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Kutak Rock Grows Employee Benefits Practice With Five Attorneys in Minneapolis

Kutak Rock has expanded its Employee Benefits practice with the addition of David S. Anderson, Cindy L. Davis, Amanda R. Cefalu, Bryan J. Morben and B. Tyler Philippi, each most recently practicing with the firm of Anderson, Helgen, Davis and Cefalu, PA. The members of the Anderson Helgen team bring with them years of experience and unique expertise working with employee benefits law and are the first members of Kutak Rock's national Employee Benefits and Executive Compensation practice group in the firm's Minneapolis office. These attorneys have extensive experience with ERISA, multiemployer Taft-Hartley, single employer and government employee benefit plans. The attorneys work with institutional investors, qualified plan asset managers and others on a variety of sophisticated investment transactions including commercial real estate development. The group also has extensive expertise working on service provider and network agreements and ERISA litigation including subrogation, collection and withdrawal liability lawsuits.

Fiduciary Best Practices: How To Pay Retirement Plan Fees

By now, most fiduciaries of retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) are well aware of their duty to minimize the fees and expenses paid by plan participants. Department of Labor regulations have made it much easier for fiduciaries to know exactly how much they are paying for administrative services. A proliferation of class action litigation against fiduciaries has also served as a powerful reminder of the need to monitor the fees that plans and plan participants pay for retirement plan services.

However, minimizing the expenses that a plan pays for services does not end a fiduciary's duties with respect to fees. Once a fiduciary has determined a reasonable fee that should be paid to a service provider, the fiduciary must then decide how to pay that fee. This brief article highlights some of the issues that fiduciaries should consider when deciding how to pay a service provider for the services provided to the retirement plan.

Ask the Company

One of the most important fiduciary duties is to maximize plan benefits and minimize plan expenses. To this end, every fiduciary of a retirement plan should be attempting to shift as much of the plan's operating expenses as possible to someone other than the plan participants. Plan fiduciaries should regularly ask management whether the company will pay for the plan's administrative expenses. Failure to do so may constitute a breach of the fiduciary's duties (especially if it turns out the company would have paid some of these expenses if requested).

After asking the question of the employer, and assuming the employer is not willing to pay for all plan-related expenses, the fiduciaries must then decide how to use the plan's resources to pay for plan-related expenses. Should

the fiduciaries use the plan's forfeitures? Does the plan's record-keeper credit an "ERISA Account" with revenue sharing dollars that can be used to pay administration expenses? Should the fiduciaries select investments that generate enough revenue sharing to cover the plan's administration expenses? Or should the fiduciaries simply assess each participant a fee to cover the administration costs? If a fee is assessed, how should it be calculated—on a pro rata, per capita or some combination basis? With all of these choices available, it can be very challenging for a fiduciary to ensure that he or she is acting in the best interest of the plan's participants.

Revenue Sharing

Revenue sharing refers to fees that are paid to a plan's record-keeper from the investment provider. 12b-1 fees and sub TA fees are examples of revenue sharing. These fees are "baked in" to the expenses of the underlying investments. In this regard, many plan participants do not even realize they are paying for the administration of the plan (through revenue sharing to the record-keeper) as they believe they are just paying the costs of investing in a particular investment.

Many mutual fund managers offer different "classes" of the same mutual fund. The investments in the different classes are exactly the same. The only differences are the expense ratio of the mutual fund and the amount of revenue sharing generated by the particular class. Some mutual fund managers offer more than five classes of a mutual fund with five different levels of revenue sharing. With all of these choices, it can be a daunting task for fiduciaries to know which class is right for the plan. If revenue sharing is being used to pay the plan's administrative expenses, it is important to pick the class that generates the right amount of revenue sharing. Choose a too-expensive class, and you may generate too much revenue sharing which could mean you are paying the record-keeper more than necessary to administer the plan. Choose a class that generates insufficient revenue sharing and it could mean not having enough money to pay the plan's administrative expenses. To make matters even more complicated, estimating revenue sharing is an inexact science. Not all investments generate the same level of revenue sharing. When participants move their account balances to and from different plan investments throughout the year, the amount of revenue sharing generated for the plan can vary greatly.

Forfeitures

Many fiduciaries use the plan's forfeitures to help pay for the plan's administrative expenses. Forfeitures occur when an employee leaves the company before becoming fully vested in any company contributions to the plan. While forfeitures can be substantial in high-turnover businesses, rarely do plans receive enough forfeitures to fully cover all of the plan's administration expenses. Many fiduciaries count on using forfeitures as a "cushion" in the event that the revenue sharing generated by the plan falls short of what is needed to fully pay the plan's expenses.

A complicating factor in the use of forfeitures to pay plan expenses is that many employers use forfeitures to reduce the amount of future contributions to the plan. This creates a tension between what is best for the company (reducing the cost of future contributions) and the plan participants (reducing the costs of the plan's administrative expenses). It is important for fiduciaries to understand whether it is within their discretion to decide how to use the plan's forfeitures. If it is, it is almost always in the plan participant's best interests to use forfeitures to help pay the plan's administration expenses as opposed to offsetting future employer contributions.

