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Current Developments on Retirement & Welfare Plans Including Controlled Groups & DOMA

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Big changes for benefit plan coverage

DOMA

Post-DOMA Developments

- June 2013 - U.S. Supreme Court overturns DOMA's application to federal laws in *United States v. Windsor*
- September 2013 - IRS and Department of Labor issued notices on ERISA and federal tax law
  - Declared "state of celebration rule" for certain benefit plans

Post-DOMA Developments

- State of celebration rule applies differently for
  - ERISA qualified retirement plans (e.g. 401(k), defined benefit plans)
  - ERISA welfare plans
  - non-ERISA plans (governmental and church plans)
- Key effective date: September 16, 2013
  - Affected retirement plans must apply new spouse definition as of this date to remain “qualified” and to satisfy ERISA

Post-DOMA Developments
Qualified Retirement Plans – “To do” list

- To do!
  - Review documents to determine if definitions conflict with state of celebration rule
    - “spouse,” “marriage,” or similar terms
  - Look at
    - Plan documents & policies
    - Summary plan descriptions (SPD)
    - Administrative forms (i.e. beneficiary designation forms)
  - Revise administrative operation
  - Notify participants

Post-DOMA Developments
Qualified Retirement Plans

- *#1 - If the definition does not comply…*
  - Amend plan document and provide participants with summary of material modification (SMM) that describes new state of celebration rule.
    - **To remain tax qualified, amendment must be effective as of September 16, 2013.**
- *#2 - If the definition complies…*
  - No need to amend plan. However, consider giving participants a reminder notice that the state of celebration rule applies.
    - This can be done without mentioning the concept of same-sex by simply describing the state of celebration definition in the notice.
- *#3 - If there is no specific definition…*
  - Look to "applicable law" section of plan documents. If a state law applies that recognizes state of celebration rule, then follow #2. If state law applies that does not recognize state of celebration rule applies, then follow #1.

Post-DOMA Developments
Health & Welfare Plans

- Health & welfare plans – very different story
- Federal laws do not mandate any health and welfare benefits for a participant's spouse
  - Sharp contrast to retirement plans
- Result = *Windsor* overturn of DOMA's application to federal laws has no impact

Post-DOMA Developments
Health & Welfare Plans

- Health & welfare plans
  - Sponsors are free to choose whether their plans will recognize same sex spouses
- But …
  - The clear trend is to recognize same sex spouses
  - Making a different choice may risk litigation

Post DOMA Developments
Health & Welfare Plans

Before deciding to bypass state of celebration rule, consider…

- Will using two different standards (one for retirement plans and one for health & welfare) confuse participants and increase administrative errors
- Are you worried about the risk of employment discrimination lawsuits
  - Many expect that state and/or federal laws will eventually be revised (through court interpretations or law changes) as protecting sexual orientation
  - US Senate recently passed a bill which includes sexual orientation as a protected class under federal employment discrimination law

Post-DOMA Developments
Health & Welfare Plans – "To do" list

- To do!
  - Decide what spouse standard your plans will use
  - Review documents to determine if definitions are consistent with decision
    - "spouse," "marriage," or similar terms
  - Look at
    - Plan documents & policies
    - Summary plan descriptions (SPD)
    - Administrative forms (i.e. enrollment forms)
  - Make sure administrative operation is consistent
  - Notify participants

Post-DOMA Developments
Governmental Plans

- State & local governmental plans aren't subject to federal mandates
  - Applicable to retirement and welfare benefits to an employee's spouse
- Strictly matter of state law
- Governmental entities – free to determine
  - How plan defines "spouse"
  - What benefits will be given to spouse or domestic partner of an employee
  - Within confines of applicable state law

Post-DOMA Developments
Governmental Plans

- If state law recognizes same sex spouse
  - Governmental plans must recognize
- If state law denies same sex spouse
  - Governmental plans can decide but must specify in documents
    - the rights that are given to same sex spouses and domestic partners and
    - the definitions for determining that status

Post-DOMA Developments
Church Plans

- Federal law
  - Does not currently mandate that church plans provide either retirement or welfare benefits to an employee's spouse
- Many state laws don't apply to church entities

Post-DOMA Developments
Church Plans

- Most church entities are free to determine
  - How the plan will define “spouse” and
  - What benefits a plan will provide to the spouse or domestic partner of an employee

