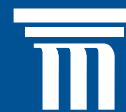
Matters of Interest

Executive and Director Benefits and COLI



M Benefit Solutions®

Fourth Quarter 2014

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2015 Tax Legislation?

Broad-based tax legislation gained little traction in 2014, but there is a possibility that tax legislation could be passed in 2015. President Obama and Mark Mazur, assistant secretary for tax policy at the Treasury Department, hinted during December 2014 of a possible tax code overhaul effort in 2015.

Speaking to reporters during his annual year-end press conference, President Obama said that he wanted to reach a deal on overhauling the tax code next year. President Obama has also stated that in the weeks leading up to his State of the Union speech in late January, there will be staff-level meetings between his administration and lawmakers' offices.

Mr. Mazur has stated that the administration's position is that a tax overhaul for corporate taxes should be revenue neutral and base broadening. It should lower the overall tax rate and strengthen international tax rules. There seems to be room in this conceptual approach for an agreement between the Administration and the Republican-led Congress.

While there may be further clarification from both the Congress and the Administration in the months ahead as to the provisions they would like to see in such tax legislation, it is worth reviewing some of the major provisions of Representative Camp's Tax Reform Act of 2015, a comprehensive tax reform proposal, and the President's 2014-15 budget proposal.

It is significant that both contain cutbacks on qualified plan retirement savings, indicating there may be room for bipartisan agreement in this area. The Camp proposal also contains significant cutbacks on executive deferred compensation plans. Presumably, the Administration would not be adverse to such cutbacks were the new Congress to include such proposals in new tax legislation.

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SUMMARY OF SOME MAJOR PROVISIONS OF THE TAX REFORM ACT OF 2014 AND THE PRESIDENT'S 2014–15 BUDGET PROPOSAL

	Tax Reform Act of 2014 (A comprehensive tax reform proposal from the House)	President's 2014–15 Budget Proposal
Tax Rates	▪ New individual tax rate structure (10% and 25% brackets, plus 10% surtax on modified income above 25% bracket) ▪ 60% of long-term capital gains and dividends taxed as ordinary income ▪ 401(k), matching contributions, and the cost of employer-sponsored health plans, would be subject to the 10% surtax	▪ Retains current 7 bracket structure with top rate of 39.6% ▪ Adds a 30% "Fair Share Tax" on taxpayers with adjusted gross income beginning at $1,000,000 ▪ Gains from derivative contracts treated as ordinary income ▪ 401(k) employee contributions, the cost of employer-sponsored health plans, and certain other deductions, would effectively be taxed to tax-payers in top 3 marginal brackets at a rate equal to the taxpayer's marginal tax rate (39.6%, 35%, or 33%) less 28%, or at a rate equal to 11.6%, 7%, or 5%
Alternative Minimum Tax	Alternative minimum tax repealed	No repeal
Executive Compensation	▪ Repeal existing carve-outs from the Section 162 $1,000,000 deduction limitation for performance-based compensation, such as stock options and commissions ▪ Repeal Section 409A prospectively ▪ Enact new Section 409B to provide that compensation deferred through nonqualified deferred compensation plans would be taxed when the compensation is no longer subject to a substantial risk of forfeiture ▪ Continue current-law rules to apply to existing nonqualified deferred compensation arrangements until the last tax year beginning before 2023, when such arrangements would become subject to the new rule	No comparable provisions

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Qualified Plans	▪ Limit pretax 401(k) elective salary deferrals in large employer plans (more than 100 employees): – Only half of the current contribution limit of $17,500 could be deferred on a pretax basis; the remaining amounts would be required to be deferred as after-tax contributions – Employer contributions would still receive pretax treatment ▪ Freeze contribution limits for tax-qualified retirement plans (such as the 415 limits and the limit on elective salary contributions and catch-up contributions) at 2014 levels until 2024	▪ Limited amounts that may be accumulated within the tax-favored retirement system (IRAs, 401(a), 403(b), and funded 457(b) plans) to an amount that would provide the maximum annuity permitted for a tax-qualified defined benefit plan (currently an annual benefit of $210,000), payable in the form of a joint and 100% survivor benefit commencing at age 62 and continuing each year for the life of the participant and, if longer, the life of a spouse, assumed to be of the same age: – Under this rule, the maximum permitted accumulation for an individual age 62 would be approximately $3,200,000 given current limits
Life Insurance	▪ Repeal the exception to the pro rata interest expense disallowance rule for corporate-owned life insurance for policies on the lives of officers, directors, and employees ▪ COLI purchases made prior to effective date would not be affected	Same provision

Upcoming Regulations—409A, 457, and 162(m)

A senior Treasury Department official, Robert J. Neis, deputy benefits tax counsel with Treasury's Office of Tax Policy, said November 4 that final regulations addressing income inclusion under § 409A wouldn't be released until the government first releases regulations under § 457(f) pertaining to ineligible deferred compensation plans.

The proposed § 409A regulations released in December 2008 address calculation of amounts includible in income and the calculation of additional taxes due upon a failure to comply with the timing rules of § 409A(a).

Neis said that while the Treasury Department intends to finalize these 409A proposed income inclusion regulations in the near future, the Department needs to issue the 457(f) regulations in proposed form first, get comments back on the 457 regulations, and ensure that when the Department finalizes both sets of regulations, they work together.

