CHAPTER 2

Employer-Sponsored Plans: The Legal Background

IN GENERAL

Employee benefit plans are regulated primarily by federal law. The Internal Revenue Code of 1986 (the Code), as amended, provides favorable tax treatment for qualified retirement plans and other benefit plans (such as health plans) maintained by an employer. With respect to retirement plans, the employer’s contributions are currently deductible (within limits) for income tax purposes; the employee is not currently taxed on the contributions made on his or her behalf; and the trust that holds the plan assets is tax-exempt. To qualify for these tax benefits, the plan must satisfy detailed qualification requirements set out in the Code: the term “qualified plan” simply means a plan that satisfies those requirements. Generally, the retirement plan rules of the Code apply only to qualified

---

1. The Internal Revenue Code is codified as Title 26 of the U.S. Code.
3. 26 U.S.C. § 402(a). The employee generally is not taxed until he or she actually receives benefits from the plan. Even at that stage, most retirement plan distributions (other than annuities or long-term installment payments) can be rolled over to another qualified plan or to an individual retirement account (IRA), which defers taxation until distributions are received from the transferee plan. 26 U.S.C. § 402(c).
5. 26 U.S.C. § 401(a), which now has 37 separate subsections.
plans.\textsuperscript{6} With respect to other employee benefits, the requirements that must be satisfied, to receive tax-favored treatment, vary from benefit to benefit.\textsuperscript{7}

The Employee Retirement Income Security Act of 1974 (ERISA), as amended,\textsuperscript{8} by contrast, applies to all pension plans and welfare plans unless there is a statutory or regulatory exemption.\textsuperscript{9} Under ERISA, the term “pension plan” is broadly defined to include:

any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program:

(i) provides retirement income to employees, or

(ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond,

regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.\textsuperscript{10}

Four points should be noted. First, ERISA applies only to plans an employer and/or an employee organization, generally a union, establish or maintain. Second, arrangements that essentially result in additional cash compensation (such as stock options, bonus plans, and short- or long-term incentive plans) generally are not subject to ERISA, even if the payout is deferred.\textsuperscript{11} Third, although almost all employers are required to pay the employment taxes that finance Social Security and Medicare, no employer is required to provide retirement or welfare ben-

\textsuperscript{6} By contrast, the term \textit{nonqualified plan} generally refers to a plan that is not intended to satisfy the qualification requirements. These plans are typically designed to provide additional benefits to highly paid executives.

\textsuperscript{7} \textit{See}, e.g., 26 U.S.C. sections 79 (group term life insurance) and 104–106 (health and disability benefits).

\textsuperscript{8} ERISA is codified in scattered sections of Titles 26 and 29 of the U.S. Code.

\textsuperscript{9} ERISA § 4(a); 29 U.S.C. § 1003(a).

\textsuperscript{10} ERISA § 3(2); 29 U.S.C. § 1002(2).

\textsuperscript{11} Employee welfare plans (such as group health plans, group life insurance, and group disability insurance) are discussed in Chapter 12.
Employer-Sponsored Plans: The Legal Background

benefits to its employees. However, if the employer does so, the plan must comply with the applicable requirements of the Code and ERISA. Finally, ERISA regulates the substantive provisions of retirement plans to a high degree, but provides very few substantive requirements for health and welfare benefit plans. This feature, combined with ERISA preemption, has led to a much criticized regulatory vacuum, where state regulation of health and welfare plans has been preempted even where ERISA provides no rules and no remedy.

ERISA and the Code regulate the design and administration of retirement plans, but do not mandate the type or amount of benefits that are provided. Accordingly while the statutes provide minimum standards with which plans must comply, it is essential to read the plan documents to determine an employee’s rights under a particular plan.

ERISA EXEMPTIONS

ERISA exempts various categories of retirement and welfare plans from its coverage. The most important exemptions are as follows:

1. **Governmental plans.** These include:
   (i) plans established or maintained for employees by the federal government, by any state government or political subdivision (such as a county or city) or by any agency or instrumentality thereof;
   (ii) any plan that is governed by the Railroad Retirement Act; and
   (iii) any plan of a tax-exempt international organization (such as the United Nations).

