



PROSKAUER ROSE LLP

Compliance Concerns:  
Basic ERISA and Tax Rules  
Every Employer Must Know  
To Keep Their Disability Plans Compliant

Twin Cities DI Day  
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# Benefits Compliance Update--2009

## Today's Agenda

- General ERISA & Tax Compliance Issues for Disability Plans

# Does ERISA Apply?

- ERISA = *The Employee Retirement Income Security Act of 1974*

# Does ERISA Apply?

- Enacted September 2, 1974
  - ERISA is the first federal statute of its kind that comprehensively regulated employee benefits
  - Establishes comprehensive rules and requirements that certain employers must follow if they sponsor employee benefit plans
  - ERISA was passed to remedy perceived and actual abuses pertaining to employee benefits

# What Is ERISA?

- ERISA governs two main types of employee benefit plans sponsored by employers:
  - *Retirement Plans*
  - *Welfare Plans*

# What Is ERISA?

- Welfare Plans

- Plan, fund or program established by employer or employee organization that provides to employees through insurance or otherwise:

- Any form of welfare benefit universal to the employee base
- Any health insurance is always covered
- Disability plans (short- and long-term) may be covered

# What Is ERISA?

- Employers Subject to ERISA:
  - ERISA applies to any employee welfare benefit plan if it is established or maintained by an employer or employee organization engaged in commerce
    - Not ALL employers – only those with an “ERISA GROUP”
    - ERISA has specific exceptions for churches

# Identifying ERISA Plans

- What constitutes an employee welfare plan subject to ERISA?
  - An ERISA employee welfare plan has three (3) basic elements:
    - Need a plan, fund or program
    - Established or maintained by an “employer”
    - For the purposes of providing ERISA-type benefits through the purchase of insurance or otherwise to participants and beneficiaries

# Identifying ERISA Plans

- Safe Harbor Exemption:
  - No employer contributions
  - Voluntary employee participation
  - No employer endorsement
  - No employer compensation (other than reasonable compensation for administrative services actually rendered in connection with payroll deductions)

# Identifying ERISA Plans

- The employer, without endorsing the program, is permitted to:
  - allow insurers to publicize the program to employees,
  - collect premiums through payroll deductions, and
  - remit premiums to insurers

# Identifying ERISA Plans

- Special Exception for Certain Disability Plans:
  - Self-Insured Short-Term Disability Plans where benefits are paid from the employer's general assets
    - Does not have to be 100% (but can't be more)

# General ERISA Requirements: *Plan Documentation*

## Written Plan Document

- ERISA requires that every employee benefit plan be established and maintained pursuant to a written plan document that describes the benefit structure and guides the plan's day-to-day operations
- Plans must reflect current law and plan operation must be in accordance with the terms of the plan

# General ERISA Requirements: *Plan Documentation*

- The document must list one or more named fiduciaries for the plan
  - Can be identified by office or by name
  - May be an administrative committee or a company's board of directors
  
- The plan document must be provided to participants and beneficiaries no later than 30 days after a written request

# General ERISA Requirements

## *Plan Documentation*

- Common Welfare Plan Issues
  - Undocumented Arrangements
  - Whether “certificate of coverage” constitutes health plan for insured plans
  - Failure to follow established procedures

# General ERISA Requirements

## *Plan Documentation*

### Summary Plan Description (SPD)

- SPD must be consistent with plan terms
- Copy of SPD must be provided to each participant and beneficiary — demonstrated procedures
- SPD can be provided to employees with enrollment materials

# General ERISA Requirements

## *Plan Documentation*

- SPD must be provided within 120 days after a plan first becomes subject to ERISA
- SPD must be provided within 90 days after an individual becomes a participant
- SPD must be provided every five years if there have been any changes to the plan during the five-year period

# General ERISA Requirements

## *Plan Documentation*

- SPD must be provided every ten years if there have been no changes to the plan
- If material reduction in covered services is made to plan, notice of the reduction must be provided within 60 days after the adoption of the change (unless SPDs are issued at least every 90 days)
- Participants and beneficiaries may also make written request for a copy of the SPD

