Significant Issue Update
Western Pension & Benefits Council, Portland Chapter
Legal and Compliance Updates – March 9, 2016

Certain Compliance Questions on 2015 Forms 5500 Do Not Need to be Answered. The IRS has announced that, because certain proposed 2015 IRS compliance questions on Form 5500 and related schedules were not approved by the Office of Management and Budget when advance informational copies of the 2015 Form 5500 series was published on the ERISA Filing Acceptance System (EFAST) webpage[1] on December 7, 2015, plan sponsors should not complete these questions for the 2015 plan year.

Because of the failure to secure OMB approval, the IRS has recently stated that plan sponsors do not need answer the following IRS compliance questions:

- on Schedules H and I, Lines 4o-4p, 6a-6d;
- on Schedule R, Part VII; Lines 20a-c, 21a-b, 22a-d, and 23;
- on Form 5500-SF, Lines 10j, 14a-d, and Part IX: Lines 15a-c, 16a-b, 17a-d, 18, 19, and 20.

The DOL has followed up on the IRS announcement and stated on its EFAST2 Filing site that, effective February 17, 2016, plan sponsors should not complete the new IRS compliance questions.

For more information, see http://www.efast.dol.gov/welcome.html.

Federal Circuit Upholds Regulation Imposing FICA Tax Liability on Full Value of Deferred Compensation. The Federal Circuit Court of Appeals has affirmed a lower court decision denying a retiree's FICA tax refund claim paid on the full value of deferred compensation the retiree will never receive as a result of his employer's bankruptcy. The lower court had upheld the validity of the regulation imposing liability.

Background. Generally, wages are subject to the FICA tax when they are actually or constructively paid. However, under a "special timing rule," amounts deferred under a nonqualified deferred compensation plan are deemed wages for FICA purposes as of the later of: (1) when the services are performed; or (2) when there is no substantial risk of forfeiture of the rights to such amount. The case involved a United Airlines employee who retired in 2004. The employee had a deferred compensation plan balance that had not been paid as of his retirement. The full present value of his deferred compensation account was included in the FICA tax base in the year of his retirement. United had entered bankruptcy proceedings two years before the employee retired and, as a result, its obligation to pay the deferred compensation was later discharged. Because United withheld FICA tax from the employee based on a present value calculation of his retirement benefits at the time of his retirement, the employee effectively paid FICA tax on wages he would never receive. The employee brought suit for a refund of that FICA tax.

Federal Claims Court. The Federal Claims Court agreed with the IRS's interpretation of the rules and upheld the validity of the regulation imposing a FICA liability finding that the regulation clearly provides for the taxation of deferred compensation based on a present value calculation that does not discount the benefits for the risk of employer default or allow refunds in the event of nonpayment due to plan failure.

Federal Circuit Court. The Federal Circuit Court of Appeals affirmed, concluding that the IRS's interpretation of present value was rational, reasonable, and not in conflict with any law.

The case is *Balestra, Jr. v. U.S.,* 803 F.3d 1363 (Fed. Cir. 2015), available at:
http://www.leagle.com/decision/In%20FCO%2020151013136/BALESTRA%20v.%20U.S.#

[1] http://www.dol.gov/ebsa/pdf/2015-5500.pdf.

EBSA Clarifies its Position on Appropriate Fiduciary Considerations of Economically Targeted Investments. EBSA has issued a new Interpretive Bulletin and regulation relating to the ERISA standards imposed on plan fiduciaries when considering "economically targeted investments" ("ETIs"). ETIs are investments selected for the collateral economic benefits they may create in addition to their investment return to the plan. The guidance, which became effective October 26, 2015, supersedes prior guidance and clarifies that plan fiduciaries:

- should appropriately consider factors that potentially influence risk and return; and
- may invest in ETIs based in part on collateral benefits, as long as the investment is economically equivalent to investments without such collateral benefits.

The EBSA has stated that fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Thus, if the requirements described above are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate ERISA Sections 404(a)(1) (A) and (B), or 403.

For more information, see DOL IB 2015-01 and DOL Regulation Section 2509.2015-01, available at: http://www.dol.gov/ebsa/.

Seventh Circuit Rejects Discretionary Clauses in ERISA Plans. In *Fontaine v. Metropolitan Life Insurance Co.*, the Seventh Circuit Court of Appeals recently held that that ERISA does not preempt an Illinois state insurance regulation prohibiting discretionary authority clauses in health and disability plan insurance policies. The court stated that using such clauses to bypass a state regulation is an artificial distinction that could potentially displace *any* state regulation. As a result, the Court of Appeals upheld a district court ruling that the regulation was not subject to ERISA preemption.

