Employee Benefits DEVELOPMENTS

January 2006

RULINGS, OPINIONS, ETC.

IRS Suspends 2005 Reporting Requirements Under Code § 409A. In late December, the Internal Revenue Service (IRS) granted a reprieve from the new reporting and withholding requirements imposed on nonqualified deferred compensation under Internal Revenue Code (IRC) § 409A. Under § 409A, all reportable deferrals under a nonqualified deferred compensation plan or arrangement for a calendar year must be separately reported on a Form W-2 or Form 1099, regardless of whether the deferrals are includible in income for the year. Reporting and wage withholding requirements also may apply to deferrals that must be included in a participant's gross income as a result of a violation of § 409A. In the face of employer concerns over the lack of guidance on calculating reportable amounts, the IRS suspended the reporting and withholding requirements for the 2005 calendar year. Under Notice 2005-94, employers are not required to report the amount of deferrals for 2005, nor are they required to include in the total amount of reportable wages or income any amounts subject to tax in 2005 for failure to comply with § 409A. Corrected payee statements will not be required later for 2005 deferrals that are not taxable in 2005, but future guidance may require an employer to file a corrected information return and provide a corrected payee statement for 2005 to report income arising from a violation of § 409A. Also, employees are not relieved of their individual responsibility to file a return and pay any taxes due on taxable deferrals. The IRS recognizes that, in the absence of reporting by the employer, an employee may not be able to determine the correct amount includible in income. Consequently, the IRS will not impose penalties for failure to accurately report the income or make estimated tax payments for 2005, so long as the employee reports and pays any applicable taxes in accordance with future published guidance. Interest will continue to apply to all underpayment of taxes by the individual.

Final Roth 401(k) Regulations. On December 30, 2005, the IRS released final regulations under Roth 401(k) provisions that take effect January 1, 2006. Highlights of the final Roth 401(k) regulations include:

- The plan document must be amended to provide for designated Roth contributions by the last day of the first plan year to which Roth 401(k) contributions are made.
- If a 401(k) plan is to provide for designated Roth contributions, it must also offer pre-taxed elective contributions.
- Forfeitures and matching contributions may not be allocated to a designated Roth account. Designations of amounts at Roth contributions are irrevocable.
- Roth deferrals may be treated as catch-up contributions and may serve as the basis for a participant loan.

Automatic Rollover Amendments, Additional Time Granted. Plans that make involuntary distributions of amounts in excess of $1,000 must comply with the new automatic rollover rules which took effect March 28, 2005. Initially, it was announced that plan amendments reflecting the new automatic rollover rules had to be adopted by the end of the first plan year ending on or after March 28, 2005. In Notice 2005-95, the IRS has provided for additional time in which to adopt the amendment. Under this notice, the date by which a plan sponsor must adopt an amendment that complies with the new automatic rollover rules is the later of the due date (including extensions) for filing the income tax return of the employer's taxable year that includes March 28, 2005, or the last day of the plan year that includes March 28, 2005. While an extension is granted to adopt the amendment, plans must have been in operational compliance commencing on March 28, 2005.

DOL Publishes Final USERRA Rules and Notice. The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) was enacted to ensure that those who serve in the uniformed services can retain their civilian employment and benefits, and can seek employment free from discrimination because of their service. On December 19, 2005, the Department of Labor (DOL) issued final regulations detailing and explaining the requirements of USERRA. The final rules replace the proposed rules issued in September 2004. The final regulations became effective January 18, 2006. According to the DOL, the final regulations do not impose any new obligations on employers. The final regulations, however, provide specific guidance on USERRA issues and are binding.

Along with the final rules, the DOL also published a revised and final version of the USERRA notice employers are required to furnish to their employees. This version replaces the interim notice published early in 2005. The modifications are minor and there are two notices now instead of one: one for private and state employers, and a second for federal agency employees. Both versions contain the logos and telephone numbers of the federal agencies who administer and enforce the law. The notice may be sent directly to affected employees and/or posted in an area where employer notices are commonly placed. To ensure receipt of the notice by all affected employees, we recommend distributing a print or electronic version in addition to posting.

