Snell & Wilmer L.L.P.

EMPLOYEE BENEFITS UPDATE

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November 2008

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2008 End of Year Plan Sponsor "To Do" Lists

Attached are seven "to do" lists that may require you to take action before the end of 2008 or in early 2009. Many of the action items are a result of the Pension Protection Act of 2006 (the "PPA").

For your convenience we have broken the "to do" lists into the following seven categories:

- All Qualified Plans
- Section 401(k) Plans
- Defined Contribution Plans (other than Section 401(k) Plans)
- Defined Benefit Plans
- Section 403(b) and Section 457(b) Plans
- Health and Welfare Plans
- Executive Compensation

The All Qualified Plans list applies to all qualified plans in addition to the specific list for each type of plan. For example, if you sponsor a Section 401(k) plan, you will want to review both the All Qualified Plans list and the Section 401(k) Plans list for that plan.

Following the lists are articles that describe some of the action items in more detail.

If you have any questions or need help with any of the action items, please contact any member of our Employee Benefits Group.

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All Qualified Plans "To Do" List

- [ ] **Adopt Design Changes by End of Plan Year:** If you made any design changes to the plan during the year, you generally must amend your plan to reflect those design changes by the last day of the 2008 plan year (i.e., December 31, 2008 for calendar year plans).

- [ ] **Adopt EGTRRA Restatement if in Cycle C:** If your qualified plan is individually designed and falls in Cycle C (i.e., the employer identification number associated with the plan ends in 3 or 8, or you have made a Cycle C election) you must restate the plan on or before December 31, 2008 and submit the plan for an EGTRRA determination letter on or before January 31, 2009. We previously sent detailed information about EGTRRA restatements to those clients who have asked us to be responsible for keeping their plans updated.

- [ ] **Review 2009 Plan Limits:** Familiarize yourself with the 2009 plan limits and make system changes as needed. See "*Retirement Plan Limits for 2009*" on page 15 for more information.

- [ ] **Adopt Amendments Complying with the Final Section 415 Regulations:** As reported in our *2007 End of Year Plan Sponsor "To Do" Lists*, the final regulations under Section 415 of the Internal Revenue Code (the "Code"), which were issued in 2007, made a number of technical changes to the Section 415 limits. The changes are effective for limitation years beginning on or after July 1, 2007 (i.e., January 1, 2008 for calendar year limitation years). For plans that have a calendar year limitation year/plan year/tax year, the mandatory Section 415 changes must be adopted by the due date for filing the employer's 2008 tax return, which would be at some point in 2009. However, just recently the IRS indicated that the optional Section 415 provisions must be adopted by the end of the plan year that includes the effective date (i.e., December 31, 2008 for plans with a calendar year limitation year and plan year.) If we prepare your qualified plan documents, we will send you a Section 415 amendment before the appropriate deadline. If someone else prepares your plan documents, you should check with your document preparer to confirm that they will timely amend your plan for Section 415.

- [ ] **Adopt Pension Protection Act Amendments:** The Pension Protection Act of 2006 (the "PPA") made many changes that impact qualified plans. We have previously reported on those changes in our *2006* and *2007 End of Year Plan Sponsor "To Do" Lists.* Some of the PPA changes took effect as early as the date the PPA was enacted, August 17, 2006, while others had delayed effective dates. The PPA included a helpful provision that allows all PPA amendments, whether mandatory or optional, to be adopted by the last day of the 2009 plan year (i.e., December 31, 2009 for plans with calendar year plan years). Accordingly, all plan sponsors must adopt a conforming PPA amendment, reflecting how the plan has been administered on the various PPA changes, by the end of the 2009 plan year. If we prepare your qualified plan documents, we will send you a PPA amendment before the appropriate deadline. If someone else prepares your plan documents, you should check with your document preparer to confirm that they will timely amend your plan for the PPA.

- [ ] **Comply with HEART Act Changes:** The Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART Act") made changes that impact qualified plans. Some of the changes are mandatory (e.g., plans must provide additional death benefits, other than benefit accruals, when a participant dies during

All Qualified Plans "To Do" List (continued)

active military duty, and differential wage payments must be treated as compensation) and others are optional (e.g., plans may provide contributions or benefit accruals if a participant dies or becomes disabled during active military duty). Some of the changes took effect as early as January 1, 2007, while others are effective January 1, 2009. Plan sponsors should familiarize themselves with the changes, determine whether any benefits must be provided retroactively, and make adjustments to plan administration on a going-forward basis. Plan sponsors must adopt a conforming amendment by the end of the 2010 plan year. See *"Heroes Earnings Assistance and Relief Tax Act of 2008"* on pages 16 to 18 for more information.

- ❑ **Consider Amending Qualified Plans to Clarify Definition of Spouse:** As reported in our *September 2008 Employee Benefits Update*, with same-sex marriages now being performed in a number of states and Canada, it is only a matter of time before you will be asked whether you provide same-sex spouse benefits. Regardless of whether you do or do not want to provide same-sex spouse benefits, you should review the definition of "spouse" in your qualified plans. If you do not want to provide same-sex spouse benefits, you should amend your plans to adopt a Defense of Marriage Act ("DOMA") definition of spouse. If you do want to provide same-sex spouse benefits, plan amendments may also be needed. However, in some instances, DOMA prevents same-sex spouses from being treated the same as opposite-sex spouses. For example, a same-sex spouse cannot be treated as a spouse for certain purposes under the Code, including the required minimum distribution rules and the qualified joint and survivor annuity requirements.

- ❑ **Consider Whether the New Aggregation Rules for Tax Exempt Entities Apply:** In addition to the Code's controlled group rules and affiliated service group rules, organizations that are exempt from tax under Code Section 501(a) also have to determine if any other entities should be aggregated for plan testing purposes using new common control rules that apply to tax exempt entities effective for plan years after December 31, 2008. Plan amendments may also be necessary if a plan generally allows participation by members of the controlled group and affiliated service group, but wants to exclude members under the new tax exempt common control rules from participating in the plan. See *"New Aggregation Rules for Tax Exempt Entities"* on pages 18 and 19 for more information.