Transparency

A trend in the retirement plan arena the last several years has been toward more transparency in the fees participants pay for their retirement plan. As noted above, when the company pays all of the administration expenses, or when revenue sharing and forfeitures are used to pay the expenses, plan participants really have no way of knowing what it actually costs to administer their retirement plan. And with the proliferation of class action cases alleging that fiduciaries using higher-cost share classes are violating their ERISA duties, it is no wonder that more and more fiduciaries are looking to be more transparent in explaining the fees that participants must pay for their retirement plan.

The most transparent way to charge plan participants for the costs of administering the plan is to itemize the costs that each participant pays for each service provider. The investment management expenses are included in the operating expenses of the particular investment. If

the investment generates no revenue sharing, participants know that 100% of the expenses related to the investment fund are for investment management services. Fiduciaries can then itemize other expenses such as record-keeping fees and audit, legal and investment consulting expenses. This allows participants to know exactly what each service costs them.

But being transparent on fees does not end the fiduciary's work. How is the fiduciary going to determine how to charge service provider fees to each participant? Should each participant pay the same amount for each service, regardless of the size of the participant's account balance? Or should participants with larger account balances pay more than those with smaller balances? And should active employees pay a different amount than retired or terminated employees? While there are no "right" or "wrong" answers to these questions, it is important that plan fiduciaries consider the pros and cons of each alternative. It is paramount that the plan's fiduciaries carefully weigh each decision to ensure they are acting in the best interest of the plan's participants and fiduciaries.

Communication

Regardless of the manner in which a fiduciary decides to pay for plan administration expenses, communicating that decision is often the best defense against a claim that the fiduciary has breached his or her duties to the plan. By letting participants know that the company pays some of the plan's expenses, or that revenue sharing will pay some of the expenses, the fiduciaries are proactively addressing claims made by class action plaintiffs' lawyers that the fiduciaries are "asleep at the wheel." As noted earlier, there are many different ways to pay for a plan's administrative expenses, and there is no "right" way that must be followed. However, after a decision is made on how to pay the service providers, it is important for the fiduciaries to accurately and timely communicate this information to all of the plan's participants.

If you or your co-fiduciaries have questions regarding the various ways in which your retirement plan can pay its administration expenses, please contact the undersigned, any member of the Employee Benefits group or your primary Kutak Rock contact.

IRS Continues To Encourage Adoption of Pre-Approved Plans

With the elimination of the five-year determination letter cycle for individually designed plans effective January 1, 2017, the Internal Revenue Service has begun a number of initiatives designed to encourage plan sponsors to adopt pre-approved plans. In general, these initiatives involve expanding the types of plans eligible for pre-approved status, allowing more flexible design of pre-approved plans and simplifying the existing pre-approved plan program.

Eligible Types of Pre-Approved Plans

In recent years, the IRS has significantly expanded the types of pre-approved plans that can receive opinion letters. Specifically, the pre-approved opinion letter program now allows nonstandardized ESOPs to contain 401(k) arrangements. Additionally, the IRS has begun to issue opinion letters for pre-approved 403(b) plans.

Additional Design Flexibility

Earlier this year, the IRS also expanded plan design options for plan sponsors adopting pre-approved plans. These changes include allowing sponsors of nonstandard plans to adopt minor modifications to the plan document's language and allowing pre-approved plan sponsors to choose to adopt either safe harbor or non-safe harbor hardship distributions.

Program Simplification

In connection with its changes to the opinion letter program for pre-approved plans, the IRS also eliminated the distinction between volume submitter and master

and prototype plans. This change will likely simplify the process of selecting a pre-approved plan for plan sponsors and lead document vendors to consolidate their offerings.

Required Amendments List

Although the IRS has scaled back the determination letter program for individually designed plans, it is continuing to release some guidance with respect to those plans. Specifically, in early 2017 the IRS published its Required Amendments List. Plan sponsors have until December 31, 2018 to adopt a remedial amendment to incorporate the requirements of the list. However, the current Required Amendments List is unlikely to affect most plan sponsors because the only applicable item for the current year applies to collectively bargained defined benefit plans.

Next Steps

In light of the changes made by the IRS to the pre-approved opinion letter program, plan sponsors who use individually designed plans should review whether it is appropriate to convert to a pre-approved plan. Plan sponsors who decide to retain an individually designed plan should consider alternatives to the determination letter program to ensure that their plans remain compliant with changes in the Internal Revenue Code and ERISA.

Factors To Consider in Adopting a Pre-Approved Plan

As a result of the elimination of the five-year remedial amendment cycle for individually designed retirement plans, many plan sponsors are considering whether they should adopt pre-approved plans. There are a number of factors that should be considered in deciding whether to adopt a pre-approved plan, including the following:

Pre-approved plans can offer some cost and time savings for certain employers. Drafting a new pre-approved plan is generally cheaper than drafting a new individually designed plan, and can be accomplished more quickly. However, plan sponsors who wish to convert from an individually designed plan to a pre-approved plan may incur additional costs during the conversion process.

The restatement and amendment process can be more straightforward for pre-approved plans. Because pre-approved plan document vendors issue "one size fits all" documents for required amendments and restatements, the process for these changes can be faster.

Pre-approved plan sponsors can receive a limited opinion letter directly from the Internal Revenue Service. Because the procedures governing regular opinion letters for pre-approved plans are still in effect, pre-approved plan sponsors have the opportunity to receive direct approval from the IRS on the form of the plan document.