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We also suggest that USERRA notices be included in the information furnished to all new employees. Employers may download the required USERRA notice from the DOL web site at http://www.dol.gov/elaws/userra.htm. An employer that previously posted the interim notice should substitute the new poster to be in compliance with the new notice requirements. The new notice requirement became effective January 18, 2006.

Expanded Hurricane Relief. The Gulf Opportunity Zone Act of 2005 (GO Zone), signed into law on December 21, 2005, extends the Katrina Emergency Tax Relief Act of 2005 (KETRA) provisions allowing for distributions and loans from eligible retirement plans to include victims of Hurricanes Wilma and Rita. GO Zone, while providing the same relief described in KETRA, has added new disaster areas and effective dates applicable to the appropriate hurricanes (Katrina, Wilma, and Rita). For information on the relief provisions provided by KETRA see our recent article at http://www.hodgsonruss.com/article_723.html. The deadline for making plan amendments for GO Zone provisions is the last day of the first plan year beginning on or after January 1, 2007 (i.e., by December 31, 2007, for a calendar year plan).

In related news, the DOL announced that IRS Notice 2005-92 also applies to the Employee Retirement Income Security Act of 1974 (ERISA) for distributions and loans. Specifically, the DOL clarified that it "will not treat any person as having violated the provisions of Title I of ERISA, including the requirements that plan loans be available on a reasonably equivalent basis and be adequately secured, solely because they made a plan loan to a qualified individual in compliance with the provisions of KETRA." KETRA provisions allow eligible participants to take up to an aggregate of $100,000 in plan loans and up to 100 percent of their vested accrued benefit.

IRS Adjusts Standard Auto Mileage Expense Rates. The IRS issued new standard mileage rates for taxpayer use in computing the deductible costs of the business use of automobiles. The new business standard mileage rate effective for expenses incurred on and after January 1, 2006, is $0.445 per mile. The IRS typically issues these standard rates at the beginning of each calendar year. Due to rising fuel costs, the IRS took the unusual step of raising the rate for the last four months of 2005 (to a rate of $0.485 per mile) above the rate established at the beginning of 2005 (a rate of $0.405 per mile published in Rev. Proc. 2004-64). This four-month increase was published in IRS Announcement 2005-71. The new 2006 rate is a four-cent-per-mile decrease from the September–December 2005 rate. Taxpayers may continue to use actual allowable expenses for the business use of automobiles if the taxpayer maintains adequate records and sufficient evidence for proper substantiation. The IRS also announced the standard mileage rate of $0.14 per mile for purposes of computing the charitable contribution deduction for use of an automobile in connection with rendering gratuitous services to a charity. This charitable rate is increased to $0.32 per mile in the case of automobile use in providing donated charitable services for the provision of relief related to Hurricane Katrina. Rev. Proc. 2005-78.

Rulings Are a Reminder That Waivers of 60-Day Time Limit for Rollovers Can Be Obtained. If a rollover of a qualified retirement plan distribution is not made by direct rollover, the rollover must be made within 60 days of the participant's receipt of the distribution. That 60-day time limit once was a very strictly enforced requirement. The IRC, however, was amended in 2001 to allow taxpayers to apply for waivers of the 60-day time limit on traditional rollovers for hardship situations like casualty, disaster, or other events beyond the reasonable control of the taxpayer. Since that relaxation in the 60-day time limit on rollovers, there has been a fairly steady stream of rulings in which the IRS has granted waivers of the 60-day time limit. For example, in recently published Private Letter Ruling 200550041, the 60-day time limit was waived for a taxpayer who terminated employment and moved to another city. When he was terminated, the taxpayer did not immediately receive a distribution of his qualified retirement plan benefit. Some time after the taxpayer terminated employment, his old employer's plan was terminated and the plan issued a check to the taxpayer for the amount of his benefit less applicable withholding. The check was mailed to the taxpayer's old residence, and the check was not forwarded to the taxpayer in accordance with the instructions given to the U.S. Postal Service. By the time the taxpayer actually received the check, the 60-day time limit had expired. The taxpayer applied for a waiver of the 60-day time limit for making a tax deferred rollover. In his application, the taxpayer asserted he was unaware that the plan was being terminated or that the distribution was being sent to him. The IRS granted the taxpayer's waiver request. Note that the IRS charges a user fee to consider an application to waive the 60-day time limit. Beginning February 1, 2006, the user fee will increase from a flat rate of $95 to a fee ranging from $500 to $3,000, depending on the amount to be rolled over.