- ❑ **Update Notice to Participants of Consequences of Failing to Defer:** Section 411(a)(11) of the Code requires plan sponsors to provide participants with a notice of the right to defer distributions from a qualified plan. Effective for plan years beginning on or after December 31, 2006, the PPA also required plan sponsors to provide participants with a notice of consequences of failing to defer receipt of a qualified plan distribution. Plan sponsors must make a reasonable attempt at complying with the new requirements until the final regulations are issued. The IRS has issued proposed regulations that plan sponsors may follow to comply with these regulations. See *"IRS Issues Proposed Regulations on Notice to Participants of Consequences of Failing to Defer Receipt of Qualified Plan Distributions"* on pages 20 and 21 for more information.

- ❑ **Conflicted Plan Fiduciaries Should Review Investment Advice Programs:** The PPA provides that otherwise conflicted plan

All Qualified Plans "To Do" List (continued)

fiduciaries may provide investment advice pursuant to an "eligible investment advice arrangement." The PPA permits fiduciary advisers to provide investment advice based on "generally accepted investment theories" if the fees received by the fiduciary do not vary depending on the investment option selected. Alternatively, the PPA permits fiduciary advisers to provide investment advice pursuant to an unbiased computer model. See *"Department of Labor Issues Proposed Regulations and Class Exemptions Relating to Investment Advice"* on pages 21 and 22 for more information.

- ❑ **Begin Identifying Service Provider Contracts To Which New Fee Disclosure Rules Apply:** ERISA provides relief from the prohibited transaction rules for contracts or arrangements for the provision of services between an ERISA plan and a party in interest. In order to be eligible for this relief, the contract or arrangement must be reasonable, the services must be necessary for the establishment or operation of the plan, and the plan cannot pay more than reasonable compensation for the services. The Department of Labor ("DOL") issued proposed regulations that govern the service provider fee disclosures that must be included in the service provider contract in order for the contract to be considered "reasonable" under ERISA. The proposed regulations do not become effective until 90 days after the publication of the final regulations. We expect the DOL to issue final regulations before the end of 2008, which means these new rules will likely take effect during the first quarter of 2009. In the meantime, plan sponsors should consider starting to identify service provider contracts to which the new rules apply. We will send more information regarding the new disclosure rules in a subsequent *Employee Benefits Update*.

- ❑ **Comply with New Rules Requiring Disclosure of Plan and Investment-Related Information for Participant Directed Individual Account Plans:** The DOL issued proposed regulations under ERISA Section 404(a) and proposed changes to the regulations under ERISA Section 404(c) regarding a plan fiduciary's duty to disclose information, including fee and expense information. These regulations apply only to participants in participant directed individual account plans. The proposed rules require disclosure of certain "plan-related" and "investment-related" information to participants on a regular and periodic basis. The DOL published a model comparative chart that serves as a safe harbor for satisfying the "investment-related" disclosure requirements. The proposed regulations are effective for plan years beginning on or after January 1, 2009. Plan sponsors should consider checking with their third party administrator ("TPA") to confirm that the TPA will assist them in complying with these new rules. We will send more information regarding the new disclosure rules in a subsequent *Employee Benefits Update*.

Section 401(k) Plans "To Do" List

- **Comply with Items on All Qualified Plans List:** The items on the All Qualified Plans list also apply to Section 401(k) plans.

- **Provide Section 401(k)/401(m) Safe Harbor Notice by December 2, 2008 for Calendar Year Plans:** As a reminder, if your plan has a Section 401(k)/401(m) contribution safe harbor, you must provide the safe harbor notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2008 for calendar year plans).

- **Provide Annual Automatic Enrollment Notice by December 2, 2008 for Calendar Year Plans:** As a reminder, for those of you who have adopted an automatic contribution arrangement, an eligible automatic contribution arrangement ("EACA"), or a qualified automatic contribution arrangement ("QACA"), or any combination thereof, you must give an annual automatic enrollment notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2008 for calendar year plans).

- **Provide Annual Qualified Default Investment Alternative Notice by December 2, 2008 for Calendar Year Plans:** In our 2007 *End of Year Plan Sponsor "To Do" Lists* we reported on the new default investment safe harbor, which is known as a qualified default investment alternative ("QDIA"). As a reminder, for those of you who are relying on the QDIA safe harbor, you must give an annual notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2008 for calendar year plans).

- **If Adding Qualified Automatic Contribution Arrangement or Eligible Automatic Contribution Arrangement for 2009, Adopt Amendment Before the 2009 Plan Year:** As reported in our *2007 End of Year Plan Sponsor "To Do" Lists*, plans may add QACAs and EACAs to plans for plan years beginning on or after January 1, 2008. Currently, neither a QACA nor an EACA may be adopted mid-year. Accordingly, if you wish to add a QACA or an EACA to your plan for the 2009 plan year, you must adopt an amendment by December 31, 2008 for calendar year plans.

- **Adopt Amendment Conforming Section 401(k) Definition of Compensation:** As reported in our *2007 End of Year Plan Sponsor "To Do" Lists*, effective for plan years beginning on or after July 1, 2007 (i.e., January 1, 2008 for calendar year plans), Section 401(k) elective deferrals may only be made with respect to compensation that qualifies as compensation under Code Section 415(c)(3). Due to changes to the Section 415 regulations, the types of compensation from which Section 401(k) elective deferrals may be made has changed. You should consider reviewing plan terms and administration to determine whether any post-termination compensation was impermissibly included in your Section 401(k) definition of compensation and, at the same time, consider whether you wanted to revise your definition to allow deferrals on some or all of the post-termination compensation on which Section 401(k) elective deferrals are now permitted (such as regular or overtime pay that is paid within a specified timeframe after termination). If you made any changes to your Section 401(k) definition of compensation, you must adopt a conforming amendment by the end of the plan year in which the change is effective (i.e., December 31, 2008 for calendar year plans). If we prepare your qualified plan documents, please let us know as soon as possible if you made any changes to your Section 401(k) definition of compensation so we may prepare

Section 401(k) Plans "To Do" List (continued)

an amendment. If someone else prepares your plan documents, you should check with your document preparer to confirm that they will timely amend your plan for any changes you have made to your Section 401(k) definition of compensation.

