an accelerated timetable before the end of the year (and effective for plan years beginning on or after January 1, 2009).

Treasury Outlines Executive Compensation Restrictions in Economic Rescue Package

The U.S. Treasury Department on October 14 provided additional details on the Emergency Economic Stabilization Act (EESA). Most notably for employer plan sponsors, the administration unveiled the executive compensation restrictions for companies participating in the federal relief program.

Section 302 of EESA added new tax code requirements under Section 162(m) (which generally limits the deductibility of compensation paid to certain corporate executives) and Section 280G (which provides that a corporate executive's excess parachute payments are not deductible and

imposes an excise tax on the executive for those amounts). EESA's provisions provide additional limitations on the deductibility of compensation paid to certain executives by employers who participate in the Troubled Asset Auction Program, the Capital Purchase Program or the Programs for Systemically Significant Failing Institutions:

- The new section 162(m)(5) generally reduces the $1 million deduction limitation to $500,000 for certain taxable years and provides that certain exceptions to the deduction limitation, including the exception for performance-based compensation, are not applicable.
- The new section 280G(e) generally expands the definition of a "parachute payment" to include certain payments made contingent on severance from employment from a company that participates in an EESA program.

Notice 2008-94, issued by the Internal Revenue Service (IRS), sets forth the rules corresponding to these new sections and provides guidance in the form of questions and answers. The notice is effective from October 3, 2008. Additional guidance regarding sections 162(m)(5) and 280G(e) is expected.

All EESA announcements are posted on the dedicated Treasury Department Web site at http://www.treasury.gov/initiatives/eesa/.

Regulatory Agencies Announce Cost-of-Living Adjustments for 2009 Tax Year

The Internal Revenue Service (IRS) recently announced the inflation adjustments applicable to dollar limitations for Tax Year 2009. Section 415 of the Internal Revenue Code provides for dollar limitations on benefits and contributions under qualified retirement plans. In most cases, hikes in the cost-of-living index have triggered increased limits. Key adjustments are listed in the table below:

	2008	**2009**
Maximum annual pension benefit [415(b)] (The limit applied is actually the lesser of the dollar limit or 100 percent of the participant's average compensation (generally the high three consecutive years of service))	$185,000	$195,000
Defined contribution maximum deferral [415(c)]	46,000	49,000
Maximum elective deferral [401(k) and 403(b)]	15,500	16,500
Maximum catch-up contribution for those age 50 and over [414(v)]	5,000	5,500
Qualified plan compensation limit [401(a)(17)]	230,000	245,000
Highly compensated threshold [414(q)]	105,000	110,000

In related regulatory news, the Social Security Administration has announced that Monthly Social Security and Supplemental Security Income benefits will also increase by the largest annual amount since 1982. The increase for 2009 will be 5.8 percent. Additionally, the maximum amount of earnings subject to the Social Security tax (taxable maximum) will increase to $106,800 from $102,000. The SSA released a fact sheet on the announced adjustments.

Agencies Release Final Regulations for Insurance Coverage under Newborns' and Mothers' Health Protection Act

The U.S. Treasury Department and Internal Revenue Service, the U.S. Department of Labor's Employee Benefits Security Administration and the U.S. Department of Health and Human Services' Centers for Medicare & Medicaid Services recently released final regulations pursuant to the Newborns' and Mothers' Health Protection Act of 1996 and the Taxpayer Relief Act of 1997. The regulations provide guidance for group health plans and health insurance issuers concerning hospital lengths of stay for mothers and newborns following childbirth.

The Newborns' Act was enacted to provide protections for mothers and their newborn children with regard to hospital lengths of stay following childbirth. Interim final rules implementing the group and individual market provisions of the Newborns' Act were published in the Federal Register on October 27, 1998. In general, these final regulations do not change the interim final rules. However, the text of these final regulations incorporates a clarifying statement from the preamble of the interim final rules that the definition of attending provider does not include a plan, hospital, managed care organization, or other issuer. The text also makes a small clarification with respect to state law applicability. In addition, these final regulations make minor clarifications to the notice requirements for nonfederal governmental plans. The final regulations are effective December 19, 2008.

