

# EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

LEGAL PERSPECTIVES

July 2002

## IRS and DOL Issue New Guidance in Several Key Areas

The Internal Revenue Service (“IRS”) and the Department of Labor (“DOL”) have issued guidance in several key areas.

### The IRS has issued:

- guidance on the meaning of “reasonable time” for providing a notice to defined benefit and money purchase pension plan participants when the rate of future accrual under such plans will be significantly reduced under the Internal Revenue Code of 1986, as amended (“Code”) Section 4980F and the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) Section 204(h).
  - a new revenue ruling which permits automatic enrollment of participants in cafeteria plans under Code Section 125.
  - a model amendment to satisfy minimum distribution rules under Code Section 401(a)(9).
  - a new notice which eliminates the requirement to file Form 5500 Schedule F for fringe benefit plans.

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### The DOL has issued:

- a revised Delinquent Filer Voluntary Compliance Program guidance which allows employers who have failed to timely file annual Form 5500s to file such form and pay a reduced fee for the late filing. The IRS has also agreed to waive its penalties if the employer complies with the revised DFVC Program guidance.
- new regulations relating to claims procedures for ERISA-covered employee benefit plans under ERISA Section 503. ©

# IRS Issues Proposed Regulations on 204(h) Notices

The IRS has issued proposed regulations providing rules for advance notice of certain pension plan amendments under Section 4980F of the Code and Section 204(h) of ERISA. The rules describing advanced notice were enacted as part of last summer's Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").

Before EGTRRA, ERISA Section 204(h) required that sponsors of defined benefit and money purchase ("pension plans") provide participants with 15-day advance notice of an amendment that significantly reduced the rate of a benefit accrual (a "204(h) Notice"). As amended by EGTRRA, ERISA Section 204(h) now specifies that the 204(h) Notice must be provided within a "reasonable time" before the effective date of such an amendment. The amended ERISA Section 204(h) also requires advanced notice of an amendment reducing or eliminating an early retirement benefit or retirement-type subsidy.

The proposed regulations state that the 204(h) Notice must be provided to all applicable persons at least 45 days before the amendment's effective date (as opposed to the pre-EGTRRA 15-day advance notice rule). The original 15-day advance notice rule still applies to:

- amendments to plans with fewer than 100 participants; and
- amendments adopted in connection with a business merger or acquisition.

The proposed regulations state that in connection with a business merger or acquisition involving a plan-to-plan trans-

fer which only affects an early retirement program or retirement-type subsidy, the 204(h) Notice must be provided within 30 days after the amendment is effective.

The proposed regulations now require that a 204(h) Notice include sufficient information to allow applicable individuals to understand the effect of a plan amendment, including the approximate magnitude of the expected reduction. The regulations require the 204(h) Notice to:

- describe the affected provisions before the amendment;
- describe the provisions as amended; and
- state the effective date of the amendment.

The 204(h) Notice may not include materially false or misleading information, nor may it omit any relevant information. Finally, the regulations provide that if the approximate magnitude of a reduction in benefits would not be reasonably apparent from a narrative description, one or more illustrated examples should be included in the 204(h) Notice.

The proposed regulations also set forth permitted means for distributing the 204(h) Notice. These permissible means include:

- first class mail;
- hand delivery; and
- electronic media.

Posting of a 204(h) Notice on a bulletin board is not an acceptable means of delivery. Plan Administrators may rely on electronic delivery of the 204(h) Notice through e-mail, internet sites and DVDs or CDs that may be accessed using a computer at the employer's worksite, provided that appropriate and necessary measures reasonably calculated to ensure that the notice is actually received are used and that participants are informed of their rights to request and receive paper copies of the 204(h) Notice.

These proposed rules, implementing / continued page 3

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## Old 204(h) Rule

Notice must be provided "not less than 15 days before the effective date of the plan amendment"

### Applies to all pension plans

## New 204(h) Rule

Notice must be provided "within a reasonable time before the effective date of the plan amendment"

**Small pension plans** (fewer than 100 participants) — 15 days before the effective date of the plan amendment

**Large pension plans** (100 participants or more) — 45 days before the effective date of the plan amendment

**All plans in connection with a merger or acquisition** — 15 days before the effective date of the amendment

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## IRS Issues Proposed Regulations

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the changes to both the Code and ERISA made by the EGTRRA, will not become effective until 120 days after the IRS publishes the regulations in final form.

Code Section 4980F imposes an excise tax of \$100 per day for each individual for whom the 204(h) Notice requirement was not met, and, for egregious failures, ERISA Section 204(h) specifies that affected individuals will be entitled to the greater of the benefit under the plan as amended or the bene-

fit determined as if the plan had not been amended. An egregious failure is defined as a failure that is:

- within the control of the plan sponsor; and
- either an intentional failure or a failure to provide most of the individuals with most of the information they are entitled to receive.

