LEGISLATIVE AND REGULATORY UPDATE

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<u>No clear path to 403(b) plan termination, despite IRS guidance</u>: Though recent IRS guidance suggests steps for terminating 403(b) plans, technical issues still may impede employers' ability to wind up these plans while preserving favorable tax treatment for participants and beneficiaries. Rev. Rul. 2011-7 is helpful in confirming that mere distribution of an individual annuity contract is *not* a taxable event. But the ruling glosses over some critical issues unique to 403(b) plans, such as what to do if an employer can't authorize distributions from the plan's mutual fund custodial accounts without participant consent. Pending satisfactory resolution of these issues, plan termination may remain an elusive option for many 403(b) sponsors.

Gaps in guidance on termination issues

Many hospitals, universities, charities and public schools have been evaluating the merits of continuing their 403(b) arrangements since the release of comprehensive IRS regulations in 2007. For example, some tax-exempt employers have considered replacing their 403(b) plans with 401(k) plans. Though the regulations specifically allow for 403(b) plan termination, they offer virtually no guidance on how to mesh technical IRS requirements with the contractual obligations associated with various funding vehicles. New IRS guidance in Rev. Rul. 2011-7 offers some answers but falls far short of providing a roadmap for terminating a 403(b) plan – particularly if employers don't have the right to move money out of individual custodial accounts without participant consent.

Plan termination steps

Rev. Rul. 2011-7 addresses various scenarios involving governmental and ERISA-covered 403(b) plans funded by individual annuity contracts, group annuity contracts and/or mutual fund custodial accounts. Taken together, the scenarios suggest the following steps for terminating a 403(b) plan. Except where noted, the steps below apply to ERISA and non-ERISA plans alike (the ruling does not address special issues for church plans).

Review plan document's termination clause. An employer seeking to terminate a 403(b) plan first should confirm that the governing documents authorize payments to be made on plan termination. The IRS scenarios assume this to be case, but the reality could be otherwise. When plans don't contain the required authorization, employers should consult legal counsel to determine whether such language could be added and applied to already-accrued benefits. Tax-exempt employers with salary-deferral-only plans face a unique issue in this regard: If the plan is exempt from ERISA by virtue of the employer's limited role, could the employer forfeit that exemption by deciding to terminate the plan or getting too closely involved in the termination process? Fortunately, the Department of Labor (DOL) "does not believe that the employer's determination to terminate a [403(b)] program in compliance with the Treasury regulations will cause a program not otherwise covered by Title I of ERISA to become covered" (Field Assistance Bulletin 2007-02). Speaking informally, DOL representatives have recommended that employers include nondiscretionary termination steps in their plan documents to ensure the exemption remains intact.

Check for other 403(b) plans of employer or its affiliates. Employers desiring to terminate just some (not all) of their 403(b) arrangements could get tripped up by the regulations' prohibition on maintaining a successor plan. Amounts attributable to salary reduction contributions may be distributed on plan termination only if the employer doesn't contribute to any 403(b) plan from the termination date until 12 months after distribution of all assets from the terminated plan. The same restriction applies to any amounts held in custodial accounts. An exception applies if, at all times starting 12 months before termination and ending 12 months after distribution of all assets from the terminated plan, fewer than 2% of employees eligible on the termination date are eligible under another 403(b) plan.

This restriction is applied on a controlled-group basis. So, unless the 2% exception applies, a tax-exempt organization that terminates its program could violate the regulations' distribution restrictions if 403(b) contributions continue under a separate plan maintained by another member of the organization's controlled group, as determined under Code Section 414. State and local public schools, and certain churches (as narrowly defined in Section 3121(w)), may determine their controlled group by applying the reasonable, good-faith standards in *Notice 89-23*.

Adopt resolution. On or before the termination date, the employer must adopt a binding resolution freezing contributions, ceasing future purchases of annuity contracts or mutual funds, and approving the plan termination. The termination resolution must provide for full vesting of all benefits as of the termination date and direct that benefits be distributed as soon as practicable.

