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Monthly Newsletter – Volume 2, No. 1 – January 5, 2006

Highlights of the Month

1. IRS Issues Final Roth 401(k) Regulations
2. IRS Raises Employee Plan User Fees for 2006
3. PBGC Announces Maximum Guarantee for Single-Employer Defined Benefit Plans that Terminate in 2006
4. House and Senate Approve Deficit Reduction Omnibus Reconciliation Act of 2005
5. Congress Approves Extension of Mental Health Parity Rules
6. DOL Issues Final USERRA Rules
7. 2005 Form M-1 for MEWA Reporting is a Useful Tool for Entities other than MEWAs

IRS Issues Final Roth 401(k) Regulations

On December 31, 2005 the IRS issued the final regulations relating to designated Roth contributions for 401(k) plans. The final regulations did not address the distribution and taxation issues. Beginning January 1, 2006 employers can permit employees to designate their deferrals as either pre-tax or after-tax to a Roth account in the 401(k) plan. The Roth 401(k) provisions are due to expire for plan years beginning after December 31, 2010 unless extended or made permanent by legislation.

The Roth 401(k) permits an employee to designate his/her elective contributions as either pre-tax or Roth after-tax contributions. The advantage to designating the contributions to a Roth account means that the contributions are taxed when made to the 401(k) plan and not taxed when distributed. In addition, earnings on a Roth account are tax-free when distributed as long as the distribution is a “qualified distribution.” A “qualified distribution” has to meet the following requirements: (a) the distribution is on account of a qualifying distribution event (age 59 ½, death or disability), and (b) the participant has satisfied the five-year exclusion period.



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The areas addressed in the final regulations include:

- ◆ Roth deferrals are treated the same as pre-tax deferrals for the following provisions:
 - 100% immediate vesting requirements
 - Actual deferral percentage test (ADP test)
 - Ability to make catch-up contributions
 - Ability to serve as a basis for participant loans
 - Required minimum distributions
 - Frequency of contribution elections (the plan must permit the participant to change his/her election at least once per year)
 - Automatic enrollment provision of the plan (whether the default contributions are pre-tax or Roth)
 - Rollover of the Roth account into another tax qualified retirement plan or Roth IRA
 - Automatic direct rollover requirements of the plan
 - Correction methods that may be used when a plan fails the ADP or ACP test for a year.
 - Distribution of excess contributions is not includible in gross income to the extent the contributions are Roth contributions. However, the income allocable to the contributions is includible in gross income.
- ◆ Separate accounting requirement. A plan permitting Roth contributions must establish a separate account for purposes of tracking Roth contributions, earnings and distributions. The plan must maintain the account until the plan has completely distributed the Roth account. The plan must also allocate gains, losses and expenses on a reasonable and consistent basis. Furthermore, the plan cannot allocate forfeitures to the Roth account. Therefore, the Roth account should only include Roth contributions, rollovers from other Roth 401(k) or 403(b) plans and earnings on such contributions.

The final regulations do not contain any guidance on the timing of the Roth 401(k) amendments. Since the Roth 401(k) option is a voluntary EGTRRA option, an employer should have until the end of the plan year in which it implements the Roth 401(k) to amend its plan. Therefore, a 2006 calendar year plan would need to be amended by December 31, 2006 to include the Roth 401(k) option if participants are given the opportunity on January 1, 2006 to designate deferrals as Roth contributions.



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IRS Raises Some Employee Plan User Fees for 2006

The IRS has announced increased user fees for certain types of applications that impact employee benefit plans. The IRS stated that the fee increases more accurately reflect the costs of processing the various types of applications. Generally the increased user fees are effective for any requests that are postmarked after January 31, 2006. Determination letter requests for retirement plans which currently range from \$125 to \$700 will increase to \$300 to \$1,000. Determination letter requests upon termination of a retirement plan which currently range from \$225 to \$375 will increase to \$1,000 to \$1,800. For exempt organization applications (includes VEBAs/501(c)(9) trusts) and requests for group exemption letters which currently range from \$150 to \$500 will increase to \$300 to \$900.

