EMPLOYEE BENEFITS

Developments

Hodgson Russ LLP ATTORNEYS

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HOT TOPIC

IRS Publishes Final Split-Dollar Life Insurance Regulations—No Significant Changes Made. On September 11, the Internal Revenue Service ("IRS") issued long-awaited final regulations and a revenue ruling addressing the tax treatment of split-dollar life insurance policies. Virtually ignoring all criticism leveled by commenting interested parties, the final regulations do not significantly change the proposed regulations previously issued. Going forward, ownership of the insurance policy will drive the related income tax consequences:

- Where the employee owns the policy, premium payments by the employer are treated as loans, exposing the employee to tax on the difference in interest between the market rate and actual rate charged (the so-called **"loan regime"**); and
- Where the employer owns the policy, premium payments by the employer are deemed to provide the employee with taxable economic benefits—i.e., the cost of any current life insurance protection provided to the employee, the amount of policy cash value to which the employee has current access, and the value of any other economic benefits provided to the employee (the so-called **"economic benefit regime"**). For these purposes, an employee has "current access" to the policy's cash value if the employee has a current or future right to it and if the cash value is currently, directly or indirectly, accessible by the employee, inaccessible to the employer, or inaccessible to the employer's general creditors.

The final regulations permit beneficiaries to exclude death benefit proceeds from income only to the extent those proceeds relate to life insurance protection, the cost of which was paid for by the employee or taken into account as an economic benefit provided by the employer to the employee.

The final rules apply to any split-dollar life insurance arrangement entered into after September 17, 2003 and any arrangement in existence on or before September 17, 2003 that is materially modified after that date. Every policy needs to be reviewed well before the tax consequences go into effect January 1, 2004. (T.D. 9092; Rev. Rul. 2003-105.)

Split-Dollar Planning Opportunity—Act Soon. The publication of the final split-dollar insurance regulations reinforces a potential tax planning opportunity for employers with "older" split-dollar insurance arrangements. Guidance published in 2002 allows certain split-dollar arrangements to be terminated and "rolled out" on a tax-advantaged basis, but action to terminate the arrangement may be needed *before December 31, 2003*. Employers with existing split-dollar arrangements should review those arrangements well before the December 31 deadline to determine if the split-dollar policies should be "rolled out" and to understand how the IRS will tax the arrangements under recent guidance.

IRS/DOL RULINGS, ETC.

DOL Holds Profile is Prospectus for Purposes of § 404(c) Regulations. In a September 8 advisory opinion concerning § 404(c) of the Employee Retirement Income Security Act of 1974 ("ERISA"), the Department of Labor ("DOL") ruled the delivery of a mutual fund profile (i.e., a non-technical, summary prospectus in a format prescribed by the rules of the Securities and Exchange Commission) will satisfy an ERISA 404(c) plan's obligation to deliver a copy of the most recent prospectus to plan participants and beneficiaries who invest in mutual funds. Under certain circumstances, however, participants still may secure copies of a more detailed prospectus on request. An ERISA 404(c) plan is a participant-directed individual account plan under which the plan's fiduciaries generally may avoid liability for investment losses resulting from a participant or beneficiary exercising investment control over his or her plan account. Most 401(k) plans are designed to be 404(c) plans. (DOL Adv. Op. 2003-11A.)

Plan Sponsor Allowed Reversion Following Disallowance of Deduction. In an interesting use of an IRS ruling procedure, the IRS recently allowed a $200,000 reversion to the sponsor of a defined benefit plan and ruled the reversion would not adversely affect the qualified status of the plan if the reversion occurs no later than one year from the date of the private letter ruling. Reversions of plan contributions may be allowed if the contributions are conditioned on their deductibility under § 404 of the Internal Revenue Code ("Code") and the deduction is disallowed. The reversion of a contribution generally must take place within one year from the date of disallowance of the deduction. The maximum amount that may be returned to the sponsor is the excess of the amount contributed, over the amount that would have been contributed had the contribution been limited to the amount that is deductible. The IRS has procedures (see Rev. Proc. 90-49, 1990-2 CB 620) under which a sponsor of a defined benefit plan, for which quarterly contributions are required to satisfy the minimum funding requirements, may request a ruling letter that a contribution would be nondeductible if claimed as a deduction. The reversion in this instance was granted in response to a ruling request made under Rev. Proc. 90-49. In the ruling, the IRS noted if the reversion amount was not returned by the sponsor's tax filing date, including extensions, the tax on nondeductible contributions to qualified employer plans (Code § 4972) would apply. (Priv. Ltr. Rul. 200336036 (September 5, 2003).)