A plan sponsor's reliance on an opinion letter is more limited than on an individually designed determination letter. Plan sponsors who rely on pre-approved plan opinion letters are not entitled to rely on those letters if they make certain modifications to the pre-approved plan. Additionally, the IRS frequently requests documentation preceding the current opinion letter in requests for information and audits, which was generally not the case with determination letters for individually designed plans under the IRS's prior procedures.

Pre-approved plans offer less design flexibility than individually designed plans. Pre-approved plans offer a set menu of elections to plan sponsors and are generally limited in the ways that they can be amended. Further, plan sponsors risk losing reliance on the plan's opinion letter if they make impermissible changes. Thus, pre-approved plans can be inappropriate for certain types of plan designs.

When adopting a pre-approved plan, the plan sponsor needs to ensure that the standard provisions of the plan are appropriate. The terms of a pre-approved plan may not make sense for a plan sponsor, especially with respect to the plan's "boilerplate." Furthermore, pre-approved plans are written in a way that typically provides protection to document vendors and trustees that may not be desirable for all plan sponsors.

If you have questions about adopting a pre-approved plan or are not sure whether a pre-approved or individually designed plan document is appropriate for your plan, please contact a member of our Employee Benefits Practice Group.

Kutak Rock Retirement Plan Opinion Letter Program Offers Plan Sponsors Document Compliance Assurance

In light of the discontinuance of the IRS's determination letter program for individually designed plans, plan sponsors who were previously on Cycle B or C (i.e., multiple-employer plans, governmental plans and plans whose sponsor's EIN ends in 2, 3, 7, or 8) need to consider alternatives to the IRS determination letter program to ensure that their programs comply with applicable law. The Kutak Rock Retirement Plan Opinion Letter Program (RPOL) is a valuable tool that offers plan sponsors assurance that their qualified plans are, in fact, qualified.

Why Does Qualification Matter?

Although the IRS determination letter program is no longer available, there are a number of reasons that plan sponsors need to be able to document that their plans remain in compliance with the Internal Revenue Code. Most significantly, a plan sponsor can protect itself from penalties associated with plan disqualification and defend itself against IRS audits by obtaining regular opinion letters. Additionally, many outside parties, such as lenders, auditors and potential acquirers or targets may require an opinion letter. Finally, the opinion letter process gives plan sponsors the ability to correct minor document and operational issues before they become more significant.

What Does RPOL Provide?

In addition to providing plan sponsors with assurance that their plan documents comply with the Internal Revenue Code, the RPOL program offers a variety of additional benefits to plan sponsors. Under the RPOL program, Kutak Rock's Employee Benefits Practice Group conducts an annual review of an employer's retirement plans to confirm compliance with the Internal Revenue Code's document requirements and issues an opinion letter allowing plan sponsors to demonstrate compliance with applicable law.

The RPOL program also provides recommendations and suggestions to plan sponsors on best practices with respect to their documents and plan operations. As a result, each client who utilizes the RPOL program receives the benefit of Kutak Rock's experience working with hundreds of custom retirement plans for employers of all types and sizes throughout the country.

Next Steps

If you have questions about RPOL or are interested in utilizing the RPOL program, please contact a member of our Employee Benefits Practice Group. For more information about our employee benefits practice, please visit us at www.KutakRock.com.

Could ERISA Preempt State and Local Paid Sick Leave Laws?

A wave of state and local paid sick leave laws passed in the last decade has made it more difficult for employers to do business in multiple states. As of October 2017, eight states, 30 cities, two counties and the District of Columbia require employers to provide paid sick leave. Additionally, Executive Order 13706 requires certain government contractors to provide paid sick leave to their employees.

Employers seeking to avoid the headache of complying with the nuances of each paid sick leave law might consider an alternative and untested approach: establishing a paid sick leave plan governed by the Employee Retirement Income Security Act of 1974 (ERISA). An ERISA paid sick leave plan would arguably preempt state and local paid sick leave laws. This means that an employer would be able to create a uniform paid sick leave plan that applies to employees working in all jurisdictions that require paid sick leave.

An employer's paid sick leave plan would need to satisfy two essential requirements for ERISA to preempt a state or local paid sick leave law: (1) the plan would need to be structured as a welfare plan under ERISA; and (2) the state and local paid sick leave laws would need to "relate to" the employee benefit plan.

Creating a Welfare Plan Under ERISA

Regulations under ERISA, Supreme Court precedent and Department of Labor Advisory Letters provide guidance for creating an ERISA welfare plan that provides vacation benefits. Becuase vacation plans and paid sick leave plans are treated similarly legally, this guidance would also likely apply to an employer's paid sick leave plan.

For a paid sick leave plan to be a welfare plan under ERISA, paid sick leave could not be paid out of the employer's general assets. This generally means that an employer would be required to set up a trust for the sole purpose of distributing paid sick leave. However, funds in a trust might still be considered a part of an employer's general assets. In an advisory opinion letter, the Department of Labor analyzed the following factors to determine whether the funds in an employer's trust were still a part of an employer's general assets:

- whether the trust was a bona fide separate fund;
- whether the trust had the direct legal obligation to pay benefits under the plan;
- whether there was a contribution obligation enforceable against the employer; and
- whether contributions were actuarially determined, established through collective bargaining or otherwise had a relationship to the plan's accruing liability.