PBGC Announces the Maximum Guarantee for Single-Employer Defined Benefit Plans that Terminate in 2006

The maximum benefit that is guaranteed by the PBGC for retirees in underfunded single-employer defined benefit plans that terminate in calendar year 2006 is \$47,659.08 per year (\$3,971.59 per month). The maximum guaranteed amount is adjusted annually by the PBGC based on changes in the Social Security contribution and benefit base.

You should note that the maximum guaranteed amount applies to workers who retire at age 65 with a single life annuity. The maximum guaranteed amount is adjusted for early retirement and survivor benefits. In addition, a retiree may receive amounts in excess of the guarantee if the PBGC recovers sufficient amounts. Alternatively, a participant could receive less than the guaranteed amount because of limits on PBGC coverage of early retirement supplements and/or recent benefit enhancements.

House and Senate Approve Deficit Reduction Omnibus Reconciliation Act of 2005

On December 21st the Senate approved the conference report on the Deficit Reduction Omnibus Reconciliation Act of 2005 (the “DRA”). The House of Representatives passed the conference report on December 19, 2005. However, the version of the conference report passed by the Senate contained amendments that were not included in the House version. Therefore, the House must vote on the Senate passed version when it returns on January 31, 2006.



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The DRA would increase the annual premiums that employers pay to the PBGC in 2006, as follows:

- Single-employer plans – premiums would increase from \$19 to \$30 per participant
- Multiemployer plans – premiums would increase from \$2.60 to \$8.00 per participant
- Automatically index premium increases to wage increases

In addition, the DRA would establish an employer-paid termination premium of \$1,250 per participant for the first three years for companies emerging from bankruptcy that terminated their defined benefit pension plans while in bankruptcy. The special premium provision would also apply to distress terminations outside of bankruptcy. This termination premium provision would sunset five years after enactment.

Congress Approves Mental Health Parity Rule Extension

The Mental Health Parity Act (MPHA) was enacted in 1996 to prevent employers and health insurers from establishing annual and lifetime limits on mental health benefits unless similar limits were also set for medical and surgical benefits. The original provision was set to expire on September 30, 2001. However, the original sunset date has been extended annually since 2002. The most recent extension passed by Congress will apply to mental health benefits services rendered before December 31, 2006. The President is expected to sign the bill which was passed by the House on December 17, 2005 and by the Senate on December 21, 2005.

DOL Issues Final USERRA Rules

DOL's Veterans' Employment and Training Service issued two sets of final rules that implement the provisions of the Uniformed Services Employment and Reemployment Rights Act (USERRA). The first set of rules adopts the proposed regulations that were issued on September 20, 2004. The second set of rules adopts interim rules that were issued on March 10, 2005 which implement the requirement that employers provide employees with notice of their rights and duties under USERRA and provides revised versions of the text that employers may use to fulfill the notice requirement. The final rules made some changes to the previously published rules. These rules take effect on January 18, 2006.



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Health Plans

The final regulations contain the following continuation coverage rules for health plans:

