Orphan Plans & ERISA Vacation Plans

By Marty Heming, Esq.

The DOL started its orphan plan project on October 1, 1999. Since that date, the DOL has been able to return more than 250 million dollars to about a half million participants. However, there still remain several items of concern with respect how orphan plans should be handled by the DOL.

Specifically, the DOL has yet to define what constitutes an orphan plan. Does it refer to a plan with no fiduciaries or to any plan where the only remaining fiduciary is a bank or other directed trustee with limited authority only to manage the assets of the plan? What happens if the directed fiduciary assumes the authority of the employer who was the administrator under the plan document despite the limits in the document as to who is the ERISA administrator? What if the plan has more than 100 participants and the Forms 5500 have not been filed for several years? What if the data needed for a CPA audit is no longer in existence? Voluntary Correction Program for approval of retroactive updates to the plan document, does it become potentially liable for late filing penalties? Moreover, who would pay for this expense? Alternatively, if the directed trustee doesn't take on authority to operate the plan beyond the terms of the plan document, will the DOL take the position it has breached its fiduciary duty?

At the present time the DOL will informally help directed trustees with these issues on an ad hoc basis both on the regional level and at the Office of the Chief Accountant. Moreover, it is even possible to work with the DOL to resolve issues for multiple orphan plans handled by a single record keeper as a package. Nevertheless, it is my understanding that the DOL will be adopting a more formal position on some or all of these matters in the near future. In the meantime, if one of your clients is experiencing an orphan plan problem, you should contact the appropriate Regional Director and or the Office of the Chief Counsel.

ERISA Vacation Plans –Trap for the Unwary

Payment of compensation to employees who are on vacation or absent on a holiday is generally not considered a Welfare Plan as defined in Section 3 of ERISA. This is because under the ERISA Regulations, vacation pay by the employer out of its general assets is a "payroll practice" not an ERISA Welfare Plan. The result is two fold, (i) no Form 5500 needs to be filed for a payroll practice and (ii) state labor law governing the payment of vacation pay is not preempted because the payroll practice is not an ERISA plan.

Companies that don't choose to be covered by a state's restrictive rules governing how vacation pay must be accrued and paid may decide to adopt a funded ERISA vacation plan rather than adopt a payroll practice. On the surface, the only disadvantage to this approach is the need to file a Form 5500. However, as was pointed out in an EBSA Advisory Opinion dated July 2, 2004 to Denny's, Inc., establishing a welfare plan within the meaning of Section 3(1) of ERISA isn't as easy as it may first appear.

Facts:

Denny's established a vacation trust to fund the vacation plan using an IRS 501(c)(9) VEBA to hold the vacation plan assets, which provided that all assets in the VEBA must be used for the payment of vacation benefits and could never revert to the employer. However, all assets of the trust were held in a non-interest bearing account because the expense of investment would exceed the expected return. Denny's was required to contribute sufficient money to the Trust to pay benefits when they became due. Denny's voluntarily made sufficient contributions to the Trust to maintain a constant minimum account balance of $250,000. All vacation checks were written from money in the Trust. The Plan covered about 32,000 participants and paid about eight million in benefits each year. The amount that passed through the Trust each week equals or exceeds the $250,000 minimum balance maintained by the Trust.

Ruling:

Based on these facts, it is clear that Denny's vacation trust makes payment from a source other than the general assets of the employer and thus, doesn't meet the definition of payroll practice in the ERISA regulation. The key to this ruling is the statement by the DOL that just because the vacation pay program doesn't meet the payroll practices rule, doesn't make it automatically an ERISA Welfare Plan. Citing from the Supreme Court in *Massachusetts v. Morash,* the DOL said that the reference to vacation pay in ERISA must be understood to include only those plans in which the employee's right to a benefit is subject to a risk different from his employment risk. In short, if Denny's were to go bankrupt, the vacation trust would have sufficient funds to pay the accrued vacation benefits. Accordingly, it is the DOL's view that a vacation program such as Denny's must be evaluated to see if it is a bona fide separate fund worthy of ERISA status. DOL lists the following criteria used to make the determination; (i) the trust must have the direct legal obligation to pay benefits, (ii) the trust must contain a contribution obligation enforceable against the employer (iii) the contributions must be actuarially determined or established through collective bargaining or otherwise bear a relationship to the plan's accruing liability. Based on these criteria, Denny's vacation plan was ruled not to be an ERISA plan.

The reason that the establishment of a funded vacation plan is a trap for the unwary is because, in most cases, the plan has been put into effect before any ruling is obtained from the DOL, or any court has ruled on whether it is an ERISA plan. In the meantime, the employer has

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NIPA to Co-Sponsor L.A. Benefits Conference

For the second year, NIPA will be a co-sponsor of the L.A. Benefits Conference. The three-day event will be held January 26-28, 2005 at the Hilton Universal City & Towers in Universal City, California. The other co-sponsors of the event will be the Internal Revenue Service (IRS), the American Society of Pension Actuaries (ASPA) and the Western Pension and Benefit Conference. The conference starts on January 26 with a pre-conference program called “Conversations with the IRS.” The regular program begins on January 27 and features private pension practitioners, along with senior IRS staffers, many of whom will be coming from Washington, DC, to participate in the conference. Because of the increased role of the Department of Labor (DOL) in employee benefit matters, speakers from the DOL, both locally and nationally, will be invited to participate.

In addition to NIPA being a co-sponsor of the event, the San Diego, Los Angeles, San Joaquin, San Francisco, Orange County, Sacramento and Spokane Chapters will be cooperating sponsors. Each cooperating chapter has a representative on the program steering committee which determines the topics and speakers. This participation allows NIPA members to get actively involved in an event with members of the pension community from other areas and other organizations.

Last year, over 300 pension professionals participated in the L.A. Benefits Conference. Many of those were NIPA members. The conference and pre-conference are eligible for NIPA continuing education credits. NIPA is proud to be a co-sponsor of this important event, so mark your calendars and plan to attend as this conference may be sold out in 2005. ✷

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typically not followed the mandated state labor laws governing vacation pay and is subject to adverse action both by the state and by the employees. Moreover, even after the publication of the Advisory Opinion, the evaluation to determine if the vacation program is an ERISA plan is, at best, somewhat vague as to the exact criteria that must be met. In summary, an ERISA vacation plan can be created and can save the employer money because it is run without the restrictions of the state labor laws. However, any employer contemplating the use of such a plan must be mindful of the potential pitfall of failing to be classified as an ERISA plan. ✷

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