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RECENT JUDICIAL ACTIVITY – Nothing to Report This Month

RECENT LEGISLATIVE ACTIVITY

Pension Relief Measure Signed into Law

The Worker, Retiree, and Employer Recovery Act (H.R. 7327), legislation to provide defined benefit plan funding relief and other technical corrections to the Pension Protection Act of 2006, was signed into law by President Bush on December 23. The measure, sponsored by Representatives Charles Rangel (D-NY) and Jim McCrery (R-LA) (chairman and ranking member of the House Ways and Means Committee), and Representatives George Miller (D-CA) and Buck McKeon (R-CA) (chairman and ranking member of the House Education and Labor Committee), was approved by unanimous consent in the House of Representatives and in the Senate.

A Joint Tax Committee technical explanation of H.R. 7327 is currently available, as well as a new budget estimate with the expected revenue effect of the new law.

CBO Releases Reports on Health Care and Budget Issues

The Congressional Budget Office (CBO) published two long-awaited reports focusing on health care issues, setting the stage for an extensive policy debate in 2009. The analyses are intended to assist Congress as it contemplates possible changes to national health care programs and systems, though it does not make any recommendations.

The reports are especially timely and important because the current director of CBO, Peter Orszag, has been tapped by President Obama to serve as director of the executive branch Office of Management and Budget, essentially the chief budget official for the United States. His views on health care and budget issues, therefore, are very pertinent in terms of gaining insights to some of the incoming administration's thoughts.

Key Issues in Analyzing Major Health Insurance Proposals focuses on large-scale proposals, provides extensive background information, and explains CBO's analysis of numerous issues that could arise should the Congress seek to enact major changes in the health insurance system. This publication does not provide analyses of specific proposals; rather, it provides an overview of CBO's approach to major questions and issues that would likely arise in the context of such legislation. Among the main conclusions:

- The rising costs of health care and health insurance pose a serious threat to the future fiscal condition of the United States.
- Without changes in policy, a substantial number of nonelderly people (those younger than 65) are likely to be without health insurance.
- Those problems cannot be solved without making major changes in the financing or provision of health insurance and health care. In considering such changes, policymakers face difficult trade-offs between the objectives of expanding insurance coverage and controlling both federal spending and total costs for health care.
- By themselves, premium subsidies or mandates to obtain health insurance would not achieve universal coverage. Proposals could, however, achieve near-universal coverage using a combination of approaches.
- Serious concerns exist about the efficiency of the health care system, but no simple solutions are available to reduce the level or control the growth of health care costs.
- Other approaches — such as the wider adoption of health information technology or greater use of preventive medical care — could improve people's health but would

probably generate either modest reductions in the overall costs of health care or possibly increases in such spending within a 10-year budgetary window.

- In many cases, the current health care system does not give doctors, hospitals, and other providers of health care incentives to control costs.

Budget Options, Volume I: Health Care focuses on possible specific changes. The document addresses a broad array of discrete issues related to the financing and delivery of health care. (Volume 2 of Budget Options, which will address policy options in other areas of the federal budget, will be issued in 2009.) This volume also presents CBO's estimates of year-by-year costs or savings for five years, as well as a 10-year total. The options in the volume are organized by thematic chapters:

- The private health insurance market
- The tax treatment of insurance
- Changing the availability of health insurance through existing federal programs
- The quality and efficiency of health care
- Geographic variation in spending for Medicare
- Paying for Medicare services
- Financing and paying for services in Medicaid and SCHIP
- Premiums and cost sharing in federal health programs
- Long-term care
- Health behavior and health promotion
- Closing the gap between Medicare's spending and receipts

RECENT REGULATORY ACTIVITY

IRS Issues Revenue Ruling on Permitted Disparity

The Internal Revenue Service (IRS) recently issued Revenue Ruling 2009-02, which provides the new covered compensation tables for use in determining contributions to employer-sponsored defined benefit plans and permitted disparity (the method for integration of Social Security benefits with private pension distributions). The compensation tables apply to Section 401 of the Internal Revenue Code for the year 2009.

Regulatory Agencies Issue Additional Disaster Relief

The Internal Revenue Service, the Department of Labor's Employee Benefits Security Administration and the Pension Benefit Guaranty Corporation issued Notice 2008-87, providing relief to certain employee benefit plans affected by Hurricane Ike. It applies to plan sponsors with headquarters in the Texas counties of Brazoria, Chambers, Galveston, Harris, Jefferson, Liberty, Montgomery, or Orange as of September 7, 2008.

