

Benefits Alert

March 2010

Small Pension/Welfare Plans Get New Optional Safe Harbor

Employees contribute into their pension, health, and other welfare benefits plans via paycheck withholding. Under final regulations, employers that move those contributions from their general assets into the plans' assets within seven business days of payday can take advantage of a new optional safe harbor under which they will have satisfied the requirement to segregate employees' contributions on the earliest date on which those contributions can reasonably be segregated from the employer's general assets. The regs, which became effective January 14, 2010, apply to pension and welfare benefits plans that have fewer than 100 participants at the beginning of the plan year.

IS THE SAFE HARBOR REALLY SAFE?

The optional safe harbor gives you seven business days after withholding (in effect, seven business days after payday) to segregate employees' contributions from the company's general assets. The regs clarify that the optional safe harbor applies to employees' contributions into pension plans, including SIMPLE IRAs and salary reduction SEPs; welfare benefits plans other than cafeteria plans; and employees' loan repayments. The regs further clarify that the optional safe harbor applies on a deposit-by-deposit basis, so that missing the safe harbor's seven-day deadline for one pay period won't jeopardize access to the safe harbor for other pay periods. As under current

In This Issue

- Small Pension/Welfare Plans Get New Optional Safe Harbor
- IRS Clarifies Distributions And Benefits Under The HEART Act
- Webcast Clarifies COBRA Subsidy Extension Issues
- Fiduciaries May Deliver Summary Prospectuses To Plan Participants

rules, employees' contributions need not be allocated to their accounts within those seven days.

A seven-business-day safe harbor, while providing a high degree of compliance certainty, isn't very long. For example, under the general rule that defines plan assets, employees' contributions into a 401(k) plan must become plan assets at the earliest date on which those contributions can reasonably be



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IRS Clarifies Distributions And Benefits Under The HEART Act

The 2008 Heroes Earnings Assistance and Relief Tax Act, dubbed the HEART Act, provides benefits preferences to employees who are in the National Guard and Reserves and who are called to military service. For example, it allows in-service distributions from 401(k) plans and enhances survivor benefits. The IRS has issued guidance on the HEART Act.

CONTRIBUTIONS AND DISTRIBUTIONS

The IRS clarifies that under the HEART Act, employer-paid military differential pay — the difference between employees' regular pay and military pay paid to employees who will be away on military service for longer than 30 days — doesn't have to be treated as compensation for pre-tax contribution purposes, but must be treated as compensation for section 415 purposes (i.e., the overall pre-tax contribution, after-tax contribution, and employer matching contribution limit for

401(k) plans).

As for distributions, the HEART Act allows employees who are called to active military service for a period exceeding 30 days to be deemed severed from employment. Employees, therefore, may receive distributions of their pre-tax amounts. The IRS says that every employee who is called to military duty for longer than 30 days is deemed severed from employment, and, therefore, eligible for distributions, not just those who receive military differential pay. The IRS also says that plans aren't required to make these distributions, and these distributions don't affect a plan's ability to make other in-service distributions, such as hardship distributions.

Employees called to military service for longer than 30 days don't get their in-service distributions scot-free, however. Those who take distributions can't contribute into the plan during the six-month period beginning on the distribution date. On the other hand, em-

ployees who are called to active military service for longer than 179 days, or for an indefinite period, may take qualified reservist distributions, which aren't subject to the six-month ban on contributions. According to the IRS, if an employee receives a distribution that meets both the definitions of a qualified reservist distribution and a distribution under the deemed-severance rule, the distribution will be treated as a qualified reservist distribution. Employees, therefore, could make contributions immediately.

SURVIVOR AND DISABILITY BENEFITS

The HEART Act prohibits 401(k) plans from discriminating in paying survivor benefits. If, for example, a plan accelerates vesting, ancillary life insurance benefits, or other survivor benefits that are payable on an employee's death, those same benefits must be available to survivors when employees die during military service. The IRS explains that although the HEART Act doesn't require that benefit accruals be provided for the deceased employee's period of military service, service credit for vesting purposes must be provided. *Catch:* The IRS stresses that these death benefit provisions don't apply if an employee would not have been entitled to reinstatement under the Uniformed Services Employment and Reemployment Rights Act.

For benefit accrual purposes, the HEART Act allows but doesn't require a retirement plan to treat employees who leave for military service, and who can't be reemployed

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Small Pension/Welfare Plans Get New... (cont.)

segregated from the employer's general assets. The outside time limit is the 15th day of the month following the month during which the withholding occurred. For welfare benefits plans, the outside time limit is the 90th day after withholding.

The regs leave intact the general rule and the two out-

side dates. *Potential impact:* If you miss the seven-day safe harbor, no breach of fiduciary duty would occur if you meet the two outside deadlines, just as you do now. The fear is that Department of Labor investigators will concentrate on the safe harbor, and not when employees' contributions become plan assets. ❖

Webcast Clarifies COBRA Subsidy Extension Issues

The extension and expansion of the 65% COBRA subsidy created transition periods for assistance-eligible individuals (AEIs) who timed out of subsidized coverage and imposed new requirements on COBRA-payable entities to provide notices to these individuals and to any employee who was terminated from employment on or after October 31, 2009. Representatives from various government agencies recently collaborated on a webcast that shed light on these COBRA subsidy issues.

SUBSIDY ELECTION AND TRANSITION PERIOD ISSUES

The original COBRA subsidy was enacted as part of the 2009 American Recovery and Reinvestment Act (ARRA). Amendments made to ARRA by the 2010 Department of Defense Appropriations Act allow AEIs to elect subsidized COBRA coverage at any time, provided they were involuntarily terminated and eligible to elect COBRA by February 28, 2010.