DOL Releases Proposed Investment Advice Regulations

The U.S. Department of Labor (DOL) Employee Benefits Security Administration (EBSA) released the following proposals interpreting a new prohibited transaction exemption for providing investment advice to plan participants: (1) proposed regulations, (2) a proposed class exemption, and (3) a report to Congress regarding availability of computer investment advice programs for IRAs. The regulations and class exemption provide general guidance on the new prohibited transaction exemption (added in the Pension Protection Act of 2006) that is intended to allow greater flexibility for participants in 401(k) plans and IRAs to obtain investment advice. They are proposed to be effective 90 days after publication of the final versions.

Bob Doyle, director of regulations & interpretations for EBSA, discussed that the "SunAmerica" approach will continue to work (referring to a pre-Pension Protection Act (PPA) DOL opinion letter that permits advice if certain requirements are met). If, however, the proposed class exemption is used in conjunction with the "SunAmerica" approach some PPA conditions also will be applicable.

The proposed regulations, like Field Assistance Bulletin 2007-1, allows investment advice to be given under the exemption through the use of a computer model certified as unbiased or through an adviser compensated on a "level-fee" basis. The proposed regulations allow some flexibility in the determination of the credentials of the expert needed to certify the computer model (the regulations provide a framework) and the "level-fee" requirement continues to apply at the entity level (the fees to the company – but not its affiliates -- employing the individual providing the advice cannot vary based on the investment selections made by the participant receiving the advice).

The proposed class exemption allows individualized one-on-one advice under certain circumstances. Under certain conditions, the exemption permits individualized non-computer modeled advice following the provision of investment advice generated by a computer model. Alternatively, such individualized investment advice may be provided with respect to which fees or other compensation received by the adviser (at the individual employee level) does not vary on the basis of the investment option selected by the participant. One-on-one investment advice delivered after the computer model advice is given must generally be accompanied by an explanation of the basis for the advice. Records of such explanations must be retained. Both

aspects of the class exemption would apply to IRAs. However, if an IRA's investment options do not lend themselves to a computer model, the adviser must provide general asset allocation models in lieu of computer-generated advice. Any subsequent individualized advice generally must also be accompanied by an explanation of the basis for the advice.

Other requirements apply to both the regulatory exemption and the proposed class exemption such as (1) authorization by a plan fiduciary (other than the plan fiduciary providing the advice), (2) audits, (3) disclosure (a model form is provided but not mandatory), and (4) maintenance of records.

Treasury, DOL, HHSA Request Information on Genetic Information Nondiscrimination Law

The U.S. Departments of Treasury, Labor and Health and Human Services (HHS) issued a formal request for information regarding sections 101 through 104 of the Genetic Information Nondiscrimination Act of 2008 (GINA). GINA passed both houses of Congress and was signed into law in the spring. The administration is required to issue final regulations not later than 12 months after enactment and regulators have already received inquiries from the public on a number of issues. The agencies are soliciting public comments in advance of future regulations implementing GINA.

GINA prohibits employer-sponsored group health plans and health insurers providing group and individual health insurance from restricting enrollment or adjusting premiums based on genetic information or requiring or requesting genetic testing. Civil penalties are added to ERISA and the Public Health Service Act for violations of the new rules, in addition to remedies available under previous law. GINA also prohibits employers from using genetic information to discriminate against an individual in hiring or other employment opportunities, subject to civil rights remedies under the Civil Rights Act, including compensatory and punitive damages. The GINA provisions are effective with respect to group health plans for plan years beginning after May 21, 2009. Public comments on the request for information are due by December 9.