IRS Issues Relief for Section 403(b) Plans, Other Programs Announced

The Internal Revenue Service (IRS) issued Notice 2009-3, providing relief for sponsors of 403(b) retirement plans. Organizations with 403(b) plans will have until the end of 2009 to adopt

written plans if they meet other requirements in the notice. Prior to the notice, written plan documents for 403(b) plans were required by December 31, 2008.

The notice states that IRS will not treat a 403(b) plan as failing to satisfy current law requirements and the final regulations during the 2009 calendar year provided the plan sponsor meets all of the following conditions:

- On or before December 31, 2009, the sponsor of the plan has adopted a written § 403(b) plan that is intended to satisfy the requirements of § 403(b) (including the final regulations) effective as of January 1, 2009;
- during 2009, the sponsor operates the plan in accordance with a reasonable interpretation of § 403(b), taking into account the final regulations; and
- (3) before the end of 2009, the sponsor makes its best efforts to retroactively correct any operational failure during the 2009 calendar year to conform to the terms of the written § 403(b) plan, with such correction to be based on the general principles of correction set forth in the Service's Employee Plans Compliance Resolution System (EPCRS).

This relief applies to 2009 only and may not be relied upon subsequently.

The notice also announces that IRS will publish a request for comments on a draft revenue procedure regarding obtaining Service approval of prototype 403(b) plans that will be adopted by eligible employers and sample plan language for drafting prototype plans. Once the prototype program is established, the IRS will begin a determination letter program for individually designed 403(b) plans. IRS also expects to modify EPCRS to address additional 403(b) issues.

IRS Releases Guidance on Executive Compensation Reporting and Wage Withholding Requirements

The Internal Revenue Service (IRS) released Notice 2008-115, providing interim guidance to employers on their reporting and wage withholding requirements with respect to amounts includible in gross income under Section 409A of the Internal Revenue Code (sometimes referred to as "Code Z" reporting). Section 409A governs nonqualified deferred compensation (NQDC) plans.

The notice also provides interim guidance that employers are not required to report all deferrals of compensation under Section 409A until further guidance is issued (sometimes referred to as "Code Y" reporting). The interim guidance is in effect for the 2008 calendar year and will remain in effect until subsequent guidance is issued. (Further guidance is not expected until the recently proposed 409A regulations are finalized.)

Treasury/IRS Propose Regulations on Calculating Taxable Income under 409A

The Revenue Service (IRS) and the U.S. Treasury Department released proposed regulations and Notice 2008-113 which provide guidance on the calculation of amounts includable in income and a correction program, respectively, under Internal Revenue Code Section 409A (which governs nonqualified deferred compensation (NQDC) plans).

The proposed regulations generally address the calculation of amounts includible in income for violations of 409A(a), which are subject to an additional tax of 20 percent and a premium interest tax. The proposed regulations simplifies required calculations (and mitigates the harsh consequences of 409A) by limiting the taxed amounts to the total amounts deferred in the year of the violation and previous years. Notably, the proposed regulations consider and reject the idea of continuing to tax income attributable to amounts deferred in the year of the violation in

subsequent years (provided no further violations of 409A occur). Some other key points in the proposed regulations include:

- The adverse tax consequences of a violation of 409A(a) apply with respect to the total amounts deferred under a plan in which the noncompliance occurs and all previous years, to the extent the amounts are not subject to a substantial risk of forfeiture and have not previously been included in income.
  - The total amount deferred and the amount vested is determined as of the last day of the participant's taxable year without regard to when the 409A violation occurred. Reductions before year end due to deemed investment losses or actuarial losses reduce the taxable income. Additions before year end due to deemed investment gains or actuarial gains or additional deferrals increase taxable income.
    - While this rule will likely reduce taxable amounts this year and in any down market year, it could increase the amount of taxable income in years in which "investments" in the plan have substantial gains. Clearly the rule would also simplify administration by eliminating tracking requirements.
  - Distributions before year end must be included in the calculation for the additional tax.
  - A substantial risk of forfeiture is ignored if facts and circumstances indicate the plan sponsor has a pattern or practice of permitting impermissible changes in the time and form of payment with respect to non-vested deferred amounts (regardless of whether such changes apply to vested amounts).
- Amounts which may qualify as a short-term deferral after the close of the year are not counted as part of the amounts deferred for the first taxable year (but are counted in the second taxable year if they do not qualify as a short-term deferral).
- The adverse tax consequences would not apply to amounts deferred under the plan for a subsequent taxable year in which the plan complies with Code Section 409A(a).
- However, if the plan also fails to comply with 409A(a) in a subsequent taxable year, deemed income in the subsequent year attributable to previously included amounts must be included in income and is subject to the additional taxes under 409A. This treatment is significantly different than the treatment of such earnings for purposes of Federal Insurance Contributions Act (FICA) taxes.
- The proposed regulations provide guidance on calculating the additional premium interest tax, which applies from the later of the time the amounts were first deferred or when they became vested.
  - In situations involving prior payments or investment losses, the proposed rule generally treats includible amounts as first deferred and vested in the latest possible years (generally resulting in less premium interest).
  - Since the calculations are based on the taxpayer's taxable income and other relevant tax information for the years involved, the IRS and Treasury recognize they would be cumbersome and ask for comments on possible safe harbor calculation methods.