Governmental/Church plan “To do” list

- To do!
  - Decide what spouse standard your plans will use
  - Review documents to determine if definitions are consistent with decision
    - “spouse,” “marriage,” or similar terms
  - Look at
    - Plan documents & policies
    - Summary plan descriptions (SPD)
    - Administrative forms (i.e. beneficiary designation forms)
  - Make sure administrative operation is consistent
  - Notify participants

Post-DOMA Developments
Notice 2014-1 – IRS Guidance

- December 16, 2013 - IRS issued guidance
  - Describing tax rights of employees with same sex coverage, and
  - Rights that can be given in cafeteria plans without losing tax status of plan provided benefits
- Benefits covered include
  - Pre-tax payment of insurance costs
  - Health and dependent care flexible spending arrangements
  - Health savings accounts
  - Applying for tax refunds to employee & employer

Post-DOMA Developments
Notice 2014-1

- Items covered by the Notice:
  - When can a coverage change occur based on having a same-sex spouse
  - When is the change in tax treatment of same-sex coverage a basis for making a coverage change
  - When does a same-sex coverage change take effect
  - When must the employer change the employee's payments to pre-tax for same sex spouse coverage
  - Applying for a tax refund of taxes paid by the employee and employer on same sex coverage
  - How reimbursement plans can recognize expenses back to first day of 2013 plan year
  - What to do when HSA or dependent care contributions have been too large
  - When do plans need to be amended

IRS RELAXES USE IT OR LOSE IT RULE
FOR UNINSURED HEALTH REIMBURSEMENT ACCOUNTS

FLEXIBLE SPENDING ACCOUNTS

FSA – Relaxation of Use it or Lose it

- In the past
  - One of the biggest risks in health FSAs was the use it or lose it rule
  - $2,500 limit has made this less risky
- In the past
  - FSA plans could allow participants a 2 ½ month grace period into the next year to use unused FSA funds
  - To offer the grace period, written plan must say so

FSA – Relaxation of Use it or Lose it

- Starting 2013
  - Health FSA can either
    - Offer 2 ½ month grace period, or
    - Allow carryover of up to $500 of unused funds to be used anytime during following year
  - Plan document must specify which (if either) is being offered
  - Can't use both
  - Good idea to change method early in year so participants can plan medical expense timing

New Rules for Mid Year Plan Design Changes

SAFE HARBOR 401(K) PLANS

Mid-Year Design Changes to Safe Harbor 401(k) Plans

- In the past
  - IRS position
    - Any mid year design change destroys safe harbor status
  - Even including the following improvements
    - Relaxing eligibility rules
    - Adding new class of eligible employees
    - Improving vesting schedule
    - Adding new category of contribution
    - Increasing nonelective contribution
    - Adding loans, or new distribution options

Mid-Year Design Changes to Safe Harbor 401(k) Plans

- Several years ago
  - IRS issued rules allowing mid year suspension of safe harbor match contributions or nonelective contributions
  - In very limited circumstances
    - i.e. business in financial distress

Mid-Year Design Changes to Safe Harbor 401(k) Plans

- 2013 – IRS updated rules for making mid year contribution changes
  - Applies to any mid year reduction or suspension of 401(k) safe harbor contributions
  - Applies to both safe harbor matching contributions and safe harbor nonelective contributions
- New rules add the option of using a “maybe” notice for safe harbor matching contributions
- Does not authorize other “design” changes

The *Sun Capital* Case

CONTROLLED GROUPS – NEW DEVELOPMENTS YOU MAY WANT TO KNOW

What is “Sun Capital”?

- Sun Capital threatens massive change for companies owned by private equity or similar investment funds
  - *Sun Capital Partners III, LP et al. v. New England Teamsters & Trucking Industry Pension Fund et al.*
    - No. 12-2312, 2013 WL 3814984 (1st Cir., July 24, 2013)
  - Decided July 24, 2013, by 1st Circuit U.S. Court of Appeals reversing an earlier U.S. District Court decision

Sun Capital Decided July 24, 2013

- 1st Circuit Court of Appeals reversed lower court holding that had ruled ERISA withdrawal liability would not apply to a private equity fund investor
- Involved a fight over withdrawal liability to a union pension fund
- Teamsters Fund went after two private equity fund owners of a bankrupt portfolio company that had defaulted on its pension liabilities to a Teamsters pension fund

Why does it matter?

