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A newsletter on current legal issues impacting employee benefits and executive compensation

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Upon Further Review, Plaintiff Does Have a Remedy!

By Brian D. Sullivan

Last year, in *CIGNA Corp. v. Amara*, the Supreme Court signaled a willingness to broaden the scope of equitable remedies available to successful ERISA plaintiffs. However, in *McCravy v. MetLife*, the Court of Appeals for the Fourth Circuit, in response to that signal, has now reversed itself regarding the issue of what remedies a court may impose in a case involving an employer-sponsored welfare plan where a life insurance beneficiary seeks the insurance proceeds to which she thought she was entitled. Thus, it appears the federal courts may be poised for a significant expansion of equitable remedies in ERISA cases.

Facts

Debbie McCravy participated in her employer's life insurance plan, which was issued and administered by MetLife. The plan permitted participants to purchase life insurance for their children, and McCravy elected to insure her teenage daughter. McCravy continued paying premiums, and MetLife continued to accept them, until her daughter's untimely death at age 25. McCravy was the named beneficiary on the policy, but MetLife denied her claim for the life insurance proceeds because, under the terms of the plan, the daughter's eligibility to participate in the insurance program had ended six years earlier when she reached her nineteenth birthday.

The plan administrator refunded the premiums it had mistakenly accepted, but McCravy refused to cash the check. Instead, she filed suit in federal court, alleging that MetLife had breached its fiduciary duties under ERISA by representing that the daughter had dependent life insurance coverage and by accepting the premium payments that McCravy had remitted year after year, thereby causing McCravy to believe that her daughter was insured. Had McCravy known that her daughter was not insured, the complaint alleged that she would have obtained coverage elsewhere.

Court Restricts Plaintiff's Remedy

Section 502(a)(3) of ERISA allows a participant, beneficiary or fiduciary to obtain "appropriate equitable relief" to redress any act or practice that violates Title I of ERISA or the terms of an employee benefit plan. The district court ruled that McCravy could establish a claim under section 502(a)(3) of ERISA, but reluctantly concluded that the only recovery available to her under that section was a refund of the premiums mistakenly accepted by MetLife. The court viewed this result as unjust, but determined it had no other option in light of Fourth Circuit precedents limiting the scope of equitable remedies and specifically precluding money damages as an option. On May 16, 2011, the Fourth Circuit affirmed the District Court's ruling, concluding that it too was limited by its own precedents and by those of the Supreme Court regarding equitable relief under ERISA.

Supreme Court Decides *Amara*

The Fourth Circuit's opinion most likely would have ended McCravy's lawsuit except that, on the same day that the appellate court filed its opinion, the Supreme Court announced its decision in *Amara*, signaling a significant departure from earlier rulings in which the equitable remedies available under section 502(a)(3) appeared to be far more limited.

Amara involved an employer's conversion of a traditional defined benefit plan to a cash balance retirement plan. The affected participants filed a class-action, alleging that the disclosures regarding the transaction were "defective, harmful, and contrary to ERISA." The district court concluded that the plan fiduciaries had violated specific ERISA provisions regarding notice and disclosure, and reformed the plan so that it is terms conformed to those described in the defective disclosures.

In This Issue:

It ordered the plan fiduciaries to administer the plan as reformed rather than pursuant to the terms of the plan document actually adopted by the sponsoring employer.

The district court held that section 502(a)(1)(B) of ERISA provided the legal authority for its order reforming the plan. The court considered whether section 502(a)(3) might also provide such authority, but did not answer this question, having already concluded that section 502(a)(1)(B) provided a basis for the remedy. Similarly, in affirming the district court's rulings, the Court of Appeals for the Second Circuit relied on section 502(a)(1)(B), and did not consider what remedies, if any, might be available under section 502(a)(3).

When *Amara* reached the Supreme Court in 2011, the Justices concluded that section 502(a)(1)(B) does not permit a court to reform an employee benefit plan, but only to enforce its terms *as written*. Having so concluded, the Court could have simply remanded the case to the lower court for further proceedings, and the concurring Justices contended that the Court should have done so. Instead, the Court addressed the question of whether section 502(a)(3) provides authority for reforming the terms of a plan, and concluded that it does.

The Court explained that the term "appropriate equitable relief" as used in section 502(a)(3) refers to the categories of relief that were traditionally available in courts of equity prior to the merger of the law and equity courts. The Court distinguished earlier cases in which it held that relief was unavailable under section 502(a)(3), in part because those earlier cases had not involved a situation in which a plan participant or beneficiary sought relief against a plan fiduciary. The Court noted that, prior to the merger of law and equity, such claims could only be brought in a court of equity, not a court of law, and that the range of remedies traditionally available in those equity courts were broad enough to encompass the relief that had been fashioned by the district court for the *Amara* plaintiffs.

