

# QUALIFIED PLANS 2006-1

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### 1. Comprehensive IRS Guidance on Roth 401(k) and 403(b) Plans

The IRS recently issued proposed and final regulations that provide guidance on the requirements applicable to Roth contributions under Code section 402A. 71 Fed. Reg. 6 (Jan. 3, 2006) and 71 Fed. Reg. 4320 (Jan. 26, 2006). The final regulations provide guidance on the requirements applicable to Roth contributions to 401(k) plans. The proposed regulations provide guidance on the taxation of distributions from Roth accounts, Roth account recordkeeping and reporting requirements, and Roth contributions to 403(b) plans.

The final regulations apply on and after January 1, 2006. The general effective date of the proposed regulations would be January 1, 2007, although a number of provisions would apply as of January 1, 2006. Taxpayers may rely on the proposed regulations until final regulations go into effect. Comments on the proposed regulations should be submitted by April 26.

### A. Summary of Key Changes and Clarifications in the Final Regulations

The final regulations are generally consistent with the proposed Roth 401(k) regulations that were issued last March (Qualified Plans 2005-3). Key changes and clarifications include the following:

- **Roth-Only Contribution Arrangements.** An employer may not offer a Roth 401(k)-only plan. If a Roth 401(k) plan is to be offered, pre-tax elective deferrals must also be permitted.
- **Timing of Roth Election.** Roth contributions must be irrevocably elected as part of a participant's cash or deferred election, not at a later date; retroactive recharacterization is not permitted. (This is probably a blessing for plan administrators and payroll personnel.)
- **Ability to Change Roth 401(k) Contribution Election.** Consistent with the final 401(k) regulations, a

participant must be permitted to change his or her Roth 401(k) contribution election as to future contributions at least once per year.

- **Catch-Up Contributions.** Catch-up contributions may be made as Roth contributions.
- **Automatic Enrollment.** Individuals who become participants in a 401(k) plan because of an automatic enrollment feature may be automatically enrolled with Roth rather than pre-tax 401(k) contributions. A plan document must specify whether contributions made for automatically enrolled participants will be Roth or pre-tax elective deferral contributions.
- **Small Roth 401(k) Accounts.** A plan may provide that accounts of \$200 or less may not be rolled over in a direct rollover (plan-to-plan or IRA). Amounts held in Roth 401(k) accounts may be treated as a separate plan for purposes of applying this \$200 de minimis rule.
- **401(k) and 401(m) Nondiscrimination Testing.** A plan may, but is not required to, permit a participant to elect whether his or her Roth 401(k) or pre-tax elective deferral contributions will be refunded to satisfy the Code section 401(k) and 401(m) nondiscrimination tests. If a Roth 401(k) contribution is distributed as an excess contribution, only income on the distributed Roth contribution is subject to tax.

## **B. The Proposed Regulations**

The proposed regulations provide guidance on the taxation of distributions from Roth accounts, Roth account recordkeeping and reporting requirements, and Roth contributions to 403(b) plans. In general, the regulations treat Roth amounts like other qualified plan funds whenever the statute does not preclude that. They also take a fairly restrictive approach on rollovers. Significant issues addressed by the proposed regulations are highlighted below.

### **1. Qualified Distributions**

- **Definition of "Qualified Distribution."** "Qualified distributions" of Roth

contributions and earnings are tax-free. A "qualified distribution" is a distribution made after the 5-taxable year participation period has been met, and that is made on account of a participant's attaining age 59½, death, or becoming disabled (as defined in Code section 72(m)(7)). The proposed regulations provide that distributions of amounts in excess of the Code section 402(g) limit (\$15,000 in 2006), amounts in excess of the Code section 415(c) limit (\$44,000 in 2006), distributions necessary to pass nondiscrimination testing, deemed distributions due to loan defaults or Table 2001 insurance costs, and ESOP dividends paid in cash to participants under Code section 404(k) are not qualified distributions. The IRS notes that ESOP dividends reinvested in employer securities and subsequently distributed from Roth accounts in otherwise qualified distributions may be tax-free.

