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Employee Benefits Bulletin

A review and analysis of recent developments affecting employee benefits

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WOMEN'S CANCER RIGHTS ACT REQUIRES ACTION BY YEAR END

Buried in the 4,000-page omnibus appropriations bill enacted last month is the Women's Health and Cancer Rights Act of 1998 (the "Act"). The Act requires group health plans and insurers providing benefits for mastectomies to provide benefits for breast reconstructive surgery performed in connection with such surgery.

The practical impact of this legislation is unclear, since the type of reconstructive surgery mandated often is already covered and not within the ambit of typical exclusions for cosmetic surgery. The Act becomes effective the first day of the first plan year beginning on or after October 21, 1998.

However, the Act contains a *special notice provision requiring immediate action* by group health plans and

insurers. Specifically, the Act states that written notice of breast reconstructive surgery coverage as required by the law must be prominently positioned in any literature or correspondence distributed by the plan or insurer and transmitted by the earliest of (a) the next mailing to participants; (b) any yearly informational packet distributed to participants; or (c) January 1, 1999.

Although the notice must be distributed in the next two months, no guidance on the form or content of the notice has been issued, nor do we expect it to be issued in the near future. For proposed notice language, please contact any member of the firm's Employee Benefits Group listed at the end of this *Bulletin* or any other Vedder Price attorney with whom you have worked.

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401(K) HARDSHIP WITHDRAWAL CHANGES

The IRS Restructuring and Reform Act of 1998 makes important changes in the way hardship withdrawals from 401(k) plans are treated. These changes, which are effective for distributions made after December 31, 1998, are likely to require changes to both administrative forms and recordkeeping practices.

Beginning next year, hardship withdrawals from 401(k) plans may no longer be rolled over into another qualified plan or IRA. Specifically, Internal Revenue Code Section 402(c)(4), which defines what constitutes an eligible rollover distribution, has been amended to exclude "any hardship distribution described in Section 401(k)(2)(B)(i)(IV)."

This change was prompted by Congress' desire to close a loophole under which some participants avoided the 10% tax on hardship distributions made prior to age 59½ by rolling over their distributions into IRAs and then withdrawing the money for first home purchases or for higher education expenses. Distributions for these purposes are exempt from the 10% tax when made from an IRA but not from a qualified plan.

This change is likely to significantly complicate the

handling of hardship distributions for 401(k) plan administrators. The legislation applies only to 401(k) hardship withdrawals, *i.e.*, elective employee deferrals. It does not apply to in-service withdrawals of employer matching or other profit-sharing contributions.

Thus, the impact of the legislation is twofold:

First, because 401(k) hardship withdrawals are no longer eligible for rollover treatment, they are no longer subject to the mandatory 20% income tax withholding, but are subject to the elective withholding rules of Code Section 3405. However, any other withdrawal made at the same time will continue to be subject to the 20% withholding requirement if not made as a direct rollover.

Second, all 401(k) hardship withdrawals will now be subject to the 10% early withdrawal penalty because they must be paid directly to the participant.

In light of this legislative change, plan administrators need to:

- Update administrative forms; and
- Make any required changes in recordkeeping practices.

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COMMUTING BENEFITS ON SALARY REDUCTION BASIS

Commuting fringe benefits (such as vouchers to purchase transit passes and vanpooling) may now be offered to employees in place of cash compensation. If the employee chooses the fringe benefit, the value of the benefit, up to $65 a month, may be excluded from the employee's gross income. Prior to this legislative change, the value of commuting fringe benefits could be excluded from gross income only if the benefit was in addition to, rather than in place of, cash compensation.

The treatment of transit vouchers and vanpooling is governed by Internal Revenue Code Section 132(f), which

also governs the treatment of parking fringe benefits. The Taxpayer Relief Act of 1997 earlier allowed an employer to offer a choice between parking benefits and cash compensation. The Transportation Equity for the 21st Century Act extends this same favorable treatment to mass transit vouchers, essentially playing catch-up with parking benefits.

In practice, an employer purchases vouchers in various denominations ($5, 10, 20, etc.) from the mass transit entity (such as the Regional Transportation Authority) and distributes them to employees who have elected to reduce their cash compensation. The employees then use the vouchers, which have been obtained on a pre-tax salary reduction basis, to pay for their train, bus, or other transit passes and tickets.

Currently, up to $65 per month in transit card and vanpool benefits may excluded from gross income. That limit will jump to $100 per month for tax years beginning after December 31, 2001, with additional adjustments based upon cost-of-living indexing.

