

Developments

December 15, 2003 to December 26, 2003

IRS/DOL Rulings, Opinions, Etc.

IRS Issues Final Regulations Affecting Distribution Election Forms and Explanation of Distribution Alternatives. The Internal Revenue Service (IRS) issued final regulations outlining the required description on distribution election forms of the relative values of optional forms of benefit compared to the value of a qualified joint and survivor annuity. These final regulations (TD 9099) generally follow the proposed regulations issued by the IRS in 2002. Plan sponsors should review with their advisors whether modifications of their distribution forms are required to comply with these new requirements. The regulations require the relative value of an optional form of benefit, compared to the value of the qualified joint and survivor annuity, must be expressed in a manner that provides a meaningful comparison of the relative economic values of the two forms of benefit without the participant making calculations using interest or mortality assumptions. One change made in the final regulations allows a uniform explanation for both married and unmarried individuals where the benefit options are the same. Under the proposed regulations, different calculations would have been required for married and unmarried participants. The final regulations apply to explanations of qualified joint and survivor annuities with annuity starting dates after September 30, 2004 and to qualified pre-retirement survivor annuity explanations provided after June 30, 2004.

IRS Permits Government Employees to Contribute Unused Leave to Retirement Plans. An unidentified state adopted a comprehensive leave program for its employees. Under the new leave program, at the time of retirement or termination of employment, any unused leave will be contributed to that state's defined contribution Internal Revenue Code (IRC) § 401(a) plan. The contributions will be made to the plan without an employee's choice. However, any amount not eligible for contribution by the state to the IRC § 401(a) plan, at the employee's election, may be taken in cash or contributed under the state's grandfathered IRC § 401(k) plan or to the state's IRC § 457(b) program. Any amount that cannot be contributed to the plans is forfeited. The IRS held employees would not be currently taxable on these amounts under the economic benefit or constructive receipt doctrines. Also, it found this plan was not subject to the requirements of IRC § 457 until the time the value of the leave is actually contributed to the state's IRC § 457 program. (PLR 200351002).

Guidance on Health Savings Accounts Available. The IRS and the Department of the Treasury recently provided guidance in a question-and-answer format about the new tax-favored Health Savings Accounts (HSAs) created by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. (See *Employee Benefits Developments* December 1 to December 12, 2003 for more information about this Act). Notice 2004-2 addresses requirements governing high-deductible health plans that accompany HSAs, requirements regarding HSA trustees, the form of contributions to HSAs, the tax treatment of HSA contributions and distributions, excess contributions to HSAs, and transfers of Archer Medical Savings Accounts to HSAs. (2004-2 IRB ____ (Jan. 12, 2004).)

Cases

Fiduciary Status Does Not Apply to Executives Who Terminated Plan on Court Order. Determining fiduciary duty sometimes requires an examination of how a plan decision was made. The District Court for the

Northern District of Illinois held executives who shut down a health plan pursuant to a bankruptcy order are not liable for a breach of fiduciary duty. In September 1997, Greenmarine Holdings LLC completed a takeover of Outboard Marine Corp. and subsequently caused Outboard Marine Corp. to shut down a plant in Waukegan, Illinois and file for bankruptcy in December 2000. The plaintiffs were all participants in the OMC Health Plan (Plan). Outboard Marine Corp. applied for and received approval from bankruptcy court to terminate the Plan in February 2001. The plaintiffs alleged the defendants (Greenmarine Holdings LLC and executives of Outboard Marine Corp.) violated their duty as fiduciaries under the Employee Retirement Income Security Act (ERISA) for the failure to provide notice of the impending termination of the Plan, which in turn prevented them from obtaining alternative insurance without a break in coverage. The plaintiffs sought damages and equitable relief under ERISA. The Plan document stated no notice of termination need be given to Plan participants. The plaintiffs argued the Plan document was not provided to all Plan participants. The federal district court noted the bankruptcy court directed the defendants to terminate their Plan as soon as reasonably possible and held the lack of notice by the defendants was not an exercise of discretionary authority on the part of the defendants and cannot be characterized as a breach of fiduciary duty. (*Baker v. Kingsley*, ____ F.Supp.2d ____ (N. D. Ill., Dec. 10, 2003).)