- **Calculation of Roth Account Five-Year Participation Period.** A distribution from a Roth account will not be tax-free if it is made within five years of a participant's first contribution to his or her Roth account. This five-year participation period is calculated as starting on the first day of a participant's tax year (generally the calendar year) in which a Roth contribution is made to the plan and ends after the completion of five tax years. Notably, a five-year participation period is determined separately for each plan in which a person participates. If a Roth account is directly rolled into a plan from another Roth 401(k) or 403(b) program, the five-year participation period for amounts in the recipient plan is treated as commencing as of the earlier of (1) the first Roth contribution to the transferor plan or (2) the first Roth contribution to the recipient plan.
- **Calculation of Roth IRA Five-Year Participation Period.** The five-year participation period for Roth accounts has no impact on the five-year participation period applicable to Roth IRAs. Instead, amounts rolled into a Roth IRA are subject to a separate five-

year Roth IRA participation period. If a Roth account is rolled into an existing Roth IRA, the five-year Roth IRA participation period for all amounts in the Roth IRA, including the rollover contribution, will be based on the date of the first contribution to the Roth IRA. This provision would be effective as of January 1, 2006.

## **2. Restrictions on Roth Rollovers**

Numerous restrictions apply to rollovers to and from Roth IRAs, Roth 401(k) and 403(b) accounts.

- The portion of a Roth account that is not subject to taxation on distribution (i.e., a participant's Roth contributions, and, if the five-year participation period is satisfied, the earnings on these contributions) may only be rolled over to a Roth IRA or to a Roth account under the same type of plan that agrees to separately account for Roth contributions and earnings (e.g., 401(k) to 401(k)). Non-taxable Roth 401(k)-to-Roth 401(k) and Roth 403(b)-to-Roth 403(b) rollovers must be made by direct rollover. However, the non-taxable portion of a Roth account may be rolled to a Roth IRA by direct or indirect (60-day) rollover.
- The portion of a Roth account that is subject to taxation on distribution (i.e., a distribution that is not a qualified distribution and is not a return of basis) may be rolled over to another eligible plan or Roth IRA by direct or indirect (60-day) rollover.
- A Roth IRA may not be rolled into a Roth 401(k) or 403(b) account.

## **3. Basis in Roth Accounts and Roth IRA Rollovers**

Amounts contributed to a Roth account are treated as "basis" in the Roth account. A number of special rules apply when determining basis.

- Non-qualified distributions from a Roth IRA are treated as a tax-free return of basis up to the amount of Roth contributions. However, non-qualified distributions from a Roth account (i.e.,

distributions made within five years of the initial contribution to the Roth account, or distributions not made on account of disability, attainment of age 59-1/2 or death) are treated like other plan distributions, i.e., as a pro-rata return of non-taxable basis and taxable earnings, under the Code section 72 rules

- If only a portion of a non-qualified distribution is rolled over, the amount rolled over is first deemed to be from the taxable portion of the distribution, then from basis. This permits an owner to roll over only the otherwise taxable portion.
- If a qualified distribution from a Roth account is rolled into a Roth IRA, a participant's basis in his or her Roth IRA is increased by the value of the entire distribution (in effect giving the participant the full benefit of Roth treatment).
- If a non-qualified distribution of a Roth account is rolled into a Roth IRA, a participant's basis in his or her Roth IRA is increased by the participant's basis in the Roth account distribution.
- If rolled-in amounts are distributed from a Roth IRA prior to satisfaction of the Roth IRA five-year participation period, the original rollover contribution to the Roth IRA (but not the earnings) would be treated as a return of basis from the Roth IRA.
- These basis calculation rules would generally apply as of January 1, 2006.
- Each plan must track the five-year holding periods for Roth contributions to the plan and the amount of each participant's Roth contributions. When a plan makes a direct rollover, it is required to provide a rollover statement to the recipient. If the distribution is a qualified distribution, the statement must indicate that it is a qualified distribution. If the distribution is not a qualified distribution, the statement must provide the year of the first Roth contribution to the plan and the portion of the rolled-over distribution

attributable to basis. A participant making an indirect (60-day) rollover may request a similar rollover statement, although the first year of the Roth account five-year participation period need not be provided in the statement. A required rollover statement must be provided within 30 days of a request or the direct rollover.

