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Compensation & Benefits IN FOCUS

Developments in executive compensation and employee benefits

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In This Issue

Spotlight on Health Care Reform

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (together, PPACA), promises dramatic changes in the availability, delivery and funding of health care in the United States, and employers are not immune to these changes. Consequently, employers should keep abreast of PPACA developments (e.g., regulatory agency guidance), and this newsletter attempts to assist in that regard. This issue (among other topics of current interest) provides an overview of the PPACA requirements for employers' group health plans with the earliest effective dates, focuses on a couple of these requirements, and highlights one requirement that has not yet received much attention.

The Patient Protection and Affordable Care Act can be found **here**.

The Health Care and Education Reconciliation Act can be found **here**.

First Wave of Health Care Reform About to Hit Group Health Plans

Employers sponsoring group health plans should begin to focus on plan amendments that may be required in the near term under the PPACA. Below is a list of the most important requirements that become effective with respect to group health plans (both insured and self-insured) for plan years beginning on and after September 23, 2010 (i.e., January 1, 2011 for calendar year plans):

1. No pre-existing condition limits for participants under age 19
2. No lifetime limits on the dollar value of "essential health benefits"
3. Regulated annual limits on the dollar value of "essential health benefits"
4. No rescission or cancellation of coverage, except for fraud or misrepresentation
5. Required provision of designated preventive care services and immunizations, with no cost-sharing with participants

The Pulse

COBRA Subsidy Eligibility Extended Again

Under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), certain group health plan participants who lose their coverage are permitted to continue coverage for a period of time by electing continued coverage and paying the relevant premium themselves. The American Recovery and Reinvestment Act of 2009, as amended, provided a subsidy to certain eligible individuals that allowed them a discount of up to 65% of their COBRA premiums for up to 15 months.

The eligibility period for the COBRA subsidy has expired and been extended several times. Most recently, the eligibility period was extended to May 31 by the Continuing Extension Act of 2010. Consequently, participants who experience a qualifying event on or before such date may be eligible for the subsidy. As of press time, legislation had been introduced to further extend the eligibility period to December 31, but had not yet been enacted.

The text of the Continuing Extension Act of 2010 can be found here.

ESOP Legislation Introduced

A bipartisan pair of representatives introduced the ESOP Promotion and Improvement Act of 2010 in the House of Representatives on May 5. This legislation is intended to make the federal tax code more business friendly for employee stock ownership plans (ESOPs). Among other things, the tax law changes would change how dividends from S corporation stock are taxed and the tax deduction rules.

The text of the ESOP Promotion and Improvement Act of 2010 can be found here.

6. Required extension of dependent coverage to adult children until age 26 (see below for more information)
7. At least 60 days advance notification to participants of material changes to a group health plan
8. Restrictions on discrimination in favor of "highly compensated individuals" by insured plans (see below for more information)
9. External review process included in new procedures for appealing denied claims
10. Removal of certain restrictions on access to primary care providers, emergency services, pediatric specialists, and obstetrical and gynecological care
11. Cost of health coverage included on 2011 Forms W-2
12. Over-the-counter medicines cannot be reimbursed by a flexible spending account unless they are prescribed by a doctor

Some of the changes listed above are optional for "grandfathered" plans (generally, plans in existence on March 23, 2010).

The list is finite, but so is the time period for making these changes. Plan sponsors and/or administrators should begin to review their plan documents, noting where changes will be required, and then begin discussions with their insurers, third party administrators and counsel to ensure a timely and coordinated implementation of these changes.

Insured Health Plans to Comply with Nondiscrimination Rules

Certain insured group health plans will soon be subject to nondiscrimination rules that are similar to those that have applied to self-insured plans for the past 30 years. In other words, such insured plans will be prohibited from discriminating in favor of "highly compensated individuals," which generally includes the employer's 10% shareholders, five highest paid officers and highest paid 25% of employees. These nondiscrimination rules apply to non-grandfathered plans (generally, plans not in existence on March 23, 2010) for plan years beginning on or after September 23, 2010. The PPACA does not specify when these rules will apply to grandfathered plans, but regulatory guidance is anticipated to address this.