IRS Proposes Guidance on Failure to Defer Receipt of Qualified Retirement Plan Distribution

The Internal Revenue Service (IRS) issued a notice of proposed rulemaking and announced a public hearing concerning certain timing and content requirements for distribution notices under the tax code. The Pension Protection Act (PPA) provided that the required notice to participants notifying them of their right to defer a benefit (benefits exceeding $5,000 can be deferred until normal retirement age) must also describe the consequences of failing to defer receipt of the distribution. The PPA also extended the distribution notice period (for both defined contribution and defined benefit plans) as well as the applicable election period for waiving the qualified joint and survivor annuity (QJSA) form of benefit from 90 days to 180 days before the annuity starting date (or distribution date). The proposed regulations provide guidance on meeting the new PPA requirements.

Plans can rely on the proposed regulations, or the interim guidance previously provided in Q&A 32 and 33 of IRS Notice 2007-7, until the effective date of the final regulations. For purposes of the expanded applicable election period and period for notices, plans can rely on the proposed regulations retroactively back to the first plan year beginning on or after January 1, 2007, and ending on the effective date of the final regulations. The final regulations are expected to be effective for notices provided (and election periods beginning) on or after the first day of the first plan year beginning on or after January 1, 2010. However, in no event will regulations become effective prior to the first day of the first plan year beginning 90 days after publication of the final regulations.

The proposed regulations provide guidance on specific information needed to inform a participant of the consequences of failing to defer receipt of the benefit. The information includes:

- A description of specified federal tax implications of failing to defer.
- Any provisions of the plan (or any accident or health plan maintained by the employer) which could reasonably be expected to materially affect a participant's decision whether to defer (such as retiree health benefits only available to participants who have an undistributed benefit under the retirement plan).
- For defined benefit plans, a statement of the amount payable under the normal form of benefit both upon immediate commencement and when the benefit is no longer immediately distributable (that is, the later of age 62 or attainment of normal retirement age).
    - If regulations under Code Section 417 allow a plan to provide a QJSA explanation which does not vary based on the participant's marital status, of the relative value of the optional forms of benefit compared to the value of the QJSA, the proposed regulations permit the statement of the amount payable to not be based on the participant's marital status.
- For defined contribution plans, a statement that some currently available investment options in the plan may not be generally available on similar terms outside the plan, and contact information for obtaining additional information.
- For defined contribution plans, a statement that fees and expenses (including administrative or investment-related fees) outside the plan may be different from fees and expenses that apply to the participant's account, and contact information for obtaining information on fees.

The proposed regulations would permit a cross-reference to required information so long as the notice includes a statement of how the referenced information may be obtained without charge and explains why the referenced information is relevant to a decision whether to defer. In order to expand the applicable election period and period for notices, the proposed regulations also substitute "180 days" for "90 days" in the relevant regulatory sections.

IRS will host the public hearing on February 20, 2009. Written or electronic comments and requests to speak at the public hearing must be received by January 7, 2009.

DOL/EBSA Finalizes Regulations for Fiduciaries Selecting Annuity Providers

The Department of Labor (DOL) Employee Benefits Security Administration (EBSA) published final regulations that establish a safe harbor for plan fiduciaries selecting annuity providers for benefit distributions from defined contribution plans. In connection with release of the final regulations, EBSA also amended Interpretive Bulletin 95-1 to provide that the guidance in that bulletin only applies to the selection of annuity contracts for distributions from defined benefit plans.

The regulations finalize rules proposed in September 2007 with some modifications. Some of the key modifications include:

- Elimination of a detailed list of factors that a plan fiduciary should consider in evaluating an annuity, including (among other things) review of the issuer's level of capital, surplus and reserves available to make payments under the contract as well as state

guarantees, and ratings by insurance rating services. The final rules direct the plan fiduciary to generally consider "information sufficient to assess the ability of the annuity provider to make all future payments under the contract." The preamble suggests that fiduciaries may want to consider ratings (particularly if the ratings raise questions regarding the provider's ability to make future payments under the annuity contract) even though they are not part of the final safe harbor.