#### **4. Other Distribution Issues**

- **Hardship Distributions.** Roth contributions – but not earnings on these contributions – are available for hardship distributions. (This is the same treatment as 401(k) elective deferrals.) Nevertheless, when distributed in a hardship distribution, Roth contributions are treated as a pro rata return of basis and earnings, so the earnings portion of the hardship payout is taxed and the basis is not.
- **Separate Contracts/Loans.** All of the participant's Roth and non-Roth accounts are combined for purposes of applying the plan loan rules (e.g., 50% of vested accrued benefit limit, \$50,000 loan limit, etc.). Otherwise, a participant's Roth account is considered a single "separate contract" from any other plan account (e.g., 401(k) rollover) for the participant, i.e., distributions from each contract are subject to the section 72 rules independently (with limited exceptions for certain QDROs and post-death beneficiary accounts). A regular Roth account and a rollover Roth account for the same participant in the same plan are aggregated as a single contract.
- **Distribution of Excess Deferrals.** If a participant makes deferrals (including Roth contributions) in excess of the Code section 402(g) limit (\$15,000 in 2006), he or she may designate whether the excess will be paid out of his or her pre-tax or Roth contributions. Further, distributions of excess contributions (Code sec. 402(g)) are subject to the "gap period" income calculation rules in the new Code section 401(k) and 401(m) regulations. If excess Roth contributions are not distributed by April 15th of the tax year

following their contribution, the excess Roth contributions are not eligible for rollover, and will be taxed again on distribution (i.e., not treated as a return of basis); also, the first distributions out of the Roth account will be attributed to the participant's excess Roth contributions and earnings on these contributions.

- **Distribution of Employer Securities.**

A participant who receives a qualified distribution of employer securities with net unrealized appreciation will have basis in the securities equal to the fair market value of the securities as of the date of distribution; thus, only future appreciation will be subject to tax at capital gains rates. The Preamble indicates that a distribution that is not a qualified distribution will be subject to the regular net unrealized appreciation rules under Code section 402(e)(4) except that the Roth account is treated as a separate contract.

#### **5. Reporting and Recordkeeping Issues**

- **Information Reporting of Indirect Plan-to-Plan Rollovers.** Each plan accepting an indirect rollover must report the following to the IRS by the due date for filing Form 1099-R: (1) a participant's name and social security number, (2) the amount rolled over, (3) the year in which the rollover contribution was made, and (4) such other information as may be required by the IRS in later guidance.
- **Form W-2 and 1099-R Reporting.** The 2006 Form W-2 contains two new codes for Box 12 of Form W-2 – one for Roth contributions to 401(k) plans and one for Roth contributions to 403(b) plans. Plan sponsors will also likely need to report Roth distributions on a separate form 1099-R. The separate Form 1099-R will list the amount of a distribution, the taxable amount of the distribution, and the first year of the five-year holding period.
- **Tracking Basis in Roth IRAs.** The proposed regulations recommend that participants who roll their Roth

accounts to a Roth IRA track their basis to facilitate the reporting of their Roth IRA distributions on Form 8606 when they receive a distribution from their Roth IRA.

- **"Anti-Abuse" Provision.** Consistent with the final regulations, any transaction or accounting methodology that has the effect of directly or indirectly transferring value from another account into the designate Roth account violates the Roth separate accounting requirement. This provision would be effective as of January 1, 2006.