- ☐ **Comply with Additional HEART Act Changes:** In addition to the Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART Act") changes listed on the *All Qualified Plans "To Do" List*, Section 401(k) plans must allow for distributions of elective deferrals to participants who are on active military duty in certain circumstances. In addition, the HEART Act made permanent the exception from the 10% early withdrawal penalty for qualified reservist distributions that had expired December 31, 2007. While plan sponsors must generally adopt a conforming amendment by the end of the 2010 plan year, if a plan sponsor wants to retroactively add a qualified reservist distribution, the plan must be amended to make this change by the end of the 2009 plan year. See *"Heroes Earnings Assistance and Relief Tax Act of 2008"* on pages 16 to 18 for more information.

Defined Contribution Plans (Other Than Section 401(k) Plans) "To Do" List

- ❑ **Comply with Items on All Qualified Plans List:** The items on the All Qualified Plans list also apply to defined contribution plans.

- ❑ **Provide Annual Qualified Default Investment Alternative Notice by December 2, 2008 for Calendar Year Plans:** In our 2007 *End of Year Plan Sponsor "To Do" Lists* we reported on the new default investment safe harbor, which is known as a qualified default investment alternative ("QDIA"). As a reminder, for those of you who are relying on the QDIA safe harbor, you must give an annual notice at least 30 days, but not more than 90 days, before the beginning of each plan year (i.e., December 2, 2008 for calendar year plans).

Defined Benefit Plans "To Do" List

- ❑ **Comply with Items on All Qualified Plans List:** The items on the All Qualified Plans list also apply to defined benefit plans.

- ❑ **Comply with Annual Funding Notice to Participants:** The Pension Protection Act of 2006 (the "PPA") requires single employer defined benefit plan sponsors to provide participants with an annual notice of the plan's funding status. The plan administrator is required to send a notice each year to participants, beneficiaries, labor organizations representing participants, and the Pension Benefit Guaranty Corporation (the "PBGC"). The notice must include detailed information on the plan's funding, including but not limited to, the plan's funding target attainment percentage for the current year and the two preceding years, and a statement of the plan's funding policy and asset allocation. The notice must be provided within 120 days of the end of the plan year to which the notice relates, although plans with fewer than 100 participants do not have to provide the notice until the Form 5500 annual report is due for the plan year. This notice requirement is effective for plan years beginning after December 31, 2007.

- ❑ **Comply with Participant Notice Requirement if Adjusted Funding Target Attainment Percentage is less than 80%:** In addition to the annual funding notice described above, Section 101(j) of ERISA requires a plan administrator to provide a notice to participants if the plan is subject to a restriction on payment of benefits. Certain exceptions exist if, under the terms of the plan, no participant accrued additional benefits under the plan on or after September 1, 2005. This notice requirement is effective for plan years beginning after December 31, 2007. You should check with your plan actuary regarding the funding levels of your plan. If your plan falls below these funding levels, please contact us for assistance in preparing the participant notice.

- ❑ **Comply with PBGC Notice Requirement if Funding Target Attainment Percentage is less than 80%:** The PPA requires plan sponsors of defined benefit plans to notify the PBGC if the plan has a funding target attainment percentage of less than 80%. The PPA also requires additional funding information as part of the notice. The PBGC notice requirements are effective for years beginning after December 31, 2007. You should check with your plan actuary regarding the implementation and impact of these new rules.

- ❑ **Provide Pension Benefit Statement:** In our *May 2007 Employee Benefits Update* we reported that the PPA now requires defined benefit plans to automatically provide benefit statements to participants and increases the amount of information that benefit statements must include. Defined benefit plans are generally required to provide benefit statements at least once every three years. As a reminder, the first benefit statement is due for the 2009 plan year (i.e., must be furnished within 45 days of the end of the 2009 plan year) unless you previously elected to take advantage of the alternative notice requirement.

Section 403(b) and Section 457(b) Plans "To Do" List

- ❑ **Adopt a Written Section 403(b) Plan by December 31, 2008:** Under the new Section 403(b) final regulations, for the very first time, Section 403(b) programs are required to be maintained pursuant to a written plan, which both in form and operation, satisfies the Section 403(b) requirements and contains all the terms and conditions for eligibility, limitations, and benefits under the plan. Plan sponsors of Section 403(b) programs must adopt a formal plan by December 31, 2008, subject to certain transition rules that apply to collectively bargained plans and church plans. Plan sponsors will also have to enter into appropriate service agreements and information sharing agreements with vendors who issue annuity contracts and custodial accounts under the plan.

- ❑ **Comply with Additional HEART Act Changes:** In addition to the Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART Act") changes listed on the *All Qualified Plans "To Do" List,* Section 403(b) and Section 457(b) plans must allow for distributions of elective deferrals to participants who are on active military duty in certain circumstances. In addition, the HEART Act made permanent the exception from the 10% early withdrawal penalty for qualified reservist distributions under a Section 403(b) plan that had expired December 31, 2007. While plan sponsors must generally adopt a conforming amendment by the end of the 2010 plan year, if a Section 403(b) plan sponsor wants to retroactively add a qualified reservist distribution, the plan must be amended to make this change by the end of the 2009 plan year. See *"Heroes Earnings Assistance and Relief Tax Act of 2008"* on pages 16 to 18 for more information.

- ❑ **Consider Whether the New Aggregation Rules for Tax Exempt Entities Apply:** In addition to the Internal Revenue Code's controlled group rules and affiliated service group rules, organizations that are exempt from tax under Section 501(a) also have to determine if any other entities should be aggregated for plan testing purposes using new common control rules that apply to tax exempt entities effective for plan years after December 31, 2008. Plan amendments may also be necessary if a plan generally allows participation by members of the controlled group and affiliated service group, but wants to exclude members under the new tax exempt common control rules from participating in the plan. See *"New Aggregation Rules for Tax Exempt Entities"* on pages 18 and 19 for more information.