   Thus, for instance, the various retirement programs maintained by the state of New York for public sector employees (civil servants, teachers, police, and firefighters) are not subject to ERISA, and are governed primarily by state law. Two pre-

---

12. Thus, about 96 percent of American workers are covered by Social Security and over 90 percent of public sector employees are covered by a retirement plan, but only about 50 percent of private sector employees are covered by any other retirement plan.

13. ERISA preemption is discussed in detail in Chapter 16, infra.

14. The term includes some, but not all, plans established and maintained by Indian tribal governments. ERISA §§ 3(32) and 4(b)(1); 29 U.S.C. §§ 1002(32) and 1003(b)(1).

15. See N.Y. RETIRE. & SOC. SEC. LAW § 110.
liminary points should be stressed. First, the tax rules that govern private sector retirement plans generally apply to governmental plans as well. Second, there is no uniform definition of what constitutes a governmental plan or a governmental employer. Different definitions apply for different purposes, and often those definitions are difficult to apply, which accounts for the large number of Internal Revenue Service (IRS) and U.S. Department of Labor (DOL) rulings concerning whether a particular plan is or is not a governmental plan.\textsuperscript{16}

Governmental plans are discussed further in Chapter 4.

2. \textit{Church plans}, a term that is broader than it appears, as it extends to plans maintained by certain church-associated organizations such as hospitals.\textsuperscript{17} There is an element of confusion with respect to these plans because different definitions of “church” apply for different purposes. Church plans are discussed in greater detail in Chapter 4. With respect to retirement plans, the exclusion applies only to plans for which no election has been made under Code section 410(d). Section 410(d) allows the church, convention, or association of churches that maintains any church retirement plan to make an irrevocable election for the participation, vesting and funding rules to apply to the plan, as if those rules did not contain an exclusion for church plans. Few plans have so elected.

3. Plans maintained \textit{solely} for the purpose of complying with applicable workmen’s compensation, unemployment compensation, or disability insurance laws.\textsuperscript{18}

The U.S. Department of Labor (DOL) regulations provide additional exemptions and clarifications of the scope of ERISA


\textsuperscript{17} ERISA §§ 3(33), 4(b)(2); 29 U.S.C. §§ 1002(33), 1003(b)(2).

\textsuperscript{18} ERISA § 4(b)(3); 29 U.S.C. § 1003(b)(3). \textit{See also} Shaw \textit{v. Delta Airlines, Inc.}, 463 U.S. 85 (1983) (exclusion does not apply to plans that provide other benefits as well as state-mandated disability benefits).
coverage. Thus, for instance, a plan that covers only self-employed individuals (partners, sole proprietors or members of a limited liability company) is exempt from ERISA, because it does not cover any employees. 19

ERISA AND OTHER LAWS

ERISA provides substantive rights for individuals who are entitled to benefits under a retirement plan that is subject to ERISA. These rights can be enforced either by the individual or by the DOL on behalf of the employees. 20 Many of the ERISA provisions also appear in the Code—however, there is no individual right of action for violations of the Code. The Code’s requirements are enforced exclusively by the IRS, which has available an extensive array of enforcement tools, including, in an extreme case, disqualification of the plan. An individual who feels that his or her rights are being violated may complain either to DOL or IRS. If the IRS concludes that the complaint has merit, it will often pressure the employer to resolve the employee’s complaint.

One of the most controversial provisions of ERISA is the preemption clause, which provides that, subject to certain exceptions, ERISA:

shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. 21

ERISA preemption is discussed in detail in Chapter 16. ERISA does not preempt federal laws 22 so, for instance, an ERISA-covered plan must comply with federal age and sex discrimination laws.

For employers in the construction industry, there is an important set of prevailing wage statutes, both federal and state, that require contractors on public works projects to pay prevailing wage and benefit rates to non-union employees working on those projects. 23

19. 29 C.F.R. § 2510.3-3(b) (2009).
20. ERISA § 502; 29 U.S.C. § 1132. See also ERISA § 504, 29 U.S.C. § 1134, which confers broad investigative authority on the DOL.
21. ERISA § 514(a); 29 U.S.C. § 1144(a).
22. ERISA § 514(d); 29 U.S.C. § 1144(d).
CLASSIFYING THE PLAN

