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MEMORANDUM

TO: Committee Members
UFCW and FELRA Severance Fund

FROM: Barry S. Slevin BSS (SES)
Sarah E. Sanchez SES
Andrew R. Dietrich ARD

DATE: February 8, 2018

RE: Severance Benefit Payment Deadlines Under Internal Revenue Code Section 409A

The purposes of this memorandum are to: review the legal basis for the severance benefit payment deadlines under the UFCW & FELRA Severance Fund's Plan document and describe the potential penalties for violating such deadlines; describe proposed regulations issued in 2016 that are relevant to the Fund; and suggest steps the Fund could take to increase the likelihood that participants will apply for and receive their severance benefits before the payment deadline.

As explained below, we recommend that the Board of Trustees amend the Plan in accordance with the proposed regulations to extend the deadline for paying benefits to a beneficiary after the death of a participant. We also recommend that the Fund begin sending routine reminders to participants regarding the Plan's application deadlines and that the Trustees consider the option of automatically issuing severance payments to severed participants who do not timely apply for benefits.

I. Benefit Payment Deadlines

The Trustees adopted the Plan's current benefit payment deadline to comply with Internal Revenue Code ("Code") Section 409A and the final regulations issued thereunder ("Final Regulations") regarding the timing of payments from nonqualified deferred compensation arrangements, including severance plans. As explained in more detail in our February 27, 2008 memorandum, the Final Regulations presented two benefit payment deadline options. First, a fund could provide that payment would be made on a specified date tied to the participant's severance from service, with an "administrative delay" rule permitting the fund to actually make the payment by the later of the last day of the same calendar year or the 15th day of the third calendar month following the specified date. Alternatively, a fund could provide for payment during a specified calendar year after the year in which the participant separates from service.

In order to avoid any unnecessary delay in benefit payments to participants, the Trustees chose to comply with the Final Regulations by adopting the first option described above and amended the Plan to provide that a participant must receive his or her severance benefit no earlier than four months after the participant's severance from service date, and no later than the later of: (1) the last day of the calendar year in which the four-month waiting period expires; or (2) the 15th day of the third calendar month following the expiration of the four-month waiting period. Further, since the Fund will be considered in compliance with Section 409A and the Final Regulations only if it pays benefits within the prescribed time limits, the Trustees amended the Plan to provide that a participant's severance benefit is forfeited if it is not paid within the above time limits.

On June 21, 2016, the IRS issued proposed regulations that would make a number of modifications and clarifications to the Final Regulations. Of particular relevance to the Plan is a section that would provide additional flexibility on the timing of payments upon the death of a participant. Specifically, the proposed regulations provide that an amount payable to a beneficiary upon the death of a participant is timely if it is paid by December 31 of the calendar year following the year of the death. While the proposed regulations are not final, the IRS has advised that taxpayers and funds may rely on them until the IRS issues final regulations.

Because the Plan currently imposes the same payment deadlines on beneficiaries as participants, we recommend that the Trustees amend the Plan to extend the deadline for payment of a death benefit to December 31 of the year following the year of the participant's death, as permitted under the proposed regulations.

II. Penalties

While there are no penalties applicable to the Fund itself under Section 409A, the tax consequences of a violation for Plan participants can be substantial. An individual participant who receives a benefit in a manner that does not comply with Section 409A is subject to income tax on the portion of the vested benefit that accrued after September 27, 2008 through the year of the failure, plus interest and an additional 20% tax penalty on the benefit. Further, these taxes and penalties can be imposed before the participant actually is paid the benefit. In the event of a Plan-wide violation of Section 409A (e.g. a fund practice or plan document provision allowing for benefit payments after the Section 409A deadline), all Plan participants could become subject to the above-described taxes and penalties.

III. Options For Avoiding Forfeiture

The Plan currently requires that participants submit a completed benefit application to the Fund office prior to the payment deadline in order to receive a severance benefit. This rule occasionally results in the forfeiture of earned severance benefits due to participants' failures to timely submit their benefit applications. In order to avoid, or at least reduce the number of, future severance benefit forfeitures due to a failure to timely submit a benefit application, we recommend that the Fund office begin sending routine notices to participants, reminding them of the severance payment deadlines and encouraging them to timely submit a severance application in order to avoid forfeiture of their benefits. We also recommend that the Trustees consider adopting a process for the automatic payment of benefits to participants who do not submit a benefit application, provided the Fund is able to confirm the participant's eligibility, the amount of his earned severance benefit and his current address.

A. Participant Notices

It is our understanding that the Fund office sends letters alerting Severance Plan participants to their possible eligibility for a severance benefit, and the relevant application deadline (if known), if the participant's name appears on the VEBA Fund's COBRA eligibility list. In addition, if a severance-eligible participant applies for a benefit under the FELRA Pension Fund, the Fund office automatically will send the participant a severance benefit application as well. However, because the severance benefit application currently does not prominently display the strict deadline for receiving a benefit under the Plan, it is possible that many participants who fail to timely apply for their severance benefit were simply unaware of the Plan's strict deadlines for receiving their benefits. (While the benefit payment deadlines are plainly stated in the Severance Fund's SPD, most participants are unlikely to refer to the SPD unless they have a specific question or they have been directed to do so by the Fund office.) Further, it is possible that participants whose names do not appear on the VEBA Fund's COBRA list, or who have not applied for a pension, are not even aware of their eligibility for a benefit under the Severance Plan.

Based on the foregoing, a relatively simple way to significantly decrease the number of severance benefit denials resulting from untimeliness would be to update the severance application such that it highlights the payment deadline and to implement a participant reminder program incorporating multiple strategies, such as: (a) a general notice in the VEBA Fund's quarterly For Your Benefit newsletter; (b) an annual postcard to all Severance Plan participants; (c) a targeted reminder post-card to terminated severance-eligible participants; and (d) phone calls from both the Fund office and the Locals to participants who are approaching their application deadline. Thus, we suggest that the Trustees request information from the Fund office on the feasibility and costs of implementing such options.

B. Automatic Payment of Benefits

In addition to sending reminder notices to participants, the Trustees also could adopt a procedure for automatically paying benefits to participants who do not timely submit a completed benefit application. However, because the Final Regulations under Code Section 409A prohibit the Fund from issuing automatic payments on a discretionary basis, the Fund would need to establish a nondiscretionary procedure for determining and paying benefits in the event that a participant does not timely apply. For example, the Trustees could amend the Severance Plan to provide that, if a participant experiences a severance from service and does not submit an application within 30 days of the payment deadline, the Fund will calculate the participant's severance benefit based on the information available to the Fund at that time and will mail a benefit check to the participant at his current address, provided the Fund is able to confirm, to the best of its ability, that the participant is alive and residing at that address. If the Fund office is not able to confirm the participant's address, another option may be for the Fund to pay the severance benefit to an escrow account set up in the participant's name, where the benefit will be held until the participant withdraws it. If the Trustees are interested in pursuing this option, we would need to do some additional research on the feasibility of setting up such accounts for participants.

If the Trustees elect to establish an automatic payment program, we will work with the Fund office to determine what procedures or information it would need in order to pay severance benefits without having received a completed application, and we also will draft any necessary amendment to the Fund's Plan of benefits to describe the program, specify that it is non-discretionary in nature and clarify the Fund's right to recover any overpayment in the event that it subsequently determines an automatic payment was made in error.

We look forward to discussing this memorandum with you.

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cc: Harry W. Burton, Esq. (w/encl.)
William R. Jensen (w/encl.)

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