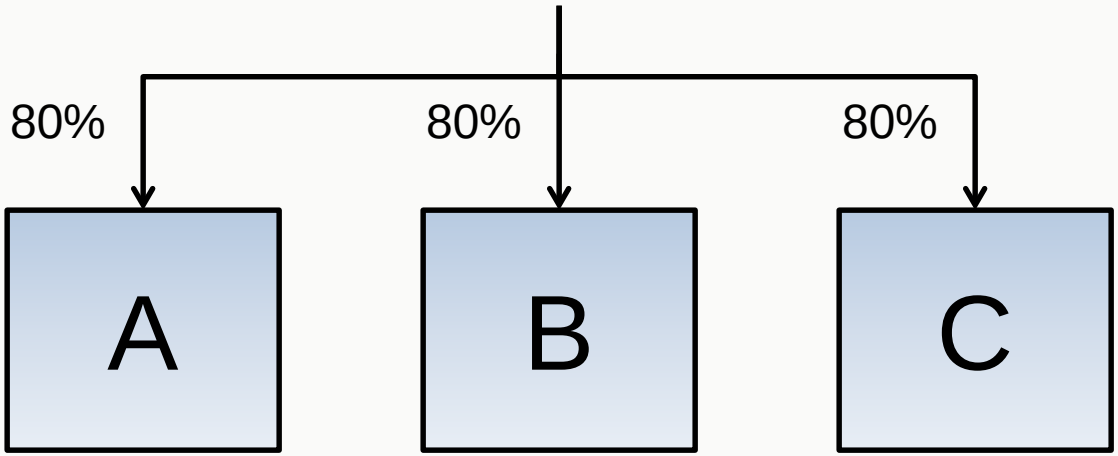
- If *Sun Capital* applies to Code §414, then many aspects of benefit plan testing could be impacted
  - Control group members - treated all as a single employer
- *Sun Capital* interpreted ERISA withdrawal and PBGC liability questions
  - Code §414 rules – not clear at present if they must follow *Sun Capital*
  - Other tax rules – even less clear that affected

What if Sun Capital applies?

- Broad impact
  - Defined benefit plan liabilities – clearly applies
    - All PBGC covered defined benefit plans - liability to PBGC
    - Union plans - withdrawal liability to multi-employer plan
  - Other plan testing requirements - unclear whether also applies to:
    - Retirement plans (i.e., 401(k) & defined benefit)
      - Testing for nondiscriminatory coverage
    - COBRA
    - Large employer status under ACA for pay or play
    - Medical & cafeteria plan benefits - nondiscrimination rules
  - Other tax rules – even less certain whether applies

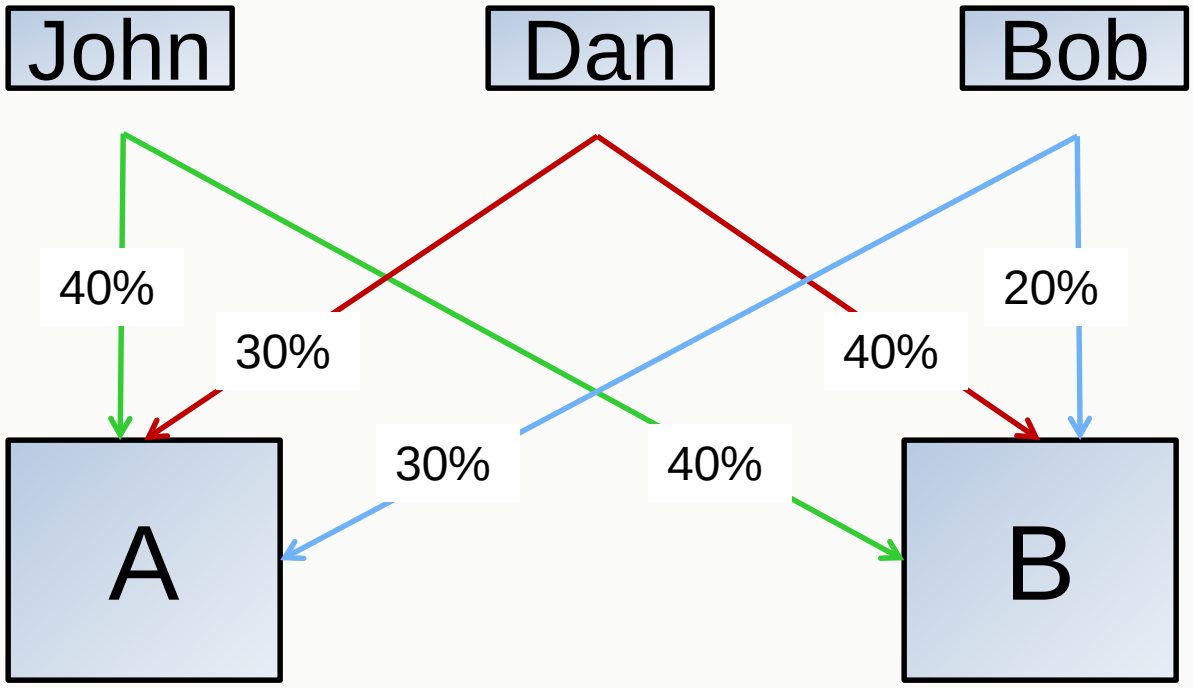
Simple Parent-Subsidiary Control Group

Parent Company P



A, B, C, & P are in a parent-subsidiary controlled group.

