THE JAECKLE ALERT
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EMPLOYEE BENEFITS UPDATE

YEAR END CONSIDERATIONS FOR EMPLOYEE BENEFIT PLAN SPONSORS

The end of the year is rapidly approaching! The following are some year-end issues and deadlines that sponsors of employee benefit plans should keep in mind:

QUALIFIED RETIREMENT PLANS

Roth 401(k) Contributions

Beginning January 1, 2006, 401(k) plans may permit participants to make "Roth 401(k) contributions". Unlike regular 401(k) contributions - which are, of course, made on a pre-tax basis - Roth 401(k) contributions are made on an after-tax basis. Roth contributions accumulate earnings tax free, and Roth contributions (and earnings on such contributions) are not taxed when distributed from the plan, as long as the distribution occurs after age 59½ or upon the participant's death or disability, and after such contributions have been in the plan for at least five years.

Roth 401(k) contributions are generally subject to the same rules and limitations as regular 401(k) contributions. For example, both Roth and regular 401(k) contributions count towards the annual 401(k) contribution limit ($15,000 for 2006, or $20,000 for participants age 50 and older who make "catch-up contributions").

Plan amendments are not required to be adopted until the end of the plan year during which Roth contributions are first permitted – so December 31, 2006 would be the amendment deadline for a calendar year plan that permits Roth contributions beginning January 1, 2006. However, employers that wish to permit Roth contributions beginning January 1, 2006 should provide appropriate notices to participants before year-end, so that they can make an informed decision as to whether to make Roth contributions when the new year begins.

"Anti-cutback" Regulations

The IRS issued regulations under the "anti-cutback" provisions of the Internal Revenue Code in August 2005. (The anti-cutback rule limits an employer's ability to amend a retirement plan so as to eliminate or reduce any accrued benefit, early retirement benefit, retirement-type subsidy, or optional form of payment.) Under the regulations, if an employer wishes to amend its retirement plan to eliminate a plant closing benefit, it must do so on or before December 31, 2005. Otherwise, the rule under the regulations, which prohibits the elimination of such a benefit with respect to service performed prior to the date of the amendment, will apply.

Automatic Cash-Out Procedures

Many qualified retirement plans automatically "cash out" a terminated participant's account if the account value is $5,000 or less and the participant has not elected a direct rollover to another plan or IRA, or otherwise provided payment directions. Beginning March 28, 2005, for all such "involuntary cash-outs" of more than $1,000, if the participant doesn't designate a plan or IRA to receive a rollover of the distribution, the plan must transfer the amount cashed out to an individual retirement account (IRA) designated by the employer. In light of this new "automatic rollover" requirement, employers that sponsor qualified plans now have three choices:

- Designate an IRA to receive involuntary cash-out distributions (when the participant fails to provide payment directions);
- Lower the threshold for involuntary cash-outs to $1,000, so that the only cash-outs that would be paid would be those for which an automatic rollover to an IRA would not be required; or
- Stop making any involuntary cash-outs.

Most plan sponsors must choose one of these options and amend their plans accordingly by the latest of (1) December 31, 2005, (2) the last day of the plan year that includes March 28, 2005, or (3) the deadline (including extensions) for filing the employer's tax return for the year that includes March 28, 2005.

HEALTH AND WELFARE PLANS

Medicare Part D Notice

Medicare-eligible persons can begin enrolling in the new Medicare Part D prescription drug program on and after November 15, 2005. Employers that sponsor a group health plan which includes prescription drug coverage, and that covers any Medicare-eligible persons, were required to notify such participants by November 15, 2005 about the new Part D benefit. Specifically, employers have to inform such participants whether the employer-provided drug benefit is expected to be, on average, as valuable as the Medicare Part D benefit – that is, whether the employer benefit is "creditable". Participants need this information because, if the employer-provided drug benefit is not "creditable", the participant would have to pay a higher premium if the participant enrolled in Medicare Part D after he or she was first eligible. Employers who haven't sent the required notice yet should notify any Medicare-eligible participants in their health plan – or simply send the notice to *all* plan participants – as soon as possible.

HIPAA Portability

HIPAA's "portability" rules (1) require group health plans to grant "special enrollment rights" to employees, allowing them to enroll in the plan in certain circumstances, outside of the regular annual enrollment period; (2) require such plans to provide "certificates of creditable coverage" to participants when they terminate participation in the plan, and in certain other circumstances, and (3) limit the ability of plans to impose "pre-existing condition" limitations. Final regulations under the HIPAA portability provisions were published earlier this year, and go into effect (for a calendar year plan) on January 1, 2006.

The final regulations add several new clarifications and requirements. For example, the regulations:

- require group health plans to establish procedures for requesting certificates of creditable coverage;
- require certificates to include an "education statement" that explains HIPAA rights;
- clarify that participants can request a certificate before termination of coverage;
- explain pre-existing condition limits that may be "hidden" in a plan's terms; and
- provide new examples of events that constitute a "loss of coverage" that triggers special enrollment rights.

Health plan sponsors should review their plan documents and procedures before year end to make sure that they comply with the final regulations.

EXECUTIVE COMPENSATION

Section 409A

Section 409A of the Internal Revenue Code, which contains new rules governing deferred compensation, became effective on January 1, 2005. In October, 2005, the IRS issued proposed regulations under Section 409A. Although the proposed regulations extended, until December 31, 2006, the deadline for amending deferred compensation plans to comply with the new rules, other actions still need to be taken by December 31, 2005:

- An employee's election to defer compensation to be earned in 2006 generally must be made by December 31, 2005.
- If an employee wishes to change the timing or form of a benefit payment that was to be received in 2006, or wants to receive payments in 2006 that were scheduled to be received in a different year, the election has to be made by December 31, 2005.
- If an employee wishes to terminate his or her participation in a deferred compensation plan, or cancel a previous deferral election, so as to avoid coverage by Section 409A, this must be done by December 31, 2005.
- If an employer wishes to provide a cash payment to an employee as compensation for giving up a discounted stock option or stock appreciation right (SAR), so as to avoid coverage by Section 409A, this must be done by December 31, 2005.

If you have any questions about the required actions discussed in this Alert, or any other questions about your employee benefit plans or compensation issues, please contact any member of our Employee Benefits Practice Group:

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