Identify plan's accounts. The employer must identify all annuity contracts and custodial accounts treated as part of the terminating plan to know which assets must be distributed for a valid termination. (This task may be challenging, as many ERISA plan sponsors discovered during the 2009 audit season for expanded Form 5500 filings.) For example, a plan typically would exclude "grandfathered" contracts issued before Sept. 25, 2007, in an exchange formerly permitted under now-obsolete *Rev. Rul. 90-24*. Ideally, these contracts – and possibly certain others described in *Rev. Proc. 2007-71* – could be disregarded in the termination process. However, employers may face some risks here because Rev. Rul. 2011-7 is silent on this point.

Distribute assets as soon as practicable. A plan is not considered terminated unless all accumulated benefits are distributed as soon as administratively practicable (generally within one year after the plan termination date). ERISA plans must comply with qualified joint and survivor annuity (QJSA) requirements to the extent applicable. A critical issue is whether an employer has sufficient control over the plan's funding vehicles to distribute assets without participant consent. (The answer may depend in part on federal and state laws regulating securities and contracts.) The new IRS guidance hints at some flexibility here but is so vague on certain points that employers may not find much reassurance:

- **Individual annuity contracts.** Rev. Rul. 2011-7 calls for the distribution of "fully paid individual insurance annuities" to each participant, alternate payee (under a domestic relations order) and beneficiary of a deceased participant. Thereafter, participants and beneficiaries are entitled to payments in accord with the contract terms, which may permit single-sum payments as a form of liquidating distributions as soon as practicable after plan termination.

- The ruling doesn't say what's expected if participants already hold individual contracts in their own names (in which case there's nothing to "distribute"). Can the employer simply notify participants and issuers that the contracts are no longer part of the plan, and let those parties make their own arrangements for immediate or deferred payouts?

- **Group annuities.** In plans funded by group annuity contracts, Rev. Rul. 2011-7 calls for distributing as soon as practicable an individual certificate – evidencing a fully paid interest in benefits under the contract – to each participant, alternate payee and beneficiary of a deceased participant.

  - Some participants and beneficiaries may receive liquidating distributions as a lump sum in accord with the group contract's terms.
  - As a practical matter, the process of issuing the required certificates may be fraught with delays, especially since the paperwork for older contracts may not be readily available. A process that drags on more than 12 months could cause the whole termination to fail unless the particular facts and circumstances justify the delay (see *Rev. Rul. 89-87*).

- **Custodial accounts.** The IRS acknowledges that many plans are funded by mutual fund custodial accounts maintained under either individual or group agreements. Rev. Rul. 2011-7 contemplates that the custodial account balances would either be distributed in cash (or in-kind mutual fund shares) or rolled over to an IRA or an eligible retirement plan, depending on the elections made by participants and beneficiaries.

  - The ruling doesn't explain whether the whole termination would fall apart if some participants fail to make elections. In some cases, restrictions imposed by the contract or applicable law may prevent employers from unilaterally moving assets out of the account on plan termination.
  - The ruling doesn't mention the possibility of "distributing" the custodial accounts themselves (as permitted for individual annuity contracts or certificates), casting doubt on whether participants have the option of simply keeping their assets in a 403(b)(7) custodial account established in their own name outside the plan.
  - To satisfy ERISA's QJSA rules (if applicable), amounts held in custodial accounts may be used to purchase and distribute a fully paid individual insurance annuity.

- ***Notify participants.*** Participants and beneficiaries must be notified of the termination and the associated tax consequences. Rev. Rul. 2011-7 confirms that the distribution of an individual annuity contract or an individual certificate under a group contract is *not* a taxable event. This means participants and beneficiaries needn't include any amount in gross income until money is actually paid out of the contract (assuming the plan document and termination resolution allow deferral of the benefit starting date and the contract retains its status as a 403(b) contract).

- ***Administer rollovers.*** For individuals entitled to single-sum payments or other eligible rollover distributions, the plan administrator must supply a 402(f) tax notice describing rollover rights. In general, participants may elect a direct rollover to an IRA, another 403(b) plan or any other eligible retirement plan (such as a 401(k) plan). These rollover rights apparently remain intact even after an annuity contract is distributed from the plan, so amounts distributed from the annuity contract may be rolled over if they otherwise qualify as eligible rollover distributions.