- The final regulations make clear that engaging a qualified independent expert to conduct an analysis of the provider and contract will not be required in all cases. Rather, it simply states that a fiduciary should, if necessary, consult with an appropriate expert.

- The final regulations provide that the fiduciary review of the annuity provider and contract may be conducted either (i) at the time the provider and contract are selected as a distribution option (subject to monitoring thereafter), or (ii) at the time the provider and contract are selected for distribution to a specific participant. The proposed regulations appeared to require a fiduciary review at the time an annuity option was made available to participants and beneficiaries in the plan.

- EBSA also clarified that the regulations provide a safe harbor (not a minimum standard of conduct) and that there are other means for satisfying ERISA's fiduciary responsibilities with respect to the selection of an annuity provider.

DOL/EBSA Issues Guidance on Orphan Plans, Cross-Trading

The Department of Labor (DOL) Employee Benefits Security Administration (EBSA) released final regulations amending the ERISA regulations that provide a fiduciary safe harbor for the distribution of benefits on behalf of participants or beneficiaries in terminated or abandoned plans.

The final regulations (like the original proposed amendment) require that, as a condition of relief under the fiduciary safe harbor for distributions from terminated defined contribution plans, the distribution of a deceased plan participant be directly transferred to an individual retirement account on behalf of a missing designated nonspouse beneficiary (rather than a non-retirement account). The change in the regulations reflects changes enacted as part of the Pension Protection Act of 2006 (PPA) under which a distribution of a deceased plan participant's benefit may be directly transferred to an individual retirement plan established on behalf of the designated nonspouse beneficiary. A similar change was made in an amendment to Prohibited Transaction Exemption 2006-06, allowing a "qualified termination administrator" to select itself to provide services to the plan in connection with the plan's termination (for abandoned or orphaned individual account plans) if certain requirements are met.

EBSA also released final regulations implementing the content requirements for the written cross-trading policies and procedures required under ERISA. The final regulations, which are very similar to the interim final rule (issued in February 2007) addressing the new statutory exemption on cross-trading under PPA, provide guidance on the written cross-trading policies and procedures required under the provision of PPA that allows the purchase and sale of a security between a plan and any other account managed by the same investment manager if certain conditions are satisfied. Both amendments are effective 30 days after publication in the Federal Register.

Treasury Opens Money Market Funds Guarantee Program

The U.S. Treasury Department officially opened its temporary program on September 29 in which the government will guarantee the share price of any publicly offered eligible money market mutual fund – both retail and institutional – that applies for and pays a fee to participate

in the program. All money market mutual funds that are regulated under Rule 2a-7 of the Investment Company Act of 1940, maintain a stable share price of $1, and are publicly offered and registered with the Securities and Exchange Commission will be eligible to participate in the program; this includes both taxable and tax-exempt money market funds.

Funds should have applied for the program by October 8, 2008. Treasury has also provided guidance on the program in the form of Frequently Asked Questions.

IRS Issues Guidance on HEART Act FSA Provisions

The Internal Revenue Service (IRS) issued Notice 2008-82 on September 29, providing particular guidance under the Heroes Earnings Assistance and Relief Tax (HEART) Act (H.R. 6081), a military tax relief bill signed into law earlier this year. The HEART Act provides tax and savings assistance for military veterans and their families and includes a number of other provisions affecting employer-sponsored benefit plans.

Specifically, Notice 2008-82 allows "qualified reservist distributions" (QRD) of unused amounts in a health flexible spending account (FSA) to reservists called to active duty. Such a program would be voluntary for employers and may be implemented at any time. In addition:

- Health FSAs must be amended if an employer wants to allow QRDs; a transition rule allows plans to be amended by December 31, 2009 effective retroactively to provide for QRDs prior to January 1, 2010 (but on or after June 18, 2008); Amendments allowing QRDs prospectively can be done at any time;
- QRDs are included in the income and wages for the reservist;
- Employees may request a QRD when they receive an order or call to active duty, and before the last day of the plan year (and grace period, if applicable); and
- Employers may allow employees to continue to participate in the health FSA after the QRD if amounts remain in the health FSA.