The conventional way to satisfy these four factors would be to create a voluntary employees' beneficiary association (a VEBA). A VEBA for these purposes is an entity that is exempt from taxation under the Internal Revenue Code

and that provides for the payment of life, sick, accident or other benefits to employees.

Creating a Plan That "Relates to" Paid Sick Leave Laws

Even if an employer established a paid sick leave plan that satisfied the requirements listed above, ERISA preemption will apply only if a state or local law "relates to" the paid sick leave plan. The question of whether paid sick leave laws relate to an employer's ERISA paid sick leave plan has not yet reached the Supreme Court of the United States. However, there is a compelling argument to be made that paid sick leave laws have an impermissible connection with ERISA plans.

Courts generally hold that ERISA preemption applies when a state statute interferes with a central matter of plan administration and with the uniform administration of employee benefit plans. A law that requires an employer to pay benefits, such as paid sick leave, clearly interferes with a central matter of plan administration (i.e., paying benefits). Further, as evidenced by the complex legal landscape of paid sick leave laws today, it is impossible for multistate employers to accomplish uniform administration of paid sick leave plans.

Next Steps

Employers should consider bypassing the challenge of complying with individual state and local paid sick leave laws by creating an ERISA paid sick leave plan. The conventional way to accomplish this would be to create a VEBA to provide paid sick leave benefits. Although this approach has not been tested yet in the courts, an ERISA paid sick leave plan could allow for significant savings in legal fees and recordkeeping costs, especially for employers with a national presence.

Design Considerations for Nonqualified Deferred Compensation Arrangements

Many employers seek opportunities to provide their senior employees with methods to defer compensation in addition to that which is allowed under "qualified" employee benefit plans, such as pensions and 401(k) plans. One of the most popular ways to accomplish this is through nonqualified deferred compensation (NQDC) arrangements.

NQDC arrangements provide additional ways for senior employees to defer taxation on their compensation to a later tax year—generally one where the employees find themselves in lower tax brackets. While NQDC arrangements are generally subject to strict rules, employers do have quite a few design options when designing NQDC arrangements.

- **Eligibility.** NQDC arrangements must be limited to covering a "select group of management or highly compensated employees." However, the employer has full discretion within this group to decide who can participate and to what extent each individual can participate.

- **Contributions.** Employers can set up contributions to an NQDC arrangement in myriad ways. The employer can allow employee deferrals, matching contributions, discretionary employer contributions, etc. An NQDC can provide either pension-like defined benefits or 401(k)-like defined contribution benefits. An NQDC arrangement can even be linked to a qualified plan, which takes over once the employee maxes out under the qualified plan limits.

- **Distributions.** NQDC arrangements can be set up to allow participants to elect several ways to receive their benefits or can be set up with payment dates locked in from the beginning. Payments may be made upon (1) a specific date, (2) separation from service, (3) Disability, (4) death, or (5) a change of control event. Participants may choose any single payment trigger or may choose to receive payment beginning at the "earlier of" or "later of" two or more triggers. The NQDC arrangement may also allow for distributions upon an unforeseeable emergency. In addition, payment may be made in almost any form, including lump sums,

installments and annuities.

Employers seeking ways to allow senior employees to defer compensation in addition to the compensation they defer under qualified plans should consider NQDC arrangements. With so many different design options, a custom NQDC arrangement can accomplish almost any employer's goals.

If you would like to explore the options of establishing an NQDC arrangement, or you would like your NQDC arrangement reviewed to see if it can be redesigned to better accomplish your goals, please contact your Kutak Rock LLP attorney or a member of our Employee Benefits and Executive Compensation Practice group.

Plans Established by Church-Affiliated Organizations May Be Exempt From ERISA

On June 5, 2017 the United States Supreme Court issued its ruling in *Advocate Health Care Network v. Stapleton*, the long-awaited "church plan" case. The Court held that the employee benefit plans of a church-affiliated organization—such as a hospital or a school—may qualify as church plans, even though the plans were not established by an actual church. This ruling concludes many years of uncertainty and delivers a decisive victory to church-affiliated employers seeking exemption from the Employee Retirement Income Security Act of 1974 (ERISA).

ERISA generally requires employers that sponsor employee benefit plans to adhere to a comprehensive set of rules, including minimum funding, eligibility, disclosure and reporting requirements. "Church plans," however, are exempt from these rules. ERISA originally defined a "church plan" as "a plan established and maintained . . . for its employees . . . by a church." However, Congress amended ERISA in 1980 to expand this definition to include a plan maintained by an organization controlled by or associated with a church (a "church affiliated" organization).

The three federal agencies responsible for administering ERISA—the Internal Revenue Service, the Department of Labor and the Pension Benefit Guaranty Corporation—have long interpreted Congress's amended definition of "church plan" to exempt plans of organizations controlled by or associated with churches from ERISA's mandates. This includes plans established by the "good works" ministries of churches, such as religiously affiliated hospitals and schools.