The application of the nondiscrimination rules to insured health plans will likely affect certain welfare benefits that employers often provide exclusively to executives and other highly compensated individuals. Under current rules, employers may adopt fully-insured, executive-level welfare plans that offer medical, dental and vision benefits that are over and above the coverage provided to rank and file employees. Employers also sometimes purchase insurance policies to satisfy obligations associated with post-termination or retirement health care benefits provided to certain former executives. However, when insured health plans become subject to the nondiscrimination requirements, providing such benefits to only a select group of highly compensated individuals will likely result in adverse tax consequences to both the executive and the employer.

Because the PPACA is new, it is currently unclear how the new nondiscrimination rules will be enforced and what consequences will apply if discrimination exists. However, given that enforcement of the law may begin in the near future, employers should examine their insured plans for evidence of discrimination and determine what must be done to avoid continuation of any discriminatory non-grandfathered plans into 2011.

IRS Sends 401(k) Questionnaires

The IRS announced that it has sent employers sponsoring 401(k) retirement plans a questionnaire to gather information to help it "maximize its resources for education, outreach, guidance and enforcement efforts while minimizing the burden to compliant plan sponsors." These questionnaires address contributions, compliance testing, distributions, automatic contribution arrangement, Roth features, administration and the IRS voluntary correction programs.

More information is available here.

Consolidated 409A Correction Program Under Development

At a recent conference of tax practitioners, an IRS official indicated that the IRS may issue a revenue ruling consolidating the Section 409A operational and document correction programs. However, no expected date of issuance was given and no dramatic changes are anticipated. The IRS official thought the revenue ruling would contain more examples of corrections and might address some of the criticism the current correction programs have received from practitioners. Thus, waiting for additional Section 409A relief may not be beneficial. As a reminder, the current document correction program provides incentives for employers to correct document failures by December 31, 2010. For more information about the document correction program, click here.

Federal Agencies Publish Spring 2010 Regulatory Agendas

The IRS, DOL and Pension Benefit Guaranty Corporation have released their respective semiannual agendas. To see what these agencies are working on, click here and then select the agency's list you wish to view.

Health Plan Coverage of Adult Children Is Tax Free

The PPACA requires employer-sponsored health plans to allow coverage of eligible employees' children until the children reach age 26 (Adult Children). The Department of Health and Human Services issued interim guidance on May 10, 2010, that further explains the mandatory coverage of Adult Children.

Tax Guidance

To address questions about the tax ramifications of extending coverage to a child who is not otherwise considered a dependent of the employee for tax purposes, the IRS issued Notice 2010-38, which provides the following guidance:

- Health plan coverage of an Adult Child through the end of the calendar year in which the child attains age 26 will be tax free to the employee and the child. Neither the benefits provided nor the value of the coverage will be subject to income or employment taxes (i.e., FICA and FUTA). The coverage is tax free even if the child is married, lives independently from the employee, has separate employment or is eligible for other group health plan coverage.
- The value of coverage provided through a parent's employer-sponsored plan to the spouse of an Adult Child is taxable to the employee-parent.
- Cafeteria plans and premium-only plans may allow employees to pay an Adult Child's share of any health plan premium or contribution using pre-tax dollars.
- For purposes of health reimbursement arrangements, flexible spending accounts and voluntary employee benefits associations, Adult Children are eligible dependents.

Effective Date

Under the PPACA, employer-sponsored plans are either grandfathered (generally, plans in existence as of March 23, 2010) or not grandfathered (generally, plans that are new after March 23, 2010). For plan years beginning on or after September 23, 2010, non-grandfathered plans must offer coverage to all Adult Children, while grandfathered plans must offer coverage only to Adult Children who are not eligible to participate in health plans sponsored by their employer. For plan years beginning on and after January 1, 2014, grandfathered plans must expand the availability of coverage to all Adult Children. Even though coverage of Adult Children is not yet required, Notice 2010-38 allows employers to voluntarily offer such benefits before the required date, and the tax-free benefits described above apply on and after March 30, 2010.

Employer Action

Employers electing to voluntarily cover Adult Children may immediately begin allowing employees to pay for their Adult Children's share of the premium with pre-tax dollars under applicable plans. By December 31, 2010, such employers must amend the relevant plans retroactively to the first date employees were able to elect such coverage through the plan, but no earlier than March 30, 2010.