To determine the correct approach, the threshold issue is to classify the plan correctly. All pension and welfare plans subject to ERISA are required to distribute to participants and beneficiaries a summary plan description (SPD).24 The plan documents and SPD should identify whether a retirement plan is intended to be qualified and what type of plan it is (for example, defined benefit or profit sharing). For a welfare plan, the SPD should describe the benefits that are provided: an SPD for a health plan is typically much more complex than the SPD for a retirement plan because health plans, with their detailed schedules of benefits, exclusions, and limitations, are inherently much more complex than retirement plans. The SPD must also identify the employer(s) sponsoring the plan, the plan administrator,25 and the trustees. Additional information can be obtained from the annual report (in the Form 5500 series), which the plan is required to file annually.26

If the situation still is unclear, information should be requested directly from the plan sponsor.

MULTIEMPLOYER PLANS

Most benefit plans are sponsored by a single employer, or by a group of affiliated employers, for its employees, and the employer decides the important terms of the plan (such as the level of benefits). However, if the covered employees are members of a bargaining unit, the employer must negotiate with the union with respect to benefits. Some collectively bargained plans are negotiated between a union and a single employer, and affect only the bargaining unit members employed by that employer.

The larger collectively bargained plans are multiemployer plans, and cover the members of a union (such as the Teamsters) who are employed

24. ERISA §§ 101(a), 104(b)(1); 29 U.S.C. §§ 1021(a)(1), 1024(b)(1). The plan must distribute an updated SPD every five years or, if the plan has not been amended, every 10 years. See Chapter 3, which summarizes the requirements for SPDs.

25. The term plan administrator is a term of art. It does not, as is often assumed, refer to the employee or outside service provider who performs ministerial record-keeping functions for the plan. Rather, it describes the party (usually the employer or a committee appointed by the employer) that ultimately controls the operation of the plan. See ERISA § 3(16); 29 U.S.C. § 1002(16).

26. ERISA § 104(a); 29 U.S.C. § 1024(a).
by many different employers. Typically, each employer and the union negotiate a contribution rate, generally expressed as a fixed amount for each hour worked by a member of the union in covered employment. The rate may be a combined rate for pension and other benefits, or there may be one contribution rate for pension benefits and a separate contribution rate for health and welfare benefits. If the retirement plan is a defined contribution plan, the contribution for each employee is simply deposited in the employee’s account. In the case of a defined benefit plan or a welfare-benefit plan, the trustees determine the level of benefits that can be supported by the expected employer contributions.

The board of trustees must include an equal number of employer representatives and union representatives. All important decisions are made by the trustees, with advice from the plan’s staff and its professional advisors.

One major advantage of multiemployer plans is that they offer complete portability of benefits as long as the individual continues to work in an occupation covered by the plan and within the plan’s geographic area, no matter how often he or she changes employers. This is important for the employees, as multiemployer plans typically operate in areas (such as construction) where employees often work for many different employers for a short period. Many large plans also have reciprocity agreements, which credit service under different regional plans of the same union.

Generally, if an employer complies fully with its obligations under a collective bargaining agreement, then neither the union nor a benefit plan nor any participating employee has any further claim against the employer, even if the negotiated contribution rate proves to be insufficient to fund the anticipated benefits. However, there is an important exception—an employer that ceases to contribute to, or substantially reduces its contributions to, an underfunded multiemployer defined benefit pension plan, can incur withdrawal liability, even if it has complied fully with its contractual obligations. This can apply even if the withdrawal was not initiated by the employer—for example, if the employees voted for a new union and the employer could no longer contribute to the old union’s plan.

AGENCIES WITH PENSION JURISDICTION

Three federal agencies have jurisdiction over private sector retirement plans. The IRS is responsible for ensuring that qualified plans satisfy the Code’s qualification requirements, both in form and in operation. To fulfill these functions, the IRS performs three major types of activity. First, it is usual (though not required) for an employer to seek a ruling from the IRS (a determination letter) that the language of its plan satisfies the requirements of the Code and regulations. Many employers adopt preapproved plans (prototypes or volume submitter plans) rather than individually designed plans. An employer that does so generally need not apply to the IRS for its own determination letter—instead, it relies on the approval letter the IRS issues to the plan sponsor. Second, the IRS issues guidance (regulations, notices, announcements, etc.) to clarify and to assist employers in complying with the rules. Third, the IRS audits plans to ensure that they are being operated in accordance with the rules. To the extent that the plan is found not in compliance, the IRS will require correction and, in some cases, payment of a sanction.