Despite this long-standing interpretation, in 2013 participants began to file class action lawsuits claiming that the plans maintained by their religiously affiliated employers (typically Catholic health care institutions) were not church plans and therefore were subject to ERISA. Federal trial and appellate courts arrived at inconsistent conclusions regarding the church plan exemption, which led to several years of uncertainty as to whether a plan established by a church-affiliated organization would be exempt from ERISA.

Advocate Health Care Network began as three distinct cases. The defendants in each case were church-affiliated not-for-profit hospitals that offered their employees a defined benefit pension plan. Employees of the hospitals sued, alleging that the plans did not fall within ERISA's church plan exemption because a church did not establish the plans. While the lower courts agreed with the plaintiffs, the Supreme Court unanimously held that a plan *maintained* by a church-affiliated organization qualifies as a church plan, regardless of whether an actual church established it. The Court noted that the most rational statutory interpretation is that Congress intended to place such plans within the exemption's scope regardless of whether a church or a church-affiliated organization originally established the plan.

Clarifying Executive Compensation for Non-Profit and Governmental Employers

On June 22, 2016 the Internal Revenue Service (IRS) published long-awaited proposed regulations under Section 457(f) of the Internal Revenue Code (Code) regarding the taxation of compensation deferred under plans established and maintained by non-profit and governmental employers. Prior to the regulations, Section 457(f) plan sponsors faced uncertainty regarding when compensation is deferred, when deferred amounts are includable in income and whether certain plans are exempt from these rules. The regulations provide much-needed clarification.

The regulations specifically exempt certain arrangements from Section 457(f), including Section 457(b) "eligible" deferred compensation plans and Section 457(e) "bona fide" severance, disability, death benefit, sick leave or vacation leave plans. Unless specifically excluded under the regulations, all other deferred compensation arrangements of non-profit and governmental employers are subject to Section 457(f). Determining whether a plan is subject to Section 457(f) is important because benefits under exempt arrangements are not subject to income tax until the benefits are paid whereas benefits subject to Section 457(f) are subject to income tax when the compensation is no longer subject to a substantial risk of forfeiture. Section 457(f) plans also must conform with Code Section 409A, or the employee will lose the deferral of the compensation under the plan and be subject to a 20% penalty and interest.

A plan provides for a deferral of compensation if a participant has a legally binding right to compensation that may be payable in a later year. However, the regulations include a welcome exception from Section 457(f) known as "short-term deferral." Compensation is not considered deferred when the compensation must be paid and is paid within 2½ months following the end of the calendar year in which the payment is no longer subject to a substantial risk of forfeiture. For year-end bonuses, this means that as long as an agreement provides the bonus must be paid by March 15 of the year after the year the bonus is earned, and the bonus is actually paid on or before that date, the bonus is not deferred compensation subject to Section 457(f).

Where compensation is deferred, it is generally includable in a participant's income when the amount is no longer subject to a substantial risk of forfeiture. A substantial risk of forfeiture exists when the participant must perform future services or meet a compensation-related condition to obtain a right to the compensation, and the possibility of forfeiture is substantial. The proposed regulations clarify that plans may create a substantial risk of forfeiture through non-compete agreements, elective deferrals, and rolling risks of forfeiture.

In summary, the proposed regulations provide welcome clarification for Section 457(f) plans. Although the proposed regulations are not yet finalized, they may be relied on immediately. Once the regulations are finalized, the IRS will require compliance no later than the beginning of the subsequent plan year.

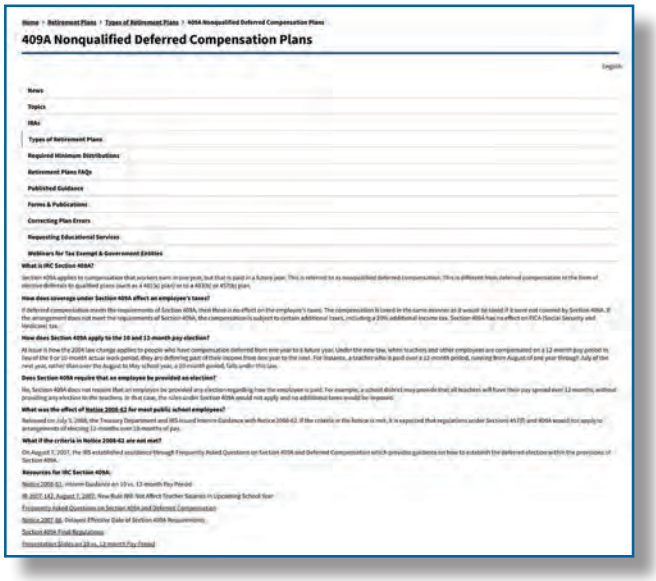
IRS Issues Guidance on 409A and Back-to-Back Arrangements

On June 23, 2017 the IRS Office of Chief Counsel issued Chief Counsel Memorandum Number 201725027 (the "CCM") addressing the application of Section 409A of the Internal Revenue Code to certain back-to-back arrangements.

Section 409A applies to arrangements in which a service provider has a legally binding right to compensation from the service recipient that may be payable in a later year. If Section 409A's requirements are not satisfied, the service provider must include all deferred compensation that is not subject to a substantial risk of forfeiture in gross income and pay an additional 20% tax plus premium interest.

