Compliance News

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Ready or Not: Mandatory Electronic Filing of Form 5500 Now Applies

Beginning January 1, 2010, all plan sponsors filing Forms 5500 must file electronically through the new electronic ERISA Filing Acceptance System II (EFAST2). Subject to some narrow exceptions, the electronic filing requirement also applies to prior years' amended Form 5500 filings, as well as filing under the delinquent filer program (Delinquent Filer Voluntary Compliance or DFVC).

This mandatory electronic filing requirement was one of the many outcomes of The Pension Protection Act of 2006. The DOL's objective for mandatory electronic filing is to improve the accuracy of the collected data and result in faster disclosure times. Once EFAST2 is up and running, the DOL will be able to quickly identify late filers and assess penalties. Under the law, the DOL can assess penalties up to $1,100 per day for late filings.

Consequently, the process for submitting 5500s has drastically changed. Plan sponsors must choose to use EFAST2 approved vendor software or the DOL's "bare bones" Web-based filing system (IFILE) to prepare the Form 5500. Before the form can be submitted, a representative from the plan sponsor must obtain electronic credentials from the DOL's Web site www.efast.dol.gov to sign and submit the Form 5500 through EFAST2 (Signing Filer).

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Not only has the process for submitting forms changed, but the forms themselves have received a face lift. Some forms are changing content and repositioning plan information. A new form (Form 5500-SF) will be required for some small plans, while other schedules and forms will be eliminated. The instructions to the forms clarify that welfare plans that pay benefits solely from general assets will not need to include the Schedule C. One form that will not change is the Form 5558 – Extension. This form must still be submitted to the IRS in paper form. One reprieve is that plan sponsors will not need to attach a copy of the Form 5558 with the electronic Form 5500.

Plan sponsors should consider several aspects of this new requirement. One important issue is timing. The DOL will have limited capacity to accept a large quantity of forms at the final hour. Plan sponsors will want to get a jump start on gathering and preparing their Forms 5500. In particular, we recommend that the plan sponsor proceed with obtaining Signing Filer credentials sooner rather than later.

Another important matter is creating procedures for preparing forms, obtaining credentials, submitting final forms through EFAST2, and later checking on the filing status and submission approval from the DOL. For example, if the plan sponsor uses a third party to prepare the form with vendor software, the plan sponsor will be invited by the form preparer to an electronic "signing ceremony." Because of the added complexities with the new system, many plan sponsors will want (or need) to file for an extension.

If Lockton prepares Forms 5500 for your welfare plans, we will be using approved vendor software. You should receive information from your account services team that discusses the steps under the new process.

DOL Issues New Model CHIPRA Notice With Delayed Compliance Date

The U.S. Department of Labor has issued a new model notice that employers will need to annually distribute to inform employees, regardless of enrollment status, of the availability of premium assistance under Medicaid and the Children's Health Insurance Program (CHIP) for employment-based health coverage. There are currently 40 states that offer this premium assistance. Each year the DOL is required to update its model notice to reflect any changes to the list of states offering premium assistance.

The new notice requirement applies by the later of:
1) The first day of the first plan year after February 4, 2010, or
2) May 1, 2010.

Therefore, employers with calendar year health plans will need to provide the notice by January 1, 2011. The model form is available at http://www.dol.gov/ebsa/chipmodelnotice.doc.

Under CHIPRA, a law enacted in February 2009, employers are required to notify each employee of potential opportunities currently available in their state of residence for premium assistance under Medicaid and CHIP for health coverage of the employee or the employee's dependents. The law also added new HIPAA special enrollment rights when employees and dependents lose coverage under Medicaid or CHIP or qualify for a premium subsidy under Medicaid or CHIP. *See our Alert of 02/13/09 for more details.*

Employers can include the new notice with other plan materials, such as the SPD, and can electronically distribute it if the DOL's standards are met. Because the notice requirement is based on the employee's residence (not the employer's place of business), most employers will simply include the notice in open enrollment materials that are given to all employees rather than distribute the notice just to those employees who reside in a state that offers premium assistance.