Federal Agencies Provide Hurricane Relief

Several federal agencies have provided relief to businesses whose operations were interrupted by hurricanes in the gulf coast:

- The Pension Benefit Guaranty Corporation (PBGC) issued Disaster Relief Announcement 08-27, providing relief for PBGC filing deadlines for parties affected by Hurricane Ike. The relief generally extends from September 7, 2008 through January 5, 2009.
- The U.S. Department of Labor (DOL) announced an extension of the deadline for filing Form 5500 and Form 5500 EZ annual report/returns due to damage from Hurricane Ike in Texas and Louisiana.
- The Internal Revenue Service (IRS) announced that the agency would provide tax relief to victims of Hurricane Gustav in affected areas of Louisiana. This includes the postponement of tax filing and payment deadlines until Jan. 5, 2009. On September 18, the IRS extended similar relief to Texas taxpayers who were adversely affected by Hurricane Ike.

IRS Commissioner Suspends Collection of ISO/AMT Liability

Internal Revenue Service Commissioner Douglas Shulman announced that the agency will not undertake collection enforcement action on incentive stock option/alternative minimum tax liability through the end of the fiscal year.

This provision, embodied by the AMT Credit Fairness and Relief Act (H.R.3861/S. 2389) but also contained in the Jobs, Energy, Families, and Disaster Relief Act (S. 3335, the "extenders" bill) would resolve the unintended application of the AMT tax as applied to ISOs.

The suspension gives Congress time to enact such a provision, as Grassley and his fellow legislators indicated would be likely before the end of the year.

IRS Guidance Clarifies Definition of Dependent for Divorced or Separated Parents

The Internal Revenue Service (IRS) issued Revenue Procedure 2008-48, clarifying that IRS will treat a qualifying child of divorced or separated parents as the dependent of both parents for purposes of health and welfare arrangements under the Internal Revenue Code, whether or not the custodial parent releases the claim to the exemption under section 152(e). Specifically, these tax code sections relate to the tax-favored treatment of certain employer-provided medical expense reimbursements, employer-provided coverage under an accident or health plan, certain fringe benefits that qualify as no-additional-cost services or qualified employee discounts, deductions for medical expenses and distributions from Archer Medical Savings Accounts (MSAs) and Health Savings Accounts (HSAs).

The guidance explains that under a prior Section 152(e), children of divorced or separated parents were treated as dependents of both parents under certain sections of the tax code, whether or not a parent released a claim to the exemption. Section 152(e) was amended, however, by the Working Families Tax Relief Act of 2004 and the Gulf Opportunity Zone Act of 2005, to provide that a child may be treated as the dependent of a noncustodial parent only if the custodial parent releases the claim to the exemption (section 152(e)(2)). In the preamble to implementing regulations for Section 152(e) issued July 8, 2008 (73 Fed. Reg. 37797) the IRS explained that, it if a custodial parent does not release the claim to an exemption, only the taxpayer who is entitled to claim the child as a dependent that is a "qualifying child" or "qualifying relative" under section 152(c) or (d) may treat the child as a dependent for purposes of the relevant sections of the tax code. Revenue Procedure 2008-48 provides a limited exception to that conclusion.

IRS Revises Voluntary Correction Program for Employee Retirement Plans

The Internal Revenue Service (IRS) released Revenue Procedure 2008-50, which revises procedures for the Employee Plans Compliance Resolution System (EPCRS) and modifies and supersedes IRS Revenue Procedure 2006-27, issued in May 2006. EPCRS allows retirement plans that have failed to meet one or more qualification requirements to be corrected under one of three programs: the Self-Correction Program (SCP), the Voluntary Correction Program (VCP), and the Correction on Audit Program (Audit CAP).

