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Monthly Newsletter – Volume 3, No. 6 – June 15, 2007

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Highlights of the Month

- 1. IRS Publishes Regulations on Minimum Normal Retirement Age and In-Service Distributions**
- 2. IRS Releases Adjusted HSA Limits for 2008**
- 3. IRS Sets Semiannual Regulatory Agenda**
- 4. EBSA Sets Semiannual Regulatory Agenda**
- 5. PBGC Sets Semiannual Regulatory Agenda**
- 6. Court Holds that Elimination of Put Option in 401(k) Plan Violates the Anti-Cutback Rule**
- 7. Thousands of HIPAA Privacy Violations are Resolved Through Corrective Action**

IRS Publishes Regulations on Minimum Normal Retirement Age and In-Service Distributions

The Pension Protection Act of 2006 (“PPA”) amended the Internal Revenue Code’s (“Code’s”) provisions to provide that a pension plan which permits in-service distributions to employees who have attained age 62 can still be a tax qualified retirement plan. This provision is effective for plan years that began after December 31, 2006.

In 2004, the Internal Revenue Service (“IRS”) issued proposed regulations governing “phased retirement.” The “phased retirement” regulations were issued in response to requests from employers and would have allowed employees to begin receiving distributions from pension plans while continuing to work for their employer on a less than full-time basis. These regulations provided that the “phased retirement” rules were met only if certain maximum hours were not exceeded. Therefore, the employer had to be willing to allow the employee to work on a less than full-time basis.

As a result of the enactment of the PPA in-service distribution rules, the IRS has issued final regulations which finalize only portions of the proposed “phased retirement” regulations. The final regulations also contain rules on how low a plan’s normal retirement age can be and include an exemption to the Code’s anti-cutback rules in Code § 411(d)(6). In addition, the final regulations implement the PPA provisions which provide that a participant in a defined benefit pension plan or a money purchase pension



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plan can begin receiving benefits upon the attainment of normal retirement age even if the employee has not severed employment with the plan sponsor.

The final regulations are generally effective May 22, 2007. Special rules apply to governmental plans and collectively bargained plans.

Definition of Normal Retirement Age

These regulations define normal retirement age as the age that is not earlier than the earliest age which is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. However, the regulations provide a safe harbor. The safe harbor states that a normal retirement age of 62 or later is deemed to satisfy this requirement. Whether an employer can establish a normal retirement age between 55 and 62 depends on the relevant facts and circumstances. It is presumed that a normal retirement age of less than 55 is not permitted. However, if the employer can provide evidence that the normal retirement age in their industry is less than age 55, the IRS will allow a normal retirement age of less than age 55.

In order for a pension plan to be a tax-qualified pension plan, the plan must provide for definitely determinable benefits payable over a period of years (generally over the life of the employee) after retirement or attainment of normal retirement age, generally over the life of the employee. PPA amended the Code to provide that an employee who has attained age 62 and is still working may begin receiving benefits from a tax-qualified pension plan. The regulations further provide that retirement does not include a mere reduction of work hours.

Transition Relief under Anti-Cutback Rules

The regulations also contain some transition relief where it is necessary to amend a plan's normal retirement date to comply with the new regulations. The transition relief provides an amendment made to comply with PPA provisions with respect to the right to receive an in-service distribution prior to the amended normal retirement age and does not violate the anti-cutback provisions of the Code. However, this relief does not extend to other Code provisions such as the requirement that the normal retirement benefit not be less than the greater of an early retirement benefit payable under the plan or the benefit under the plan commencing at normal retirement age, or other prohibitions in Code § 411(d)(6).



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IRS Releases Adjusted HSA Limits for 2008

IRS issued Revenue Procedure 2007-36, 2007-22 IRB, which revised the previously released 2007 inflation-adjusted figures for health savings accounts (“HSAs”). Employees and employers can make tax deductible contributions to HSAs within statutory limits as long as the health plan in which the individual is a participant is a high deductible health plan (“HDHP”). In order to be classified as an HDHP, the health plan must provide for certain minimum out-of-pocket expenses and annual deductible. Annual out-of-pocket expenses include deductibles, co-pays, and other amounts but not premiums. The revised limits for 2007 and the 2008 limits are as follows:

	2007	2008
Annual contribution limitation		
Self only coverage	\$2,850	\$2,900
Family coverage	\$5,650	\$5,800
Minimum Annual deductible under HDHP		
Self only coverage	Unchanged	\$1,100
Family coverage	Unchanged	\$2,200
Minimum out-of-pocket expenses		
Self only coverage	Unchanged	\$ 5,600
Family coverage	Unchanged	\$11,200

IRS Sets Semiannual Regulatory Agenda

IRS has issued its semiannual regulatory agenda which lists regulatory priorities for the next 12 months. This agenda includes items that are applicable to pension and benefit plans. The IRS has identified the following pension regulations that are at the proposed rule stage.