#### **6. Roth 403(b) Plans**

In general, the rules governing Roth contributions to 401(k) plans apply to contributions to Roth 403(b) plans. Thus, for example, special catch-up and other 403(b) rules apply equally to Roth 403(b)s. IRS notes that the basis recovery rules for annuity distributions will apply separately to payouts from Roth and regular 403(b) accounts. The proposed rules clarify that the right to make Roth contributions to a 403(b) plan must be universally available to satisfy the Code section 403(b)(12) universal availability requirement.

The Preamble reflects an expectation that the final 403(b) rules (currently expected in mid-2006) will also be effective for 2007 plan years.

#### **C. Plan Amendments**

Plan sponsors that implement Roth contributions in 2006 must amend their plans as required by the guidance in Revenue Procedure 2005-66 (Qualified Plans 2005-8) and the IRS cumulative list of changes in Notice 2005-101 (Qualified Plans 2005-12). In general, this means that amendments to calendar-year plans should be made by December 31, 2006, because the addition of Roth contributions appears to be a discretionary plan amendment. Plan sponsors whose plans are not subject to the final 401(k) regulations (Qualified Plans 2005-1) as of January 1, 2006 (e.g., fiscal year plans), need not adopt the final 401(k) regulations early in order to apply the Roth 401(k) regulations on or after January 1, 2006.

Although the IRS has not provided model language on implementing Roth contributions other than basic language in its Listing of Required

Modifications for defined contribution and 401(k) plans (<http://www.irs.gov/retirement/article/0,,id=97182,00.html>), the proposed and final regulations indicate that amendments covering Roth contributions should at least address the following:

- the extent, if any, to which an employee can choose whether his or her distribution from a plan is attributable to his or her pre-tax and Roth contributions;
- whether excess deferrals will be distributed out of pre-tax, Roth, or a combination of the two accounts and whether this hierarchy will be elected each participant or established in the plan document;
- the rollover of Roth contributions into and from the plan;
- whether automatically enrolled participants are deemed to have elected Roth or pre-tax contributions;

Final regulations and/or additional IRS guidance may require the incorporation of additional Roth-specific distribution rules, such as the implementation of mandatory rollovers to Roth IRAs, in plan documents.

#### **D. Additional Administration and Communication Issues**

There are many administration and communication issues for plan sponsors that have already adopted or intend to implement Roth contributions in 2006, including the following –

- Plan sponsors who implemented Roth contributions as of January 1 should review the final regulations and new proposed regulations to ensure that their implementation is consistent with the final regulations and new proposed regulations.
- Because pre-tax elective deferrals generally may not be refunded or recharacterized once contributed, plan sponsors considering implementing Roth contributions in the middle of 2006 may want to advise participants of this possibility earlier in the year. Otherwise, Roth contributions may be effectively unavailable to participants

who are interested in making Roth contributions in 2006, but who reach the 2006 \$15,000 (\$20,000 for catch-up eligible participants) elective deferral limit before Roth contributions are made available.

- Plans using automatic Roth contribution enrollment should ensure that the automatic enrollment with Roth contributions is timely communicated to potential automatic enrollees.
- Plan administrators will need to update their systems for the new basis recordkeeping, rollover recordkeeping, Form W-2, and Form 1099-R requirements.

Plan administrators will need to prepare procedures and notices for the rollover statements required by the proposed regulations that will go into effect in 2007. Further, because plans will need to track rollover contributions in 2007 and later years, the IRS suggests that plans accepting direct Roth rollover contributions in 2006 request a statement from a transferor plan that states (1) that the amount rolled in is from a designated Roth account and (2) the participant's investment in the contract (*i.e.*, the participant's basis).

## **2. DOL Guidance on Investment Advice and IRA Rollovers**

The Department of Labor ("DOL" or "the Department") recently issued much-needed guidance on the application of ERISA's fiduciary rules to investment recommendations given to participants in the context of retirement planning. DOL Adv. Op. 2005-23A (Dec. 7, 2005). In the opinion, the Department addressed several questions that involve the application of DOL's investment advice regulation to the activities of investment advisers who assist participants in rolling over their individual account plan balances to IRAs. While the Department's guidance generally should come as good news to investment advisers, it leaves several open questions in its wake.