When employers are considering amending defined benefit and money purchase pension plans, particularly in the context of mergers and acquisitions, they should ensure that these new regulations are considered. ☺

## IRS Allows Automatic Enrollment for Participants in Cafeteria Plans

The IRS issued Revenue Ruling 2002-27 which gives employers the ability to automatically enroll eligible participants in cafeteria plans. Cafeteria plans are governed by Code Section 125 which provides that if an employee chooses between receiving cash or other taxable benefits, and reducing his or her salary to pay for health insurance premiums, the amount chosen as

into cafeteria plans would cause the compensation contributed automatically to the cafeteria plan to be excluded from the definition of compensation for purposes of Code Section 415. If the automatically deferred compensation is excluded from the definition of Code Section 415 compensation, nondiscrimination testing issues for the qualified retirement plan might arise.

Revenue Ruling 2002-27 clarifies that if employees are automatically enrolled in a cafeteria plan, the contributions are still considered to be deferred on account of the employee's choice and are excludible from the employee's gross income. In addition, if the employer amends the qualified retirement plan, the automatically deferred amounts may still be included in the definition of compensation for Code Section 415 purposes. The Revenue Ruling provides a model amendment that qualified retirement plans may use to adopt this alternative definition of Code Section 415 compensation.

### Employers may automatically enroll participants in health premium Code Section 125 plans and may amend the definition of Code Section 415 compensation used in qualified retirement plans to include such mandatory deferrals.

salary reduction will not be included in the employee's gross income. Such compensation deferred under Code Section 125 would be included in the definition of "compensation" used for purposes of nondiscrimination testing for qualified retirement plans.

The revenue ruling addressed several concerns that employers had regarding automatic enrollment. One concern was whether under Code Section 125, the employee was still considered to have a choice between taxable and nontaxable benefits, or whether automatic enrollment makes the premium payment reductions includible in the employee's gross income. Another concern was whether automatic enrollments

If an employer used automatic enrollment for cafeteria plans in 2002 (or in any years beginning after 1997) and included the automatically deferred amounts as compensation for purposes of Code Section 415, the qualified retirement plan must be amended. For plan years beginning after 1997, the amendment must be made not later than the end of the 2002 plan year and effective for all years the plan operated in accordance with the new definition. If the employer has not included automatically deferred amounts in the definition of the Code Section 415 compensation, the plan may be amended prospectively to include such amounts no later than the last day of the plan year in which the amendment is effective. ☺

## IRS Issues Model Amendments to Satisfy Minimum Distribution Requirements

The IRS issued Revenue Procedure 2002-29 containing model amendments that plans may adopt in order to satisfy the minimum distribution requirements under Code Section 401(a)(9).

Code Section 401(a)(9) provides the minimum distribution requirements for plans qualified under Code Section 401(a), as

**To comply with new minimum distribution regulations, qualified retirement plans must be amended by the last day of the 2003 plan year.**

well as for Code Section 403(b) annuity contracts, Code Section 408 individual retirement accounts (“IRAs”), Code Section 408A Roth IRAs, and Code Section 457 eligible deferred compensation plans. For employer-sponsored plans, subject to certain exceptions, minimum distributions must generally begin no later than the April 1 following the later of:

- the calendar year in which the participant retires; and
- the calendar year in which the participant attains age 70½.

## DOL Amends DFVC Program

### Amended DFVC Program

The DOL simplified and updated procedures under the Delinquent Filer Voluntary Compliance Program (the “DFVC Program”) and reduced the penalties for late filers of Form 5500. These modifications are designed to encourage plan administrators to voluntarily comply with the annual Form 5500 filing requirements of ERISA.

The DOL initiated the DFVC Program in 1995. Under the

For IRAs, minimum distributions must begin no later than the April 1 following the calendar year in which the participant attains age 70½.

The model amendments may be used by sponsors of master and prototype plans, volume submitters, and individually designed plans. The model amendments are described by the IRS as “snap-on” amendments, that is, amendments that are designed to supersede those portions of a plan that are inconsistent with the amendments and to retain those portions that are not inconsistent. Two sets of model amendments are included — one for defined contribution plans and one for defined benefit plans.

With few exceptions, qualified retirement plans must be amended to comply

with the minimum distribution requirements by the end of the first plan year beginning after January 1, 2003. Determination letter applications for individually designed plans filed on or after the first day of the first plan year beginning after January 1, 2003 will be reviewed with respect to the plan’s compliance with the 2002 final and temporary regulations. Adoption of the model amendment verbatim (or with only “minor changes”) will not adversely affect a plan sponsor’s reliance on a prior favorable determination letter. ©

DFVC Program, plan administrators who are delinquent in filing Form 5500s may pay reduced civil penalties for voluntarily complying with the annual reporting requirements. Under the modified DFVC Program, the penalty per day for delinquent filings has been reduced from \$50 to \$10 for both large plans (100 participants or more) and small plans (under 100 participants). The maximum “per filing” penalty (for each late Form 5500) under the DFVC Program also has been reduced:

- for small plans — to \$750 from a maximum \$2,000 penalty; and
- for large plans — to \$2,000 from a maximum \$5,000 penalty for a single late annual report.

