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Highlights

1. FASB to Revisit How Employers Account for Pensions and Other Postretirement Benefits
2. IRS Issues Temporary Regulations that Formalize an Automatic Extension of Time to File Form 5500
3. IRS Provides Two Methods for Handling HSA Eligibility during Cafeteria Plan Grace Period
4. U.S. Supreme Court Agrees to Hear Case Dealing with the Scope of Equitable Relief under ERISA

FASB to Revisit How Employers Account for Pensions and Other Postretirement Benefits

The Financial Accounting Standards Board (FASB) has decided to add a two-phase project to improve the reporting of pensions and other postretirement benefits. According to FASB's news release, the goal is to make information reported in a company's financial statements more useful and transparent for investors, creditors, employee, retirees and other users. The two accounting standards that will be reviewed by FASB are: Statement No. 87, "Employers' Accounting for Pensions" and Statement No. 106, "Employers' Accounting for Postretirement Benefits other than Pensions."

The two accounting standards that are being reviewed touch on many fundamental areas of accounting, including the measurement of assets and liabilities, consolidations, and financial reporting performance. While the complex funding and tax rules that apply to pensions and postretirement benefits other than pensions are not directly associated with accounting, they do affect the economics the accounting standards are attempting to depict.

The first phase of the project will seek to address the fact that currently important information about the financial status of a company's plan is reported in the footnotes but not in the basic financial statements. This phase is expected to be completed by the end of calendar year 2006. The financial status of a company's plan is measured as the difference between the fair value of the plan's assets and current measure of the benefit obligation incurred for past employee service. Under this phase of the project, FASB will



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issue guidance on how the plan's funded status will be recognized in the company's balance sheet.

The second phase of the project will address several remaining issues, including:

- ◆ How to best recognize and display in earnings and other comprehensive income, the various elements that affect the cost of providing postretirement benefits.
- ◆ How to best measure the obligation, in particular the obligations under plans with lump-sum settlement options.
- ◆ Whether more or different guidance should be provided regarding measurement assumptions, e.g., discount rate.
- ◆ Whether postretirement benefit trusts should be consolidated by the plan sponsor.

During the review process, FASB will coordinate with the U.S. Department of Labor and the Pension Benefit Guaranty Corporation. In addition, FASB will work with the International Accounting Standards Board and other standard setters.

IRS Issues Temporary Regulations that Formalize an Automatic Extension of Time to File Form 5500

On November 7, 2005 the IRS released temporary regulations that grant plan administrators or sponsors of employee benefit plans an automatic extension of 2 ½ months to file Form 5500, Annual Return/Report of Employee Benefit Plan. Under the temporary regulations the extension is automatic as long as the plan administrator or sponsor submits to the IRS a completed application for the extension. The extension application may be submitted on Form 5558, Application for Extension of Time to File Certain Employee Benefit Plan Returns, or any other manner as may be prescribed by the IRS.

The temporary regulations also give the IRS the ability to terminate an automatic extension at any time by mailing a notice of termination to the plan administrator or sponsor 10 days before the termination date designated in the notice.

The temporary regulations apply to extension applications filed after December 31, 2005 and before November 4, 2008. Since 1998 the IRS has routinely granted extension requests by plan administrators and sponsors, the automatic extension was not reflected in the regulations. Prior to 1998, extension requests were approved by the IRS when the filer was able to demonstrate that it was impossible to file the Form 5500 series return on time because of circumstances beyond the plan administrator's or sponsor's control.



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Another method to extend the filing date for the Form 5500 series return is based on the extended due date of the employer's tax return. In order to utilize this extension, the following conditions must be met: (1) the plan year and employer's tax year are the same; (2) the employer has been granted an extension of time to file its federal income tax return to a date later than the normal due date for filing the Form 5500 series return; and (3) a photocopy of the IRS extension of time to file the federal income tax return is attached to the Form 5500 series return. This extension cannot be further extended by filing a Form 5558 after the normal due date of the Form 5500 series return.

IRS Provides Two Methods for Handling HSA Eligibility during Cafeteria Plan Grace Period

IRS issued Notice 2005-86, 2005-49 IRB which provides two methods for dealing with the situation where a participant in a health flexible spending account (health FSA) during the 2 ½ month grace period generally cannot contribute to a health savings account (HSA) even if the participant's health FSA has no unused benefits at the end of the prior cafeteria plan year. In this notice the IRS stated that the employer can use either of the following two methods:

1. the employer can continue to maintain a general purpose health FSA and participants in it can contribute to an HSA on the first day of the first month following the end of the grace period, or
2. an employer can amend the cafeteria plan document to convert the general health FSA to an HSA-compatible health FSA, and allow participants to make full contributions to HSAs.

Background

Under the "use it or lose it" requirement that applies to health FSAs, cafeteria plan benefits cannot be carried over from one plan year to the next. However, the IRS recently concluded that a cafeteria plan may provide for a 2 ½ month "grace period" after the end of the plan year during which the participant may use up benefits left in his/her FSA at the end of the preceding plan year.

The HSA rules make it clear that an otherwise eligible individual cannot contribute to an HSA if he/she is covered under a "general purpose" health FSA since this type of FSA provides impermissible "other coverage." A "general purpose" health FSA is an FSA that provides reimbursements for medical and dental expenses on a first-dollar basis. Therefore, an employee cannot contribute to an HSA during the portion of the HSA plan year that includes the extended FSA coverage.