Simple Brother-Sister Control Group



A & B are in a brother/sister controlled group.

Control Group Rules

- Control group status rules appear in both tax code and ERISA
- Tax code rules – used for many purposes unrelated to benefit plans
  - Partnership carried interest rules
  - Foreign investors

Before *Sun Capital*

- Companies owned by investment funds (i.e. private equity investors, investment LLCs)
  - Routinely ignored control group rules
  - Relied on investment fund not being a "trade or business" but instead a mere passive investor
- Result = plans tested and liabilities measured ignoring other companies owned by same investment funds

The *Sun Capital* Case

- Sun Capital clearly imposes defined benefit plan PBGC liability and ERISA withdrawal liability
  - On companies owned by private equity that fit the *Sun Capital* criteria
  - As well as on the private equity investors themselves and their portfolio companies

The *Sun Capital* Case

- Sun Capital may also force private equity owned companies (meeting the criteria)
  - To count all employees of otherwise unrelated companies (the other companies owned by the private equity firm)
    - To conduct coverage and nondiscrimination testing
    - To determine large employer status under ACA pay or play rules
    - To force COBRA health continuation when other portfolio companies continue to offer coverage
    - To test nondiscrimination in medical & cafeteria benefits

Is there wiggle room?

- Holding may be limited to defined benefit liabilities under ERISA
  - This possibility is unclear at present time
  - *Sun Capital* is clearly an ERISA case
    - While ERISA and control group rules of tax code are supposed to mirror each other, there may be arguments to make a distinction
- Holding limited to investors considered operating a trade or business – if no T/B
  - No Title IV defined benefit liability
  - No T/B and operating in non-corporate form = remaining plan controlled group rules won't apply
- BUT – No T/B but operating in corporate form =
  - No Title IV defined benefit liability, BUT
  - Remaining plan controlled group rules DO apply

The *Sun Capital* Case

- *Sun Capital* turned on whether the private equity fund owner was a "trade or business" under "common control" with the employer
  - Employer had defaulted on its obligations to a multiemployer pension plan triggering ERISA withdrawal liability
    - At risk was exposure for multiemployer plan withdrawal liability
  - Trade or business question - Sun Capital funds argued they were passive investors and not trades or businesses
    - District Court agreed, First Circuit reversed
  - Common control question - now back at District Court
    - To determine if there is enough common ownership to cause the employer and the private equity investor to be considered under "common control"

The *Sun Capital* Case

- If PE fund is both a trade or business & under common control with the employer,
  - then it and all of its portfolio companies in a controlled group are *jointly and severally liable* for certain ERISA pension liabilities, including liabilities for both single-employer and union multiemployer pension plans
- The First Circuit adopted an "investment plus" test to determine a "trade of business"
  - The test looks for "active involvement" factors
  - The 7th Circuit has previously adopted "investment plus" in similar trade or business determinations

The *Sun Capital* Case

- The case raises as many questions as it provides answers
- The case has been remanded to the District Court and may ultimately be heard by the U.S. Supreme Court, so the case law at this time is not settled

The *Sun Capital* Case – To do list

- To do!
  - Identify who control group members are
    - Identify corporate vs non-corporate members
      - Corporate members only need common control (not T/B) to be subject to general CG rules (other than defined benefit liabilities which need T/B)
      - Corporate members are subject to both general CG rules and defined benefit joint & several liability only if both common control and T/B
    - For non-corporate owners – determine whether considered in a “trade or business”
      - If not, CG rules won’t apply for any benefit plan issues

- Identify potential defined benefit plan liabilities within the control group
  - Review loan and transaction documents where default events might be triggered by these CG issues

More protective steps

- More protective steps that an employer should be prepared for:
  - Determine if coverage & nondiscrimination testing will be a problem if run counting all commonly owned companies
  - Count service with all commonly owned companies
    - Toward eligibility and vesting
  - Consider impact on health & welfare plans & COBRA
  - Consider impact on ACA large employer status

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