- Each taxable year is analyzed independently and thus assessment of tax liabilities due to a plan's failure to comply with 409A in a closed year would be time-barred.
- The proposed regulations also provide guidance on calculation adjustments for plans that have (1) unreasonably high earnings, (2) payments on a triggering event (instead of a fixed date), (3) formulas, rather than a fixed payment amount to determine the amount payable, (4) alternative times and forms of payment, (5) formulas based on future variable factors, (6) no account balances (nonaccount balance plans), and (7) stock rights.
- The proposed regulations also address (1) separation pay arrangements, (2) reimbursement arrangements, (3) split-dollar life insurance arrangements, (4) foreign arrangements, and (5) treatment of payments, forfeitures, or permanent losses of deferred amounts after the amount is included in income under 409A(a).

The proposed regulations indicate that IRS and Treasury anticipate that reporting of all NQDC deferrals will be implemented beginning with the first taxable year after the proposed regulations are finalized and effective. Before the applicability date of the final regulations, taxpayers can rely on the proposed regulations only to the extent provided in further guidance.

The proposed regulations do not address calculation of includible income under Code Section 409A(b) which occurs when trust assets are restricted to the provision of benefits under a NQDC in connection with a change the plan sponsor's financial health, or when there is a transfer of NQDC plan assets (1) to a trust outside the United States, or (2) during a restricted period with respect to the plan sponsor's qualified defined benefit plan. This may be significant for plan sponsors with qualified defined benefit plan assets that have declined in value as a result of the economic downturn (and could face benefit restrictions in 2009 or 2010). The IRS and Treasury anticipate issuing further guidance on this section but taxpayers can use the guidance in Notice 2007-89 for calculations for taxable years beginning on or before January 1, 2007.

Notice 2008-113 expands and clarifies a correction program first proposed in December 2007 in Notice 2007-100 that allows participants to obtain relief from the full application of the income inclusion and additional taxes under 409A. The notice contains more categories of problems eligible for relief and, in some cases, less costly fixes. For example, errors corrected in the year following the violation for "non-insiders" will not be subject to the additional 20 percent additional tax. In addition, the correction program now requires repayment plus interest for some corrections, increasing the similarity to correction programs for qualified plans. Notably, the new notice provides a special transition rule for "non-insiders" that allows certain operational errors that occurred prior to 2008 to be corrected during 2009. Non-insiders exclude officers, directors and beneficial owners as defined in securities laws.

The notice provides (1) methods for correcting certain violations of 409A during the taxable year in which the failure occurs (or the subsequent taxable year in some cases), (2) relief limiting the amount includible in income under 409A(a) for certain violations that involve only limited amounts, (3) relief limiting the amount of includible income under 409A(a) for certain violations regardless of whether they involve only limited amounts if required actions are taken to correct the failure, and (4) special transition relief for operational failures occurring before January 1, 2008.

Although the notice does not include a correction program for plan document errors, the Treasury Department and IRS indicate they are considering such a program and request comment on that possibility. The Council has previously raised the need for a plan document correction program with the agencies and welcomes your insights on this and other issues for the comment letter we plan to file.

Comments on the proposed regulations are due by March 9, 2009 (the proposed regulations list 2008 but that is obviously a typographical error) and a hearing will be held April 2, 2009.

PBGC Updates Maximum Guaranteed Benefit, Age Rate Table, Premium Rates

The Pension Benefit Guaranty Corporation (PBGC) issued guidance on a number of defined benefit plan technical issues.

The agency's final regulations on benefits payable in terminated single-employer plans adds the maximum guaranteeable pension benefit that may be paid by the PBGC with respect to a plan participant in a single-employer pension plan that terminates in 2009. The amendment is necessary because the maximum guarantee amount changes each year, based on changes in the contribution and benefit base under section 230 of the Social Security Act. The maximum monthly benefit guarantee in 2009 will be $4,500 per month in the form of a life annuity beginning at age 65. The 2008 guarantee had been $4,312.50.

The agency's final regulations on expected retirement age amend the PBGC's current rule on allocation of assets in single-employer plans, substituting a new table that applies to any plan being terminated either in a distress termination or involuntarily by the PBGC with a valuation date falling in 2009. This table is used to determine expected retirement ages for plan participants, the value of early retirement benefits and the total value of benefits under the plan.