Section 409A permits arrangements that tie the timing of deferred compensation distributions under one arrangement to another arrangement's distribution events. This is referred to as a back-to-back plan. Such plans consist of two nonqualified deferred compensation arrangements between three parties: the ultimate service recipient plan (the USR Plan) provides for payments by the ultimate service recipient to the intermediate service recipient, and the intermediate service recipient plan (the ISR Plan) provides for payments by the intermediate service recipient to the service provider. Back-to-back plans are permissible under Section 409A; however, the time and form of payment must be the same between both plans, the amount of the payment under the USR Plan cannot exceed the amount of the payment under the ISR Plan, and the plans must specify the ultimate service providers involved.

The taxpayer in the CCM managed investment funds, including the funds of a foreign corporation. The foreign corporation paid the taxpayer management and performance fees for investment advisory services, and the taxpayer in turn employed individual investment professionals who received salaries and bonuses for management and investment advisory services performed. The foreign corporation and the taxpayer were parties to a deferred compensation arrangement—a USR Plan—under which the taxpayer deferred some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What is IRC Section 409A?

Section 409A applies to compensation that workers earn in one year, but that is paid in a future year. This is referred to as nonqualified deferred compensation. This is different from deferral compensation in the form of elective deferrals to qualified plans (such as a 401(k) plan) or to a 403(b) or 457(b) plan.

How does coverage under Section 409A affect an employee's taxes?

If deferred compensation meets the requirements of Section 409A, then there is no effect on the employee's taxes. The compensation is taxed in the same manner as it would be taxed if it were not covered by Section 409A. If the arrangement does not meet the requirements of Section 409A, the compensation is subject to certain additional taxes, including a 20% additional income tax. Section 409A has no effect on FICA (Social Security and Medicare) tax.

How does Section 409A apply to the 10 and 12-month pay election?

At issue is how the 2004 tax change applies to people who have compensation deferred from one year to a future year. Under the new law, when teachers and other employees are compensated on a 12 month pay period in lieu of the 9 or 10 month actual work period, they are deferring part of their income from one year to the next. For instance, a teacher who is paid over a 12 month period, running from August of one year through July of the next year, rather than over the August to May school year, a 10 month period, falls under this law.

Does Section 409A require that an employee be provided an election?

No, Section 409A does not require that an employee be provided any election regarding how the employer is paid. For example, a school district may provide that all teachers will have their pay spread over 12 months, without providing any election to the teachers. In that case, the rules under Section 409A would not apply and no additional taxes would be imposed.

What was the effect of Notice 2008-62 for most public school employees?

Released on July 1, 2008, the Treasury Department and IRS issued Interim Guidance with Notice 2008-62. If the criteria in the Notice is met, it is expected that regulations under Sections 457(f) and 409A would not apply to arrangements of electing 12-months over 10-months of pay.

What if the criteria in Notice 2008-62 are not met?

On August 7, 2007, the IRS established assistance through Frequently Asked Questions on Section 409A and Deferred Compensation which provides guidance on how to establish the deferred election within the provisions of Section 409A.

Resources for IRC Section 409A:

Notice 2008-62, Interim Guidance on 10 vs. 12-month Pay Period

IR-2007-142, August 7, 2007, New Rule Will Not Affect Teacher Salaries in Upcoming School Year

Frequently Asked Questions on Section 409A and Deferred Compensation

Notice 2007-86, Delayed Effective Date of Section 409A Requirements

Section 409A Final Regulations

Presentation Slides on 10 vs. 12 month Pay Period

of its management fees and/or performance fees. The taxpayer in turn sponsored a deferred compensation arrangement—the ISR Plan—for individual investment professionals (the Participants) working for the taxpayer.

If a Participant became entitled to payment under the ISR Plan, the taxpayer would also become entitled to a payment under the USR Plan. While the deferral elections and payment triggers of the plans were coordinated, the USR Plan provided that payment would be made to the taxpayer under the USR Plan even when amounts were forfeited by a Participant under the ISR Plan upon a Participant's separation from service. The IRS found this feature caused the arrangement to violate the requirements for back-to-back arrangements because Section 409A prohibits a USR Plan payment from exceeding the amount paid under the ISR Plan. In addition, the USR Plan violated Section 409A by allowing for payment to the taxpayer under the USR Plan relating to unvested amounts forfeited upon separation from service of a Participant in the ISR Plan, which is not a permissible payment event under Section 409A. Thus, all vested amounts deferred by the investment management firm were taxable income to that firm in its earliest open year and subject to the Section 409A penalties.

A 2017 "Repeal and Replace" Recap

2017 has seen various attempts to repeal and replace the Patient Protection and Affordable Care Act (the PPACA). On May 4, 2017 the United States House of Representatives passed the American Health Care Act of 2017 (the AHCA), which made a number of changes to the PPACA. These changes generally included repealing the PPACA's cost-sharing subsidies, repealing the PPACA's premium tax credit and replacing it with a refundable tax credit based on age and income, repealing the "individual mandate" and "employer mandate" penalties, further delaying the excise tax on high-cost employer-sponsored coverage, phasing out the Medicaid expansion and creating state waivers relating to pre-existing conditions and minimum essential benefits.