Failure to Discharge Employees Does Not Interfere With Benefit Rights. The United States Court of Appeals for the Fifth Circuit rejected the argument of a group of employees that ERISA § 510 prohibits employers from retaining employees to prevent employees from obtaining benefits. The federal appellate court also held the decision to "terminate an employee, who is also a plan beneficiary, is inherently not fiduciary in nature." The employer, Employers Casualty Co., was experiencing financial difficulties and implemented a workforce reduction program. The employer also amended its retirement plan to provide enhanced benefits for employees selected for termination between October 1, 1990 and December 31, 1993. Twenty-five employees were not selected for termination during this period and thus were not eligible for enhanced benefits under the retirement plan. The plaintiffs argued there was a lack of material business reasons for the employer to treat the plaintiffs differently from the other employees who were selected for termination under the workforce reduction program. They alleged this constituted impermissible discrimination under ERISA § 510. In effect, the plaintiffs argued the act of continuing the plaintiffs' employment caused impermissible interference with their benefit rights. The federal appellate court agreed with the district court's holding and ruled the plaintiffs had not stated a claim for which relief could be granted. The plaintiffs also argued the employer violated its fiduciary duty under ERISA by failing to terminate the plaintiffs' employment, because there was a lack of a legitimate business need to retain them as employees. The court held the employer is not a fiduciary simply because "an ordinary business decision turned out to have an adverse impact on the plan." (*Bodine v. Employers Casualty Co.*, ____ F.3d ____ (5th Cir., Dec. 12, 2003).)

Second Circuit Holds IRAs Are Subject to Criminal Forfeiture; Not Protected by ERISA. The United States Court of Appeals for the Second Circuit ruled individual retirement accounts (IRAs) held by an individual who was convicted of illegal drug distribution are subject to forfeiture. The defendant, Michael Vondette, was found guilty of conspiring to distribute hashish, marijuana, and methaqualone, and guilty





of laundering money. The defendant was ordered to forfeit a number of assets, including several IRAs, to partially satisfy a more than \$2 million monetary judgment entered against him. The defendant argued the protection of pension funds from civil forfeiture should be expanded to protect his IRAs from criminal forfeiture. The federal appellate court held that “nonforfeitable” under ERISA § 408(a)(4) is to be “interpreted as synonymous with ‘vested’” and merely establishes the defendant had a vested interest in his IRA accounts. The court further held IRAs are criminally forfeitable because ERISA’s anti-alienation provisions apply to pension plans and do not “purport to apply to IRAs or any other type of retirement benefit beyond pension plans.” (*United States v. Vondette*, ___ F.3d ___ (2d Cir., Dec. 16, 2003).)

Sole Proprietor Personally Liable for Unpaid Contributions to Plans.

The District Court for the Northern District of Illinois held an individual sole proprietor was personally liable for unpaid contributions to the multiemployer pension fund of the Construction and General Laborers’ District Council of Chicago and Vicinity from January 2001 to July 30, 2002. In January 2001, James McDaniel signed a collective bargaining agreement (CBA) obligating McDaniel Construction Corporation to make contributions to the pension funds on behalf of employees covered by the agreement. At the time of the signing, McDaniel Construction Corporation was nonexistent as a corporation, having been dissolved in September 1998, and a successor entity was not incorporated until July 30, 2002. The court agreed with the Laborers’ Pension Fund’s argument that James McDaniel signed the CBA in his capacity as a sole individual proprietor and should be held individually liable for the delinquent contributions to the plans. The court held a “corporation officer who is aware of a corporation’s dissolution and carries on business under the nonexistent corporation’s name is personally liable for debts incurred during the period under which he conducts such operations.” (*Laborers’ Pension Fund v. McDaniel*, ___ F.Supp.2d ___ (N. D. Ill., Dec. 22, 2003).)