- ◆ *Definition.* Health plan definition includes an insurance policy or contract, medical or hospital service agreement, membership or subscription contract, or arrangement under which the employee's health services are provided or the expenses are paid. Health plan also includes a health plan that is established pursuant to one or more collective bargaining agreements and health plans that are generally not covered by ERISA such as state or local government or religious organization health plans.
- ◆ *Period of continuation coverage.* The minimum period of continuation coverage is the lesser of (1) the 24-month period beginning on the date on which the employee's absence for military service begins or (2) the period beginning on the date on which the employee's absence for the performing military service begins and ending on the date on which the employee fails to return to service or apply for a position of employment.
- ◆ *Election procedures.* Plan administrator has discretion in developing reasonable requirements addressing how the continuation coverage may be elected, consistent with the terms of the plan and USERRA's exceptions to the requirement that the employee provide advance notice of military service.
- ◆ *Calculation of premiums.* Plan administrators may develop reasonable procedures for payment of health premiums, except that (1) if the employee is on military service for fewer than 31 days, the employee cannot be required to pay more than the regular employee share, if any, for health plan coverage; and (2) if the employee is on military service for 31 or more days, he/she may be required to pay no more than 102% of the full premium under the plan (which represents both the employer's and employee's share plus 2% for administrative expenses).
- ◆ *Permissible plan administrator actions where no election to continue coverage.* The plan administrator may terminate an employee's participation in the health care plan: (1) if the employee fails to provide advance notice of military service and the failure is unexcused, and (2) if the employee provides notice but fails to elect continuing coverage. Under scenario 2, the plan administrator must permit retroactive coverage to the date of departure if the employee elects continuing coverage and pays all unpaid amounts due within the periods established by the plan or the minimum period of coverage (i.e., the lesser of the 24-month period beginning on the date on which the employee's absence begins for military service or the period between the date on which the employee's absence begins and the date on which the employee fails to return to service or apply for a position of employment).



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- ◆ *No waiting period.* The plan administrator cannot impose an exclusion or waiting period in connection with the reinstatement of coverage upon reemployment, if an exclusion or waiting period would not have been imposed had coverage not been terminated by reason of military service, except with respect to illnesses or injuries determined by the Secretary of Veterans Affairs to have been incurred in, or aggravated during performance of military service.
- ◆ *Delayed reinstatement.* The plan administrator may permit an employee to delay reinstatement of coverage until a date that is later than the date of reemployment.
- ◆ *Multiemployer plan liability allocations.* Liability under a multiemployer plan for employer contributions and benefits in connection with USERRA's health provisions must be allocated as follows: (1) as the plan sponsor provides; (2) if the sponsor does not provide, to the employee's last employer before his/her military service; or (3) if the last employer is no longer functional, to the health plan.
- ◆ *Multiemployer bank plans.* For multiemployer plans that allow employees to accumulate prospective health benefit eligibility through a health benefits account system and who elect to continue coverage during the period of military service, the employee must be able to further elect either (1) to expend the health account balance instead of paying for the continuation of coverage, in which case, upon reemployment, the employee may be required to pay the cost of the coverage until enough credits are earned to sustain continued coverage in the plan or (2) to pay for continuation coverage in order to maintain intact his/her account balance, in which case, the employee may resume usage of the account balance upon reemployment.

Pension Plans

The final rules provide the following regarding pension plans.

- ◆ *Definition.* Pension Plans include both pension plans that are covered by ERISA as well as pension plans that are sponsored by state, governmental entities or churches.
- ◆ *Break in service rules.* Employees who are on military service will not incur a break in service for the period of military service when they are reemployed. In addition, an employee who is returning from military service will be entitled to take an additional 1 to 90 days after the completion of the military service (depending on the length of the period of military service) before reporting back to work or applying for reemployment. However, if an employee is hospitalized or convalescing from an illness or injury that



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occurred, or was aggravated, during the period of military service, the employee has two years from the time he/she completed military service.