Background. In the 1989 *Firestone Tire & Rubber Co. v. Bruch* case,[2] the U.S. Supreme Court held that an ERISA plan administrator's decisions will be reviewed under a *de novo* standard of review (which allows the reviewing court to take a new look at the case without deference to the decision of a lower court or administrative agency), unless the ERISA plan document confers discretion on that administrator to determine eligibility for benefits and construe the plan terms. If the plan document grants the administrator such discretionary authority, the lesser "arbitrary and capricious" standard of review applies. Thus, when a plan document gives the plan administrator discretion to interpret its terms, the administrator's interpretation should be given deference by the courts. As a result of these cases, most employers and insurance companies began including such discretionary language in plan documents.

The Case. *Fontaine* involved the appropriate standard of review applicable to a decision under an insurance policy in Illinois which provided that the insurer's claim determination would be "given full force and effect" unless it was "arbitrary and capricious."

At issue was an Illinois regulation providing that:

> No policy, contract, certificate, endorsement, rider application or agreement offered or issued in this State, by a health carrier, to provide, deliver, arrange for, pay for or reimburse any of the costs of health care services or of a disability may contain a provision *purporting to reserve discretion* to the health carrier to interpret the terms of the contract, or to provide standards of interpretation or review that are inconsistent with the laws of this State. (Emphasis added.)

Based on *Firestone*, this regulatory prohibition against an insurer's reservation of discretionary authority would, absent ERISA preemption, typically result in insured plans being reviewed by a court under a *de novo* standard of review. Thus, the primary issue before the Court of Appeals was which standard of review should apply based on whether the plan language violated the Illinois insurance regulation or whether the regulation was preempted by ERISA.

[2] 489 U.S. 101 (1989).

The Court of Appeals found that the Illinois regulation applied to the benefit claim and was saved from ERISA preemption because that law was specifically directed toward entities engaged in insurance and substantially affected the risk pooling arrangement between the insurer and the insured. In denying ERISA preemption, the court reasoned that the Illinois regulation merely restored ERISA's default standard of *de novo* review in cases challenging benefit denials and that deferential review is not required by ERISA.

Potential Impact on Plan Sponsors and Administrators. The *Fontaine* case raises important lessons. Most employers and insurers include discretionary language clauses in insurance policies and related plan documents. These clauses are intended to cause a reviewing court to apply the deferential "arbitrary and capricious" standard of review when reviewing a plan administrator's claim determination. To the extent deferential review is not granted to a plan administrator's decision, a reviewing court will review any claim *de novo,* substituting its judgment for that of the plan administrator.

The case is *Fontaine v. Metropolitan Life Insurance Co.,* and is available at:
http://law.justia.com/cases/federal/appellate-courts/ca7/14-1984/14-1984-2015-09-04.html

Plan Sponsor Advances Novel Suit Accusing IRS of Mismanaging Voluntary Correction Program. A novel lawsuit accusing the IRS of mismanaging its EPCRS Voluntary Correction Program (VCP) is proceeding after a federal judge denied the IRS's motion to dismiss. The VCP allows retirement plans to identify and correct errors in plan design and operation that would jeopardize their tax-qualified status. The suit accuses the IRS of refusing to consider a retirement plan's attempt to maintain tax-qualified status and is the first lawsuit challenging the IRS's administration of its VCP in this way. The U.S. District Court for the District of Columbia denied the IRS's motion to dismiss the lawsuit without an accompanying written opinion explaining its reasoning.

The plan sponsor had filed a VCP application with the IRS in 2012 in an attempt to correct missteps allegedly related to the plan's court-appointed independent fiduciary. Although the service was receptive to some of the correction efforts, it eventually stated that it could not rule on the VCP application because it involved fiduciary issues that should be addressed by the Department of Labor.

In filing the suit, the plan sponsor argued that this move by the IRS violated the Administrative Procedure Act and threatened the plan's tax-qualified status. The IRS responded that the plan sponsor lacked standing to sue because it had not been injured by any IRS conduct. It will be interesting to watch this case proceed, as it highlights a gap in the IRS's VCP and existing DOL correction procedures in handling correction of plan failures involving fiduciary issues.

The case is: *Information Systems & Networks Corp. v. IRS*, D.D.C., No. 1:14-cv-02019.

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