CASES

Take Care of SPD Language. We have seen plenty of litigation over language used in, or omitted from, an employee plan summary plan description (SPD). A recent federal district court case from Ohio denied a claim that a severance pay plan under ERISA could not be amended to eliminate benefits for a group of employees because the right to amend the plan was not described in the SPD. Union Central Life Insurance Company (Union Central) maintained a severance plan that provided benefits to employees who were terminated for any reason other than just cause. On March 17, 2003, Union Central amended the plan to eliminate severance benefits for employees who were terminated as a result of a sale of a business unit if the employees were offered substantially similar jobs by the buyer of the unit. Two days later, Union Central completed the sale of a business unit. The plaintiffs in this case worked in the sold business unit and lost their jobs with Union Central but were offered and accepted jobs with the buyer. They sued to collect severance benefits from Union Central. The plan's SPD said nothing about the employer's right to amend,

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and the plaintiffs argued that without describing this right in the SPD, the plan amendment could not be applied to them. In a decision rejecting this argument, the court repeated one position that all employers should heed: "Statements in a summary plan description are binding and if such statements conflict with those in the plan itself, the summary shall govern." In this case, there were no conflicting statements, but the right to amend was omitted from the SPD. The federal district court dismissed the plaintiff's case and concluded that the omission did not mean that the employer could not effectively adopt the plan amendment. *Tamera Sears v. Union Central Life Insurance Co.* (S.D. Ohio 2005).

Benefit Promises Not "in the Plan" May Be Enforceable. In *Ladouceur v. Credit Lyonnais*, the plaintiffs made a claim for pension benefits promised, not by the pension plan document itself, but by the company's human resources officer and pension plan fiduciary. As a general rule, benefit promises made outside of the four corners of a governing plan document and SPD are unenforceable under ERISA. However, in "extraordinary circumstances," benefit promises made outside of the plan and SPD will be enforced against the plan if an employee can establish that he or she relied on the promise in making some important decision and was injured as a result. This doctrine is known as the doctrine of promissory estoppel.

The plaintiffs in this case worked for Credit Lyonnaise Rouse ("Rouse"), a subsidiary of Credit Lyonnaise ("Lyonnaise"). Rouse was merged into Lyonnaise. Prior to the merger, the company's human resources manager allegedly told the plaintiffs that if they joined Lyonnaise, the salaries they had been receiving as Rouse employees would be continued and that, upon retirement from Lyonnaise, they would each be entitled to a pension benefit based on their combined service with Rouse and Lyonnaise rather than just their service with Lyonnaise. Within months of the merger, the plaintiffs' salaries were reduced and shortly thereafter each left the employ of Lyonnaise. The plaintiffs then learned that their pension with Lyonnaise would be based on their short service with Lyonnaise instead of their combined service with Rouse and Lyonnaise, as they were promised. Presumably, the Lyonnaise pension plan document did not recognize the plaintiffs service with Rouse for purposes of vesting or benefit accrual; credit was given only for service with Lyonnaise. The plaintiffs then sued for the additional benefit, in part, on the basis of promissory estoppel. The federal trial court ruled against the plaintiffs and dismissed their complaint, holding that "inducing a current employee to continue working for his employer or its successor does not rise to the level of 'extraordinary circumstances' required to proceed in a promissory estoppel claim under ERISA." In addition, the court held plaintiffs failed to allege how their reliance on this promise caused them any injury. The plaintiffs appealed the decision to the U.S. Court of Appeals for the Second Circuit and the federal appellate court, in an unreported decision, reversed the dismissal and sent the case back to the federal trial court for further proceedings. In so ruling, the Second Circuit held that inducing continued employment by making false promises is sufficient to make out "extraordinary circumstances" at the motion to dismiss stage. The Second Circuit did not address the plaintiffs' failure to allege how they were injured or otherwise prejudiced by the promise of additional pension benefits. *Ladouceur v. Credit Lyonnaise* (2d Cir., 2005).

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