The AHCA then moved to the United States Senate, where it underwent significant changes. On June 22, 2017 the Senate released a discussion draft of their proposal titled the Better Care Reconciliation Act of 2017 (the BCRA). The BCRA updated the AHCA to slow the phase-out for the Medicaid expansion, retain the PPACA's premium subsidy structure, reduce state waiver flexibility and delay effective dates for certain PPACA tax provisions. On July 13, 2017 the Senate released a second working draft of the BCRA, which ultimately collapsed.

On September 13, 2017, Senators Lindsey Graham and Bill Cassidy unveiled the Graham-Cassidy Bill, which would redirect PPACA funding directly to the states. On September 26, 2017, Majority Leader Mitch McConnell announced the Graham-Cassidy Bill would not be brought up for a vote.

On October 12, 2017, President Trump released an executive order directing the Departments of Labor, Treasury and Health and Human Services to begin drafting rules expanding the use of association health plans, expanding the length and renewability of short-term coverage and expanding the ability of employers to use health reimbursement accounts to shift coverage of their employees to the individual market. The same day, the administration announced it would no longer be reimbursing insurers for the reductions in out-of-pocket limits, deductibles and other forms of cost sharing the PPACA requires insurers to provide to certain enrollees. The Departments will proceed under the typical rulemaking process, which includes publishing draft rules and allowing for public comment.

As it currently stands, the PPACA is in effect in its entirety and employers should continue to comply with its provisions until any modifying legislation is enacted.

New Disability Claims Procedures on the Horizon

In December 2016 the U.S. Department of Labor (DOL) published new regulations on disability claims for certain plans governed by the Employee Retirement Income Security Act of 1974, as amended (ERISA) (the Disability Regulations). As originally published, the Disability Regulations were generally effective on January 1, 2017, but did not apply to claims for disability benefits filed before January 1, 2018. However, on October 12, 2017 the DOL issued a proposed rule to delay the applicability of the Disability Regulations for 90 days, making the Disability Regulations applicable to claims for disability benefits filed after April 1, 2018. The DOL solicited comments on the proposed rule, and we anticipate the DOL will make a decision in December.

The Disability Regulations have a far reach, as they affect any plan that offers disability benefits. A benefit is a "disability benefit" if the participant must make a showing of disability as a condition to receive the benefit. Accordingly, long-term and short-term disability plans, retirement plans, group health plans and other welfare plans can be subject to the Disability Regulations.

ERISA generally requires employers to provide adequate notice to plan participants whose claims for benefits have been denied, and to provide the participant a full and fair process for review of the claim denial. The Disability Regulations are intended to increase transparency and fairness to participants. The Disability Regulations modify procedures for disability benefits claims in a number of ways. For example, under the Disability Regulations:

- A benefit denial notice must include a more complete discussion of why the claim was denied. If applicable, the denial notice must include a discussion of why the plan disagreed with the findings of health care professionals or vocational experts, or determinations made by the Social Security Administration.

- If used, the plan administrators must disclose the specific internal rules, guidelines or protocols used in making a determination regarding benefits.

- A benefit denial notice must inform a participant that he or she is entitled to reasonable access to, and copies of, all documents that are relevant to the participant's claim for benefits, free of charge.

- Plans are generally required to make benefit determinations in a manner that ensures the independence and impartiality of the individuals involved. Plans may not make decisions regarding hiring, firing, promotions or other similar employment decisions on the basis of the likelihood that an individual will support the denial of benefits.

- A denial notice must be written in a culturally and linguistically appropriate manner. Plans must also provide notice that oral language services are available, and must provide that the participant may, upon request, receive any notice in the applicable non-English language.

- Plan failure to strictly adhere to the Regulations will allow participants to pursue remedies on the basis that the plan failed to provide a reasonable claims procedure. A participant will be immediately allowed to bring a denial of benefits lawsuit in court. This rule will generally apply unless the failure did not cause prejudice to the participant, was for good cause and was not a part of a pattern of non-compliance.

Although the DOL may extend the applicability date of the Disability Regulations to April 2018, employers and

plan administrators should take steps to comply with the Disability Regulations. For example, employers and plan sponsors should:

- Identify all plans that provide "disability benefits" that are subject to the Disability Regulations.
- Prepare and adopt new disability claims procedures for the applicable benefit plans and issue summaries of material modifications.
- Determine whether current denial of benefits notices comply with the Disability Regulations and confirm with the insurer or third-party administrator that denial of benefits notices will comply.
- Determine whether the selection, compensation and retention of claims adjudicators complies with the Disability Regulations and, if not, make appropriate changes.
- Ensure procedures are in place to accommodate non-English language speakers.

Newsworthy Items

Disaster Relief for Benefit Plans. Following several major hurricanes this year, the Internal Revenue Service and Department of Labor extended emergency relief to benefit plan participants in affected areas. Relief includes: waiver of the 10% penalty on early withdrawals from retirement plans (up to $100,000); in-service withdrawals from 401(k) plans without mandatory 20% withholding (up to $100,000); increases plan loan limits to $100,000; and delays loan repayments for up to one year.

New Mortality Table for Pension Plans. The IRS issued final regulations and guidance on mortality tables, in accordance with the Pension Protection Act of 2006. The new table generally reflects lower mortality rates than the current table. The result for many plans will be an increase in the present value of plan liabilities and minimum funding requirements.