- ***File final Form 5500.*** ERISA plan administrators must file a final Form 5500 for the plan year that includes the final distribution of plan assets.

- ***Maintain 403(b) status after termination.*** Upon completion of the above steps, the employer no longer has any responsibility for the plan or its assets. However, as noted above, participants avoid taxation on receipt of their annuity contracts (or certificates) only if those contracts maintain 403(b) status. According to the ruling, a contract maintains its 403(b) status if it "adheres to the requirements of § 403(b) that are in effect at the time of delivery of such contract." While the full extent of a 403(b) vendor's continuing responsibilities remains unclear, it seems a vendor must track the legal requirements (as to minimum required distributions, etc.) in effect on the annuity delivery date and enforce those grandfathered rules in perpetuity for this group of annuitants.

Open issues

The lack of clear guidance – particularly for custodial accounts – could limit the usefulness of Rev. Rul. 2011-7. If custodial accounts can't be unilaterally distributed or transferred to an IRA without participant consent, then employers may be unable to require any distributions (including annuity distributions) on plan termination.

Other gaps in the IRS guidance may raise additional concerns for some plan sponsors:

- To what extent can grandfathered contracts be excluded from the termination process?
- How should employers handle participants who cannot be located or fail to respond to communications? Any answer to this question needs to take into account any conditions imposed by contract, securities law, and, if applicable, ERISA's consent requirements and fiduciary standards.
- Can outstanding participant loans be moved intact to the individual annuity contract/account? What happens to loan repayments being made via payroll deduction?
- Do any special rules apply to 403(b) contracts that include life insurance? Or to plans holding Roth contributions or after-tax contributions (since none of the IRS scenarios involved a plan holding Roth or after-tax money)?
- Can ERISA plan sponsors assume that a valid termination under IRS rules will be recognized by DOL, in particular for Form 5500 filing purposes? (The ruling mentions the need to file a final Form 5500 but doesn't say anything about DOL's stance.)

Perhaps the IRS will issue more guidance to fill in the gaps – maybe in connection with its much-anticipated 403(b) determination letter program. Until then, plan termination may be impractical for many employers.

US Justice Department steps back from Defense of Marriage Act: Despite the Obama administration's recent decision not to defend the Defense of Marriage Act (DOMA) in certain cases, the act remains intact. A key DOMA provision limits the definition of "marriage" and "spouse" under federal tax, benefit and other laws to only opposite-sex couples. The administration won't defend that provision in cases involving state-recognized, same-sex marriages if the court has yet to set a judicial review standard for sexual orientation discrimination claims. The policy shift has no impact on benefit plans or operations, but employers should monitor DOMA developments. Full text of attorney general's statement (Justice Department, 23 Feb 2011); Full text of attorney general's letter to Congress (Justice Department, 23 Feb 2011); Full text of the Defense of Marriage Act (GPO, 21 Sep 1996)

FBAR filing deadlines approach for benefit plans with foreign accounts: Final Treasury Department rules provide welcome clarity about which US persons must file a Report of Foreign Bank and Financial Accounts (FBAR) because of a financial interest in or signature authority over foreign investment accounts. Although regulators rejected requests for a blanket exemption for retirement and welfare benefit trusts, some relief is available for plan-related filings. The final rules apply to filings due June 30, 2011. Related disclosures must be included on an individual's 2010 Form 1040, due April 18 (absent extensions). Full text of final FBAR regulation (Federal Register, 24 Feb 2011)

DOL proposes few changes in pension plans' annual funding notices: DOL's proposed regulation on pension plans' annual funding notices hews closely to interim guidance in a 2009 field assistance bulletin (FAB). Updates to this article clarify the year-end liability disclosures and DOL's policy allowing use of improved model notices before a final regulation is issued. Administrators may not rely on other aspects of the proposal, which would exempt certain terminated and merged plans from providing notices, clarify required significant event disclosures and fill in gaps in the 2009 interim guidance. The FAB remains in effect until the regulations are finalized. Full text of proposed regulation on annual funding notice for DB plans (DOL, 18 Nov 2010); Full text of model annual funding notice for multiemployer plan (DOL, 18 Nov 2010); Full text of model annual funding notice for single-employer plan (DOL, 18 Nov 2010); Full text of fact sheet on proposed regulation (DOL, 18 Nov 2010)