The DOL, through its Employee Benefits Security Administration (EBSA), is responsible for ensuring that covered plans satisfy the requirements of ERISA, and give plan participants all of the rights and protections to which they are entitled under ERISA. The DOL performs two major types of activity. First, it issues guidance (regulations, advisory opinions, etc.) to clarify and to assist employers in complying with the rules. Second, it audits plans to ensure that they are being

29. Other agencies may become involved on certain issues, e.g., the Equal Employment Opportunity Commission if the plan is alleged to discriminate on the basis of age, race, etc.
30. The current rules for correcting plan defects under the Employee Plans Compliance Resolution System (EPCRS) are found in Revenue Procedure 2008-50, 2008-2 C.B. 464.
31. Because many rules appear in both ERISA and the Code (for instance, the vesting rules), there is significant overlap between the jurisdiction of the IRS and the DOL. To avoid duplication, the agencies have entered into agreements dividing areas of responsibility between them. See, e.g., Reorganization Plan No.4, 43 Fed. Reg. 47,713, 92 Stat. 3790 (1978). A list of the EBSA Field Offices is available from the DOL website, www.dol.gov/ebsa.
32. The DOL has several helpful, consumer-oriented publications available through its website, www.dol.gov/dol/ebsa, including PROTECT YOUR PENSION: A QUICK REFERENCE GUIDE; TOP 10 WAYS TO PREPARE FOR RETIREMENT; WHAT YOU
operated in accordance with the ERISA rules. To the extent that the plan is found not to be in compliance, the DOL will require correction and, in some cases, payment of a sanction.\textsuperscript{33}

Third, the Pension Benefit Guaranty Corporation (PGBC) was created by ERISA to run the pension insurance program under Title IV of the act.\textsuperscript{34} The PBGC collects annual premium payments from covered defined benefit pension plans, oversees the termination of such plans, and provides benefits to participants if a single-employer plan terminates without sufficient assets to pay all guaranteed benefits.\textsuperscript{35} In recent years, the PGBC has accumulated a substantial deficit as a result of terminations of large underfunded plans, and the basic annual premium payable by single-employer plans has increased to $35 per participant for plan years beginning in 2010. There is also a variable rate premium for underfunded plans and a termination premium for terminating plans. Multiemployer plans are subject to a different set of rules, and the multiemployer plan premium is currently $9 per participant.\textsuperscript{36}

\textit{Should Know About Your Pension Rights; Women and Pensions: What Women Need to Know and Do; and How to Obtain Employee Benefit Documents from the Labor Department.}

\textsuperscript{33} On April 19, 2006, the DOL published an amended and restated correction program for specified types of breach of ERISA, the Voluntary Fiduciary Correction Program (VFCP), 71 Fed. Reg. 20,261.

\textsuperscript{34} ERISA § 4002, 29 U.S.C. § 1302.

\textsuperscript{35} Defined contribution plans are not covered by the termination insurance program. Some defined benefit plans are also excluded, e.g., plans of small professional employers. In addition, PBGC does not guarantee all benefits under defined benefit plans: the amount guaranteed is subject to a dollar maximum, which is adjusted annually, and certain types of benefit are not guaranteed at all. ERISA § 4022; 29 U.S.C. § 1322. PBGC also offers (1) a Pension Search Directory and (2) Finding a Lost Pension, a Guide to Help People Search for Lost Pensions from Former Employers, both of which are available to the public through its website, www.pbgc.gov. PBGC’s address is 1200 K St. NW, Washington, D.C. 20005-4026, phone 202-326-4000, or 1-800-400-7242. PBGC has also published a booklet, A Predictable, Secure Pension for Life: Defined Benefit Pensions, available through its website, www.pbgc.gov.

\textsuperscript{36} See PGBC Pension Insurance Premiums Fact Sheet Page, \textit{available at} www.pbgc.gov/media/key-resources-for-the-press/content/page13541, html; and PGBC Page Multiemployer Insurance Program Fact Sheet Page, \textit{available at} www.pbgc.gov/media/key-resources-for-the-press/content/page13544, html.