- ❑ **Begin Identifying Service Provider Contracts To Which New Fee Disclosure Rules Apply:** ERISA provides relief from the prohibited transaction rules for contracts or arrangements for the provision of services between an ERISA plan and a party in interest. In order to be eligible for this relief, the contract or arrangement must be reasonable, the services must be necessary for the establishment or operation of the plan, and the plan cannot pay more than reasonable compensation for the services. The Department of Labor ("DOL") issued proposed regulations that govern the service provider fee disclosures that must be included in the service provider contract in order for the contract to be considered "reasonable" under ERISA. The proposed regulations do not become effective until 90 days after the publication of the final regulations. We expect the DOL to issue final regulations before the end of the year, which means these new rules will likely take effect during the first quarter of 2009. In the meantime, plan sponsors should consider starting to identify service provider contracts to which the new rules apply. We will send more information regarding the new disclosure rules in a subsequent *Employee Benefits Update*.

Health and Welfare Plans "To Do" List

- [ ] **Amend Health Plans to Comply with New Mental Health Parity Rules:** The Emergency Economic Stabilization Act ("EESA") prohibits employer group health plans from adopting limitations on mental health treatment, financial requirements, or out-of-network limits unless comparable limits apply to medical and surgical benefits. This new rule provides truer mental health parity than the current mental health parity rules. The new mental health parity rules are effective for plan years beginning more than one year after October 3, 2008 (i.e., January 1, 2010 for calendar year plans). EESA also repeals the sunset provision in the current mental health parity provisions effective January 1, 2009, which means that the current mental health parity rules will continue in effect until the new mental health parity rules become effective. The new mental health parity rules do not apply to employers with fewer than 50 employees. Amendments to comply with the new mental health parity rules should be adopted before the rules take effect (i.e., December 31, 2009 for calendar year plans).

- [ ] **Amend Health Plans to Comply with Michelle's Law:** The newly-enacted "Michelle's Law" requires group health plans to continue coverage for dependent college students who take medically necessary medical leave for up to one year or if earlier, the date on which coverage would otherwise end under the plan. Any notice regarding a requirement for certification of student status must include a description of the requirements for continued coverage during a medically necessary leave. A $100 per day excise tax may be assessed for failure to comply. Michelle's Law is effective for plan years beginning more than one year on or after October 9, 2008 (i.e., January 1, 2010 for calendar year plans) and to medically necessary leaves beginning during such plan years. Amendments to comply with Michelle's law should be adopted before the rules take effect (i.e., December 31, 2009 for calendar year plans).

- [ ] **Amend Health Plans to Comply with GINA:** As reported in our *September 2008 Legal Alert*, the Genetic Information Nondiscrimination Act of 2008 ("GINA") prohibits genetic discrimination in two general areas: (1) employment; and (2) health insurance. Title I of GINA prohibits group health plans and health insurance issuers from discriminating on the basis of genetic information with respect to eligibility, premiums, and contributions and applies to group health plans for plan years beginning after May 21, 2009 (i.e., January 1, 2010 for calendar year plans). Title II prohibits employers from discriminating on the basis of genetic information in employment decisions and acquiring genetic information except in limited circumstances (which will impact wellness programs) and is effective on November 21, 2009. Genetic information is broadly defined to include information about the genetic tests of an employee and the employee's family members, as well as the employee's family medical history. Family members is also broadly defined to include dependents (or eligible dependents) under the employer's group health plan and fourth degree relatives of the employee or the employee's dependents. Employers will have to examine their group health plans, wellness programs, and employment practices and make the necessary changes to comply with GINA. Group health plan amendments to comply with GINA should be adopted before the rules take effect (i.e., December 31, 2009 for calendar year plans).

Health and Welfare Plans "To Do" List (continued)

- ❑ **Consider Amending Plans to Clarify Definition of Spouse:** As reported in our *September 2008 Employee Benefits Update*, with same-sex marriages now being performed in a number of states and Canada, it is only a matter of time before you will be asked whether you provide same-sex spouse benefits. Regardless of whether you do or do not want to provide same-sex spouse benefits, you should review the definition of "spouse" in your qualified plans. Employers also should review their insurance policies to determine whether they have any hidden same-sex spouse benefits and/or domestic partner benefits and notify participants regarding such benefits. If you do not want to provide same-sex spouse benefits, you should amend your plans to adopt a Defense of Marriage Act ("DOMA") definition of spouse. If you do want to provide same-sex spouse benefits, plan amendments may also be needed. However, in some instances, DOMA prevents same-sex spouses from being treated the same as opposite-sex spouses. For example, a same-sex spouse cannot be treated as a spouse for certain purposes under the Internal Revenue Code (the "Code"), such as the change in status rules under a cafeteria plan.

- ❑ **Update Your Medicare Part D Creditable Coverage Notice**: As previously reported in our *September 2005 Employee Benefits Update*, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 requires group health plans that provide prescription drug coverage to notify Medicare Part D eligible individuals whether their prescription drug coverage is at least actuarially equivalent to Medicare Part D coverage. As explained in our earlier newsletter, Medicare Part D creditable coverage notices must be provided at various times to participants and Centers for Medicare and Medicaid Services ("CMS"). CMS posted revised model notices on its website that may be used after June 15, 2008. Although most of the changes are cosmetic, plan sponsors should consider updating their Medicare Part D creditable coverage notices to reflect the changes recently made by CMS.

- ❑ **Comply With Medicare Secondary Payer Mandatory Reporting Requirements:** The Medicare, Medicaid, and SCHIP Extension Act of 2007 ("MMSEA") adds new mandatory reporting requirements for group health plans and for liability insurance (including self-insurance), no-fault insurance, and workers' compensation. Under the MMSEA, a group health plan's insurer or third party administrator, or if a plan is self-funded and self-administered, the plan administrator or another plan fiduciary, must: (1) obtain from the plan sponsor and participants such information as the Secretary may specify to identify situations where the group health plan is a primary plan to Medicare; and (2) report such information to the Secretary in the form and the manner, including frequency, specified by the Secretary. On August 1, 2008, CMS published a Supporting Statement that outlines the data elements that must be reported to CMS. The data elements must be electronically reported to CMS quarterly. The effective date for group health plans is January 1, 2009. Instructions are published at http://www.cms.hhs.gov/MandatoryInsRep/. The penalty for failing to report the required data elements is $1,000 per day of noncompliance for each individual for which information should have been submitted. Plan sponsors should check with their insurers and third party administrators to confirm that they will comply with these new requirements.