# General ERISA Requirements

## *Plan Documentation*

- Common Issues:
  - SPD Not Up-To-Date
  - SPD inconsistent with plan terms
  - SPD inconsistent with employer operation
  - SPD not properly distributed
  - Eligibility provisions do not clearly and properly exclude ineligibles

# General ERISA Requirements

## *Plan Documentation*

- Common Issues (in addition to above):
  - Benefits description booklets provided by insurers may not constitute an SPD
  - SPD does not properly reflect eligibility requirements imposed by employer

# General ERISA Requirements

## *Plan Documentation*

### Summary of Material Modification (SMM)

- Copy of SMM must be provided to each participant and each beneficiary no later than 210 days after the end of the plan year in which the change is adopted
- No prescribed format for SMM
- SMM can be in letter, memo or other format

# General ERISA Requirements

## *Plan Documentation*

- An updated SPD can be provided instead of the SMM
- SMM may be combined with other documents
- Plan identifying information should be included

# General ERISA *Form 5500's*

## Annual Report--Form 5500

- Form 5500 must be filed by the end of the seventh month after the close of the plan year (July 31 for calendar year plans)
- Form 5500 must be filed for *all Retirement Plans*
  - *Under 100 employees do not require audited financials*

# General ERISA *Form 5500's*

- Form 5500 must be filed for Welfare Plans with 100+ *Participants* at beginning of Plan Year
- Extension of 2½ months if Form 5558 timely filed

# General ERISA *Form 5500's*

- Late Filers - Plan administrators filing a late annual report (i.e., after the date the report was required to be filed, including extensions) may be assessed \$50 per day, with no limit, for the period they failed to file, determined without regard to any extensions for filing
  - Non-Filers - Plan administrators who fail to file an annual report may be assessed a penalty of \$300 per day, up to \$30,000 per year, until a complete annual report is filed
  - For Welfare Plans: Consider a Wrap Plan Document

# General ERISA *Form 5500's*

## Consider Delinquent Filer Program (“DFVCP”)

- Amnesty program offered by the United States Department of Labor
  - Must not have been notified by federal government that 5500 is delinquent to be eligible
  - Form 5500-EZ filers and Form 5500 filers for plans without employees are not eligible to participate in the DFVCP because such plans are not subject to Title I