The Court observed that the power to reform a contract is a traditional power of an equity court. Similarly, in requiring the plan fiduciaries to provide what they had promised, the district court had invoked promissory estoppel, another traditional equitable remedy. As the court explained, equitable estoppel "operates to place the person entitled to its benefits in the same position he would have been in had the representations been true." The Court also noted that the equitable remedy of "surcharge" might be appropriate in compensating the *Amara* plaintiffs. Equity courts were empowered to provide relief from a loss caused by a trustee's breach of fiduciary duty by "surcharging" the trustee; *i.e.*, requiring the trustee to pay money damages to the plaintiff.

Having provided this guidance, the Court remanded the case so that the lower courts could determine which of these equitable remedies, if any, should be utilized in redressing the *Amara* plaintiffs' injuries.

Fourth Circuit Reconsiders McCravy's Appeal

In light of *Amara*, the Fourth Circuit reheard McCravy's appeal and reversed its earlier affirmance of the district court's ruling. The appellate court noted that prior to the Supreme Court's decision in *Amara*, both it and other lower courts had misconstrued Supreme Court precedent as severely limiting the remedies available to plaintiffs suing fiduciaries under section 502(a)(3), but found that *Amara* had now clarified that remedies traditionally available in courts of equity, specifically including estoppel and surcharge, are available to a plaintiff suing fiduciaries under section 502(a)(3) of ERISA.

The Fourth Circuit remanded the case to the district court so that it could fashion an appropriate remedy. In addition, noting that the district court had given only cursory attention to the merits of McCravy's claim, the appellate court instructed the district court to reevaluate the merits of the claim and provide a more detailed explanation of its reasons for determining that MetLife had violated a fiduciary duty owed to McCravy. Thus, while the Fourth Circuit made it clear that McCravy has a remedy if she can establish her claim, she must do so before the district court can give her *any* relief.

Conclusion

Having concluded in *Amara* that section 502(a)(1)(B) does not permit a court to reform an employee benefit plan, the Supreme Court could have remanded the case without providing guidance regarding section 502(a)(3). Thus, its discussion regarding equitable relief under section 502(a)(3) of ERISA is technically non-binding *dicta*, and it is unclear to what extent the lower courts will embrace this guidance. Traditionally, federal courts have often been reluctant to allow a participant to recover more than the benefit provided under the terms of a plan for fear of undermining the plan's financial integrity. In recent years, however, the appellate courts have shed this reluctance to varying degrees in addressing what they perceive as serious inequities.

It remains to be seen to what extent *Amara* will accelerate this trend, but the Fourth Circuit's holding in *McCravy* suggests that appellate courts will embrace the additional options that have apparently been added to their arsenal of remedies under section 502(a)(3) of ERISA. If so, plan sponsors and administrators should anticipate an increasing number of estoppel cases and other equity-based claims.

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The Gripes of Roth: New Decisions Highlight the Boundaries of Roth's Golden Country

By Daniel N. Kuperstein and Mark H. Hess

The Migration...

A coming storm of increased tax rates is encouraging high net worth individuals and business owners to migrate to new lands and to take refuge in the Roth IRA's tax benefits. However, when viewing the lay of the land that makes up Roth's golden country, it is important to be aware of recent decisions that limit Roth's bounties.

Roth IRA Basics

The Roth IRA is a unique type of nondeductible IRA. Although contributions to Roth IRAs are not deductible, all of the qualifying distributions received from the Roth IRA are tax-free. Unlike the Roth IRA, in a regular or traditional IRA, withdrawals of contributions and earnings are taxable, but the money contributed to the IRA is deducted from income.

The maximum annual contribution an individual can make to his or her Roth IRA is subject to both a "dollar limitation" (which caps contributions by a dollar amount) and an "AGI limitation" (which stands for adjusted gross income, and caps contributions based on the participant's modified adjusted gross income).

Since the inception of the Roth IRA, individuals have sought to avoid the statutory limits on Roth IRA contributions. Often, transactions between different corporate entities are designed to indirectly contribute to a Roth IRA in an attempt to protect assets or evade taxes. The IRS has responded by challenging such avoidance transactions, and in such cases, it has denied deductions, required corporations involved to recognize the gain on the transfer, required inclusion of the payment in the taxpayer's income, and/or reallocated income to other involved entities in order to prevent tax evasion or to reflect the income clearly. In addition to these possible consequences, the amount treated as a contribution is subject to a 6 percent excise tax under Section 4973 of the Internal Revenue Code.