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INDEPENDENT CONTRACTORS AND TEMPS: DOL ENTERS THE FRAY

Last year the highly publicized class action lawsuit *Vizcaino v. Microsoft Corporation* heightened employer awareness of the risk that employees improperly classified as independent contractors might be entitled to retirement, stock option, health, and other employee benefits for which the employer (and usually the employees) assumed they were not eligible. The *Microsoft* lawsuit, which was profiled in the March 1997 edition of Vedder Price's *Labor Law Newsletter*, remains ongoing and has sparked similar lawsuits across the country as employers increasingly try to hold down benefit costs by utilizing part-timers, temporary employees, independent contractors, and other workers who are not considered regular full-time employees. Potential liability in such cases often runs into six figures and sometimes significantly higher.

The U.S. Department of Labor, which previously had shown little interest in the issue, recently entered the fray, filing a federal court lawsuit against Time Warner Inc., publisher of *Time*, *Sports Illustrated*, *Fortune*, *People*, *Entertainment Weekly*, *Life*, and *Money* magazines. Also named as defendants are the members of the Time Warner employee benefit plans administrative committee.

According to the complaint, most of Time Warner's benefit plans specifically excluded "temporary employees" but often did not define that term. In contrast, employee handbooks and labor agreements generally defined temporary employees as employees hired for temporary or seasonal work not exceeding four or six months, depending upon the business unit.

The complaint alleges that Time Warner managers misclassified numerous workers as "temporary employees" or "independent contractors" when they were in fact "regular" employees as defined by the relevant handbook or labor agreement and, but for their misclassification, would have been eligible to participate in Time Warner's employee benefit plans. Time Warner managers also allegedly manipulated breaks in service for numerous employees to maintain their purported "temporary" status and ineligibility for benefits.

Time Warner and the plans' administrative committee members allegedly breached their fiduciary duties to administer the plans in accordance with their terms and for the sole purpose of providing benefits to eligible participants and beneficiaries by, among other things, failing to examine whether workers classified as "temporary employees" or "independent contractors" were in fact eligible to participate in the benefit plans.

The *Time Warner* lawsuit and other recent litigation suggests some practical steps that employers and plan administrators can take to help protect themselves from liability:

- Review plan documents, employee handbooks, personnel policies, and labor contracts periodically. Make sure they accurately reflect the employer's practices and its current workforce composition, specifically describe who is intended to be included in the plan, and are consistent with one another.

- Periodically review classifications of workers to verify that the classifications are accurate and that breaks in service are not being manipulated to avoid coverage.

- When questions of coverage arise, make sure the appropriate plan fiduciary, in accordance with the plan's claim review procedures, makes a careful and reasoned decision interpreting the plan, considering all relevant facts and governing plan documents.

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PROPOSED CLAIMS PROCEDURE REGULATIONS

The Department of Labor issued proposed regulations in September that, if finalized in their current form, would significantly change the claim procedure rules for health and disability benefit plans, while making modest changes for other employee benefit plans. This proposal has generated substantial controversy.

Health and Disability Plans

The proposed regulations would dramatically shorten the time periods for processing health and disability benefit claims. Under present law, health and disability benefit plans can take 90 or more days to respond to a claim. Critics have argued that this period is simply too long, especially in the context of medical care where treatment decisions requiring prompt action increasingly hinge on claim approval. The proposed regulations address those concerns by radically reducing the time frames within which claim decisions must be made. Under the proposed regulations:

- Urgent health care claims decisions must made as soon as possible, but not later than 72 hours after receipt of the claim. For appeals of denied claims, decisions must be rendered within 72 hours after receipt of the appeal.

- Non-urgent health care claims must be processed within a reasonable period of time but no later than

15 days for the initial decision and no later than 30 days for an appeal.

- Disability benefit claim decisions must be made within 30 days of receipt of the initial claim, with decisions on appeal rendered within 45 days.

Pension and Welfare Plans Generally

The proposed regulations would also make changes in the claims procedures rules applicable to all ERISA pension and welfare benefit plans. The proposal would require plans to provide participants with more timely information about the plan's claims procedures and more information about the claim decision when a claim has been denied. The proposal also would require that appeals be decided by a party who is neither the initial claim reviewer nor a subordinate. Moreover, where decisions are based on medical judgments, the reviewer of a denied health care claim would be required to consult with a medical professional. In addition, the proposal would ensure that claimants have access to judicial review when plans fail to establish or to follow reasonable claims procedures that comply with the new rules.

These proposed changes, if incorporated into final regulations, would be significant. Compliance will require significant administrative changes and new methods of communication. For example, many plans have not clearly identified who decides initial claims and appeals. That approach will have to change if a plan intends to continue to maintain effective control over plan benefits and costs. More importantly, successful defense of claim decisions in court has always relied on careful compliance with existing claims procedures. For example, the record on review in court is now generally limited to the record established in the claims procedure process. If plan administrators fail to adjust their procedures in accordance with these regulations when finalized, they may impair the record in court along with the ability to successfully defend the ultimate claim decision.