CHIPRA also requires that federal agencies develop a model coverage disclosure form for health plans to use to describe benefits available under the employer's plan. Plans will use the form to respond to a state's inquiry about the availability and cost of coverage for persons covered under Medicaid or CHIP but who may also be eligible for the employer's coverage. States expect to use the information gathered from the employer's plan to determine if it is cost-effective for the state to enroll the individual in the plan. Employer plans are not required to respond to these state inquiries until the first plan year after the model form is created. The DOL expects to issue that model form in the near future.

IRS Issues Surprising HEART Act Guidance

The IRS recently issued interesting guidance on the impact of the 2008 Heroes Earnings Assistance and Relief Tax Act (HEART) on qualified retirement plans, Code section 403(b) plans and section 457(b) plans.

Survivor Benefits

Many qualified retirement plans provide for accelerated vesting, ancillary life insurance and other benefits upon the death of an active participant. Under HEART, when a participant dies while performing qualified military service, the plan must provide the same survivor benefits it would have supplied had the participant returned to active employment and then died.

The IRS's recent guidance, contained in Notice 2010-15, includes an interesting twist. According to the Service, the plan must credit a participant who dies while performing qualified military service with the vesting service he or she would have earned had he or she remained an active participant, and must supply this service whether or not the plan would have similarly credited a participant who dies while an active participant.

However, the plan is not required to provide actual retirement benefit *accruals* for the period of military service when the participant dies while on active duty, nor is the plan required to supply vesting credit in the case of a participant who becomes disabled (as opposed to dies) while on active duty. But in both cases the plan is permitted to do so as long as the plan provides the same treatment to similarly situated participants. The plan should be amended to reflect the plan's practice in this regard.

A plan that chooses to supply benefit accruals would calculate the additional accrual as the amount the participant would have accrued or contributed had he or she not been on qualified military service. In the case of a 401(k) plan, for example, that amount is determined by averaging the participant's actual contributions for the 12-month period prior to his or her stint on active duty.

Differential Wage Payments

Some employers continue an employee's pay for a period of time after the employee is called to active duty. Typically, these payments equal the difference between the employee's military pay and his regular salary paid by the employer.

Prior to HEART, employers often reported this "differential pay" on a Form 1099. HEART requires employers to treat such payments as W-2 compensation, and to consider the pay as "compensation" for retirement plan purposes. As a result, some employers – perhaps many employers – began to supply additional retirement benefits to the participant, based on the differential pay. This was not entirely unreasonable, as many plans define a participant's "compensation" for retirement plan purposes (including benefit accruals) as W-2 compensation.

In Notice 2010-15, the IRS clarified that differential pay may be treated as compensation for benefit accrual purposes, but the plan is not required to do so. Nevertheless, the plan must consider the differential pay when calculating the participant's compensation for *other* purposes, such as applying the Code section 415 annual contribution limit. Apparently, the plan is not required to consider

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the differential pay as "compensation" for accrual purposes, even where the plan uses a section 415 definition of compensation for that purpose.

Plan sponsors may wish to contact legal counsel if they treated differential pay as "compensation" for accrual purposes without specifically amending the plan to do so, or if they amended the plan as such (believing they were required to do so) but now wish to prospectively cease providing accruals based on differential pay (it seems unlikely a sponsor could retroactively do so).

Distributions

HEART indefinitely extended a new form of distribution first authorized by the Pension Protection Act. The distribution is called a "qualified reservist distribution" (QRD). A QRD is available to a participant who is in the Reserve forces and is called to active duty for 180 days or more (or indefinitely). A QRD is a distribution of the participant's elective deferrals, and is available even where the participant's employment has not been terminated by the employer. The QRD is not subject to the same restrictions as are other in-service distributions, such as the six-month prohibition on elective deferrals or the 10% penalty tax that applies to premature distributions.

