

Employee Benefits Update

May 2019

Recent Legal Developments for Employee Benefit Plans

Executive Summary

- **Status of Association Health Plans:** The Department of Labor will be appealing a federal court decision setting aside most of the final regulations authorizing the establishment of Association Health Plans, effectively putting the development of new Association Health Plans on hold.
- **Reduced Fines for HIPAA Violations:** The Department of Health and Human Services has significantly reduced the maximum penalty amounts for most violations of HIPAA's privacy and security rules.
- **Expansion of IRS Determination Letter Program:** The Internal Revenue Service added new categories of qualified retirement plans eligible to request determination letters. Plan sponsors should determine whether they qualify for the expanded categories and, if so, whether they wish to apply for a determination letter.
- **Expansion of the IRS Retirement Plan Correction Guidelines:** The IRS has revised its Employee Plans Compliance Resolution System to include additional types of failures available for self-correction. Plan sponsors should continue to promptly identify errors in their retirement plans' documents and operations and consult with counsel about how to utilize available correction methods.
- **New VCP Electronic Filing System:** Plan sponsors submitting VCP applications must do so online at www.pay.gov.

Important Dates

May 1:

- For defined benefit pension plans, provide notice of benefit restrictions to participants if AFTAP for pension plan is less than 80% and notice has not been previously provided

May 15:

- For defined contribution retirement plans, confirm 1st Quarter benefit statements have been provided to participants, including fee disclosure information
- For tax-exempt trusts or voluntary employee beneficiary associations, file Form 990 returns.

June 30:

- For ESOPs, process participant diversification elections that were made by March 31



I. *Department of Labor Will Appeal Association Health Plan Ruling*

In June 2018, the Department of Labor issued a final rule regarding Association Health Plans (“AHPs”), which expanded the opportunity for small businesses, including self-employed workers, to band together by geography or industry to obtain healthcare coverage as if they were a single large employer. This final rule

was in response to President Trump’s executive order on October 12, 2017 to encourage the expansion of AHPs for small businesses and the self-employed.

On March 28, 2019, the U.S. District Court for the District of Columbia invalidated a majority of the provisions of the final AHP rule. In particular, the Court took issue with the provision that allows AHPs to be formed solely on the basis of geography or for the purpose of selling insurance. The DOL has announced that it will appeal the Court’s decision, and in the meantime has released guidance to AHPs that were already established before the Court’s decision, requiring such AHPs to continue providing coverage and paying claims. However, for AHPs that have not yet been established, the appeal of the Court’s ruling has effectively put the development of any new AHPs on hold.

II. *Reduced Fines for HIPAA Privacy and Security Violations*

In the wake of record-setting fines for violations of the privacy and security rules under the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”), the Department of Health and Human Services is reducing the maximum fines for certain HIPAA privacy and security violations, effective immediately.

<i>Type of HIPAA Breach of Privacy or Security Rule</i>	<i>Prior Maximum Penalty</i>	<i>New Maximum Penalty</i>
Violation due to willful neglect and not corrected	\$50,000 per violation up to \$1.5 million total per year	\$50,000 per violation up to \$1.5 million total per year (unchanged)
Violation due to willful neglect but violation is corrected	\$10,000 to \$50,000 per violation up to \$1.5 million total per year	\$10,000 to \$50,000 per violation up to \$250,000 per year
Violation due to reasonable cause	\$1,000 to \$50,000 per violation up to \$1.5 million total per year	\$1,000 to \$5,000 per violation up to \$100,000 per year
Did not know of violation and by exercising reasonable diligence would not have known	\$100 to \$50,000 per violation up to \$1.5 million total per year	\$100 to \$50,000 per violation up to \$25,000 per year

The maximum penalty per violation still will vary depending on the entity’s culpability and appropriate correction of the violation. Despite the reduction in fines, entities subject to HIPAA, such as employer-sponsored group health plans, should remain diligent about maintaining appropriate HIPAA safeguards to ensure the privacy and security of protected health information, and taking prompt action if a breach or other violation occurs.

III. *IRS Updates Determination Letter Program*

In 2017, the Internal Revenue Service (the “IRS”) limited its determination letter program for individually-designed tax-qualified retirement plans to newly-established or terminated plans. The IRS recently released new rules expanding the eligibility to apply for a determination letter to include statutory hybrid plans and merged plans.

- **Statutory hybrid plans.** Statutory hybrid plans, such as pension equity plans and cash balance plans, can submit applications to the IRS requesting a favorable determination on their tax-qualified status beginning September 1, 2019 until August 31, 2020.

- **Merged plans.** The IRS will also accept determination letter applications for plans that are merged into a single, individually-designed plan as a result of a merger or acquisition, beginning September 1, 2019. The merged plan must submit the determination letter application to the IRS during a period beginning on the date of the plan merger and ending on the last day of the first plan year of the merged plan.