The structure of the EPCRS remains relatively the same but according to the IRS media release, the revision "incorporated comments from the retirement plans community by adding flexibility and increasing correction methods." Some of the new changes will:

- Expand the availability of SCP in situations where operational mistakes have been partially corrected when the plan comes under examination.
- Add new examples relating to the exclusion of employees from 401(k) plans available for standardized corrections and expands the correction method with respect to elective

deferrals to include catch-up contributions under Section 414(v) and plans that provide the opportunity for an employee to designate all or a portion of elective deferrals as designated Roth contributions.

- Expand the definition of plan loan failure to include Internal Revenue Code violations even if not referenced in the plan documents, clarifying reporting requirements with regard to deemed distributions and permitting reductions in the fees under VCP for correcting loan failures.

- Streamline application procedures under VCP for numerous issues, including failure to amend plans for law changes, loan problems, failure to make minimum distributions to participants, excess elective deferrals made by participants to 401(k) plans and plans established by ineligible employers. In addition, streamlined application procedures have been developed for SEPs, SARSEPs and SIMPLE IRAs.

This revenue procedure is generally effective January 1, 2009. However, plan sponsors are permitted, at their option, to apply the provisions of this revenue procedure on or after September 2, 2008.

CMS Will Use Web Site to Issue Implementation Guidance for Mandatory Medicare Secondary Payor Reporting Requirements

The U.S. Department of Health and Human Services' Centers for Medicare and Medicaid Services (CMS) has begun posting documents and links on its new Web site, http://www.cms.hhs.gov/MandatoryInsRep/, providing implementation guidance for new Medicare Secondary Payor (MSP) reporting requirements enacted in late 2007.

Section 111 of the Medicare, Medicaid, and SCHIP Extension Act of 2007 requires insurers and third-party administrators for group health plans to collect and report information from plan sponsors and participants to identify whether the group health plan is or should be the primary payor to Medicare. Under MSP rules, employer group health plans, as well as automobile, no-fault and liability insurance are primary payors and Medicare is the secondary payor.

The mandatory MSP requirements are effective January 1, 2009, and apply to "an entity serving as an insurer or third party administrator for a group health plan … and, in the case of a group health plan that is self-insured and self-administered, a plan administrator or fiduciary." The new requirements also apply to liability insurance, no-fault and Workers' Compensation insurance.

Data elements and the form, manner and frequency of reporting will be determined by the Secretary of Health and Human Services. According to the CMS website, group health plan reporting will likely be no more than quarterly and submissions will be in an electronic format. The mandatory reporting process will build upon CMS' Voluntary Data Sharing Program (VDSP), an existing voluntary process for insurer reporting.

All instructions for implementation will appear at the CMS Web site, through a link at the site, or as a document which may be downloaded from the site or an associated link. The materials will include both draft and final documents, including information on how interested parties may comment on the documents and/or CMS' implementation of Section 111.

DOL Issues Revised ERISA Enforcement Manual

The U.S. Department of Labor (DOL) Employee Benefits Security Administration issued a revised ERISA Enforcement Manual, which articulates new standards as to whether a plan fiduciary's acceptance from plan service providers of "consideration" such as gifts and payment

of expenses associated with conferences, are fiduciary violations. The manual sets forth the following investigator guidelines for enforcement purposes:

Receipt by a fiduciary (or his or her relatives) from any one individual or entity of gifts, gratuities, meals, entertainment, reimbursement of expenses associated with educational conferences, or other consideration (other than cash or cash equivalents) should be treated as "insubstantial" so long as the aggregate annual value is less than $250 and their receipt does not violate any plan policy or provision. The reimbursement to a plan of expenses associated with a plan representative's attendance at an educational conference should not be treated as a violation of ERISA section 406(b)(3) if a plan fiduciary reasonably determined, in advance and without regard to whether such expenses will be reimbursed, that (i) the plan's payment of such expenses was prudent, (ii) the expenses were consistent with a written plan policy or provision designed to prevent abuse, (iii) the conference had a reasonable relationship to the duties of the attendee, and (iv) the expenses were reasonable in light of the benefits afforded to the plan and unlikely to compromise the attendee's ability to carry out his or her duties faithfully in accordance with ERISA.