Notice 2010-38 can be found **here**.

PPACA Provides a Surprise to Large Employer VEBAs

The PPACA imposes an annual fee on "health insurance providers." The fee is assessed annually upon all providers based upon their proportionate amount of aggregate "net premiums written" in excess of $25 million. The fee commences in 2014 in the aggregate amount of $8 billion, increases to $14.3 billion in 2018 and escalates thereafter.

The PPACA provides exclusions in the case of "(A) any employer to the extent that such employer self-insures its employees' health risks," and "(B) any governmental entity (except to the extent such an entity provides health insurance coverage through the community health insurance option)."

There is no such blanket exclusion provided in the case of a voluntary employees' beneficiary association, typically referred to as a "VEBA," described in Section 501(c)(9) of the Internal Revenue Code. Instead, the PPACA contains a very limited exclusion for VEBAs established by an entity (other than by an employer or employers) for purposes of providing health care benefits.

As a result, VEBAs established by trade associations or through specific legislation or bankruptcy orders appear to be excluded from the annual fee imposed upon "health insurance providers." But the typical arrangement, whereby a large employer provides its employee health insurance benefits through its own VEBA, appears to be subject to the annual fee.

Target Date Retirement Fund Investor Bulletin Issued by DOL and SEC

The Department of Labor's Employee Benefits Security Administration (EBSA) and the Securities and Exchange Commission (SEC) have published a bulletin about target date retirement funds (also known as "life cycle funds") that is intended to help investors and plan participants understand and evaluate such investments. The bulletin also is a useful resource for retirement plan sponsors and investment committees that are responsible for selecting and monitoring the investment alternatives available under retirement plans.

Target date funds are intended to simplify retirement investing for plan participants and other investors by using a combination of investments that is gradually adjusted to become more and more conservative as a fund's "target date" approaches. Investors often choose a particular target date fund based on their retirement time horizon. However, the investment strategies and adjustment timelines of different target date funds vary widely. Many investors and plan fiduciaries may not be aware of these differences, or may not know how to assess the differences. The EBSA/SEC guidance is intended to assist plan participants and other investors in evaluating the benefits and risks associated with target date funds and the appropriateness of investing their retirement assets in such funds.

The bulletin provides an overview of how target date funds are designed and intended to operate, including examples of differences in asset allocation methods and adjustment timeframes that may be used by various funds. The guidance discusses key considerations for evaluating target date funds and outlines factors for investors to consider before investing in a particular target date fund. The bulletin also lists other resources issued by the Department of Labor, the SEC and the Financial Industry Regulatory Authority that may be helpful to investors.

The guidance, "Investor Bulletin: Target Date Retirement Funds," is available **here**. According to Louis Campagna, chief of the EBSA Division of Fiduciary Interpretations, EBSA also is compiling a target date funds checklist for retirement plan sponsors.

Investment Adviser Convicted of Defrauding Employee Benefit Plan

On April 16, the U.S. Attorney for the Eastern District of Michigan, together with EBSA's regional director and the FBI, announced the conviction of Anthony James for 14 criminal counts relating to his operation of a Ponzi scheme. The charges included mail fraud, wire fraud and embezzlement from an employee benefit plan. James, an investment adviser from Parkland, Florida, was indicted on charges that he received over $5.3 million from more than 40 investors, including pension plan participants.

Instead of investing the money, Mr. James spent approximately $2.5 million on personal items, including two residences and several cars, while using the remaining amount (approximately $2.8 million) to pay back earlier investors. In the press conference following the conviction, Paul Baumann, director of EBSA's Cincinnati Regional Office, declared, "This criminal action demonstrates the Labor Department's resolve to vigorously enforce the law to ensure that those who steal from contributory employee benefit plans are brought to justice." Theft or embezzlement from an employee benefit plan carries a $250,000 fine and a maximum penalty of five years imprisonment. Mr. James is scheduled to be sentenced on August 17.

The Department of Labor press release regarding the conviction can be found **here**.

Please direct any questions, comments or suggestions regarding the newsletter to your Katten attorney or any of the following members of the firm's **Employee Benefits and Executive Compensation Practice**:

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