EEOC issues final rule under the Americans with Disabilities Amendments Act: Long-awaited EEOC final regulations implement and interpret key provisions of the Americans with Disabilities Amendments Act (ADAAA), which took effect Jan. 1, 2009. The ADAAA broadened protections for disabled individuals at work by expanding the definition of disability to discount mitigating measures and making it easier for employees to prove they are “substantially limited” in a “major life activity.” After receiving more than 600 public comments on its proposed regulations, the EEOC decided to retain several provisions challenged by employer groups, including a list of impairments that constitute disabilities “in virtually all cases.” The final rule is scheduled for publication in the March 25 Federal Register and will take effect 60 days thereafter. Employers should review their employment policies, reasonable accommodation processes and employee benefit plans for compliance.

<u>DOL's initial tips on nursing-mother breaks are helpful, but questions remain</u>: The health care reform law amended the Fair Labor Standards Act (FLSA) to require that covered employers provide reasonable breaks and private areas to nonexempt employees when they need to express milk during the year after their child's birth. Initial Department of Labor (DOL) guidance -- a fact sheet, FAQs and preliminary interpretations -- addresses a number of key issues, but some questions remain. More guidance is likely after DOL reviews the 1,900-plus responses received in a recently closed comment period. Related IRS guidance treats lactation supplies as deductible medical expenses. Full text of Announcement 2011-14 (IRS, 11 Feb 2011); Full text of DOL request for information on nursing-mother breaks (Federal Register, 21 Dec 2010); Full text of WHD Fact Sheet #73 (DOL, revised 17 Dec 2010); Full text of FAQs on nursing-mother breaks (DOL, 21 Dec 2010); DOL webpage on nursing-mother breaks; Full text of PPACA Section 4207

<u>Another appeals court weighs in on voluntary departures under the WARN Act</u>: Employees who stopped coming to work after receiving notice that their plant would soon close did not voluntarily terminate and thus count as employment losses under the Worker Adjustment and Retraining Notification (WARN) Act, the 9th US Circuit Court of Appeals has ruled ***(Collins v. Gee West Seattle LLC, No. 09-36110 (9th Cir. Jan. 21, 2011)***. The ruling seems at odds with a recent 7th Circuit decision ***(Ellis v. DHL Express Inc., No. 09-3596 (7th Cir. Jan. 11, 2011)*** which held that employees at a soon-to-close facility who left in exchange for severance benefits had voluntarily departed for WARN Act purposes. The differing appellate rulings are likely to complicate employers’ efforts to comply with the WARN Act.

<u>IRS guidance explains Form W-2 reporting of health coverage</u>: IRS guidance outlines how to report the value of health coverage on employees’ Forms W-2. This new reporting requirement generally will take effect for the calendar-year 2012 Forms W-2 due to employees in January 2013. The guidance, which is open to public comment, provides details about the employers and plans subject to reporting; extends transition relief for small employers and for certain types of coverage; and gives examples of how to determine the value of coverage. Form W-2 reporting will not affect the tax-favored treatment of employer-sponsored coverage. Full text of Notice 2011-28 (IRS, 29 Mar 2011)

<u>Updated FLSA regulations conform to statutory changes and court decisions</u>: Updated Fair Labor Standards Act regulations, effective May 5, reflect various legislative changes and court decisions dating back to the 1970s. Among other revisions, the final regulations clarify the exclusion of stock options in computing nonexempt employees’ regular pay rates and the crediting of tips or valid tip pools toward minimum wages. However, the Labor Department has dropped earlier proposals addressing compensatory time off, the fluctuating workweek method of calculating overtime, meal credits, and the overtime exemption for certain car dealership employees and boat salespersons. Full text of final DOL rule updating FLSA regulations (Federal Register, 5 Apr 2011)