Extended Comment Period

Clearly, these proposals merit attention. It is very likely that some of these changes will be adopted and existing claim procedures and practices will have to be redesigned.

About Vedder Price

Vedder, Price, Kaufman & Kammholz is a national, full-service law firm with approximately 180 attorneys in Chicago, New York City and Livingston, New Jersey.

The Employee Benefits Group

Vedder Price has one of the nation's largest employee benefits practices, with ongoing responsibility for the design, administration and legal compliance of pension, profit sharing and welfare benefit plans with aggregate assets of several billion dollars. Our employee benefits lawyers also have been involved in major litigation on behalf of benefit plans and their spouses. Our clients include very large national corporations, smaller professional and business corporations, multi-

Because of the controversy the proposals have generated, the Department of Labor officials recently announced that they intend to extend to December 9, 1998, the deadline for submission of written comments by interested parties, such as benefit plan sponsors, insurers, and claims administrators. Members of Vedder Price's Employee Benefits Group have already submitted comments on the proposed regulations. If you have any questions about the proposed regulations or would like to discuss the preparation of comments for submission on behalf of your organization, please contact any member of the Employee Benefits Group.

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1999: A LOOK AT THE YEAR AHEAD

Social Security Wage Base Increase. The Social Security wage base will increase from $68,400 to $72,600 for 1999. The wage base is the maximum annual earnings that are subject to the 6.2% Social Security tax. The 1.45% Medicare tax continues to apply to all wages.

Most Retirement Plan Dollar Limits Remain Unchanged. The dollar limitations applicable to qualified retirement plans will remain unchanged for 1999, except for one change for employee stock ownership plans. According to a recent IRS announcement, no cost-of-living adjustments to the dollar limitations on contributions and benefits will be made for 1999 with the exception of an increase from $725,000 to $735,000 in the maximum ESOP account balance subject to an extended five-year distribution period. The annual dollar limitations that will remain unchanged include:

401(k) Elective Deferrals	$10,000
Defined Contribution Plan Maximum Annual Addition	$30,000
Annual Compensation Limit	$160,000
Defined Benefit Plan Annual Benefit Maximum	$130,000

employer trust funds, investment managers and other plan fiduciaries.

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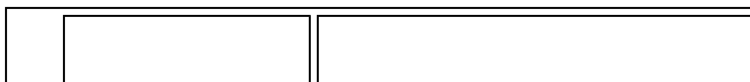
In addition, the $80,000 dollar limitation used in defining "highly compensated employee" will remain unchanged for 1999.

Remedial Amendment Period Ends. Here we go again! The current remedial amendment period for qualified retirement plans ends the last day of the first plan year beginning on or after January 1, 1999. Thus, for calendar year retirement plans, December 31, 1999 is the date by which all amendments required to reflect legal changes since 1994 must be adopted and by which requests for IRS determination letters for those amendments must be filed.

401(k) Testing Safe Harbors Available. The design-based safe harbors for ADP and ACP testing enacted as part of the Small Business Job Protection Act of 1996 become available for plan years beginning on or after January 1, 1999. Generally, annual ADP and ACP testing can be avoided if a 401(k) plan provides for either (a) a nonelective contribution equal to at least 3% of compensation on behalf of each non-highly compensated employee eligible to participate, or (b) matching contributions equal to 100% of the first 3% of each non-highly compensated employee's 401(k) contributions and at least 50% of each non-highly compensated employee's contributions from 3% to 5% of compensation. In either case, the contributions must be fully vested.

Hardship Withdrawal Changes for 401(k) Plans. Changes in the rollover treatment of hardship distributions from 401(k) plans become effective January 1, 1999. *See* "401(k) Hardship Withdrawal Changes" on page 1 for details.

Year 2000 Countdown Continues. During 1999, plan administrators and service providers will be completing compliance efforts designed to identify and correct year 2000 date-recognition and related problems in computerized compensation and benefits administration systems. The nature of the problem and need for action are described in the July 1998 *Employee Benefits Bulletin*, additional copies of which are available by contacting Barb Stawski at 312/609-7596 or bstawski@vedderprice.com.



QUESTIONS?	If you have questions or need additional information about any of the subjects addressed in this Bulletin or about any other compensation or benefits issue, please contact any member of the firm's Employee Benefits Group or any other Vedder Price attorney with whom you have worked. The names and telephone numbers of all Employee Benefits Group members are listed at the end of the Bulletin

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