### **A. Background**

Fiduciaries of ERISA-covered plans are subject to stringent standards of conduct, including the obligation to carry out their plan duties prudently and solely in the interest of plan participants and beneficiaries. ERISA §§ 403, 404. ERISA

fiduciaries must also avoid engaging in prohibited transactions, including certain transactions with parties closely related to the plan and acts of self-dealing. ERISA § 406. ERISA defines the term "fiduciary" to include any person who has or exercises authority or control over the plan's assets, management or administration, and any person who provides "investment advice" for a fee. ERISA § 3(21).

Shortly after ERISA was passed, the DOL issued regulations that define the circumstances under which a person will assume fiduciary status based on the provision of "investment advice" to the plan. Those regulations provide generally that a person will be deemed a fiduciary investment adviser *only* if: (1) the person renders advice as to the value of, or recommends the purchase or sale of, securities or other property, and (2) the person has discretion with respect to the purchase or sale of securities or other property for the plan, or such person renders individualized advice on a regular basis pursuant to an agreement or understanding that the advice will serve as the primary basis for the plan's investment decisions. 29 C.F.R. § 2510.3-21(c).

DOL's investment advice regulation is virtually identical to regulations that define the term "fiduciary" under section 4975 of the Code. Treas. Reg. § 54.4975-9. While ERISA's prohibited transaction rules apply to fiduciaries of ERISA-covered plans, the Code's corresponding prohibited transaction rules under section 4975 apply to qualified plans and IRAs, among other arrangements. Generally, IRAs are not subject to ERISA's fiduciary and prohibited transaction rules. See 29 C.F.R. § 2510.3-2(d).

### **B. The Opinion**

In the opinion, DOL was asked whether a recommendation that a participant roll over his or her plan account balance to an IRA to take advantage of investment options not available under the plan would constitute "investment advice" with respect to the plan. Question 2, DOL Adv. Op. 2005-23A.

The Department responded that advising a participant to take an otherwise permissible plan distribution did not constitute fiduciary investment advice under ERISA and therefore would not, in itself, confer ERISA fiduciary status with respect to the plan. The basis for DOL's conclusion appears to be twofold. First, DOL reasoned that advising a participant to take a permissible plan distribution did

not constitute advice with respect to "securities or other property" as required by DOL's investment advice regulation. Further, DOL reasoned that advice with respect to the investment proceeds of a plan distribution would be advice with respect to funds that have ceased to be ERISA-covered "plan assets." Accordingly, DOL concluded that the specific advice described would fail to meet the requirements of DOL's investment advice regulation.

DOL went on to opine that the analysis would differ if someone who is already a plan fiduciary responds to participant questions about the advisability of taking a distribution or the investment of amounts withdrawn from the plan. Citing the Supreme Court's decision in *Varity v. Howe*, 516 U.S. 489 (1996), DOL reasoned that a person who is already a fiduciary of the plan would be engaged in a fiduciary act of plan management by responding to such questions; accordingly, those communications would be subject to ERISA's fiduciary standards.

Next, DOL was asked whether an adviser that advises a participant to withdraw funds from the plan and invest in an IRA would engage in a prohibited transaction if the adviser earned fee income in connection with the IRA's investments. Question 3, DOL Adv. Op. 2005-23A. Based on its preceding analysis, DOL reiterated its position that a service provider who is not otherwise a plan fiduciary would not become a fiduciary solely on the basis of recommending that a participant take a distribution, even if its advice was coupled with specific investment recommendations for the IRA account. Nonetheless, DOL reiterated its view that, if the adviser was already a plan fiduciary, recommendations concerning taking a distribution and the investment of distribution proceeds would be subject to ERISA's fiduciary standards. In this regard, DOL suggested that, if the fiduciary would earn fee income or some other advantage from the investment of the IRA assets, the fiduciary's recommendations could violate ERISA's loyalty and prohibited transaction restrictions.