SEC proposal on comp committee, adviser independence tracks Dodd-Frank provisions: Proposed SEC independence rules for compensation committees and advisers closely track the Dodd-Frank Act's terms but fill in some details. Stock exchanges would have to require that compensation committees meet independence criteria and consider an adviser's independence before hire. At a minimum, independence factors would have to cover a committee member's affiliations and compensation sources and include five "competitively neutral" factors for advisers. This GRIST details the SEC proposal, which also revises proxy disclosure rules on compensation consultants and conflicts of interest. Full text of proposed rules (SEC, 30 Mar 2011)

Medicare Part D 2012 limits announced: Higher 2012 Medicare Part D amounts will yield a maximum subsidy of $1,730.40 per retiree -- up from $1,677.20 in 2011 -- for employers whose prescription drug plans qualify for government reimbursement of some costs. Issued April 4, the 2012 Part D limits for sponsors claiming the retiree drug subsidy set a minimum cost of $320 -- a $10 increase from 2011 -- and cap expenses at $6,500 -- up $200 from 2011. Though health care reform gradually closes the Part D coverage gap, this change doesn't alter how employer plans qualify for the retiree drug subsidy. Full text of fact sheet on 2012 Part D amounts (CMS, 4 Apr 2011); Full text of 2012 Part D rate announcement (CMS, 4 Apr 2011)

7th Circuit lets 401(k) participants challenge unitized stock funds, plan fees: 401(k) plan fiduciaries may face liability for failing to decide whether company stock funds should stay "unitized," the 7th Circuit has ruled ***(George v. Kraft Foods Global (7th Cir. April 11, 2011)***. Participants claimed the unitized structure, with a cash buffer, resulted in lower returns in a rising market and an inequitable allocation of transaction costs. The court also said that failure to solicit competitive bids after a recordkeeping contract expired may be a breach of fiduciary duty. A dissenting judge described the claims as "nitpicking with respect to perfectly legitimate [fiduciary] practices." The case now returns to the lower court.

Health care reform's 'free-choice vouchers' repealed: Employers no longer face the prospect of making voucher payments to help certain low-income employees buy coverage through state health insurance exchanges. Repeal of this health care reform takes effect with enactment of the fiscal 2011 government funding bill (HR 1473). The so-called "free-choice voucher" obligation, originally slated to take effect in 2014, was intended to make exchange coverage more affordable for some workers not eligible for federal income-based assistance.

<u>Court rejects ADA challenge to wellness plan</u>: A wellness program that penalized employees who failed to undergo health risk assessments and blood tests did not violate the Americans with Disabilities Act (ADA), a federal court in Florida has ruled ***(Seff v. Broward County, No. 10-cv-61437-KMM (SD FL, April 11, 2011))***. The ADA usually bars employer inquiries about disabilities and medical exams, unless they are job-related or part of a "voluntary wellness program." Without addressing those exceptions, the court found the employer's program met the ADA's safe harbor for a "bona fide" benefit plan's risk underwriting practices that are not used as a subterfuge for discrimination

<u>USERRA does not protect employees from harassment</u>: The Uniformed Services Employment and Reemployment Rights Act (USERRA) does not allow employees to sue for harassment based on military service, the 5th Circuit has ruled in the first federal appellate decision on this issue ***(Carder v. Continental Airlines, Inc., No. 10-20105 (5th Cir. March 22, 2011))***. The court pointed out that unlike other anti-bias laws, USERRA does not specifically cover "conditions of employment" -- the key statutory term deemed to authorize harassment claims. However, the appeals court noted that USERRA's protections against job termination would allow a constructive discharge claim if harassment is so severe as to force an employee to quit.

<u>Informal IRS guidance on defined benefit issues from 2011 Enrolled Actuaries Meeting</u>: This is a summary of some of the more broadly applicable defined benefit plan issues addressed in the 2011 Enrolled Actuaries Meeting Gray Book. These include deducting grace-period contributions, complying with funding-based benefit restrictions, reducing cash balance interest credits previously needed to pass accrual rules, determining normal retirement ages based in part on participants' anniversary dates, and making and rolling over additional benefit payments after completion of a standard termination. Gray Book responses represent the personal views of IRS and Treasury staff and cannot be relied on by any taxpayer.