Health and Welfare Plans "To Do" List (continued)

- ❑ **Consider Whether to Allow Qualified Reservist Distributions from Health Flexible Spending Accounts:** The Heroes Earnings Assistance and Relief Tax Act of 2008 amends Code Section 125 to allow employers to provide qualified reservist distributions from health FSAs to employees who are called to military duty for 180 or more days or indefinitely. See *"Heroes Earnings Assistance and Relief Tax of 2008"* on pages 16 to 18 for more information.

- ❑ **Amend Cafeteria Plans to Comply with Section 125 Regulations:** The IRS issued proposed Section 125 regulations in 2007. The proposed regulations were supposed to apply to plan years beginning on or after January 1, 2009, which would have required calendar year plans to be amended by December 31, 2008 to comply with the new rules. The IRS is still working on the final regulations and has indicated they will be issued before the end of the year. The IRS has informally indicated that because of the delay in issuing the final regulations, the regulations will instead apply to plan years beginning on or after January 1, 2010. This means calendar year plans will have to be amended by December 31, 2009 to comply with the final regulations. If we have previously prepared a cafeteria plan for you and you would like us for us to update it to comply with the final regulations, please let us know as soon as possible. If someone else prepared your cafeteria plan, you should check with that document preparer to confirm that they will timely amend your cafeteria plan when the final regulations are issued.

- ❑ **Consider Whether the New Aggregation Rules for Tax Exempt Entities Apply:** In addition to the Code's controlled group rules and affiliated service group rules, organizations that are exempt from tax under Code Section 501(a) also have to determine if any other entities should be aggregated for plan testing purposes using new common control rules that apply to tax exempt entities effective for plan years after December 31, 2008. Plan amendments may also be necessary if a plan generally allows participation by members of the controlled group and affiliated service group, but wants to exclude members under the new tax exempt common control rules from participating in the plan. See *"New Aggregation Rules for Tax Exempt Entities"* on pages 18 and 19 for more information.

- ❑ **Begin Identifying Service Provider Contracts To Which New Fee Disclosure Rules Apply:** ERISA provides relief from the prohibited transaction rules for contracts or arrangements for the provision of services between an ERISA plan and a party in interest. In order to be eligible for this relief, the contract or arrangement must be reasonable, the services must be necessary for the establishment or operation of the plan, and the plan cannot pay more than reasonable compensation for the services. The Department of Labor ("DOL") issued proposed regulations that govern the service provider fee disclosures that must be included in the service provider contract in order for the contract to be considered "reasonable" under ERISA. The proposed regulations do not become effective until 90 days after the publication of the final regulations. We expect the DOL to issue final regulations before the end of the year, which means these new rules will likely take effect during the first quarter of 2009. In the meantime, plan sponsors should consider starting to identify service provider contracts to which the new rules apply. We will send more information regarding the new disclosure rules in a subsequent *Employee Benefits Update*.

Executive Compensation "To Do" List

- **Nonqualified Deferred Compensation Plans Must be Amended by December 31, 2008 to Comply with Section 409A:** The transition rule for amending plans to comply with the new Section 409A deferred compensation rules ends December 31, 2008. Beginning January 1, 2009, all plans or arrangements subject to Section 409A must be in writing and must at least: (1) address the time and form of payment and when the payment will be made in accordance with the six permissible payment events; (2) require written elections be made in accordance with the Section 409A regulations; and (3) for public companies, the plan or arrangement must provide for a six-month delay for payment on account of a separation from service.

- **Identify Plans or Arrangements Subject to Section 409A:** To comply with the new Section 409A deferred compensation rules, an employer must identify all plans or arrangements subject to these new rules. Any plan that provides a service provider with a currently enforceable right to receive compensation in the future is potentially subject to Section 409A. Examples of plans or arrangements subject to Section 409A include traditional deferred compensation plans, employment agreements with severance provisions, change in control agreements, multi-year bonus plans or arrangements, stock plans offering restricted stock units or performance units, and stock options or stock appreciation rights with deferral features (including below market grants).

- **Changes to Certain Elections under Section 409A Plans Must be Made by December 31, 2008:** As a part of the Section 409A transition relief, the employee, the employer, or both may elect to change the form and timing of distributions under a Section 409A plan if the election is made on or before December 31, 2008. However, an election made in 2008 may apply only to amounts that would not otherwise be payable in 2008 and may not cause an amount to be paid in 2008 that would not otherwise be payable in 2008. This later requirement is informally known as the "in and out rule" whereby the election cannot pull amounts into 2008 that would not have otherwise been paid in 2008 or push amounts out of 2008 that would have otherwise been paid in 2008.

- **Consider Adopting Universal Section 409A Resolution:** Because the types of plans or arrangements subject to the Section 409A rules are very broad and far reaching, an employer may have difficulty identifying all plans or arrangements subject to Section 409A. In case an employer does not properly identify all plans or arrangements subject to Section 409A, an employer may consider adopting a "universal Section 409A resolution." Such a resolution could provide that all plans or arrangements subject to Section 409A are deemed to be amended to comply in both form and operation with Section 409A. It is not entirely clear whether the IRS believes such a resolution could save an otherwise noncompliant document, but in the absence of such a resolution, the plan or arrangement surely fails to comply with Section 409A.

- **Public Companies Must Review Severance, Change in Control or Other Section 162(m) Performance-Based Arrangements for New Rules before December 31, 2008:** Section 162(m) limits the annual deduction to $1,000,000 paid to a public company's CEO and certain other executives. However, this limitation does not apply to "performance-

Executive Compensation "To Do" List (continued)

based compensation." Compensation does not fail to be performance-based if it allows payment on death, disability, or change in control (even if the performance goals are not met). The IRS previously also excepted from the general rule awards paid upon an executive's termination of employment without cause or for good reason. However, in 2008 the IRS changed its position and held that a compensation arrangement is not performance-based if it pays out at target levels upon a termination of employment without cause or for good reason. This is the result even if a termination of employment does not occur and the performance goals are attained. As a result, no payments under the arrangement are considered performance-based even if they are paid after the specified performance goals are met. The IRS' new position is however applied prospectively only and does not apply to: (1) performance periods beginning before January 1, 2009; or (2) employment contracts in effect on February 21, 2008 (not including renewals).