### **C. Open Questions**

Unfortunately DOL's guidance leaves us with as many questions as answers.

First, DOL's analysis appears to be explicitly limited to whether advice and recommendations in the context of establishing rollover IRAs constitutes "investment advice" under ERISA with respect to the distributing ERISA plan. Another significant and obvious issue that arises under these facts is whether advice to invest rollover proceeds in specific

investment products would render the adviser a "fiduciary" with respect to the IRA. If the adviser was deemed to be a fiduciary to the IRA under the Code, it could be subject to excise tax liability under section 4975 for advice as to investment of IRA assets and the receipt of fees thereunder. DOL appears to have completely ignored this issue, an omission that significantly limits the value of DOL's guidance.

Second, we are troubled by DOL's apparent position that whether ERISA's fiduciary provisions apply to answering questions regarding distribution options turns on whether the adviser already has a fiduciary role in connection with the plan. DOL's position is difficult to harmonize with other guidance it has issued in the investment advice area, particularly the SunAmerica letter. DOL Adv. Op. 2001-09A (Qualified Plans 2001-11). That opinion illustrates DOL's position that an advice provider may be a fiduciary generally, but would not run afoul of ERISA's prohibited transaction rules if its recommendations do not result from its own specific activities that are fiduciary in nature. In this regard, it is unclear whether DOL intended for its new analysis to apply to a fiduciary service provider, such as a directed trustee or insurance company separate account manager, that does not typically communicate with or respond to questions from participants. Moreover, it is not clear how DOL would analyze the advice if a non-fiduciary adviser or representative provided rollover recommendations while a different business unit of the same company provided fiduciary services with respect to the plan.

Third, DOL did not address how its analysis would be affected if the information provided by the advice provider or fiduciary fit squarely within DOL's investment education safe harbor. See 29 C.F.R. § 2509.96-1 ("IB 96-1"). In this regard, IB 96-1 specifically permits a fiduciary to provide a variety of information about the terms of the plan and available investment options to participants without subjecting itself to fiduciary liability by doing so. In this regard, it would appear that an existing fiduciary could rely on IB 96-1 to provide general information about the plan's distribution options in response to participant questions without triggering ERISA's prohibited transaction restrictions.

### **3. SEC Proposes New Disclosure Scheme for Executive Comp**

On January 27, the SEC released a 370-page document proposing extensive changes in public

disclosure of executive compensation for public companies and related areas. SEC Release 33-8655. The package generally reflects the basic themes we noted in Qualified Plans 2005-12. The Commission approved the proposals – the most extensive rewrite in 14 years – at its January 17 session (2006-10). The 60-day comment period will start after publication in the Federal Register, which has not yet occurred.

It is clear that public companies will have their hands full this year in revamping the plans themselves to meet the new IRS Code section 409A rules, and preparing materials to satisfy the new SEC disclosure requirements.

We will be preparing a summary and analysis of the SEC proposal in the near future.

#### **4. Court Refuses to Interfere With IRS Correction Process**

Protracted litigation over major errors in the calculation of benefits under the Formica Corporation defined benefit plan recently resulted in the denial of a request that the court enjoin the plan administrator from recouping overpayments to 300 pensioners – some going back as far as 1986 – under the IRS "EPCRS" procedures. Ramsey, et al v. Formica Corp., 2006 WL 38995 (S.D. Ohio, Jan. 5, 2006). Last year, the Sixth Circuit ruled, among other things, that the plaintiff class' claim to maintain benefits at the "promised" – albeit incorrect – levels was not an appropriate equitable form of relief under ERISA, assuming the plan administrator did breach its fiduciary duty. 398 F.2d 421 (6<sup>th</sup> Cir. 2006).