According to Patricia McDermott, IRS Special Counsel to

the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), if there is a gap between COBRA eligibility and the commencement of COBRA coverage, the regular COBRA election rules apply. Under these rules, qualified beneficiaries have 18 months after termination of employment to elect COBRA coverage. For example, an AEI could apply the value of banked time to pay for COBRA coverage, or the employer could continue to pay the AEI's health premiums as part of a severance agreement. After the banked coverage runs out or the severance payments stop, the AEI could elect subsidized COBRA coverage. But that election must occur within 18 months of termination.

McDermott added that AEIs who terminated employment late last year could have elected to pay the full COBRA premium because their income was too high for them to qualify for subsidized coverage. But, she said, under the transition rules, these AEIs may be able to elect subsidized coverage in 2010, because their income is now

lower.

However, according to Kevin Horahan, Department of Labor (DOL) Senior Employee Benefits Law Specialist in the Office of Health Plan Standards and Compliance Assistance, if AEIs stopped paying their subsidized premiums before the end of their subsidy period (e.g., payments stopped at the end of the eighth month), they aren't eligible for a transition period or to make retroactive payments. Further, he noted that if AEIs lost subsidized coverage at the end of January 2010 and didn't pay the full COBRA premium for February 2010, the time period for making a retroactive payment is the latest of February 17, 2010, 30 days after they receive notice of the COBRA extension, or the end of their regular COBRA grace period. Finally, he stressed that plans can't require payment of the full COBRA premium and then credit AEIs' accounts, because subsidized payments are always considered to be the full payment.

NOTICE ISSUES

The DOL created three new model notices that COBRA-payable entities can use to notify AEIs of eligibility for the subsidy, the transition period,

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IRS Clarifies Distributions And Benefits Under The HEART Act (cont.)

because they die or become disabled, as if they had been rehired on the day before death or disability (i.e., a "deemed rehired employee"), and then had terminated on the date of death or disability. The IRS makes a distinction between employees who die and employees who

become disabled due to military service.

For deceased employees, plans must provide vesting credit for their military service. This is consistent with the HEART Act's ban on discrimination in paying survivor benefits. For employees who

become disabled, plans may, but aren't required to, provide vesting credit. If plans choose to provide vesting credit, they must satisfy non-discrimination rules for crediting imputed service (i.e., service other than actual service to the employer). ❖

Fiduciaries May Deliver Summary Prospectuses To Plan Participants

Under ERISA, 401(k) plan fiduciaries must ensure that plan participants receive a copy of the most recent prospectus when investments, such as investments in mutual funds, are subject to the registration requirements of the Securities Act. The Department of Labor (DOL) has concluded in a Field Assistance Bulletin that fiduciaries can fulfill this duty by providing participants with a Summary Prospectus.

SUMMARY PROSPECTUS MEETS ERISA'S DISCLOSURE GOALS

Under a new rule issued by

the Securities and Exchange Commission, mutual funds may satisfy their disclosure duties to investors by providing them with a Summary Prospectus and by posting the statutory prospectus online at a specified website. Mutual funds must also send the statutory prospectus free of charge to any investor who requests one.

ERISA requires that 401(k) plan participants be provided with sufficient information to make informed investment decisions. To satisfy this disclosure requirement, a plan fiduciary must deliver a copy of the mutual fund's most recent

prospectus either immediately before or after a participant's initial investment. Participants may also request a copy of the prospectus.

The DOL noted that while it has never defined the term "prospectus," a Summary Prospectus meets ERISA's disclosure goals because it is a short-form document, which is written in plain English, and in a clear and concise format. *DOL:* Fiduciaries may satisfy the requirement to furnish a prospectus immediately before or after a participant's initial investment in a mutual fund by delivering to him/her the most recent Summary Prospectus received by the plan, if the Summary Prospectus is the most recent prospectus provided to the plan. ❖

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Webcast Clarifies COBRA Subsidy Extension Issues (cont.)

and the extension of the subsidy. Horahan covered these four examples.

Example 1. Alan experienced a COBRA qualifying event that was a termination of employment on October 10, 2009. The plan sent him the original ARRA General Notice on November 14, 2009, and he elected subsidized COBRA coverage. What notice, if any, should Alan receive? Horahan answered that Alan must receive the Model Premium Extension Notice.

Example 2. Barbara experienced a COBRA qualifying event that was a divorce on November 21, 2009. The plan sent Barbara the original ARRA

General Notice on December 15, 2009, and she elected COBRA, which she retains. What notice, if any, should she receive? Horahan answered that Barbara doesn't need to receive any notice. Since the COBRA qualifying event was a divorce, and not an involuntary termination of employment, she's not eligible for subsidized COBRA coverage.

Example 3. Carl experienced a COBRA qualifying event on September 15, 2009. The plan sent him the original ARRA General Notice on October 20, 2009, but he didn't elect COBRA at that time. What notice, if any, must Carl receive? Horahan noted that Carl isn't

a COBRA qualified beneficiary because he didn't elect coverage. Therefore, he doesn't need to receive any notice.

Example 4. Debbie experienced a COBRA qualifying event that was an involuntary termination of employment on December 8, 2009. The plan sent her the original ARRA General Notice on December 20, 2009. What notice, if any, must Debbie receive? According to Horahan, if Debbie was first eligible for COBRA beginning in January, she must receive the full, updated Model General Notice, and she's entitled to a 60-day election clock so she can decide whether to purchase subsidized COBRA coverage. ❖