CASES

Failure to Provide Requested Benefits Information Results in Substantial Fines. Linda Sue Brown was terminated by Aventis Pharmaceuticals following a disability leave. The termination letter Brown received stated she would receive further information regarding the impact of termination on her benefits,

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but that information did not arrive. Brown's benefits as an Aventis employee included health, dental, and life insurance coverage. Brown was particularly concerned with her rights to convert her health benefits from an employer-provided plan to an individual plan because health problems would make it difficult for her to get insurance from a new provider. Aventis provided Brown with an employee yearbook containing summary plan descriptions ("SPDs"), but Brown did not possess it at the time of her termination. She left it in her employee locker when she went on disability leave. While she was on leave, the company's maintenance staff cleaned out her locker and did not return the contents. Brown placed a follow-up call to the company's human resources department, which assured her the promised benefits information would be forthcoming. When the information did not arrive nearly two months after her termination, she hired an attorney in an attempt to obtain it. Brown's attorney mailed two letters requesting the benefits information. Brown received the Consolidated Omnibus Budget Reconciliation Act of 1986 ("COBRA") information and insurance conversion forms, but not an SPD. Upon receiving these forms, Brown attempted to convert her life insurance coverage. Her conversion application and the subsequent appeal were denied.

Although her attorney's letters did not specifically ask for an SPD, the district court found they constituted a request for the SPD based on language requesting information about "all benefits." The court awarded $11,550 in ERISA civil penalties for Aventis's failure to supply an SPD upon receipt of Brown's written request. Brown also was awarded $8,030, the maximum statutory damages allowed, for Aventis's failure to provide COBRA notification within the required time period. Finally, Aventis was required to provide Brown with a life insurance certificate for $39,000 (the amount of coverage Brown was unable to convert, minus any costs Brown would have incurred in the process of conversion). The 8th Circuit Court of Appeals affirmed the district court decision. (*Brown v. Aventis Pharmaceuticals, Inc.*, ____ F.3d ____ (8th Cir. 2003).)

Reverse Age Discrimination Not Actionable Under ADEA. The Post-Retirement Benefit Plan (the "Plan") of Ecolab, Inc. ("Ecolab") provided Ecolab would pay a premium subsidy for retiree medical coverage based on a retiree's years of active service with the company. In March 2003, Ecolab eliminated the subsidy for all but two grandfathered groups. As a result, the benefit, in its revised form, was not available to Ecolab employees under age 50 as of the amendment's effective date. The affected employees cried age discrimination and sued. On these facts, the federal district court held claims of reverse age discrimination (i.e., allegations the plaintiffs were treated less favorably than others who were older than the plaintiffs) were not actionable under the Age Discrimination in Employment Act of 1967. Further, the court rejected a claim by the plaintiffs to stay the decision pending an expected ruling by the United States Supreme Court during its upcoming term in a case presenting the same issue. (*Feigl v. Ecolab, Inc.*, ___ F. Supp. 2d ___ (N.D. Ill. 2003).)

Company's Substantiation of Business Expenses Proves to Be No "Fish Tale." Townsend Industries ("Townsend") gathers its salespeople for an annual, two-day meeting at its headquarters. Corporate staff and some factory workers also attend. Following the meeting, which has occured for the last 40 years, the company sponsors a four-day, all-expense-paid fishing trip to a resort in Ontario, Canada. Aside from a dinner at which the company's owner and its CEO speak about the state of the company, the employees and salespeople are able to spend their time largely as they wish. Most go fishing. Nevertheless, business discussions are also conducted during the trip. The 8th Circuit Court of Appeals, reversing a district court decision, ruled Townsend presented adequate evidence to substantiate the business purpose of the 1996 and 1997 fishing trips, and that the per-employee cost of Townsend Industries's annual fishing trip was not taxable wages.

The questions of whether the per-employee cost of the trips amounted to taxable wages and whether Townsend should have withheld a portion of these costs turn on whether each employee could have deducted these costs as business expenses. While the court was careful to point out its decision did not propose that all corporate-sponsored hunting, fishing, or other trips to "luxury" vacation spots can avoid inclusion of the per-employee cost of the trip in employee wages, it concluded there was adequate substantiation of the business purpose in this instance. Of particular significance to the federal appellate court was the Townsend employees' testimony that they felt an obligation to attend and that they felt it was part of their job. The court also found significant the testimony of employees that specific Townsend-related business was conducted during the 1996 and 1997 trips and certain business-related activities were always conducted on the trips. (*Townsend Industries v. U.S.*, ____ F.3d ____ (8th Cir. 2003).)

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