2011 Gray Book guidance

In the 2011 Enrolled Actuaries Meeting Gray Book, IRS and Treasury representatives provide informal and unofficial guidance on a variety of defined benefit plan topics. This article summarizes the more broadly applicable questions and answers (Q&As) in the latest Gray Book, which may be purchased through the Enrolled Actuaries Meeting website. Responses represent the personal views of IRS and Treasury staff expressed in meetings with representatives of the Enrolled Actuaries Meeting Program Committee and don't necessarily represent official agency positions. Information in the Gray Book cannot be relied on by any taxpayer for any purpose.

Deducting grace-period contributions

Over the years, the IRS has issued confusing guidance on when employers may deduct contributions to single-employer pension plans made after tax year-end but before the tax return due date. In Gray Book Q&A-7, IRS and Treasury representatives take the position that when the employer's tax year and the plan year coincide, the employer may take a deduction in the prior tax year only for grace-period contributions attributed to the prior plan year on Schedule B/SB. Thus, employers may *not* take a deduction in the prior tax year for grace-period contributions attributed to the current plan year on Schedule B/SB. But employers may always deduct contributions in the tax year made, whether they are attributed to the current or prior plan year on Schedule B/SB.

Complying with funding-based benefit restrictions

A number of Gray Book questions deal with the Pension Protection Act (PPA)'s funding-based restrictions on accelerated distributions, plan amendments, plant-shutdown and other unpredictable contingent event benefits (UCEBs), and continued accruals.

USERRA benefits aren't UCEBs. In Q&A-20, IRS and Treasury representatives opine that UCEBs do not include benefit accruals for periods of military service once a service member is reinstated in accordance with the Uniformed Services Employment and Reemployment Rights Act (USERRA). This eases practitioners' concerns that USERRA benefits could be classified as UCEBs under the broad definition in the final regulations for Code Section 436. If USERRA benefits were classified as UCEBs, sponsors would have to immediately fund the benefits if the plan's adjusted funding target attainment percentage (AFTAP) is below 60% when the returning service member is re-employed (or would be below 60% after taking the USERRA benefits into account). Treating USERAA benefits as UCEBs also could have required the actuary to assess whether those benefits need special assumptions for valuation.

436 contributions to avoid amendment restrictions. Q&A-22 addresses the timing of 436 contributions to implement a plan amendment increasing benefits on the first day of the plan year. Under the final regulations, the amendment cannot take effect until 436 contributions are paid, and payment must occur "during the plan year" (Treas. Reg. § 1.436-1(f)(2)(i)(B)). In the opinion of agency staff, this means that sponsors cannot make 436 contributions before the plan year when the amendment is scheduled to take effect. This creates a significant logistical hurdle for plans that pay benefits on the first day of the month, since sponsors implementing benefit improvements on the first day of the plan year will have absolutely no leeway with respect to 436 contribution timing. To avoid this problem, whenever the amendment might cause a plan's AFTAP to fall below 80%, the sponsor should consider making the amendment effective later in the plan year or at the end of the prior year (though 415 cost-of-living adjustments – which are treated as "automatic" amendments – cannot take effect at prior year-end).

Evergreen amendments. Final regulations provide that when Section 436 prevents a plan amendment from taking effect during the plan year containing the effective date, the amendment "must be treated as if it were never adopted, unless the plan amendment provides otherwise" (Treas. Reg. Section 1.436-1(a)(4)(iv)). Q&A-24 confirms that if a plan sponsor intends for an amendment to take effect whenever plan funding allows – even after the plan year containing the original effective date – the amendment must explicitly state that point. Otherwise, the sponsor presumably will need to adopt a second amendment in the year when plan funding has improved sufficiently to implement the benefit increase.

Resumption of accruals in final-pay plan. Section 436 requires plans to freeze benefit accruals when the plan's AFTAP falls below 60%. Unless the plan provides otherwise, accruals resume prospectively when the AFTAP is certified to be at least 60%. For plans with final-average-pay formulas, Q&A-27 recommends that the plan document spell out exactly how accrued benefits will be determined after accrual restrictions are lifted. For example, the plan document should specify whether final-average pay includes or excludes pay earned during the period accruals were frozen.