Supreme Court Rules in "Church Plan" Case. In June, the United States Supreme Court issued its ruling in *Advocate Health Care Network v. Stapleton*. It held that employee benefit plans of church-affiliated organizations (e.g., hospitals and schools) may qualify as church plans, even though the plans were not established by an actual church. This ruling resolved years of uncertainty for church-affiliated employers.

18-Month Extension of Fiduciary Rule Transition Period. The DOL released a proposed rule in August that would extend the transition period for the best interest contract (BIC) exemption and the principal transactions exception by 18 months. Based on public comments, the DOL may finalize the proposed extension to July 1, 2018.

OregonSaves Filing Deadline. Employers with employees in Oregon should be aware of a certificate of exemption filing deadline for OregonSaves, the state-run retirement program. If your company offers a qualified retirement plan to its employees, it is eligible to avoid participating in OregonSaves, provided it timely seeks a certificate of exemption. The deadline for employers with 100 or more covered employees was November 15. The deadline for employers with 50-99 covered employees is May 15, 2018. Other deadlines apply to smaller employers.

New Paid Leave Laws to Take Effect. In 2018, paid sick leave laws will take effect in Rhode Island and Washington State. Existing paid sick leave laws in Vermont and St. Paul, Minnesota are scheduled to expand to cover smaller employers, and New York's City Council recently passed a bill allowing employees to take paid sick leave as a result of domestic violence, abuse or stalking, and to care for additional family members (e.g., grandparents and grandchildren).

Paid Medical and Family Leave in D.C. Washington, D.C. amended its paid leave law effective April 2017 to greatly expand employees' rights. The law allows covered employees to take two weeks of paid medical leave for their own serious health condition, six weeks of paid family leave to care for a family member with a serious health condition, and eight weeks of paid parental leave to care for children recently born or adopted. Payments are financed through an employer-paid tax.

2018 IRS Limit Increases. The IRS adjusted several of its contribution and compensation limits effective 2018. The Service's elective deferral limit will increase to $18,500 for 401(k), 403(b) and 457 plans (up $500 from 2017). Health savings account (HSA) limits will rise to $3,450 (self-only coverage) and $6,900 (family coverage) (increases of $50 and $150, respectively). The health FSA contribution limit will increase to $2,650 (up $50 from 2017). The IRS will also increase its annual compensation limit to $275,000 (up $5,000 from 2017).

In Case You Missed It

In case you missed any of our client alerts this year, please find them at the following links:

February 3, 2017
President Trump Issues Presidential Memorandum Regarding DOL Fiduciary Rule

March 2, 2017
DOL Proposes 60-Day Fiduciary Rule Delay

April 10, 2017
Department of Labor Issues Final Rule Delaying Fiduciary Rule Applicability Date

May 4, 2017
House Republicans Pass Affordable Care Act Repeal Legislation

May 15, 2017
Colorado to Provide Loans to Businesses Transitioning to Employee Ownership

May 17, 2017
Washington, D.C. Workers to Receive Paid Medical and Family Leave Benefits

May 23, 2017
Fidcuciary Rule Will Begin to Apply on June 9, 2017

May 24, 2017
New Developments Regarding 403(b) Litigation

June 6, 2017
Plans Established by Church-Affiliated Organizations May Be Exempt from ERISA

July 6, 2017
Using Pre-409A Money to Reduce Taxable Income

August 29, 2017
U.S. District Court Remands Wellness Program Regulations to EEOC for Reconsideration

September 25, 2017
University of Pennsylvania 403(b) Plan Lawsuit Dismissed

October 17, 2017
New Law Provides Tax Relief to Participants Affected by Hurricanes

October 26, 2017
OregonSaves Exemption Deadline Fast Approaching

November 1, 2017
IRS Releases Updated Mortality Tables and Guidance for Funding Method Changes

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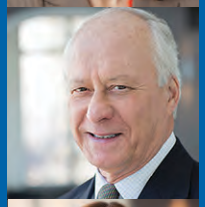

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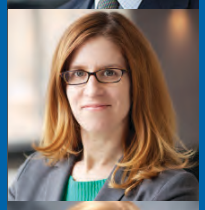

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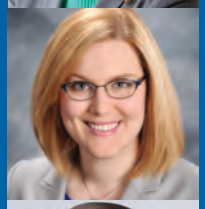

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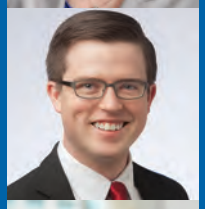

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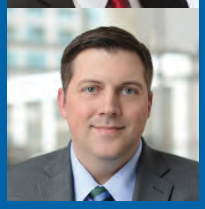

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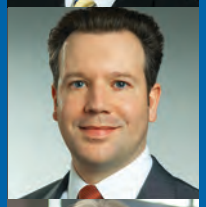

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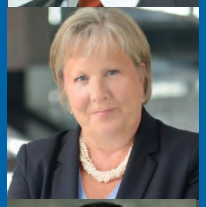

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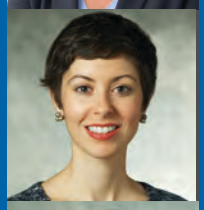

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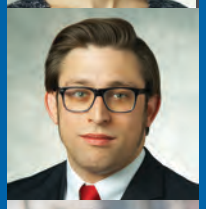

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