HEART also allowed retirement plans to deem participants called to active duty for more than 30 days as having separated from service (even though the employer retains the participant on its employee rolls) so as to justify a distribution of the participant's elective deferrals. Such a distribution is, however, subject to the 10% penalty tax, 20% income tax withholding (if not directly rolled over) and the restriction on elective deferrals for the ensuing six months.

Notice 2010-15 makes clear that the distribution upon a deemed separation of service is permissive, not required. If a plan wishes to offer it, the distribution need not be confined to those participants receiving differential wage payments (there was a question whether this was the case, due to a vagary in the statute).

Some distributions might be both QRDs and distributions upon a deemed separation. In those cases, the distribution will be considered a QRD, and not subject to the penalty tax or six-month prohibition on elective deferrals.

Amendments for HEART

Plans must be amended for HEART Act provisions by the end of their 2010 plan year (2012 for governmental plans).

New Law Expands FMLA Rules For Family Member Military Leave

A Defense Appropriations law signed by the President late last year makes some changes to the FMLA rules that apply to military family leave. Those rules were added to the FMLA in 2008 and provide for qualifying exigency and military caregiver leave for employees with family members who are covered military members. *See Alert of 01/29/08 for more details.*

Under the FMLA, an eligible employee may take FMLA leave for any qualifying exigency arising out of the fact that the employee's spouse, son, daughter, or parent is on (or has been notified of an impending call to) "covered active duty" in the Armed Forces. The law now applies to employees with family members of the armed forces. Prior to the change, FMLA leave was limited to members of the National Guard, Reservists and military retirees. In other words, leave did not apply if a family member was serving in a regular component of the Armed Forces.

The new law expands the military caregiver leave provisions of the FMLA. Military caregiver leave entitles an eligible employee who is the spouse, son, daughter, parent, or next of kin of a "covered service member" to take up to 26 workweeks of FMLA leave in a single 12-month period to care for a "covered service member" with a "serious injury or illness." The definition of "covered service member" is expanded to include a veteran "who is undergoing medical treatment, recuperation, or therapy for a serious injury or illness" if the veteran was a member of the Armed Forces "at any time during the period of 5 years preceding the date on which the veteran undergoes that medical treatment, recuperation, or therapy." Under prior law, military caregiver leave was limited to care for current members of the Armed Forces, but not veterans.

Lastly, the law expands the definition of "serious injury or illness" to apply to preexisting illnesses or injuries that are aggravated by active duty. The law directs the Department of Labor to issue guidance on this issue.

Although the DOL has posted information on its website about the FMLA changes, the agency has not yet revised its model poster or forms to address the changes. Employers should stay tuned for additional information.

Anti-Cutback Violation to Link Retiree Medical With Annuity Option

A federal appeals court recently ruled that a pension plan violated Code section 411(d)(6)'s anti-cutback rules when the employer amended its retiree medical benefit plan to make retiree medical benefits available only to those pension recipients who do not elect a lump sum payment from the employer's pension plan.

Section 411(d)(6) basically prohibits a qualified retirement plan from imposing additional requirements or restrictions on benefit payment options, at least with respect to benefits that have already accrued. Retirees complained that although the employer had amended its retiree medical plan, not the pension plan, the amendment effectively imposed a new restriction on the pension plan's lump sum distribution option.

The court agreed, finding that the amendment to the medical plan "constructively" amended the pension plan as well, to impose a restriction on the ability of employees to elect the lump sum option upon retirement.

IRS Issues New Form For Self-Reporting Health Plan Excise Taxes

The IRS has issued a new Form 8928 for employers to self-report excise taxes for failing to comply with various mandates for group health plans, including COBRA continuation coverage, HIPAA's pre-existing exclusion limits and nondiscrimination rules, and parity for mental health and substance abuse benefits. The Form is due by the employer's due date for filing its federal income tax return. Plan vendors, such as TPAs and insurance companies, are also subject to reporting to the extent they violate these requirements.