Small lump sums. As amended by the Worker, Retiree and Employer Recovery Act (WRERA), Section 436 permits plans to pay benefits that "may be immediately distributed without the consent of the participant" under Section 411(a)(11) – that is, cashouts up to $5,000. However, questions remain about how this provision applies to small ancillary benefits and to plans that allow elective lump sums up to $5,000 but have reduced the mandatory cashout threshold to $1,000 to avoid automatic rollover obligations. In Q&A-29, IRS and Treasury staff posit that plans subject to accelerated distribution restrictions may pay ancillary lump sum benefits (such as ancillary death benefits) up to $5,000, but only if the ancillary benefit is the only plan benefit payable to the participant and all the participant's beneficiaries or alternate payees. In Q&A-30, agency representatives indicate that plans may pay total lump sum distributions up to $5,000, even if cashouts of more than $1,000 are elective rather than mandatory. (The response does not address whether such plans may pay other accelerated payment forms, such as Social Security level-income options, that have a total present value of no more than $5,000.)

Restrictions on RASD back payments. Q&A-32 confirms that back payments resulting from a retroactive annuity starting date (RASD) are subject to accelerated distribution restrictions. However, the response further states that RASDs will not trigger a deemed waiver of credit balance or require participant notification if all of the following conditions are met:

- The plan is subject to only partial distribution restrictions (the AFTAP is at least 60% but less than 80%).
- The RASD is the plan's only accelerated distribution option.
- Plan terms make it mathematically impossible for RASD back payments to be restricted under the 50% present value test.

To prove that RASDs will always pass the 50% present value test, the sponsor must look beyond current participants potentially eligible for RASDs in the current plan year, but the response does not indicate how far beyond. One interpretation is that this analysis may be limited to current participants but must consider every potential future RASD eligibility date (not just dates in the current plan year). Another is that the analysis must consider anyone who hypothetically could participate and elect a RASD at any future date. As a practical matter, this exception probably will apply only to plans that tightly restrict RASD timing and thus the size of any back payments (for example, where a RASD cannot be earlier than one year before the actual commencement date).

The response is silent on whether a similar exception applies to other accelerated payment forms if the sponsor can demonstrate they will always pass the 50% present value test. For example, a plan that was contributory in the past might have a handful of remaining participants who will be eligible for refunds of their contributions. If the refunds are the plan's only accelerated payment option and will always satisfy the 50% present value test at all possible annuity starting dates for all current participants (hypothetical participants seem irrelevant since the plan is no longer contributory), can the plan avoid a deemed waiver and participant notice as long as the AFTAP remains above 60%?

Frozen plan exception to accelerated distribution restrictions after plan merger. Section 436 provides that plans with no accruals after Sept. 1, 2005, are exempt from accelerated distribution restrictions. According to Q&A-33, if a plan eligible for this exemption merges with a plan that ceased accruals later than Sept. 1, 2005, the merged plan is not eligible for the exemption, regardless of which plan is designated as the ongoing plan after the merger.

Correcting failures under Section 436. In Q&A-36, IRS and Treasury representatives confirm that Section 436 failures may be corrected using the Employee Plan Compliance Resolution System (EPCRS). The response outlines the following correction approaches:

- If a lump sum or other accelerated distribution was paid in error, the employer would have to take reasonable steps to have the recipient return the overpayment with appropriate interest and must notify the participant that the excess payment cannot be rolled over. If the participant does not return the prohibited payment, the employer would have to contribute enough to make the plan whole but need not bring legal action against the participant.
- If the Section 436 failure involves impermissible accruals, UCEB payments or plan amendment implementation, the correction would require funding the plan sufficiently to eliminate benefit restrictions.

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Reducing cash balance interest-crediting rates

Many cash balance plans with age-, service- or points-graded crediting rates provide for minimum fixed interest credits to satisfy accrual rules. Some of these plans may be required to prospectively reduce their fixed interest-crediting rates to comply with future final regulations on PPA's market-rate standard. Q&A-37 indicates that plans doing so will not face accrual rule failures for prior years because the higher minimum was actually in place in those years. However, the sponsor may need to redesign the graded schedule or make other provisions to continue to satisfy the accrual rules with the lower fixed minimum crediting rate.