Formica still has a VCP application pending before the IRS, under which recovery of overpayments is the "preferred" method of correction – in light of the overall EPCRS goal to restore the plan to the position it would have been in had the operational errors not occurred. In light of that, the court decided "to allow the administrative process . . . to play out" so as not to "limit the IRS' freedom to consider and approve creative solutions." The court was also justifiably concerned that its grant of the relief could put Formica in the "unfavorable position of having to comply with conflicting objectives" from the court and the IRS. In this regard, we find the court's closing remarks to be particularly instructive to the IRS and Formica –

The Court recognizes that this decision seems to be a particularly harsh result for a blameless group of individuals. While the Court empathizes with the

Plaintiffs and the anxiety they must be experiencing, Congress has not provided any remedy for plan participants in this situation. Having said that, the Court encourages Formica to pursue, and the IRS to accept, plan corrections which do not impose any further hardship on these Plaintiffs. The Court also encourages Formica and the IRS to resolve Formica's VCP submission as expeditiously as possible so that Plaintiffs and the class do not have to continue living with the fear and uncertainty created by these errors in plan administration.

The Service's EPCRS guidelines have long provided (see, e.g., section 6.12, Rev. Proc. 2003-47) that a compliance statement does not determine participant rights under Title I of ERISA. Nevertheless, most courts have accepted IRS corrections. The Formica case is an interesting one where the court is subtly attempting to influence the outcome, though letting the administrative process run its course. We would not be surprised if the end result is that the employer makes the plan whole for the errors, as often occurs in overpayment situations.

#### **5. New USERRA Notice in Effect**

On December 19, 2005, the Veterans' Employment and Training Service of the DOL issued final regulations regarding employer obligations to employees under USERRA. We highlighted the key changes in the pension area in Qualified Plans 2005-12. At that time, the DOL also issued updated model notices to inform members of their USERRA rights. The model notices are available at [www.dol.gov/vets/programs/userra/poster.htm](http://www.dol.gov/vets/programs/userra/poster.htm), and must be used beginning January 18, 2006.

The Preamble makes clear that employers have flexibility in determining how to provide the USERRA notice, stating that employers may "use their best judgment and discretion in determining the means by which to provide notice . . ." 70 Fed. Reg. at 75,314. Accordingly, employers may satisfy the notice requirement by posting the notice on a bulletin board where employee notices are customarily posted, providing the notice electronically, mailing it to employees, or in another manner that the employer determines is appropriate under the circumstances.

## **6. DOL Finalizes Funding Notice Rules For All Multiemployer Plans**

The Department of Labor ("DOL") has finalized a regulation implementing section 101(f) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which requires multiemployer defined benefit plans to send a plan funding notice each year to plan participants and beneficiaries, labor organizations representing them, contributing employers and the Pension Benefit Guaranty Corporation ("PBGC"). 71 Fed. Reg. 1404 (Jan. 11, 2006). The notice is to describe the funded level of the plan, the benefits that would be guaranteed by PBGC in the event the plan became insolvent, and other financial information about the plan. The notice requirement is effective for plan years ending after December 31, 2004; thus, the notices will first be distributed later this year.

Under the regulation, multiemployer plans are required to provide participants with information similar to that required of single employer plans under section 4011 of ERISA. Unlike participant notices under section 4011 – required only for underfunded single-employer defined benefit plans – the multiemployer plan notice requirement applies to all multiemployer defined benefit plans, except those that are receiving financial assistance from PBGC, *i.e.*, those that already are insolvent.

The regulation requires the plan administrator to issue an annual notice that includes (1) identifying information about the plan, (2) a statement whether the plan's funded current liability percentage is at least 100 percent, and if not, the actual percentage, (3) a statement of the market value of the plan's assets (DOL rejected a request to allow the use of any "actuarial value"), (4) the amount of benefit payments and the ratio of assets to payments for the plan year for which the notice is issued, (5) a summary of the rules governing insolvent multiemployer plans, including rules about benefit suspensions and reductions, (6) a description of guaranteed benefits under the plan and the limits of PBGC's guarantee, and (7) additional information the plan wishes to provide to help participants understand the information in the notice (provided it is included only after the required information). A model "safe harbor" notice is provided with the regulation.