- ❖ Definition of highly compensated employee;
- ❖ Clarification of the deduction rules as they apply to qualified retirement plans and other deferred compensation plans;
- ❖ Rules governing the performance of ERISA actuarial services;



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- ❖ Additional guidance on the nondiscrimination requirements that apply to benefits and contributions;
- ❖ Cafeteria plans;
- ❖ Proposed amendments to the fringe benefit regulations to eliminate a reference to Code § 414(q)(1)(C) which no longer exists and replacing it with a reference to Treas. Regs. § 1.61-21(f)(5)(i);
- ❖ Guidance on the measurement of income inclusion and calculation of applicable taxes under Code § 409A, relating to nonqualified deferred compensation;
- ❖ Guidance relating to the determination of the annual benefit under a defined benefit pension plan for the purpose of applying the Code § 415 where there is more than one annuity starting date;
- ❖ Tax treatment of payments by qualified plans for medical and accident insurance;
- ❖ Guidelines regarding the mortality tables that are used to determine the present value for purposes of the qualified defined benefit plan funding requirements that are effective in 2008;
- ❖ Guidance with respect to vesting and payment of benefits under tax-qualified hybrid defined benefit plans and age discrimination rules;
- ❖ Guidance relating to the determination of whether a plan is a governmental plan; and
- ❖ Guidance relating to the interaction of the requirements under Code § 4980F with a plan amendment that is permitted to reduce benefits accrued before the plan amendment's applicable amendment date.

The following regulations are at the final rule stage.

- ❖ 403(b) Regulations;
- ❖ Bona fide phased retirement regulations;
- ❖ Enhancement of the existing Health Insurance Portability and Accountability Act (HIPAA) by tolling the running of certain time periods in certain circumstances, clarifying the procedures for requesting special enrollment, addressing how the HIPAA portability requirements apply to individuals on Family and Medical Leave Act of 1993, and prescribing how to count the number of employees an employer has;
- ❖ Temporary regulations that provide guidance on the tax consequences of converting a non-Roth IRA annuity to a Roth IRA;
- ❖ Taxation of distributions from designated Roth accounts in 401(k) plans;
- ❖ Notice on proposed rulemaking that provides guidance on employer contributions to health savings accounts (HSAs); and
- ❖ Temporary regulations allowing governmental entities to act as non-bank trustees for deemed IRAs which are part of the entities qualified plan.



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The IRS identified the following long-term actions.

- ❖ Guidance on the allocation of accrued benefits between employer and employee contributions; and
- ❖ Guidance on the application of the grantor trust rules to non-exempt employees' trust.

The IRS stated that five items have been completed.

- ❖ HIPAA general nondiscrimination rules
- ❖ HIPAA nondiscrimination exception for church plans;
- ❖ HIPAA nondiscrimination exception for bona fide wellness programs;
- ❖ Annual addition regulations under Code § 415;
- ❖ Nonqualified deferred compensation under Code § 409A.

EBSA Sets Semiannual Regulatory Agenda

The Employee Benefits Security Administration (“EBSA”) has identified the following regulations that are currently under development or review or that it expects to have under development or review during the next 12 months. The following 6 rules are at the proposed stage.

- ❖ Existing plan asset regulations that address participant contributions will be amended to provide a safe harbor period of a specified number of business days during which contributions withheld from a participant's pay would not be considered to be plan assets;
- ❖ Amendment of the participant directed account regulations to reflect additional disclosures regarding fee and expense information;
- ❖ Amendment of the regulation governing the statutory exemption for the provision of office space for services by a party in interest to an employee benefit plan. The proposed regulation would be designed to ensure that plan fiduciaries are provided with, or have access to, the information required to determine whether an arrangement for services is reasonable within the meaning of the statutory exemption as well as prudent;
- ❖ Guidance regarding the expertise and procedures that may be needed to certify a computer model program under the investment advice exemption that was enacted in PPA;
- ❖ Guidance that establishes a safe harbor for plan fiduciaries of defined contribution plans in the selection of annuity provider for purposes of benefit distributions; and



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- ❖ Regulations regarding the content of participant statements that are to be provided by the plan administrator to participants and beneficiaries. PPA changed the disclosure rules to provide that participants in defined benefit plans must be provided a statement every 3 years with an annual alternative. In addition, participant directed account plans must provide quarterly statements and other individual account plans must provide annual statements.