Employer Not Liable for Decline in Value of Stock During Termination of Plan. As this and the subsequent item illustrate, just because the value of a plan investment declines, that does not mean a fiduciary duty was breached. Archer Daniels Midland Company (ADM) merged with Morman Manufacturing Company (Morman). Morman sponsored a profit sharing/employee stock ownership (ESOP) plan in which stock made up 65% of the plan assets. Upon merging, the Morman stock was replaced with shares of ADM. The Morman plan was to be terminated with participants offered the choice of distribution in the form of cash, ADM stock, or rollover into ADM’s ESOP or into a participant’s IRA. ADM made the termination of the Morman Plan contingent on receiving a favorable ruling from the IRS, which took 18 months. During the 18-month period, the price of ADM stock fell by almost a third. Plan participants argued the trustees of the Morman Plan, knowing a 12-month or longer period would pass before distribution of assets on termination was made, should have sold the ADM stock and invested the proceeds in suitable short-term investments, such as fixed income securities. The federal appellate court upheld the district court decision that the trustees did not act imprudently by failing to diversify the investments held in the plan. The federal appellate court pointed to the fact that an ESOP plan, by its very design, will not hold a diversified portfolio of investments and, absent other indications of imprudence, the

plan trustees fulfilled their duties to plan participants. (*Steinman v. Hicks*, ___ F.3d ___ (7th Cir., Dec. 12, 2003).)

Elimination of Employer Securities Not a Fiduciary Act. In 1999, R.J. Reynolds Tobacco Company (Reynolds Tobacco) was spun off as a subsidiary of RJR Nabisco Holdings, Inc. Prior to the spinoff, investment options available under the Reynolds Tobacco employees’ plan were shares of Nabisco and Nabisco Holdings. On the spinoff, plan participants were prohibited from allocating new contributions into Nabisco or Nabisco Holdings stock. Approximately seven months after the spinoff, Reynolds Tobacco ordered all investments in Nabisco and Nabisco Holdings stock be sold, and Nabisco and Nabisco Holdings shares were no longer offered as an investment alternative. During this period, the Nabisco share price dropped from \$42 per share to \$30 per share. Nabisco Holdings dropped from \$21 to \$8.50. Approximately six months later, the Nabisco stock was selling for approximately \$55 per share, nearly twice the price at which the plan sold. Nabisco Holdings stock was selling for \$30 per share, over three times the price the plan sold it for. A participant sued Reynolds Tobacco and the plan’s fiduciaries, alleging breach of ERISA fiduciary duty by requiring that all shares of Nabisco and Nabisco Holdings be sold at a time when the shares were near an all-time low. The District Court for the Middle District of North Carolina granted the defendant’s motion to dismiss the lawsuit, finding Reynolds Tobacco’s decision to sell these shares was part of the Reynolds Tobacco’s settlors’ actions and not an exercise of fiduciary discretion. The federal district court held any fiduciary discretion with respect to the shares was taken away when the plan was amended by Reynolds Tobacco to eliminate Nabisco and Nabisco Holdings stock as investment options. (*Tatum v. R.J. Reynolds Tobacco Co.*, ___ F.Supp.2d ___ (M.D.N.C., Dec. 10, 2003).)

Updated Taxation Treatise by Hodgson Russ Team Now Available. *Taxation of Distributions From Qualified Plans 2003/2004* has been published by Warren, Gorham & Lamont at RIA. The new edition, more than 700 pages, incorporates important new and updated material, including a full new chapter providing in-depth analysis of the different tax rules applicable to governmental plans, as well as new cases, rulings, and other significant developments.

Taxation of Distributions From Qualified Plans, the seminal work in its field, was first published in 1990 and is updated annually. The treatise is carefully designed to provide tax practitioners, benefits specialists, plan administrators, and other professionals who advise recipients of plan distributions with authoritative guidance on planning for and handling distributions from various retirement plans and programs like qualified retirement plans, 403(b) tax deferred annuities, and IRAs. The treatise provides many practical examples.

Taxation of Distributions From Qualified Plans can be ordered at www.riahome.com/estore.



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