- ◆ *Make-up contributions.* Employers must make-up contributions once an employee is reemployed. For a defined contribution plan, the employer must allocate the amount of its make-up contribution, if any and the employee's elective deferrals, if any, in the same manner and to the same extent that the employer allocates the amounts for other employees during the same period. For a defined benefit plan, the employer must increase the employee's benefit for the period of service provided that the employee repays any amounts previously paid to the employee from the plan and makes any employee contributions that may be required to be made under the plan.
- ◆ *Timing for make-up contributions.* The employer does not have to contribute the make-up contributions until the employee is reemployed. For noncontributory plans, the employer must make the contributions by the later of: (1) 90 days after the date of reemployment; or (2) when contributions are normally due for the year in which the military service was performed. Employee contributions must be made within a period not to exceed five years, starting with the date of reemployment and continuing for three times the length of the employee's immediate past period of military service. Employer contributions that are contingent on or attributable to the employee's make-up contributions or elective deferrals must be made according to the plan's requirements for employer matching contributions.
- ◆ *No interest on make-up contributions.* An employer cannot require or permit an employee to add interest to any make-up contributions.
- ◆ *Repayment of prior distributions.* If an employee received a distribution of all or part of his/her accrued benefit from a defined benefit plan in connection with military service before being reemployed, the employee must be given the right to repay the withdrawn amounts upon reemployment including any interest. The repayment period begins with the date of reemployment and continues for three times the length of the employee's immediate past military service not to exceed a period of five years. The employee must be employed with the post-service employer during the repayment period.
- ◆ *Effect of military service on benefit amount.* In a noncontributory defined benefit plan, the employee will receive the same benefit as though the employee had remained continuously employed during the period of military service. In a contributory defined benefit plan, the employee will only receive the same benefit if he/she makes up the contributions. In a defined contribution plan, the benefit may not be the same even though the employee and the employer make up missed contributions since the employee is not



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- entitled to forfeitures and earnings on the missed contributions or experienced losses that accrued during the period of military service.
- ◆ *Definition of employee compensation during period of military service.* In determining pension benefits based on compensation, the employee's compensation must be calculated using the rate of pay that the employee would have received but for the military service. In situations where the employee's rate of pay is not reasonably certain, such as where compensation is based on commissions earned, the average rate of pay during the 12-month period (or the period of the employee's employment, if shorter) prior to military service must be used.
 - ◆ *Multiemployer plans.* The last employer that employed the employee prior to the period of military service is responsible for making contributions to the multiemployer plan on the employee's behalf. If the last employer is no longer functional, the plan must still provide the benefits to the employee. An employer who reemploys an employee pursuant to USERRA must provide notice to the multiemployer plan administrator within 30 days after the date of reemployment or, if later, the date the employer has knowledge that the employee was reemployed. In addition, the employee must receive the same employer contribution under the multiemployer plan whether reemployed by the pre-military service employer or by a different employer contributing to the same multiemployer plan if the employers share a common means or practice of hiring the employee, e.g., union hiring hall.

The appendix to the final rules contains two versions of the USERRA notice. One version is for private sector and state government employers. The other version is for federal executive agencies.

2005 Form M-1 for MEWA Reporting is a Useful Tool for Entities other than MEWAs

The Form M-1 is utilized by multiple employer welfare arrangements (MEWAs) to report compliance with the HIPAA portability, the Mental Health Health Parity Act (MHPA), the Newborns' and Mothers' Health Protection Act (NMHPA), and the Women's Health and Cancer Rights Act (WHCRA) requirements. Certain entities claiming they are not MEWAs because of the exception for plans maintained under collective bargaining agreements are also required to file the Form M-1.

The 2005 form is substantively identical to the 2004 form and like the 2004 form can be filed electronically over the internet. The 2005 filing package also includes EBSA's Self-Compliance Tool for Part 7 of ERISA. The Self—Compliance Tool has been enhanced



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and includes numerous examples and practical tips for compliance with HIPAA portability requirements, the MHPA, the NMHPA and the WHCRA. This compliance tool is not only useful for MEWAs but also group health plans, plan sponsors, plan administrators and health insurers to determine compliance with Part 7 of ERISA.

The 2005 Form M-1 is due March 1, 2006. Administrators can request an automatic 60-day extension to May 1, 2006.

A copy of the EBSA news release can be accessed at <http://www.dol.gov/ebsa/newsroom/pr120805.html>. A copy of the federal register notice can be accessed at <http://www.dol.gov/ebsa/regs/fedreg/notices/2005023755.pdf>.