- ❑ **Consider Shareholder Reapproval of Section 162(m) Performance Compensation Plans Approved in 2004:** The Section 162(m) regulations require that shareholders reapprove the performance goals with respect to which performance-based compensation is paid every five years (other than stock options and SARs). This means that companies that obtained shareholder approval of plans containing Section 162(m) performance goals in 2004 must resubmit the plans for shareholder approval in 2009. This is generally done by having the shareholders reapprove an updated plan.

- ❑ **Code Section 6039 Information Statements Due by January 31, 2009:** Section 6039 requires a corporation to file a return and provide a written information statement to each employee or former employee regarding: (1) the transfer of stock pursuant to the exercise of an Incentive Stock Option ("ISO"), and (2) the transfer by the employee or former employee of stock purchased under an Employee Stock Purchase Plan ("ESPP"). Section 6039 applies to stock purchased under an ESPP if the option to purchase the stock was subject to Section 423(c) of the Internal Revenue Code (the "Code"). Section 423(c) of the Code imposes special rules for certain options granted under an ESPP with exercise prices at grant between 85% and 100% of the fair market value of the stock subject to the option. For ISO grants and ESPP transfers occurring in 2008, the Section 6039 information statements must be provided no later than January 31, 2009. The Section 6039 return requirement does not apply to 2008 transactions, but will apply to 2009 transactions.

- ❑ **Review Stock Option Grant Procedures for Upcoming Grants:** The stock option backdating scandals raised serious corporate, tax, accounting, and legal issues that can be resolved by an employer carefully reviewing its stock option grant practices and procedures. An employer should carefully review its stock option plan to determine which entity is charged with making grants under the plan and put in place practices and procedures to ensure that entity takes the appropriate action on the date the options are considered granted.

Retirement Plan Limits for 2009

The IRS announced the cost-of-living adjustments to various retirement plan limits for 2009. The key 2009 dollar limits (compared to the 2008 dollar limits) are noted below.

The Social Security Administration separately announced the taxable wage base for 2009, which is noted at the end of the chart.

Maximum Qualified Retirement Plan Dollar Limits		
	2008	2009
Limit on Section 401(k) deferrals (Section 402(g))	$15,500	$16,500
Dollar limitation for catch-up contributions (Section 414(v)(2)(B)(i))	$5,000	$5,500
Limit on deferrals for government and tax-exempt organization deferred compensation plans (Section 457(e)(15))	$15,500	$16,500
Annual benefit limitation for a defined benefit plan (Section 415(b)(1)(A))	$185,000	$195,000
Limitation on annual contributions to a defined contribution plan (Section 415(c)(1)(A))	$46,000	$49,000
Limitation on compensation that may be considered by qualified retirement plans (Section 401(a)(17))	$230,000	$245,000
Dollar amount for the definition of highly compensated employee (Section 414(q)(1)(B))	$105,000	$110,000
Dollar amount for the definition of key employee in a top-heavy plan (Section 416(i)(1)(A)(i))	$150,000	$160,000
Dollar amount for determining the maximum account balance in an ESOP subject to a five-year distribution period (Section 409(o)(1)(C)(ii))	$935,000	$985,000
SIMPLE retirement account limitation (Section 408(p)(2)(E))	$10,500	$11,500
Social Security Taxable Wage Base	$102,000	$106,800

Heroes Earnings Assistance and Relief Tax Act of 2008

On June 17, 2008, President Bush signed the Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART Act"), a bill primarily designed to provide tax relief for our nation's military personnel and their families. A summary of the key benefits-related provisions and what actions plan sponsors must take to comply with the HEART Act follows.

Death Benefits

All qualified plans, Section 403(b) plans, and Section 457(b) plans **are required** to provide that, in the case of a participant who dies while performing qualified military service, the survivors of the participant are entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) that would be provided under the plan had the participant resumed employment and then terminated employment on account of death. For example, if a plan provides for accelerated vesting, ancillary life insurance benefits, or other survivor benefits that are contingent upon a participant's death, the plan must provide these benefits to the beneficiary of a participant who dies during qualified military service.

This mandatory change applies to deaths occurring on or after January 1, 2007, which means that plan sponsors must review their records to determine if any participants died while performing qualified military service and, if so, provide their survivors with any additional benefits due to them under the plan.

Qualified plans, Section 403(b) plans, and Section 457(b) plans must be amended no later than the last day of the plan year beginning on or after January 1, 2010 (or January 1, 2012 for governmental plans).

Benefit Accruals

Qualified plans, Section 403(b) plans, and Section 457(b) plans **may, but are not required to,** treat a participant who dies or becomes disabled while performing qualified military service as if the participant resumed employment the day before the death or disability and then terminated employment on the date of death or disability. The plan may provide for full or partial benefit accruals or contributions as long as all individuals performing qualified military service who die or become disabled prior to reemployment are credited with benefits on reasonably equivalent terms. If the contributions are normally contingent upon employee elective deferrals or after-tax contributions, the plan sponsor must calculate the contribution based on the actual average contributions or deferrals made by the employee during the 12-month period prior to military service (or, if less, the average for the actual period of service).

This optional change applies to deaths and disabilities occurring on or after January 1, 2007. Plan sponsors that decide to make this change must determine whether they want to make this change retroactively or prospectively. It is not clear whether plan sponsors that make this change will have to make up elective deferrals and after-tax contributions as well, so plan sponsors may want to wait for more guidance from the IRS before making a decision.

Plan sponsors that wish to make this change must amend their qualified plans, Section 403(b) plans, and/or Section 457(b) plans no later than the last day of the plan year beginning on or after January 1, 2010 (or January 1, 2012 for governmental plans).