The notice must be furnished within 9 months after the close of the plan year, or, if an extension has been issued, two months after the end of the

extension period for filing the plan's Form 5500. The notice must be sent to participants, beneficiaries, labor organizations, and contributing employers, by one of the methods prescribed for providing summary plan descriptions described in DOL rules (at 29 C.F.R. § 2520.104b-1). This includes hand delivery, mail delivery and electronic delivery. The notice must be provided to PBGC by hand delivery, mail or delivery service, electronic delivery or facsimile (as described in 29 C.F.R. Part 4000).

Under section 502(c)(1) of ERISA, a court may assess personal liability of up to \$100 a day against the plan administrator, typically the multiemployer plan's trustees in this case, for failure to provide the notice.

## **7. PBGC Extends Use of Corporate Bond Rate for Section 4010 Reporting Purposes**

In Technical Update 06-1 (Jan. 12, 2006), PBGC has extended the use of a corporate bond rate for ERISA section 4010 reporting purposes, and has waived the reporting requirement for employers if no filing would be required using the PFEA 85% Rate.

Under section 4010, a contributing sponsor and each member of its "controlled group" (generally, trades or businesses directly or indirectly linked by an 80% ownership interest) must report pension plan and financial information to PBGC if the aggregate unfunded vested benefits of defined benefit pension plans in the controlled group at the end of the preceding plan year exceed \$50 million. The Pension Funding Equity Act of 2004 ("PFEA") changed the interest rate for determining unfunded vested benefits for purposes of section 4010 reporting from a rate based on 30-year Treasury yields to a rate that is 85% of long-term, investment grade corporate bonds ("PFEA 85% Rate"). The PFEA 85% Rate expired at the end of December 2005, but pending legislation would extend the use of this rate for another year. Because of the uncertainty caused by the pending legislation, PBGC has waived the section 4010 reporting requirement for information years ending on or after December 31, 2005, and on or before June 30, 2006, if no filing would be required using the PFEA 85% Rate. An "information year" is the fiscal year or, if controlled group members have different fiscal years, the calendar year.

## **8. Key 2006 Interest Rates for Calendar-Year DB Plans**

year plans, 120% of the Federal mid-term rate (Rev. Rul. 2006-4, Table I) is 5.39%.

The IRS has announced the relevant interest rates for making key funding calculations under defined benefit plans.

### **A. Lump-Sum Cashout Rates**

Plans are generally required to use GATT rates for 2006 plan years, although PBGC or other rates may still be used on an optional basis if more favorable to participants than GATT rates. Some plans use the PBGC rate in effect for January of the plan year or the GATT rate for the standard lookback month, although the regulations under Code section 417 provide many other options (for both PBGC rates and GATT 30-year Treasury rates). The applicable January 2006 rates are

PBGC rate (immediate annuities) – 2.75%

GATT rate (Dec. 2005) – 4.65%

The pending pension funding legislation would change the cashout rates, but probably not before 2007.

### **B. Funding Rates**

For purposes of certain minimum funding requirements, including the "Deficit Reduction Contribution" ("DRC") (Code sec. 412(l)), the law again requires that the interest rate assumption fall within a "permissible range," based on the 4-year weighted average rates on 30-year Treasury securities. For 2004 and 2005, the Pension Funding Equity Act substituted the rates on amounts invested conservatively in long-term investment grade corporate bonds, but that is no longer in effect. IRS Notice 2006-8 (Jan. 30 IRS Bulletin) announces the following permissible range for 2006 calendar-year plan years: 90% - 110% of permissible range – 4.37% to 5.34%. If enacted, the pension funding legislation may supersede these rates.

### **C. Contributory Pension Plans**

Code section 411(c) requires that contributory defined benefit plans credit interest on mandatory employee contributions at 120% of the Federal mid-term rate until the "determination date," and use GATT 30-year Treasury rates to determine present values from that date through the participant's normal retirement age. IRS issued proposed rules in this area 10 years ago, but they have never been finalized (Qualified Plans 96-1). For 2006 calendar-