Recent Decisions

Two recent decisions highlight some of the problems that can arise when business owners seek to utilize the Roth IRA's beneficial tax structure without considering the legal limitations.

Repetto v. Commissioner

In a recent Tax Court decision, *Repetto v. Commissioner* (June 14, 2012), the court determined that two individuals who formed two subchapter C corporations in which their Roth IRAs held a 98 percent interest were subject to the excise tax on excess contributions.

The individuals involved, Steven and Gayle Repetto, owned all of the stock in a subchapter S Corporation, SGR Investments, Inc. (SGR). Relying on the advice of an attorney and a C.P.A., the Repettos formed two C Corporations: (1) Yolo, Inc. (Yolo), which was established to provide office and support services for SGR; and (2) WFR Investments, Inc. (WFR), which was established to provide marketing and business development services for SGR. Gayle Repetto's Roth IRA owned a 98 percent interest in Yolo, and Steven Repetto's Roth IRA owned a 98 percent interest in WFR. Gayle Repetto, acting in her capacity as Yolo's president, established a medical and dental expense reimbursement plan, which made distributions to the Repettos for healthcare expenses. The IRS, on audit, determined that the Repettos made excess contributions to their Roth IRAs and were liable for the excise tax under Code Section 4973. The IRS also disallowed WFR's and SGR's deductions for facility support payments, as well as Yolo's deduction for medical reimbursement expenses and officer compensation expenses. Further, the IRS recharacterized some payments from SGR to Steven Repetto as compensation, rather than as a distribution. The IRS also assessed filing penalties and penalties for reportable transaction understatements.

In court, the Repettos argued that their corporate structure had a legitimate business purpose of asset protection, that payments between the entities were legitimate because the entities that offered support and development services to SGR actually provided such support and development services, and that the IRS had recognized the support and development entities by continuing to retain over $112,000 in federal corporate income taxes. They also noted that a Roth IRA may own shares of a C Corporation.

The court held that the Repettos were liable for the Code Section 4973 excise taxes for excess contributions to their Roth IRAs, and concluded that the service agreements, and payments between the entities, were nothing more than a mechanism for transferring value to the Roth IRAs since the Repettos had continued to do the same work that they had done prior to the time the agreements were in place.

Taproot Administrative Services v. Commissioner of Internal Revenue

In *Taproot Administrative Services v. Commissioner of Internal Revenue* (Mar. 21, 2012), the Ninth Circuit Court of Appeals, affirming the Tax Court's decision, held that a corporation was not eligible for S corporation status because its sole shareholder, a Roth IRA, was not an eligible S corporation shareholder, and consequently, that the corporation was taxable as a C corporation.

The individual taxpayer involved, Paul Di Mundo (Mundo), incorporated his business and elected subchapter S status. The sole shareholder of the corporation in 2003 was a custodial Roth IRA for the benefit of Mundo. After the IRS issued a notice of deficiency, determining that the corporation was taxable as a C corporation for 2003, Mundo filed suit.

The Tax Court agreed with the IRS, and concluded that the Roth IRA did not qualify as an eligible shareholder of the S corporation. On appeal, the Ninth Circuit rejected Mundo's corporation's argument that the custodial Roth IRA qualifies as an eligible shareholder for purposes of assessing S corporation taxation. The Ninth Circuit and Tax Court relied on IRS Revenue Ruling 92-73 (the only IRS guidance on this issue), which prohibits IRAs as S Corporation shareholders. The Ninth Circuit court, in reaching its decision to affirm the Tax Court's determination, noted that unlike grantor trusts and qualified subchapter S trusts, which are both taxed currently on their income, IRAs and Roth IRAs are subject to deferred taxation on current income, and thus are incompatible with the S corporation taxation rules. The court further noted that the legislative history of the S corporation statute favors limited eligibility.

The Migration Continues...

Although these decisions highlight some of the pitfalls that can occur when seeking tax safety, they will not deter the larger migration to Roth's golden country, and to other such refuges. Plan accordingly, and discuss these issues with your attorneys and financial advisors.

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MAP-21 Brings Good and Bad News to Sponsors of Defined Benefit Pension Plans

By Susan Foreman Jordan

This summer, President Obama signed into law the Moving Ahead for Progress in the 21st Century Act (MAP-21). The Act brings new funding relief to plan sponsors in the form of interest rate stabilization but, on the flip side, increases the cost to plan sponsors by raising PBGC premiums.