Treatment of Differential Military Pay as Wages

Effective January 1, 2009, differential wage payments must be treated as wages and subject to Federal income tax withholding. A differential wage payment is any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is on active duty for a period of more

than 30 days; and (2) represents all or a portion of the wages that the individual would have received had the individual been performing services for the employer.

Employers should modify their payroll practices to ensure that differential wage payments paid on or after January 1, 2009 are treated as wages and that Federal income taxes are properly withheld.

Treatment of Differential Military Pay as Compensation for Plan Purposes

The HEART Act establishes the following new differential wage payment rules with respect to qualified retirement plans, Section 403(b) plans, and Section 457(b) plans:

- An individual receiving differential wage payments must be treated as an employee of the employer making the payment;
- Differential wage payments are required to be treated as compensation under these plans; and
- Contributions or benefits that are based on differential wage payments will satisfy certain nondiscrimination requirements as long as: (1) all employees are entitled to receive differential wage payments on reasonably equivalent terms; and (2) all employees eligible to participate in a retirement plan maintained by the employer are entitled to make contributions based on such differential payments on reasonably equivalent terms.

It is not clear whether the HEART Act requires that: (1) employees be allowed to make elective deferrals on their differential wage payments; and (2) plan sponsors include differential wage payments when calculating employer contributions or accruals. Several groups have requested clarification from the IRS on this issue, pointing out that mandating contributions and benefit accruals on these voluntary payments seems inconsistent and, in certain circumstances, would actually reduce benefits (e.g., in final average defined benefit plans).

This mandatory change is effective January 1, 2009.

Qualified plans, Section 403(b) plans, and Section 457(b) plans must be amended no later than the last day of the plan year beginning on or after January 1, 2010 (or January 1, 2012 for governmental plans).

Distributions of Elective Deferrals

A participant in a Section 401(k) plan, Section 403(b) plan, or Section 457(b) plan who is receiving differential wage payments will nonetheless be treated as severed from employment during any period the participant is on active duty for a period of more than 30 days and may take a distribution of his/her elective deferrals. If a participant takes a distribution from the plan, the participant is prohibited from making elective deferrals or employee contributions during the 6-month period beginning on the date of the distribution.

Presumably, participants who are not receiving differential wage payments, but who are on active duty for a period of more than 30 days, may also take a distribution, however, further guidance from the IRS on this issue is welcome. It is also unclear whether the participant must wait until the 31st day of active duty to take the distribution.

This mandatory change is effective January 1, 2009.

Qualified plans, Section 403(b) plans, and Section 457(b) plans must be amended no later than the last day of the first plan year beginning on or after January 1, 2010 (or January 1, 2012 for governmental plans).

PPA Section 401(k) and Section 403(b) Qualified Reservist Distributions

The Pension Protection Act of 2006 (the "PPA") amended Section 72(t) of the Internal Revenue Code to provide that the 10% early withdrawal penalty does not apply to a qualified reservist distribution ("QRD"). A QRD is a distribution of elective deferrals under a Section 401(k) plan or Section 403(b) plan that is made to a reservist called up for active duty between September

11, 2001 and December 31, 2007 for at least 179 days or for an indefinite period, provided that such distribution is made during the individual's period of active duty. Individuals may repay all or part of the distribution back into an IRA within two years after the period of active duty.

The HEART Act makes the rules applicable to QRDs permanent with respect to individuals ordered or called to active duty on or after December 31, 2007.

Section 401(k) and Section 403(b) plan sponsors are not required to provide for QRDs. Plan sponsors that have allowed these distributions must amend their plans to include these provisions no later than the last day of the 2009 plan year.

There is some overlap between the HEART Act elective deferral distributions and the PPA QRDs. Plan sponsors should familiarize themselves with the rules applicable to both to ensure that their plans are administered correctly.

Health FSA Qualified Reservist Distributions

The HEART Act amends Code Section 125 to allow employers to provide QRDs from health FSAs to employees who are called to duty for 180 or more days or indefinitely. A QRD for this purpose is a distribution of all or a portion of the balance in an employee's health FSA account that is made during the period of the call up or order and ends on the last day that reimbursements could otherwise be made under the health FSA for the plan year. The purpose of the change is to prevent reservists from forfeiting their health FSA balances when called to active duty. Such distributions are taxable and must be reported as wages on the employee's W-2 for the year in which the QRD is paid to the employee.

This is an optional change. Employers that want to permit QRDs may do so effective as early as June 17, 2008. IRS Notice 2008-82 includes a transition rule allowing plans to be retroactively amended for QRDs made before January 1, 2010. The retroactive amendment must be adopted by December 31, 2009.

New Aggregation Rules for Tax Exempt Entities

For certain plan testing purposes, the Internal Revenue Code (the "Code") treats two or more employers as a single employer if the employers are part of the same "controlled group" or "affiliated service group" by looking at common ownership or a combination of common ownership and joint activity.

In addition to the controlled group rules and affiliated service group rules, organizations that are exempt from tax under Section 501(a) also have to determine if any other entities should be aggregated using certain additional common control rules that will become effective for plan years after December 31, 2008.

It is important to note that these rules are in addition to the controlled group rules and affiliated service group rules. For example, if an exempt organization owns 80% or more of the total value of all classes of stock of a for-profit organization, the organizations are under common control as a parent-subsidiary group under the controlled group rules.

Required Aggregation

An exempt organization must be aggregated with any other organization if either of the following two circumstances apply:

- At least 80% of the directors or trustees of one organization are representatives of the other organization. A trustee or director is treated as a representative of another exempt organization if he or she also is a trustee, director, agent, or employee of the other exempt organization.

- At least 80% of the directors or trustees of one organization are directly or indirectly controlled by the other organization. A trustee or director is controlled by another organization if the other organization has the general power to remove such trustee or director and designate a new trustee or director. The determination of whether a person has the power to remove or designate a trustee or director is based on all the facts and circumstances.

Permissive Aggregation of Entities with Common Exempt Purpose

Two exempt organizations can choose to be part of the same common control group and jointly sponsor a single plan if the organizations regularly coordinate their day-to-day exempt activities.

> **Example:** If two exempt organizations have a history of regular coordination of day-to-day activities, but there is less than 80% overlap in board membership, the two organizations are not under common control but may chose to treat themselves as under common control assuming that both act in a manner that is consistent with such choice.

