



Employee Benefits Law Action Memo

August 2008

Electronic Dispatch

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CERTAIN YEAR-END AND EARLY 2009 DEADLINES APPROACHING FAST FOR RETIREMENT AND WELFARE BENEFIT PLANS

As the end of the calendar year fast approaches, sponsors of retirement and welfare benefit plans should review those plans (including the administration of those plans) to make sure such plans are (or will be) in compliance with year-end and early 2009 requirements. Specifically, nonqualified deferred compensation plans must be amended by December 31, 2008 for compliance with Internal Revenue Code (Code) Section 409A requirements, Internal Revenue Service (IRS) proposed regulations governing cafeteria plans are generally effective beginning January 1, 2009, IRS final regulations for Code Section 403(b) plans are generally effective beginning January 1, 2009, and "Cycle C" filers must restate their qualified retirement plans and submit those plans to the IRS for determination letters by January 31, 2009.

Nonqualified Deferred Compensation Plans (December 31, 2008)

Code Section 409A generally provides that, unless the requirements of Code Section 409A are satisfied at all times, amounts deferred under a "nonqualified deferred compensation plan" for all taxable years are currently includable in the covered individual's gross income to the extent the amounts are not subject to a substantial risk of forfeiture. In other words, unless the requirements of Code Section 409A are satisfied, deferred compensation generally will be taxable when vested. (For purposes of Code Section 409A, the term "nonqualified deferred compensation plan" is defined very broadly and can include employment agreements, severance arrangements and other individual compensation arrangements.)

The application of Code Section 409A can result in premature income recognition by an affected individual, the imposition of a 20 percent excise tax on the amount included in income and the imposition of substantial interest and penalties. The excise tax and interest penalties are payable by the affected individual.

To comply with the 409A requirements, arrangements must be set forth in writing and the written terms of the plan must comply with Code Section 409A by December 31, 2008. A "savings clause" stating the plan will be interpreted and administered in accordance with Code Section 409A is insufficient.

Among other things, plan documents must contain provisions related to:

- Initial elections as to time and form of payment;
- Subsequent changes in time and form of payment;
- Certain provisions related to prohibited payment acceleration; and
- A six-month delay of certain payments to key employees of public companies.

ACTION ITEM: Plan sponsors should review current nonqualified deferred compensation arrangements to ensure any and all amendments needed are made by December 31, 2008. After December 31, 2008, certain amendments are permitted but only in very limited circumstances.

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New Proposed Cafeteria Plan Regulations (January 1, 2009)

In general, when an employer gives its employees a choice between taxable and nontaxable benefits, otherwise nontaxable benefits can become taxable income for all eligible employees, unless a specific exception applies under the Code. Code Section 125 is the exclusive means by which an employer may offer its employees a choice between taxable and nontaxable benefits without the choice resulting in taxable income for all eligible employees. The new proposed regulations require that a plan be administered in accordance with Code Section 125 in order to provide such tax-favored benefits.

Two key requirements of the new proposed regulations are that the Code Section 125 benefits must be provided under a written plan document, and that the plan must be operated in accordance with its written terms. The written plan document must include descriptions of:

- All covered benefits;
- The rules for eligibility and the procedures for making elections (including the irrevocability of elections unless the change in status rules apply);
- How employer contributions (including salary reduction contributions) may be made under the plan, and the maximum amount of elective contributions;
- The plan year (which must be a 12-consecutive month period, unless there is a valid reason for a shortened plan year); and
- The rules governing health, dependent care and adoption assistance flexible spending accounts (if applicable).

In the event a plan is not operated in accordance with its terms or Code Section 125, the plan will not be considered a cafeteria plan and will result in taxable income to all eligible employees (even if otherwise nontaxable benefits are chosen).

ACTION ITEMS: Cafeteria plan sponsors should make sure (i) a written plan document exists for its cafeteria plan by January 1, 2009, (ii) the terms of the plan comply with the IRS proposed regulations, and (iii) the plan is administered in accordance with the IRS proposed regulations.

Final Code Section 403(b) Plan Requirements (January 1, 2009)

As with cafeteria plans, IRS final 403(b) regulations now require that every Code Section 403(b) plan must be set forth in a written plan document that contains all the material provisions of the plan (including eligibility, benefits, distributions and applicable limitations) and must satisfy Code Section 403(b) in both form and operation. Existing written plan documents may need to be amended to comply with the requirements of the final regulations.

The plan need not be a single, comprehensive document, but may include a number of documents (e.g., annuity contracts or custodial account agreements) which are incorporated by reference. In the case of a plan under which multiple vendors provide investment vehicles, it is expected that an employer would adopt a single document that coordinates administration among the various vendors, rather than having a separate document for each investment vendor.

For employers that make tax-sheltered annuity products available on a voluntary basis under an arrangement that is treated as exempt from ERISA, the plan document requirement will not necessarily prevent the employer from continuing to rely on the exemption. The U.S. Department of Labor indicated in a Field Assistance Bulletin that the existence of a plan document designed solely to comply with the final Code Section 403(b) regulations will not, by itself, void an employer's ability to rely on the exemption. The Department of Labor will analyze each employer's involvement in a tax-sheltered annuity program, and the employer's ability to rely on the ERISA exemption, on a case by case basis.

ACTION ITEMS: Plan sponsors should make sure (i) a written plan document exists for its 403(b) plan by January 1, 2009, (ii) the terms of the plan comply with the IRS final regulations, and (iii) the plan is administered in accordance with the IRS final regulations (which also include more stringent nondiscrimination testing standards).

Determination Letter Applications for “Cycle C” Filers (January 31, 2009)

The IRS is currently accepting determination letter applications for individually-designed qualified retirement plans that are maintained by plan sponsors that are considered “Cycle C” filers under the determination letter application program maintained by the IRS. Governmental plans (under Code Section 414(d)) and sponsors of individually-designed plans with a federal employer (sponsor) identification number ending in a “3” or an “8” are considered Cycle C filers (although certain special rules apply for multiemployer plans, multiple employer plans, and plans maintained by multiple members of the same controlled group that may require or permit a different filing cycle). The deadline for a Cycle C filer to submit a restated plan to the IRS for a determination letter is January 31, 2009.

As an alternative to submitting an individually-designed qualified retirement plan to the IRS by the January 31, 2009 deadline, plan sponsors may sign an IRS Form 8905, Certification of Intent to Adopt a Pre-Approved Plan by January 31, 2009 (if intending to restate in the form of a prototype or volume submitter plan rather than continue as an individually-designed plan).

ACTION ITEM: Cycle C Filers must either (i) restate and submit individually-designed qualified retirement plans to the IRS, or (ii) sign a Form 8905 Certification of Intent to Adopt a Pre-Approved Plan, by January 31, 2009.

If you have any questions, please contact Darcie A. Falsioni (716-566-2862, dfalsioni@bsk.com) or any of the other members of our Employee Benefits Law Practice Group listed below.

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