In most instances, the excise tax is $100 for each day of noncompliance. However, no taxes are owed for failures that are due to reasonable cause and not to willful neglect. For example, no tax is owed if the employer corrects a failure within 30 days after the employer knows (or should have known) of the failure. Unfortunately, the Form's instructions provide no guidance on what qualifies as a "reasonable cause."

Form 8928 is also used to report employer contributions to employees' HSAs that are not comparable under the Tax Code's requirements. Most plans are structured so the employer HSA contributions are made under a Section 125 plan and are exempt from the comparability requirement.

The IRS's issuance of the form should remind employers and their vendors of the penalties associated with violating the legal requirements and the need to identify and correct any deficiencies as soon as possible.

IRS Finalizes 204(h) Notice Regulations

The IRS recently finalized its proposed regulations governing pension plans' obligation to supply an ERISA section 204(h) notice to participants prior to a significant reduction in the rate of future benefit accruals. The final regulations make few changes from the proposed regulations, but include some interesting twists.

The final regulations retain the rule in the proposed regulations requiring that a 204(h) notice be supplied at least 45 days prior the "effective date" of an amendment that is permitted to have retroactive effect. The final regulations clarify, however, that the effective date is not necessarily the date on which the plan begins to operate in accordance with the amendment. It means the earlier of that date, or the date the amendment is adopted.

Also interestingly, the final regulations provide that a separate 204(h) notice is not required if the plan is reducing benefit accruals and complies with other, specific notice obligations related to the reduction. For example, if the plan supplies a notice under code section 412(d)(2) regarding certain retroactive amendments reducing benefits, it is not also required to supply a 204(h) notice with respect to that same reduction.

Labor Department Reissues Investment Advice Regulations

The Department of Labor recently reissued proposed regulations governing the provision of investment advice under retirement plans. The DOL, under direction from the Obama administration, had earlier withdrawn final regulations prepared during the Bush administration and released just days after President Obama's inauguration.

The import of the investment advice regulations is to make clear the circumstances under which a retirement plan fiduciary, such as an investment fund firm or investment advisor, may counsel participants concerning how to invest their retirement plan benefits without the advisor committing a prohibited transaction under ERISA (ERISA frowns on fiduciaries taking advantage of their roles as fiduciaries to advance their own interests).

The proposed regulations allow a fiduciary to supply investment advice in one of two ways without risking a prohibited transaction: through the use of a computer model that is certified as unbiased, and through an investment advisor that is compensated on a level-fee basis (rather than on a commission basis, for example).

The proposed regulations are similar to the earlier withdrawn regulations. They do not require a plan to supply investment advice, nor overturn prior guidance concerning when such advice is or is not a prohibited transaction. The proposed regulations differ from the earlier final regulations in restricting some forms of fee sharing with affiliates and others, where the advisor is compensated under the "level fee" method; generally prohibit computer models from distinguishing among investment options within a single asset class, based on historical performance; and discuss investment options that a computer model need not consider.

Before either a computer model or level-fee approach to investment advice may be offered by a plan, the investment advice arrangement must be reviewed and approved by a fiduciary other than the fiduciary offering the investment advice or offering any investment option under the plan. In addition, plan participants must be supplied certain disclosures in advance of their initial receipt of investment advice, disclosures intended to supply transparency relating to the investment advisor, how he or she is paid, other potential conflicts of interest, and information about the performance of the plan's investment options.

The regulations are now in their comment period, and will become law 60 days after they are published in final form.

Reminders

- April 15 — Refund excess elective deferrals for 2008.
- April 30 — File San Francisco HCSO quarterly report for first calendar quarter.
- April 30 — File San Francisco HCSO Expenditure Annual Report.
- April 30 — Deadline for pre-approved defined contribution Master & Prototype plans or Volume Submitter plans to adopt an EGTRRA-approved plan document.

Lockton Compliance Services

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