See the Fiduciary Investigations section of the manual for the articulation of the new standards. DOL enforcement and policy staff have been reviewing these issues in recent years and the updated manual is the result of these discussions.

IRS Proposes Regulations on ESPP Options

The Internal Revenue Service (IRS) released proposed regulations regarding options granted under an employee stock purchase plan (ESPP). The regulations would provide guidance regarding compliance with the Internal Revenue Code and clarify certain rules regarding options granted under an employee stock purchase plan.

The proposed regulations would incorporate statutory changes and would be consistent with the regulations governing incentive stock options.

The regulations under Code Section 423 would apply as of January 1, 2010 and would apply to any option issued under an ESPP that is granted on or after that date. Taxpayers may rely on the proposed regulations for the treatment of any option issued under an ESPP that is granted after July 29, 2008.

IRS Issues Guidance on Part-Year Compensation

The Internal Revenue Service (IRS) has released Notice 2008-62, guidance that addresses when an arrangement – in which an employee (such as a teacher) or independent contractor receives recurring part-year compensation over an extended period (such as a 12-month payment schedule) – constitutes deferred compensation for purposes of section 457(f) of the Internal Revenue Code.

Under the guidance, such an arrangement does not constitute deferred compensation as long as:

- the arrangement does not defer payment of any of the recurring part-year compensation beyond the last day of the 13th month following the beginning of the service period, and
- the arrangement does not defer from one taxable year to the next taxable year the payment of more than the applicable dollar amount in effect for the calendar year in which the service period begins.

PGGC Releases Termination Rule for Companies in Bankruptcy

The Pension Benefit Guaranty Corporation (PBGC) proposed regulations provides that when an underfunded, PBGC-covered single-employer pension plan terminates while its contributing sponsor is in bankruptcy, the date the sponsor's bankruptcy petition was filed will be considered the termination date of the plan. The revision is required by Section 404 of the Pension Protection Act of 2006 (PPA).

According to press reports, the proposal is intended to address the additional PBGC liabilities that occur when a sponsoring employer's pension plan falls further into the red during bankruptcy proceedings. The proposed regulations would implement the following changes:

- a participant's guaranteed benefit would be based on the amount of service and the amount of compensation as of the bankruptcy filing date;
- the bankruptcy filing date would determine Title IV guarantee limits, the maximum guaranteed benefit, the phase-in limit and the accrued-at-normal limit; and
- only benefits that are nonforfeitable as of the bankruptcy filing date are guaranteed. (For example, early retirement subsidies and disability benefits to which a participant became entitled after the bankruptcy filing date.)

RECENT JUDICIAL ACTIVITY

Ninth Circuit Upholds San Francisco's Employer "Pay or Play" Mandate

On September 30, the U.S. Court of Appeals for the 9th Circuit upheld the employer spending requirements of a San Francisco health care ordinance, holding that the requirements are not preempted by ERISA. Writing for a three-judge panel in *Golden Gate Restaurant Association v. City and County of San Francisco*, Judge William A. Fletcher reversed a district court decision and rejected the arguments of plaintiff Golden Gate Restaurant Association (GGRA).

GGRA had argued that city's employer spending requirements impermissibly requires the creation of an ERISA plan, relates to an existing ERISA plan and contravenes ERISA's goal of ensuring that plan sponsors are subject to a uniform body of benefits laws.

The 9th Circuit Appeals Court reasoned that by allowing employers to satisfy the spending requirement by making direct payment to the city, the ordinance "offered employers a meaningful alternative that allowed them to preserve the existing structure of their ERISA plans." The court concluded that its decision was not inconsistent with a 2007 Fourth Circuit decision which struck down Maryland's "Fair Share" employer mandate, since the Fourth Circuit concluded that the structure of the Maryland mandate effectively gave employers covered by the law no practical choice but to modify or create an ERISA plan.