Anti-Abuse Rule

If the IRS determines that the structure of one or more exempt organizations or the positions taken by those organizations have the effect of evading certain employee benefit plan requirements, the IRS may treat an entity as under common control with the exempt organization. The Treasury regulations provide the following example:

> **Example:** If two closely related exempt organizations have several trustees in common and the common trustees constitute fewer than 80% of the trustees of either organization, but one of the organizations has the power to remove any of the trustees of the other organization and select the slate of replacement nominees, the IRS will treat the entities as under common control.

Plan sponsors should review the new tax-exempt common control rules to determine whether there are any other business entities that should be included for certain qualified retirement, health, and welfare plan testing purposes. Plan sponsors can choose whether to include or exclude other employers from participating in some or all of their plans, however, they will have to be included when running certain nondiscrimination tests under the Code. Plan sponsors should also review their plan documents to determine if any amendments are necessary, for example, if the plan generally allows participation by members of the controlled group or affiliated service group, but the plan sponsor wants to exclude members under the new tax exempt common control rules from participating in the plan.

IRS Issues Proposed Regulations on Notice to Participants of Consequences of Failing to Defer Receipt of Qualified Plan Distributions

Section 411(a)(11) of the Internal Revenue Code (the "Code") prohibits a plan from distributing a participant's vested benefit without consent if the benefit exceeds $5,000. The participant also must be informed of the right, if any, to defer the distribution. The Pension Protection Act of 2006 also requires participants to receive notice of the consequences of failing to defer a distribution from a qualified plan.

On October 8, 2008, the Internal Revenue Service issued proposed regulations on the requirements to notify participants of the consequences of failing to defer a distribution from a qualified plan. The proposed regulations provide guidance on the content of the notice to a participant describing the consequences of failing to defer. The proposed regulations require that the participant notice contain the following information:

- A description of the Federal tax implications of failing to defer including: (1) differences in the timing of inclusion in taxable income of a distribution that is not rolled over (or not eligible to be rolled over) and a distribution that is deferred until it is no longer immediately distributable (including, if applicable, differences in the taxation of distributions of designated Roth contributions); (2) the application of the 10% additional tax on certain distributions before age 59½ under Section 72(t) of the Code; and (3) in the case of a defined contribution plan, loss of the opportunity upon immediate commencement for future tax-favored treatment of earnings if the distribution is not rolled over (or not eligible to be rolled over) to an eligible retirement plan described in Section 402(c)(8)(B) of the Code.

- Defined contribution plans also must include: (1) a statement that some currently available investment options in the plan may not be generally available on similar terms outside the plan and contact information for obtaining additional information on the general availability outside the plan of currently available investment options in the plan; and (2) a statement that fees and expenses (including administrative or investment-related fees) outside the plan may be different from fees and expenses that apply to the participant's account and contact information for obtaining information on such fees.

- Defined benefit plans must include a statement of the amount payable to the participant under the normal form of benefit both upon immediate commencement and when the benefit is no longer immediately distributable (i.e., the later of age 62 or attainment of normal retirement age).

- All qualified plans also must include an explanation of any provisions of the plan (and provisions of an accident or health plan maintained by the employer) that could reasonably be expected to materially affect a participant's decision whether to defer receipt of the distribution. Examples of these provisions include a description of retiree health benefits if such benefits are limited to participants who have an undistributed

benefit under the employer's retirement plan, eligibility for early retirement subsidies or social security supplements, plan terms under which the benefit of a rehired participant who failed to defer may be adversely affected by the decision not to defer, or plan terms under which undistributed benefits that are otherwise nonforfeitable become forfeitable upon the participant's death.

This information generally must appear together (for example, in a list of consequences of failing to defer), but the notice may still satisfying the requirements of the proposed regulations if it includes a cross-reference to whether the required information may be found in notices or other information provided or made available to the participant, as long as the notice of consequences of failing to defer includes a statement of how the referenced information may be obtained without charge and explains why the referenced information is relevant to the decision of whether to defer.

Effective Date of Proposed Regulations

The proposed regulations become effective beginning on or after the first day of the first plan year beginning on or after January 1, 2010, but not earlier than 90 days following the publication of the final regulations.

Prior to the issuance of the final regulations, plans must make a "reasonable attempt" to comply with the new requirement. A plan is treated as complying with these requirements if: (1) the plan complies either with the proposed regulations or with the requirements set forth in Notice 2007-7, Q&A-32 and Q&A-33; or (2) if the plan administrator makes a reasonable attempt to comply with the requirement that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Department of Labor issues Proposed Regulations and Class Exemptions Relating to Investment Advice

Before the passage of the Pension Protection Act of 2006 (the "PPA"), the ability of a plan fiduciary to provide investment advice regarding its own products was limited. The PPA loosens these restrictions. Because of the potential conflict of interest that may arise in this context, the PPA contains safeguards designed to ensure participants are receiving objective investment guidance.

The PPA provides that an otherwise conflicted plan fiduciary may only provide investment advice pursuant to an "eligible investment advice arrangement." The PPA permits conflicted fiduciary advisers to provide investment advice based on "generally accepted investment theories" if the fees received by the fiduciary do not vary depending on the investment option selected. Alternatively, the PPA permits conflicted fiduciary advisers to provide investment advice pursuant to an unbiased computer model.

The Department of Labor recently released regulations implementing the PPA investment advice provisions. The proposed regulations generally track the PPA,

however, some key changes are worth noting. In addition to basing their advice on "generally accepted investment theories," eligible fiduciaries must also take into account the risk tolerance of a participant before giving investment advice. Additionally, fees or other compensation received by all employees, agents, or representatives that provide investment advice on behalf of a fiduciary advisor (along with the advisor itself) may not vary depending on the selected investment option.

A class exemption also has been proposed to extend the investment advice rules relating to the level fee arrangement and computer model arrangement to IRAs, provided that additional conditions are met.

The investment advice regulations are scheduled to be effective 60 days after publication of the final regulations. The public comment period for the proposed regulations ended on October 6, 2008.

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