# General ERISA *Form 5500's*

- Penalty Structure

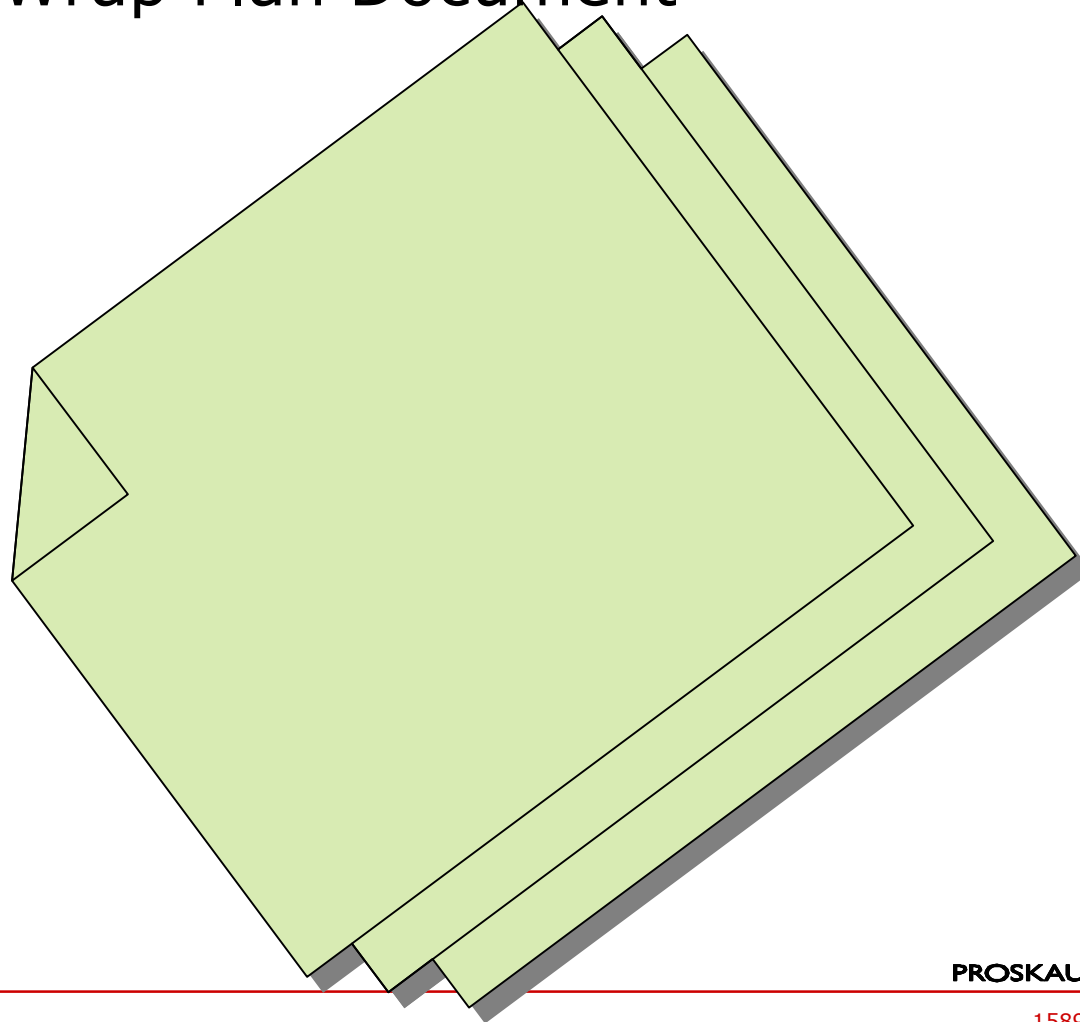
- *\$10 Per day penalty*
- *"Per filing" cap.* \$750 for a small plan (fewer than 100 participants at the beginning of the plan year) and from \$2,000 for a large plan
- *"Per plan" cap.* \$1,500 for a small plan and \$4,000 for a large plan

# General ERISA *Form 5500's*

- *Small plans sponsored by certain tax-exempt organizations.* A special “per plan” cap of \$750 applies to a small plan sponsored by a 501(c)(3)
  - Applies regardless of the number of late annual reports filed for the plan at the same time
  - Not available if there is a delinquent annual report for a plan year during which the plan was a large plan

# General ERISA *Form 5500's*

Consider A Wrap Plan Document



# General ERISA SAR

## Summary Annual Report (SAR)

- Prescribed format
- SAR must be provided by the end of the ninth month after the close of the plan year (September 30 for calendar year plans)
- Extension of two months granted if Form 5558 completed and submitted with Form 5500

# General ERISA SAR

- Common Issues — Welfare Plans
  - Common misconception that SARs are not required for health plans
  - If a Form 5500 is required, a SAR is required

# Tax Concerns

- Is the Disability Benefit Received Taxable?
  - In general, if employers pay the total cost of the premium for employees and do not include the employer-paid disability insurance premiums in employees' gross incomes, disability benefits will be received net of taxes and withholding
  - Employees who pay premiums with after-tax dollars, or by including the value of employer-paid premiums in income, may receive the disability benefit tax-free

# Tax Concerns

- If employer and employee split the premium burden (i.e., a contributory plan), taxes and withholding will apply to disability benefits under the "three-year look back rule"
  - Three-year look back rule leads to uncertainty: value included in the disability benefit for tax and withholding purposes is based on the percentage of the premium paid by the employer on the employee's behalf during the three-year period preceding the year in which the disability benefit is received

# Tax Concerns

- Employer Should Consider After-Tax Premium Payments & Adoption of 2004-55 Plan
  - Plan is amended to designate it as a 2004-55 Plan
  - Employee must irrevocably elect to have premium paid on an After-Tax Basis
    - Can be with after-tax dollars or gross up
  - Cannot be a contributory plan

# Tax Concerns

- Election is irrevocable—Section 125 Change of Status Rules Do Not Apply
- Once made, election can remain in place from year-to-year until changed



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