Common Benefit Pitfalls for Closely-Held Businesses – Part 3: Administrative “Gotchas”

Returning to our series of five alerts aimed at exploring some common pitfalls – or as we like to say, “opportunities” – for closely held companies and their benefits and compensation arrangements, this alert (third in the series of five) explores administrative pitfalls – including claims/appeals for benefits and government filings. In case you missed or want to revisit the first two alerts in our series (addressing health insurance and 401(k) plans, respectively), you can find them here and here.

Our series started with a reference to the old adage – no good deed goes unpunished. That sentiment is echoed again here. As a closely-held business, you decide to do the “right thing” and offer some form of benefits to your workforce. You sign the contract with the vendor, go through the open enrollment process, set up the payroll system to remit mandated employee contributions and you’re set, right?

Well, maybe not. There are a few common places where employers – and many times smaller, emerging or well-intentioned closely held businesses – miss a step or two vital to proper compliance with administrative landscape enveloping benefit plans. Here are a few examples:

- **Adopting a 125/Cafeteria Plan Document**
  - In order to facilitate pre-tax premium contributions for most benefits (think health, life, disability, FSA – NOT 401(k)) Internal Revenue Code Section 125 requires that a written plan document (often referred to as a 125 plan, cafeteria plan and/or flex (or flexible benefits) plan) be adopted. A failure to adopt a proper written plan can result in adverse tax consequences to both the employer
and employees – clearly an undesirable outcome.

- Legal counsel should review any plan that is/will be adopted to ensure compliance with the myriad of applicable legal guidance.

- In addition to being written, the plan should be properly adopted. Evidence of the plan’s adoption should be made by corporate or board resolution (or otherwise as approved by delegation).

**Managing Claims and Appeals**

- What’s a claim as opposed to a casual inquiry? Stated in an oversimplified manner, a request for a plan benefit, or benefits, made by a claimant (generally an employee, participant or authorized representative) in accordance with a plan’s reasonable procedure for filing benefit claims must be treated as a claim for benefits.

  - Compare a claim for benefits that with a casual inquiry regarding benefits, which is more of a general question that is not specific enough to rise to the level of a claim (and need not be treated/processed as such). **A word of warning** – there are not many bright line rules here and a plan sponsor should be cognizant of whenever there is a basis for concluding that the person making an informal inquiry is actually trying to file or further a claim for benefits. For example, is asking about whether a particular treatment or condition a claim?

- A protocol for responding to claims and appeals should be adopted (and followed!).

  - The rules governing the claims and appeals process requires certain reviewers at certain times reviewing and communicating specific information. Note that a failure to adhere to these rules may result in the loss of the deferential standard of review in litigation (i.e., the court may review the claim on its own rather than deferring to the initial reviewer – which can increase the cost of litigation and decrease the employer’s chances of successfully defending the lawsuit).

**Timely Responding to Requests for ERISA documents**

- Penalties may apply with respect to a failure to timely respond to requests for certain ERISA information (e.g., plan documents, SPDs). Again, a protocol for forwarding and responding to such requests should be adopted and compliance with the same should be audited.

**Annual Filings/”Top Hat” Plan Filing**
Generally speaking, there is a requirement to complete and file an annual return/report (on the Form 5500) for each benefit plan.

- Smaller plans may have a pass for filing a return for certain unfunded plans, but increases in coverage can cause a “springing obligation” to file in the next year.

- Also, it’s important to understand the filing requirement distinctions between retirement plans (e.g., 401(k)s, pensions and ESOPs) as compared to health & welfare plans. Retirement plans almost ALWAYS require an annual filing; an audit may be required as well.

An unfunded plan maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees (commonly known as a “top hat” plan) will generally be excluded from needing to comply with various provisions of ERISA (including the fiduciary responsibility rules) if a one-time notice is timely filed with the government.

Avoiding Conflicts of Interest

- Hiring (and monitoring) service providers/vendors for benefit plans is one of many fiduciary functions. In short, this means that the best interest of the participants and beneficiaries needs to be center stage in this decision making.

  - Consider the following example. Mary is the founder of Company X. Company X decides to adopt a 401(k) plan, effective 1/1/19. When setting up the plan, Founder Mary cannot simply hire her cousin or best friend to perform services for the benefit plan UNLESS a prudent fiduciary would hire that individual/company as well (and there’s not otherwise a prohibited transaction).

  - When in doubt concerning if/when/how a transaction with a benefit plan can be entered into, plan counsel should be engaged.

As you can see, proper plan compliance takes more than signing a contract and enrolling participants. That said, adoption of some simple best practices for reviewing and maintaining plans, and ensuring consistent operation of those plans in a compliant manner can avoid costly and cumbersome headaches for closely-held businesses down the road. Continuing with the cheesy phrases: “an ounce of prevention is worth a pound of cure.”

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