Normal retirement ages based on participants' anniversary dates

Q&A-38 reiterates how to determine normal retirement age under plans that define it as the later of age 65 or the fifth anniversary of plan participation. The regulations provide that participants are deemed to start participation on the first day of the first plan year in which participation commences (Treas. Regs. Section 1.411(a)-7(b)(1)). This is true regardless of the number of entry dates under the plan. For example, if a calendar-year plan has entry dates on the first of each month, an individual who becomes a participant Dec. 1, 2007, will reach the fifth anniversary of participation for normal retirement age purposes on Jan. 1, 2012. This answer may have implications for suspension of benefits under Section 411(b), as well as the calculation of actuarial increases after normal retirement age for plans that provide them.

Paying and rolling over additional benefits after standard termination

Additional benefits are sometimes owed to a participant after a pension plan's standard termination (for example, because the PBGC's termination audit discovers that a lump sum was calculated incorrectly). In Q&A-42, IRS and Treasury representatives indicate that the sponsor may pay such benefits directly to the participant – the payment need not pass through a trust – and the source of the payment will not affect the participant's ability to roll it over.

No reliance on Gray Book

While the Gray Book offers some useful insights, plan sponsors need to remember that the responses represent the personal views of agency staff who met with representatives of the Enrolled Actuaries Meeting Program Committee. The Q&As do not necessarily represent the positions of the Treasury Department or the IRS and cannot be relied on by any taxpayer for any purpose.

US Supreme Court OKs class-action waivers in arbitration agreements: California's refusal to enforce class-action waivers in arbitration agreements violates federal law promoting arbitration, the US Supreme Court has ruled ***(AT&T Mobility LLC v. Conception, No. 09–893 (US April 27, 2011)).*** In finding that the Federal Arbitration Act pre-empts the state's prohibition of class-action waivers, the court may have paved the way for using arbitration agreements to combat employment-related class actions, including wage-hour or systemic discrimination claims. The decision is likely to encourage employers to adopt policies requiring arbitration of employment disputes and waiving employees' rights to proceed as a class.

US Supreme Court addresses remedy for flawed SPD: Even though a summary plan description (SPD) isn't part of the plan, participants may seek equitable relief under ERISA to remedy false or misleading information supplied in an SPD, the US Supreme Court has ruled ***(CIGNA Corp. v. Amara, May 16, 2011)***. The high court reviewed the 2nd Circuit's 2009 decision holding a pension plan sponsor liable for deficient SPD disclosures about cash balance "wearaways" (The new ruling means participants in retirement, health or welfare plans seeking redress for conflicts between the plan document and SPD needn't show that they read or acted in reliance on the SPD -- only that they suffered harm.

IRS announces 2012 HSA and HDHP limits: The IRS has released 2012 inflation-adjusted amounts for health savings accounts (HSAs) and high-deductible health plans (HDHPs), confirming Mercer's earlier projections. The maximum annual HSA contribution will increase to $3,100 for single coverage and $6,250 for family coverage. The catch-up contribution limit is set by statute and remains $1,000. HDHP minimum deductibles are unchanged due to rounding: $1,200 for single coverage and $2,400 for family coverage. The maximum HDHP out-of-pocket expense will increase to $6,050 for single coverage and $12,100 for family coverage. Full text of Rev. Proc. 2011-32 (IRS, 13 May 2011)

Cafeteria plan amendments for over-the-counter drug restriction due by June 30: June 30 is the deadline to amend cafeteria plans that had allowed tax-free reimbursements for nonprescribed over-the-counter (OTC) medicines and drugs until this year. Starting in 2011, the health care reform law bans tax-free reimbursements for OTC drugs -- other than insulin -- from group health plans (including health flexible spending or reimbursement arrangements), health savings accounts, and Archer medical savings accounts. IRS will allow cafeteria plan amendments adopted by June 30 for this reform to apply retroactively to the ban's effective date. Full text of Notice 2011-05 (IRS, 23 Dec 2010); Full text of Notice 2010-59 (IRS, 3 Sep 2010)

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