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*This newsletter briefly discusses several recent developments in employee benefits and executive compensation that may be of interest to our clients. For more details on any item reported herein, please contact any member of Blank Rome's Employee Benefits and Executive Compensation Group.*

# Recent Developments In Employee Benefits And Executive Compensation

## IRS Expands Code Section 409A Document Correction Program

A broad range of plans and agreements, including traditional deferred compensation plans, equity compensation, bonus plans, severance plans, change in control agreements and employment agreements could provide for "deferred compensation" as defined in Section 409A of the Internal Revenue Code and be subject to the highly technical requirements of Section 409A. If a plan fails to comply in form or operation with these requirements, the employee (an independent contractor could be subject to Section 409A also) is required to report the "deferred compensation" payable under the plan for federal income tax purposes in the year that it vests, (not when it is paid) and pay a 20% tax on that amount and possible additional interest penalties.

Central to the prohibitions of Section 409A is that once the terms regarding timing of payment are set forth, then neither the employers nor the employee may change those terms. Frequently plans include provisions that permit an employee to indirectly change the timing of payment. For example, a severance agreement may provide for commencement of payments when the employee submits a signed release. Such provisions likely violate Section 409A. Previous IRS guidance provided several alternatives for fixing such provisions in existing plans. In Notice 2010-80, the IRS expanded the correction.

The common purpose of each of the correction options is to remove the ability of the employee to delay or accelerate the timing of the payment.

If an agreement provides for payment within a designated period the agreement could be amended to provide either (1) for payment only on the last day of the designated period or (2) for payment in the second taxable year, if it is possible that the designated period could begin in one taxable year and end in the next taxable year.

If payment is not payable within a designated period, the agreement could be amended to provide either (1) for payment only upon a fixed date, either 60 or 90 days following the occurrence of the triggering event that entitles the employee for payment or (2) for payment during a specified period no longer than 90 days beginning on the permissible payment event, provided that if the specified period begins in one taxable year and ends in the next taxable year, the payment will be made in the next taxable year.

Under Notice 2010-6, not only must a method of correction be precisely implemented, corrections are contingent upon the satisfaction of numerous requirements. Generally, these include: (1) the employer must take commercially reasonable steps to identify and correct all other agreements, (2) the employer or the employee may not be "under examination" for any taxable year during which the document failure existed, (3) the failures must be inadvertent and unintentional, (4) all income that must be included as part of the correction is included and reported and (5) employer and employee information and reporting requirements.

The information and reporting requirements provide that an employer which corrects an employment-related action failure under Notice 2010-6 must attach to its timely-filed (including extensions) original federal income tax return for its taxable year in which it corrects the failure (and under certain events, a later year), a statement that identifies the IRS guidance that authorizes the correction and provides additional required information. The employer must provide a similar statement to each affected employee no later than the date (with extensions) on which it is required to provide an information return (Form W-2 or 1099) to that employee for the calendar year in which it corrects the failure.

Notice 2010-6 imposes similar reporting (an obligation to attach certain information to federal income tax returns) and disclosure (notice to examining agent) requirements on the employee affected by the correction.

Notice 2010-80 provides transition relief through December 31, 2012 for agreements that have employment-related action failures as of December 31, 2010. For any agreement with a provision eligible for correction on or before December 31, 2010, the provision will not be treated as noncompliant with Section 409A(a) in form and payment pursuant to such a provision will not be treated as noncompliant with Section 409A(a) in operation with respect to an amount deferred under the agreement that is paid on or before March 31, 2011.

The Notice also provides relief for payments made before December 31, 2012 under plans that do not comply with Section 409A and have not been corrected appropriately.

Overall, the IRS guidance Notice 2010-80 provides significant additional guidance to address plans which could provide an employee with control over the timing of payments. An employer should review its agreements to determine whether they are compliant with Section 409A, plans and if appropriate, take corrective action.

## IRS Suspends Health Care Reform Nondiscrimination Requirements

The IRS recently issued Notice 2011-1 ("Notice"), which delays the application of certain nondiscrimination requirements to non-grandfathered insured group health plans under Health Care Reform ("HCR"). HCR prohibits non-grandfathered insured plans from discriminating in favor of "highly compensated individuals" with respect to either eligibility to participate or benefits by extending rules "similar to" those long found in Section 105(h) of the Internal Revenue Code. An insured plan that violates these rules is subject a $100 excise tax/penalty per day per individual discriminated against, and other penalties under ERISA (including an injunction to compel compliance). In contrast, under existing law, if a self-insured plan (whether or not grandfathered) violates Section 105(h), the only sanction is that highly compensated individuals' health care benefits become taxable.