Plan sponsors of statutory hybrid plans and merged plans that take advantage of the expanded eligibility and receive a favorable determination letter can rely on the letter as evidence of documentary compliance with the Internal Revenue Code (the “IRC”) tax-qualification requirements.

IV. *IRS Revises Correction Procedures available under EPCRS*

Effective April 19, 2019, the IRS issued new rules under the Employee Plans Compliance Resolution System (the “EPCRS”) that greatly expand the types of disqualifying defects that may be corrected under the self-correction program (the “SCP”). This means that more failures can be corrected without submitting an application and filing fee to the IRS through the Voluntary Correction Program (the “VCP”). The two most significant changes to EPCRS are the opportunity to self-correct many plan loan failures and the opportunity to self-correct other types of plan operational or documentary failures through the adoption of a retroactive amendment to a plan document.

- **Correction of Loan Failures**

Prior to this most recent revision of EPCRS, the only way to correct a participant’s defaulted plan loan, without tax consequences, would be to report the failure as a deemed taxable distribution to the participant and then file a VCP and pay a user fee. Under the new EPCRS guidelines, a plan sponsor may self-correct a loan default (*i.e.*, the failure to repay a plan loan according to plan terms) by (i) a single-sum corrective payment equal to the amount that the affected participant would have paid to the plan if there was no failure, plus interest accrued on the missed payments; (ii) reamortizing the outstanding balance of the loan, including accrued interest, over the remaining payment schedule of the original term; or (iii) any combination of (i) and (ii). The participant is responsible for paying the corrective payment and the employer is responsible for accrued interest, which should be determined at a rate equal to the greater of the plan loan interest rate or the rate of return under the plan.

Plan sponsors should be aware that a loan failure could be viewed by the DOL as a breach of fiduciary duty (a prohibited transaction) due to the failure to comply with the 401(k) plan provisions describing how the loan will be repaid, and could result in excise taxes. Technically, the way to correct the fiduciary violation would be to submit a filing under the DOL’s Voluntary Fiduciary Correction Program (the “VFCP”), which first requires a VCP compliance statement from the IRS. If a plan sponsor takes advantage of the IRS’s new guidance allowing self-correction of a loan failure, then the plan sponsor will not receive a VCP compliance statement and therefore would not be eligible to submit a VFCP filing to the DOL. Consequently, we recommend that each plan sponsor addressing plan loan failures evaluate its particular circumstances to determine an appropriate correction method.

The new guidance also permits self-correction for certain cases involving the failure of certain plan loans to obtain spousal consent. In cases where spousal consent is required to obtain a loan but is not obtained, it will now be possible to self-correct this defect by simply notifying the spouse and

obtaining consent retroactively. If the spouse will not consent after the fact, the failure will need to be corrected through filing a VCP submission online.

Further, if the number of plan loans exceeds the number permitted by the terms of the plan, a retroactive amendment may now be adopted to self-correct this error. In order to use this correction method, though, the plan amendment cannot violate the qualification requirements of IRC section 401(a) or the requirements of IRC section 72(p), and the plan loans had to have been available to either all participants, or solely to one or more participants who were classified as “non-highly compensated employees.”

- **Amendments to Cure Operational Failures**

Prior to the new guidance, in most instances, an operational failure corrected by a plan amendment had to be corrected through a VCP filing.

Now, operational failures may be self-corrected by a plan amendment which updates the written terms of the plan document to conform to the plan’s operation if (1) the plan amendment would result in an increase of a benefit, right or feature; (2) the increase in the benefit, right, or feature is available to all employees; and (3) providing the increase in the benefit, right or feature is permitted under the IRC and satisfies general self-correction principles. Because of these requirements, the IRS has indicated, in informal remarks, that they anticipate that the adoption of retroactive plan amendments to correct operational failures will be used sparingly.

- **Amendments to Cure Plan Document Failures**

In the past, failure to timely amend a plan document for changes in the law or regulations could only be corrected by a VCP filing. Under the new procedure, a plan sponsor can now self-correct by retroactively adopting required amendments. However, this can only be done if the plan has a favorable determination letter or, for a pre-approved plan, a favorable option or advisory letter for the most recent expired six-year remedial amendment cycle. In addition, the corrective amendment must be adopted no later than the close of the second plan year following the plan year in which the amendment should have been adopted.

V. Filing VCPs Electronically

Effective April 1, 2019, all VCP submissions are to be made electronically via www.pay.gov. Form 8950 was updated in January 2019 to reflect the new electronic filing procedures. Below is a brief outline on how to file a VCP online:

- Create an account at www.pay.gov
- Complete Form 8950 using the website
- Convert all documents related to the VCP submission (*e.g.* description of failures, Form 14568, applicable schedules, etc.) into a single PDF file and upload to www.pay.gov
 - The size of the PDF cannot exceed 15MB. Files that cannot be included in the PDF due to file size limitation may be faxed directly to the IRS at (855) 203-6996.
- Pay all applicable user fees via the website



If you would like to discuss any of the above topics, please feel free to contact any member of our Employee Benefits group below.



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