EBSA has the following 11 projects at the final rule stage.

- ❖ HIPAA regulations and the Public Health Services Act (“PHSA”) on the improvement of health care access, portability, and renewability. EBSA, IRS, and the Department of Health and Human Services are mutually dependent on these regulations since they have shared jurisdiction and proceeding concurrently to provide final regulatory guidance;
- ❖ Regulations regarding the length of hospital stays following the birth of a child;
- ❖ Electronic filing of annual reports for employee benefit plans;
- ❖ Default investment fund regulations which will describe the types of investments that qualify as default investments under the safe harbor;
- ❖ Supplemental guidance and revisions to the Form 5500, Annual Return/Report for Employee Benefit Plans to reflect changes required by PPA. Specifically, the changes will provide for separate Schedule Bs for single employer and multiemployer plans; new questions on Schedule R and Schedule H designed to collect additional information regarding single employer and multiemployer plans; and a proposal to have the Form 5500-SF Annual Return/Report be the simplified report required under the PPA for plans with fewer than 25 participants;
- ❖ Qualified Domestic Relations Order (“QDRO”) order timing rules that will provide guidance to plan administrators, service providers, participants, and alternate payees;
- ❖ Direct rollover provisions for nonspouse beneficiary;
- ❖ Guidelines for the content requirements of the written cross-trading policies and procedures required under ERISA § 408(b)(19)(H) which exempts the purchase and sale of a security between an employee benefit plan and any other account managed by the same investment manager if certain conditions are satisfied;
- ❖ Guidance regarding the information that is to be contained in the annual funding notice that a defined benefit plan administrator must provide to plan participants, beneficiaries and other parties;
- ❖ Guidance regarding changes made by PPA which require a multiemployer plan administrator to furnish within 30 days, upon written request, to any plan participant or beneficiary, employee representative, or any employer that has an



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obligation to contribute to the plan a copy of certain actuarial, financial and funding-related documents; and

- ❖ Clarification that the selection of an annuity contract as an optional form of distribution from an individual account plan is not subject to the safest available annuity requirement under Interpretative Bulletin 95-1.

EBSA reported the following long-term projects.

- ❖ Adequate consideration regulations which would set forth the standards for determining the value of assets other than securities for which there is a generally recognized market;
- ❖ Review of rules for determining when an independent public accountant is independent for purposes of auditing and rendering an opinion on a plan's financial statements; and
- ❖ Review of the plan asset/participant contribution regulations to determine whether the rules are still necessary; the nature of complaints or comments received from the public concerning the rules; the rules' complexity; the extent to which the rules overlap, duplicate, or conflict with other federal or state and local rules; and the degree to which technology, economic conditions, or other factors have changed in industries affected by the rule.

EBSA has finalized the following rules.

- ❖ HIPAA nondiscrimination rules as they apply to a group health plan or a health insurance issuer based on any health-status related factor; and
- ❖ Solicitation of comments from the public regarding the feasibility of the application for computer model investment advice programs for individual retirement accounts and similar type plans.

PBGC Sets Semiannual Regulatory Agenda

The Pension Benefit Guaranty Corporation ("PBGC") has identified the following regulations that are currently under development or review or that it expects to have under development or review during the next 12 months.

- ❖ Multiemployer Plan amendments. The proposed regulations would implement the provisions of PPA that allow for changes in the methods for computing withdrawal liability and address adjustments in withdrawal liability if a plan is in critical status;
- ❖ Premium rate regulations will be amended to reflect the changes made by the Deficit Reduction Act of 2005 and PPA that are effective beginning in 2006 and



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2007. These changes include changes to the flat rate premiums, cap on variable rate premium in certain situations, and the permanent creation of a new termination premium payable in the case of certain distress involuntary terminations;

- ❖ Proposed regulations addressing the changes made by PPA for the missing participant program. This regulation will implement the changes made by PPA with respect to use of the PBGC's missing participant program for plans that are not covered by the existing missing participant program, e.g., multiemployer plans, small professional service employer plans with no more than 25 participants, and individual account plans; and
- ❖ Regulations implementing the PPA changes that address disclosures to affected parties in connection with distress terminations. Specifically, the proposed regulations will clarify procedures, rights and responsibilities with respect to obtaining and providing this information.