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IRS Notice 2005-86

The two options contained in the IRS notice each have their own consequences. If the employer chooses the first option, which is to continue a general purpose health FSA during the grace period, the participants in the general purpose health FSA will only be allowed to make contributions to an HSA beginning on the first day of month following the expiration of the grace period. For example, a health FSA covers the 2005 calendar year and has a 2 ½ month grace period that will end on March 15, 2006. An individual who did not elect coverage by a general health FSA or other disqualifying coverage for 2006 is HSA eligible to make contributions to his/her HSA beginning April 1, 2006 and can contribute 9/12 of the 2006 HSA contribution limit. The conclusion does not change even if the participant does not have any unused contributions remaining at the end of the 2005 plan year.

If the employer chooses option two, which is to convert the general health FSA to an HSA-compatible FSA and allow participants to make full contributions to HSAs. An HSA compatible FSA is either a limited-purpose or post-deductible FSA (or a combination of a limited-purpose and a post-deductible HSA). Under this option, participants can make contributions to their HSAs during the grace period (if they are otherwise eligible to do so).

A limited-purpose FSA is defined as one which pays or reimburses expenses only for preventive care and “permitted coverage” (e.g., dental care and vision care). A post-deductible FSA pays or reimburses for preventive care and for other qualified medical expenses only if incurred after the minimum annual deductible for the HDHP is satisfied. This means that qualified medical expenses incurred before the HDHP deductible is satisfied cannot be reimbursed by a post-deductible HSA even after the HDHP deductible has been satisfied.

If the second option is chosen, individuals cannot be allowed to elect between an HSA-compatible FSA or an FSA that is not HSA-compatible. The amendment must apply to the entire grace period and to all participants in the health FSA who are covered by the grace period. In addition all other requirements contained in IRS Notice 2005-42, 2005-23 IRB, must be met. Coverage of these participants by the HSA-compatible FSA during the grace period does not disqualify participants who are otherwise eligible individuals from contributing to an HSA during the grace period.



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Transitional Relief

The transitional relief applies to cafeteria plan years ending before June 5, 2006. Under this transitional relief, an individual that participates in a general purpose health FSA that provides coverage during a grace period may contribute to an HSA during the grace period as long as:

1. If not for the coverage under a general purpose health FSA, the individual would be an eligible individual during the grace period. An eligible individual is generally defined as an individual covered under an HDHP and is not, while covered under the HDHP, covered under any impermissible other health coverage; and
2. either the individual's (and the individual's spouse) general purpose health FSA has no unused contributions or benefits remaining at the end of the immediately preceding cafeteria plan year, or in the case of an individual who is not covered during the grace period under a general purpose health FSA maintained by the employer of the individual's spouse, the individual's employer amends the cafeteria plan document to provide that the grace period does not provide coverage to an individual who elects HDHP coverage.

U.S. Supreme Court Agrees to Hear Case Dealing with the Scope of Equitable Relief under ERISA

On November 28, 2005 the U.S. Supreme Court agreed to reconsider the scope of equitable relief under ERISA. The case is *MidAtlantic Medical Services, LLC v. Sereboff*, 407 F.3d 212 (4th Cir. 2005), cert granted, No. 5 Civ. 260, 2005 U.S. LEXIS 8573 (Nov. 28, 2005). The principal issue in this case is whether a plan's claims for reimbursement of medical expenses paid on behalf of a participant or beneficiary are recoverable under ERISA section 502(a)(3). ERISA section 501(a)(3) provides that a participant, beneficiary, or fiduciary can bring a civil action to obtain other appropriate equitable relief to redress violations of ERISA or the plan document or to enforce the terms of an employee benefit plan or ERISA.

In 2002 the Supreme Court rendered its opinion in *Great West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002). In *Knudson*, the Court held that a plan could not obtain monetary relief under ERISA Section 502(a)(3) for reimbursement of medical expenses it had paid on behalf of a beneficiary because such relief was not "equitable relief" within the meaning of ERISA. The *Knudson* decision also suggested that under limited circumstances an action for restitution could lie in equity, provided that the action seeks to restore to the plaintiff funds or property in the defendant's possession.



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The U.S. Courts of Appeals have rendered varying interpretations of *Knudson*. The 4th Circuit Court of Appeals' opinion in *Sereboff* concluded that the plan's claim for reimbursement was permissible under ERISA section 502(a)(3) because the plan sought to recover funds that were specifically identifiable, belonged in good conscience to the fiduciary, and were within the possession and control of the beneficiary. The 5th, 7th and 10th Circuits have rendered similar opinions since the *Knudson* decision. However, the 6th and 9th Circuits have rendered contrary opinions finding that *Knudson* prohibits such relief regardless of whether the beneficiary possesses the money in an identifiable fund.

The opinion rendered by the Supreme Court in *Sereboff* should resolve the issue as to the circumstances, if any, under which monetary relief is available for reimbursement claims under ERISA section 502(a)(3). A broadly drafted Supreme Court opinion in *Sereboff* could also clarify the scope of equitable relief under a variety of claims for fiduciary breach brought by plan participants and beneficiaries under ERISA section 501(a)(3), including claims for losses in individual account plans.