The San Francisco employer spending requirements, which became effective January 9, 2008, mandate medium and large businesses to make minimum health care expenditures on behalf of covered workers. A private employer with 20-99 employees and a nonprofit organization with 50 or more employees would make expenditures of $1.17 per hour on behalf of each covered employee. A private employer with 100 or more employees would make health care expenditures of $1.76 per our hour. The ordinance sets out a non-exclusive list of "qualifying" health care expenditures, such as contributions to health savings accounts, direct reimbursement to employees for health care expenses, payments to third parties for providing health care services, or costs incurred for the direct delivery of health care services. Employers may also satisfy the employer spending requirement by making payments directly to the city. The city uses the payments to fund membership in its "Health Access Program" for uninsured residents and establish reimbursement accounts for covered employees. Employers are

required to maintain records and proof of health care expenditures, allow city officials "reasonable access" to such records and annually report "such other information" that the city requires.

Although the U.S. District Court for the Northern District of California ruled that ERISA preempted the employer spending requirements, the city of San Francisco was granted an emergency stay of the lower court decision on January 9, 2008, by a unanimous three-judge panel of the U. S. Court of Appeals for the 9th Circuit. This initial appeals court decision permitted the city to enforce the employer spending requirement, pending the city's appeal on the merits that was decided today. In a 30-page decision granting the emergency stay, the 9th Circuit panel indicated that it believed that there was a strong likelihood that the city would prevail in its appeal on the merits.

By allowing the San Francisco employer spending requirements to stand, the 9th Circuit decision creates an incentive and a roadmap for other cities, counties and states to enact similar requirements regulating employee benefit plans. The U.S. Department of Labor (DOL) submitted an amicus brief in support of the district court's decision, concluding that if the 9th Circuit were to uphold the city ordinance, "it would expose plan sponsors to the potentially contradictory regimes of numerous states, cities, and other localities, and it would require plan sponsors to design and administer ERISA-covered plans in accordance with the dictates of local officials. Such a result would directly contravene ERISA's express preemption of laws that 'relate to any employee benefit plan,' and wholly undermine Congress' evident intent to permit the uniform nationwide administration of employee benefit plans."

GGRA may seek a re-hearing of its appeal by a full panel of Ninth Circuit judges. Since the decision conflicts with *RILA v. Fielder*, a 2007 decision of the U.S. Fourth Circuit Court which held Maryland's "Fair Share Act" preempted under ERISA, it may eventually be appealed to the U.S. Supreme Court.

Appeals Court Sides with Plan Sponsor in Hirt v. Equitable Decision

The U.S. Second Circuit Court of Appeals has ruled favorably in a key decision regarding cash balance pension plans. In the case of *Hirt v. Equitable Retirement Plan*, the claim against the defendant alleges that Equitable's cash balance formula violates ERISA's age discrimination statute prohibiting the reduction in the rate of a participant's benefit because of the attainment of any age.

The appeals court ruling affirms the decision by the U.S. District Court for the Southern District of New York in favor of the defendant, reasoning that the phrase "rate of an employee's benefit accrual" refers to the benefits that accrue under the terms of a pension plan and concluded that the cash balance plan at issue was not age discriminatory because it credited pay and interest at the same rates for all covered employees.

The Second Circuit's favorable decision regarding the age discrimination issue means that all four circuit courts that have reviewed this issue have come out favorably: the Seventh, the Third, the Sixth, and now the Second. This decision also reinforces the appeals decision in *Cooper v. IBM*, the landmark class-action lawsuit concerning an IBM cash balance plan as it related to the age discrimination provisions of ERISA. The full U.S. Seventh Circuit Court of Appeals declined to reconsider the *Cooper* case in September 2006, letting stand a circuit court ruling in favor of the plan sponsor.