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Neis reported that the Department is working on three § 409A projects. In addition to the final regulations on income inclusion, the Department intends to release guidance to update § 409A with respect to certain technical issues.

Streamlining § 409A Correction Procedures

In addition, the Department is working on a project to consolidate a small number of § 409A correction programs addressing written plan errors and operational failures.

"There are a couple of different correction programs out there right now in separate revenue procedures," Neis said. "And for various reasons I won't bore you all with today, those revenue procedures can be very, very complicated to follow and use. That wasn't our intention; it was just how it worked out. So this project would be one to consolidate those correction procedures, streamline them, and make them a little more user friendly."

There is no plan to either add or remove correction opportunities currently available to taxpayers.

Finalizing § 162(m) Regulations

Tax code § 162(m) regulations on stock-based compensation plans should be out in final form in a matter of weeks, not months, Neis, said November 14 in a session reviewing the Internal Revenue Service's 2014–2015 Priority Guidance Plan.

The final regulations are expected to be similar to the proposed regulations, which clarify the share limit requirements for Section 162(m) plans that grant stock options or stock appreciation rights. The proposed regulations didn't include restricted stock units and the final regulations will likely exclude them as well, despite arguments that they are economically equivalent to restricted stock.

Moody's Maintains Stable Outlook for U.S. Life Insurance Industry

Moody's Investors Service is maintaining its stable outlook for the U.S. life insurance industry, according to its latest report on the industry, "U.S. Life Insurance Industry: Outlook Remains Stable" issued in November.

"We think the U.S. life insurers' financials will continue to improve over the next year, with revenue and earnings rising, owing to a strong equity market, conservative product design and pricing, a gradual rise in interest rates and an improving economy overall," says Laura Bazer, a Moody's Vice President.

Strong equity values as a result of the rising stock market are bolstering the performance of both legacy variable annuities, minimizing a major drag on the industry's earnings recovery, and fee businesses such as pensions, mutual funds and institutional asset management.

Profitability is also benefitting from product redesign and repricing. New variable annuities, for example, incorporate features that shift equity and hedging risks to policyholders. In addition, companies are repricing their "no-lapse" universal life insurance products for lower interest rates.

Moreover, Moody's stated, the likely rise in interest rates, following the Federal Reserve Bank's announcement of the end of quantitative easing, will also help earnings grow, easing the spread compression on products like fixed annuities and universal life. Higher interest rates will also minimize earnings pressure on products such as long-term care, while halting and ultimately reversing the slow decline in investment portfolio yields.

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Finally, Moody's sees the ongoing strengthening of the U.S. economy helping to push industry sales. Declining unemployment and a rising stock market will expand U.S. households' wealth and consumption, leading to a rise in discretionary spending for life insurance and annuity products, and raising insurers' revenue and earnings.

"The largest risk for the industry's recovery is that of a prolonged correction in the U.S. equity markets, combined with sustained low interest rates, which we think is unlikely at this point," added Bazer. "With few significant threats to the U.S. economy, we think there's little to hinder the ongoing improvement in the life insurers' financials over the next year."

ERISA Fiduciary's Obligation to Inform Plan Participants

In *Van Loo v. Cajun Operating Company*, No. 14-cv-10604, 2014 WL 675043 (E.D. Mich., Dec. 1, 2014), a Federal district court found that an employer, the plan administrator for a group life insurance plan, could be liable for monetary damages for breach of its fiduciary obligations as a result of its failure to inform an employee of the need to show evidence of insurability in order to be eligible for supplemental life insurance coverage under the plan.

Facts

The plan provided that a beneficiary would only be eligible for a "guaranteed issue" amount of up to $300,000. Life insurance above that amount would be subject to the life insurance carrier's approval of a person's proof of good health. In 2007, the employee increased her coverage to $400,000. She was not aware of the proof of good health requirement, nor did she receive Evidence of Insurability Form (EIF) to complete. The employer adjusted her premiums to account for the increase in coverage. In 2011, the employee further increased her coverage and premiums were adjusted upward in accordance with the increase.

The employee died in 2013 and her parents submitted a claim to the insurance carrier. The carrier paid $300,000 rather than the amount of the $614,000 claim citing the $300,000 guaranteed issue limit in the absence of a completed EIF.

According to the complaint, the employee was never informed of the EIF requirement, and was repeatedly assured by her employer that her benefits enrollment had been successfully completed. The employee paid and the employer accepted premiums based on the full coverage amount.

The employer filed a motion with the court to dismiss the complaint.

Court Finding

In ruling on the motion to dismiss, the court assumed that the allegations of the complaint were true and asked whether, if true, these facts resulted in legal liability.

The court dismissed all claims against the life insurance carrier and the employer, except the breach of fiduciary duty claim against the employer.

With respect to the fiduciary duty claim, the court stated the employer, as plan administrator had the responsibility to communicate accurately with covered employees regarding the plan and its failure to do so would result in legal liability and that monetary damages can be awarded as part of an equitable award for breach of fiduciary duty.

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Relevance to Employers

For plans with respect to which an employer is a fiduciary and subject to ERISA's fiduciary rules (this does not generally include top hat plans for key employees), the employer may be liable to employees for:

- Affirmative misrepresentations,
- Harmful misinformation, or
- Failure to inform when that silence may be harmful.

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