HCR's nondiscrimination requirements for non-grandfathered insured plans were effective the first plan year beginning on or after September 23, 2010. However, the Notice provides that compliance with HCR's nondiscrimination requirements is not necessary until regulations or other guidance is issued. In delaying the compliance date, the IRS recognized that the use the of the phrase "similar to" in HCR's means that guidance is needed to specify in what respects insured plans are subject to the same statutory provisions that apply to self-insured plans. The Notice further provides for a comment period, ending on March 11, 2011 during which comments may be submitted regarding issues related to HCR's nondiscrimination requirements.

## IRS Raises Determination Letter Request Fees

The IRS recently issued Revenue Procedure 2011-8 (the "Revenue Procedure"). The Revenue Procedure significantly increases user fees on requests for determination letters and many other types of rulings.

The IRS is required to regularly review and adjust the number of cases it processes and the time and cost of processing those cases. Among those user fees that have been increased are:

- from $1,000 to $2,500 for Form 5300, Application for Determination Letter;
- from $1,000 to $2,000 for Form 5310, Application for Determination Letter for Terminating Plan;
- from $1,800 to $4,500 if an applicant submits a Form 5300 and requests a determination letter with respect to an average benefit test and/or any general tests;
- from $1,800 to $4,000 if an applicant submits a Form 5310 and requests a determination letter with respect to an average benefit test and/or any general tests;
- from $1,000 to $1,800 if an applicant submits a Form 5307, Application for Determination Letter for Adopters of Master or Prototype or Volume Submitter Plans, and requests a determination letter with respect to an average benefit test and/or any general tests;

With limited exception, these user fees take effect for submissions made as of February 1, 2011.

## Pennsylvania Tax Code Provides For Tax-Free Health Benefits For Domestic Partners

The Pennsylvania Department of Revenue (the "Department") recently posted a Pennsylvania Personal Income Tax Ruling ("Ruling") finding that payments made for nondiscriminatory health, accident or death coverage for same-sex domestic partners and the children of same-sex domestic partners of employees, and any benefits received therefrom, are not includable in compensation for Pennsylvania Personal Income Tax purposes.

In PIT-08-002, the Department reviewed a request from an employer health plan sponsor that intended to add coverage for domestic partners and their children. In analyzing whether employer contributions for such coverage would be included in the employee's compensation for Pennsylvania Personal Income tax, the Department looked to the Pennsylvania Tax Code's definition of compensation and the regulations promulgated thereunder. The Department concluded that employer contributions for any "beneficiary" entitled to coverage under a non-discriminatory health, accident or death are excludable from Pennsylvania compensation. The Department noted that "[i]n contrast to Federal income tax rules, whether the beneficiary of a nondiscriminatory health, accident or death plan is an employee's spouse or dependent for Federal or Pennsylvania Personal Income Tax purposes is not relevant." As a result, the plan sponsor does not have an obligation to withhold Personal Income Tax from participants with respect to domestic partner benefits

This Ruling distinguishes Pennsylvania from the majority of States, which follow Federal tax rules with respect to taxation of domestic partner health benefits, and, instead, places it on par with states, such as California, Connecticut, Massachusetts, Oregon and New Jersey, which have specific laws that provide for tax-free employer provided health benefits for same-sex domestic or civil union partners. Pennsylvania, however, provides this tax benefit without having had passed specific domestic partner or civil union legislation. Pennsylvania employers should consider this Ruling and adjust their withholding practices for domestic partner health benefits accordingly.

*By: Kari Knight Stevens and Wilhelm Gruszecki*


### Employee Benefits and Executive Compensation Practice Group

| | | | | | |
|---|---|---|---|---|---|
| Helena H. Astolfi | 215.569.5498 | Cory G. Jacobs | 215.569.5481 | Mary Pierce | 424.239.3433 |
| Arthur Bachman | 215.569.5715 | Barry L. Klein* | 215.569.5403 | Kari Knight Stevens | 215.569.5705 |
| Colleen A. Carolan | 424.239.3430 | Howard M. Knee | 424.239.3439 | | |
| Paul A. Friedman | 212.885.5411 | Michael L. Ludwig | 424.239.3438 | | |
| Wilhelm L. Gruszecki | 215.569.5477 | Anthony A. Mingione | 212.885.5246 | | |
| Michael J. Hanlon | 215.569.5652 | Virginia Escobar Neiswender | 215.569.5439 | | |

* Editor