Based on escalating concerns over underfunding of pension plans, the minimum funding rules applicable to single employer defined benefit pension plans were intensified by the Pension Protection Act of 2006. In addition to reducing the period over which funding shortfalls may be amortized, PPA dictates that minimum funding liabilities be calculated either by using a "yield curve" based on corporate investment-grade bond data published by the U.S. Treasury for the preceding month or by using three "segment rates" that are determined using averages from the most recent

24-month yield curve. As interest rates and investment returns declined, plan funding obligations have increased dramatically, and plan sponsors have been seeking relief.

MAP-21 modifies the corporate bond segment rates approach and provides some stabilization of the rate by adding both a cap and floor for the current year's rate, based upon the 25-year average of each of these segment rates calculated as of September 30 of the preceding year. If a segment rate for an applicable month is less than the applicable minimum percentage, the segment rate is adjusted upward to match that minimum percentage; conversely, if the segment rate for a specific month exceeds the applicable maximum percentage, the segment rate is ratcheted downward to match that percentage. The applicable minimum and maximum percentages are as follows:

For Plan Years Beginning in this Calendar Year:	The Applicable Minimum Percentage is:	The Applicable Maximum Percentage is:
2012	90%	110%
2013	85%	115%
2014	80%	120%
2015	75%	125%
2016 or later	70%	130%

These adjustments are expected to produce meaningful increase in the effective interest rate for most plans for 2012 and 2013 and, in turn, reduce required contributions by perhaps as much as 25 percent. Over the long term, however, the impact of the rate stabilization likely will subside because of the widening disparity between the minimum and maximum percentages.

Plan sponsors can choose to use the new stabilization provisions starting with plan years beginning on or after January 1, 2012, or defer application of the new rules until plan years beginning on or after January 1, 2013.

Counterbalancing the welcome funding relief brought by MAP-21 is the disconcerting news of escalating PBGC premiums. Most defined benefit plans are covered by the PBGC insurance program and pay a flat rate premium per participant to insure basic benefits. MAP-21 increases the current single-employer premium of $35 per participant to $42 for 2013, and to $49 per participant beginning in 2014.

In addition to the flat-rate premium, PBGC assesses a variable rate premium for unfunded vested benefits. This variable rate premium currently is $9 per $1,000 of unfunded vested benefits; the rate will be indexed to reflect inflation and will rise to $13 for 2014, and to at least $18 for 2015. The per participant variable rate premium will be subject to a cap, beginning at $400 for 2013 and indexed thereafter. Note that employers with 25 or fewer employees remain subject to the maximum variable rate premium of $5 per participant; that is not changed by MAP-21.

The law includes a more modest increase in PBGC premiums for multiemployer plans. These rates will increase from $9 per participant to $12 per participant for 2013 and thereafter will be adjusted for inflation.

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IRS Changes Letter-Forwarding Program

By Seth I. Corbin

On August 31, 2012, the IRS issued guidance revising its letter-forwarding program, which has long been available to assist a plan sponsor or plan administrator in locating missing participants or beneficiaries of qualified retirement plans. These services were often utilized to contact individuals to whom a retirement benefit was to be paid and also integrated into the IRS' correction program under the Employee Plans

Compliance Resolution System (EPCRS) as an available mechanism to contact missing participants or beneficiaries affected by the correction of a qualified plan error or defect.

The IRS has cited the readily available resources found through the internet as one of the driving forces behind the change. Going forward, the IRS will continue to operate the letter-forwarding program for situations in which a person is trying to locate a taxpayer to convey a message for a humane purpose (defined to mean a situation in which a person is seeking to find a missing person to convey a message of an urgent or compelling nature) or because of an emergency situation.

As noted above, retirement plan administrators and professionals have long relied on the letter-forwarding service to locate missing participants or beneficiaries in connection with a voluntary correction under EPCRS. The IRS will continue to make the letter-forwarding program available to plan sponsors that have submitted a proposed correction postmarked by August 31, 2012; however, submissions postmarked after August 31, 2012, will have to be revised to reflect the fact that the letter-forwarding program is no longer available. It is also expected that the next iteration of EPCRS, or some guidance related to it, will include an extended correction period for plan sponsors and plan administrators affected by the recent change.

Plan sponsors and administrators should note that several readily available options already exist to locate missing participants, including the Social Security letter-forwarding program, services offered by credit reporting agencies and, as noted above, search services found on and through the internet, many of which can be used for free or minimal cost.

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