The PBGC's notice on flat rate premiums updates these premium levels for 2009, adjusted for inflation each year based on changes in the national average wage index. For 2009, the per participant flat rate premium for single employer plans for plan year 2009 will be $34, up from $33 for plan year 2008. The 2009 multiemployer plan premium rate remains at $9 per participant, the same as 2008.

IRS Issues List of Required Amendments to Plan Determination Letters

The Internal Revenue Service (IRS) issued Notice 2008-108, outlining the required changes for plan determination letters. The changes apply for one year beginning February 1, 2009. In accordance with Section 4 of IRS Revenue Procedure 2007-44, the agency annually publishes a cumulative list to identify statutory, regulatory and guidance changes that plan sponsors must take into account in their submissions for opinion, advisory and determination letters. The list of changes does not extend the deadline by which a plan must be amended to comply with any statutory, regulatory, or guidance changes.

IRS Extends Specific Disaster Relief to Midwest Areas

The Internal Revenue Service (IRS) issued Notice 2008-109, extending disaster relief to certain areas as part of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. Most notably, the notice identifies the Midwest disaster areas in which plan sponsors could allow disaster-related distributions and voluntary repayment under certain circumstances. These provisions closely mirror the 2006 relief relating to Hurricane Katrina. During the debate on this bill, the Council urged inclusion of the Midwest disaster areas as well as the Hurricane Ike and Hurricane Gustav disaster areas in the relief related to retirement plans, although the final bill only included the Midwest disaster area.

Regulatory Agencies Release New Form 5500

The U.S. Department of Labor's Employee Benefits Security Administration (EBSA), the Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation (PBGC) have unveiled advance informational copies of the 2008 Form 5500 annual return and report, the disclosure form for retirement plan sponsors. Each year, pension and welfare benefit plan sponsors may

use the Form 5500 to satisfy required disclosure of the plan's financial conditions, investments, and operations. The advance copies (not to be used for actual filing) are available at http://www.dol.gov/ebsa/5500main.html#2008.

Numerous modifications have been made to the form for 2008, including:

- New actuarial schedules replace the Schedule B (Actuarial Information) and must be used for plan year 2008 plan filings — Schedule MB (Multiemployer Defined Benefit Plan and Certain Money Purchase Plan Actuarial Information) and Schedule SB (Single-Employer Defined Benefit Plan Actuarial Information).

- Multiemployer defined benefit pension plans are generally required to file additional information to the Schedule R (Retirement Plan Information). Defined benefit plans of 1,000 or more participants must also include financial asset breakout information as an attachment to the Schedule R.

The new form reflects some of the additional reporting requirements contained in the Pension Protection Act of 2006 (PPA). EBSA has previously issued proposed and final regulations and other guidance in connection with changes to the Form 5500 (both from the PPA provisions and changes concerning fee disclosures).

EBSA Issues Bulletin on Fidelity Bonds for ERISA-Covered Plans

The U.S. Department of Labor's Employee Benefits Security Administration (EBSA) issued Field Assistance Bulletin 2008-04 regarding ERISA fidelity bonding requirements. The guidance, provided in question-and-answer format, should help address common plan sponsor issues on this topic.

Among the compliance issues related to ERISA's fidelity bonding requirements, the guidance covers:

- whether a bond may use an omnibus clause to name insured plans;

- how to calculate the bond amount when multiple plans are covered under a single bond;

- whether the $1 million bond maximum applies in the case of plans that hold employer securities solely as a result of investments in pooled investment funds; and

- whether third party service providers are subject to the bonding requirements if they handle plan funds.

PBGC Issues Final Regulations on Disclosure to Participants of Distress Terminations

The Pension Benefit Guaranty Corporation (PBGC) released final regulations governing the disclosure of plan termination information upon the request of an affected party. ("Affected party" is defined to include each participant in the plan, each beneficiary under the plan, each employee organization representing plan participants and PBGC).

In accordance with Section 506 of the Pension Protection Act of 2006 (PPA), the regulations would require that a plan administrator disclose information it has submitted to PBGC in connection with a distress termination filing, and requires that a plan administrator or plan sponsor disclose information it has submitted to PBGC in connection with a PBGC-initiated termination. The new provisions also mandate that PBGC disclose the administrative record in any PBGC-initiated termination.

The final regulation is mostly unchanged from the proposed regulations, issued in December 2007. The one difference is that final regulation states explicitly, with reference to the applicable statutory provisions that plan administrators in distress and PBGC-initiated terminations and plan sponsors in PBGC-initiated terminations may charge a reasonable fee for any information provided in other than electronic form.