There is a new “per plan” maximum / continued page 5

## DOL Amends DFVC Program

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(for plans that have failed to file Form 5500s for several years) of \$4,000 for large plans and \$1,500 for small plans. Finally, the DOL has added new rules which provide special relief for small plans maintained by 501(c)(3) tax exempt organizations (including Code Section 403(b) plans). The penalty for late filings for these plans is \$10 per day, up to a maximum \$750 penalty per DFVC Program submission, regardless of the number of Form 5500s filed in that submission.

This modified DFVC Program also provides relief for failing to file top-hat, apprenticeship and training plan filings (which are abbreviated one-time annual filings). The DFVC Program

### The DOL has reduced penalties under the DFVC Program.

penalties for these plans have been reduced to \$750 from \$2,500 per plan, regardless of the number of plans maintained by the same plan sponsor or the number of participants covered under each plan.

The modified DFVC Program also includes simplified procedures that permit plan administrators to use either the Form 5500 for the plan year in which relief is sought or the most current Form 5500. The procedures eliminate the requirement

that plans must identify annual Form 5500s in bold red ink as DFVC program filings. The DFVC Program has also been updated to conform to the computerized ERISA Filing Acceptance System, known as EFAST.

As with the original DFVC Program, however, an employer must choose to file under the DFVC Program prior to being notified in writing by the DOL of a failure to timely file a Form 5500. After notification by the DOL of a failure to timely file, an employer is no longer eligible for the DFVC Program.

### IRS Amnesty

Significantly, the IRS has also modified its rules for imposing penalties on plan administrators who fail to comply with the annual reporting requirements for Form 5550s under the Code.

The IRS may impose penalties on plan administrators under Code Section 6652 or 6692 for failing to timely comply with the annual reporting requirements under Code Sections 6033(a), 6057, 6058, 6047 and 6059. However, under Notice 2002-23, the IRS stated that it will not impose penalties on any person who is eligible for and satisfies the requirements under the DFVC Program. Once the late filer satisfies the requirements under the DFVC Program, including paying the reduced civil penalty (as described above), the relief under Notice 2002-23 will apply and the late filer need not file a separate application for relief with the IRS. ©

## DOL Issues Additional Guidance for Benefit Plan Claims Procedures

The DOL issued additional guidance under the claims procedure regulation which governs how participants may file and appeal claims for ERISA-covered benefit plans. The additional guidance was issued in question and answer format, and supplements the DOL's questions and answers previously issued on December 15, 2001.

Some of the important highlights of the recent additional guidance are:

- "Top-hat" plans (plans which only cover a select group of management or highly-compensated employees) are subject to the claims procedures regulations. Specifically, a description of the plan's claims procedure must be included in the top-hat plan's summary plan description ("SPD"). To the extent that a top-hat plan is exempted from the requirement to furnish an SPD (and most top-hat plans are exempt), participants must be made aware of the plan's claims procedure in conjunction with their enrollment in the plan.
- Any specific time period in which claimants must file their claim for benefits must be reasonable and may not be administered in a manner that unduly inhibits or hampers the initiation or processing of claims for benefits.
- If a claimant does not provide the plan / *continued page 6*

## DOL Issues Additional Guidance

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with sufficient information to process a claim for benefits, the plan is not required to provide the claimant with an extension of time to file a claim with the necessary

### Claims procedures guidance clarifies several key issues.

additional information. Such provisions are permissible rather than mandatory. As a general rule, the plan may deny such a claim at any time on the basis that the plan does not possess sufficient information to process the claim. The guidance points out that such a decision would allow the claimant to move on to the next stage of the claims process.

- As a general rule, claimants must exhaust internal claims procedures before beginning civil actions.

However, in an effort to compel benefit plans to adopt and follow proper procedures, when a plan fails to provide or follow its otherwise adequate claims procedure, the

claimant will be deemed to have exhausted the plan's administrative remedies and may initiate a civil action. Under

the guidance, claimants will bear the burden of proof on this issue.

The claims procedure regulations on which the additional DOL guidance explains was originally published by the DOL in November 2001 and applies to pension and disability benefit claims filed on or after January 1, 2002. Group health plans do not become subject to the regulations until the first day of the plan year beginning on or after July 1, 2002, but in any event, not later than January 1, 2003. ©

## IRS Eliminates Schedule F

Employers required to file Schedule F (Fringe Benefit Plan Annual Information Return) to Form 5500 for certain benefit plans under Code Section 125 (cafeteria plans), Code Section 127 (educational assistance plans) and Code Section 137 (fringe benefit plans) are no longer

required to file Schedule F. In Notice 2002-24, the IRS exemption from the filing requirement applies both prospectively and retroactively. Thus, those plans which have not yet completed Form 5500 for the 2001 plan year need not to file the Schedule F. ©

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