Court Holds that Elimination of Put Option in 401(k) Plan Violates the Anti-Cutback Rule

The U.S. District Court in Hawaii has held that the elimination of a put option in a 401(k) plan is a valuable right that cannot be eliminated under Code § 411(d)(6). Innovative Technical Solutions, Inc. (“Plan Sponsor”) sponsored a defined contribution plan that contained both a 401(k) feature and an employee stock ownership feature (“ESOP”). Both components of the plan contained Plan Sponsor stock which is not publicly traded. A put option, which allowed terminated participants to demand payment of their benefits in cash rather than Plan Sponsor stock, was contained in both components of the plan. The put option is required for the ESOP component of the plan but not the 401(k) component. When the plan was amended in 2004, the put option was eliminated from the 401(k) component of the plan. Several participants sued.

The court concluded that the put option was a valuable right since the Plan Sponsor's stock was not publicly traded. The court stated that the put option was the only means through which a participant could receive cash for shares held in the 401(k) component of the plan. Therefore, the put option is a valuable right and as such its elimination from the 401(k) component constituted a reduction of an accrued benefit in violation of the anti-cutback rules under Code § 411(d)(6).

The court also rejected the Plan Sponsor's other defense that the plan as a whole fell within an exception under the anti-cutback rules that applies only to ESOPs. Under that exception, an ESOP is not treated as failing to meet the requirements of the anti-cutback provisions merely because it modifies its distribution options in a nondiscriminatory



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manner. However, because the court had already concluded that the two components of the plan were separate and distinct plans, it held that the ESOP exception was not applicable to the 401(k) plan component.

Accordingly, the court held that the put option is an optional form of benefit under the plan which cannot be eliminated retroactively without violating ERISA's anti-cutback provisions. (*Goodin v. Innovative Technical Solutions, Inc.*, (2007, DC HI) 2007 WL 1240204)

Thousands of HIPAA Privacy Violations are Resolved Through Corrective Action

The Department of Health and Human Services (“HHS”) has received 26,408 complaints regarding HIPAA privacy violations since the original compliance date in April 2003. In the last 4 years, the Office of Civil Rights (OCR) in HHS has investigated 4,447 cases involving violations of the HIPAA privacy rules which have been resolved through corrective actions. According to the summary issued by OCR in April 2007, another 2,155 investigations did not uncover any violations of HIPAA's privacy rules.

In an additional 13,875 completed investigations, HHS determined that the complaint did not present an eligible case for enforcement of the privacy rule. The reasons cited by HHS for the conclusion that the cases did not present an eligible case for enforcement included:

- ❖ The alleged violation was prior to the compliance date;
- ❖ The alleged violation was committed by an entity not covered by the privacy rules;
- ❖ The complaint was untimely, withdrawn or not pursued by the filer; and
- ❖ The alleged activity described did not violate the rules such as when a covered entity had disclosed protected health information (“PHI”) in circumstances in which the rule permitted such a disclosure.

The compliance issues investigated the most frequently have been:

- ❖ Impermissible uses and disclosures of PHI;
- ❖ Lack of safeguards of PHI;
- ❖ Lack of patient access to PHI;
- ❖ Uses or disclosures of more than the minimum necessary PHI; and
- ❖ Lack of or invalid authorizations for uses and disclosures of PHI.



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The most common types of covered entities (“CEs”) that have been required to take corrective action to achieve voluntary compliance have been, in order of frequency, the following:

- ❖ Private practices;
- ❖ General hospitals;
- ❖ Outpatient facilities;
- ❖ Health plans including group health plan and health insurance issuers; and
- ❖ Pharmacies.

The OCR has also referred 384 cases to the Department of Justice for criminal investigation for knowing disclosure or obtaining PHI in violation of the privacy rules.

For additional information, the report may be accessed at <http://www.hhs.gov/ocr/privacy/enforcement>.