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Have you asked yourself lately about all the rules and regulations concerning the management of your human resources and employee benefit programs? You are in a minefield that could destroy you and your company.

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## WORKING FAMILIES TAX RELIEF ACT

The Working Families Tax Relief Act of 2004 (WFTRA) radically altered the definition of dependent under the tax code for tax years beginning January 1, 2005. WFTRA was meant to simplify the tax code provisions concerning children and dependents, but has complicated the definition of dependent found in Section 152 by creating two categories of dependents, qualifying children and qualifying relatives, each with different tests. As a result of the WFTRA changes, some persons who currently qualify as dependents will no longer qualify as of January 1, 2005, and vice versa. These changes can deny benefits to persons who have formerly qualified as dependents of employees or trigger tax on benefits that were previously excluded from employees' income, as well

as the associated reporting obligations for employers.

Examples of the changes to Dependent definition are: If an 18 year old who lives with his father receives one third of his support from his father and two thirds of his support from his aunt, he is currently a dependent of the aunt but starting in 2005 will be a dependent of the father.

If a 19-year-old son is not a student, earns more than \$3200, and receives more than half of his support from his father, he is currently a dependent of his father. After 2005, he will be a dependent of his father for the purposes of accident and health plans but not for other plans such as medical expense reimbursement plans.

There are issues plan sponsors of

both health and retirement plans should address:

1. Determine what plans should be addressed under the new law;
2. Amend any documents to reflect the new rules;
3. Safe Harbor withdrawals of 401ks may need to be addressed;
4. Dependents who no longer qualify as dependents under health plans should be notified...this could be a COBRA event too;
5. Change election forms to reflect the new definition;

Because of the potential COBRA ramifications of this new law these issues should be a priority.

# DAVID K. YOUNG CONSULTING TRENDS

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## US TREASURY RELEASES PROPOSED REGULATIONS FOR SECTION 403(B)

On December 14, 2004 the U.S. Treasury released proposed regulations that have a major impact on the administration of Section 403(b) Defined Contribution Plans. There are elements of the proposed regulations of which the full impact is not yet understood by the experts.

One significant change that has been a major topic for discussion since the release of the proposed regulations, is the proposed requirement that a §403(b) program be maintained under a written defined contribution plan that, in both form and operation, satisfies the regulatory re-

quirements of §403(b). These requirements must be written along with other applicable law and all of the material terms of the program within the plan's document. The preamble clarifies that the plan document does not have to be a single document, but rather this requirement could be satisfied by a group of documents. It also suggests that complying with the plan document rules for qualified plans would meet this new standard. This is a key point in the proposed regulations because it could mean the IRS expects 403(b) plan sponsors to comply with rules similar to ERISA. Title I. Nor-

mally employers such as school districts do not have to comply with these regulations under ERISA.

The full impact of this requirement is not clear. For example, it is unclear whether an individual annuity contract could satisfy all or part of the written plan document requirements, or whether a separate plan document would be necessary. Also, the proposed regulation does not address the possible impact of this plan-document requirement on contracts owned directly by individuals who have been treated as maintaining their

(See 403(b) on page 3)

## NEW AUTOMATIC ROLLOVER RULES TO BECOME EFFECTIVE MARCH 28TH

On September 28, 2004, the U.S. Department of Labor issued final "safe harbor" regulations concerning automatic rollover, or as some call them "forced distributions" for qualified re-

tirement plans.

Retirement plans are allowed to make a lump sum "cash-out" distribution to a participant whose benefits do not exceed \$5,000 without the participant's con-

sent. However, the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") amended Internal Revenue Code § 401(a)(31) to provide that any cash-out distribution in ex-

See New Rollover on page 3)

HUMAN RESOURCES  
NEWS & TRENDS

FOR THE CLIENTS  
& FRIENDS OF  
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## NEW PROVISIONS FOR NONQUALIFIED DEFERRED COMPENSATION PLAN UNDER SECTION 409A

The American Jobs Creation Act of 2004 (the "Act") made sweeping changes to non-qualified deferred compensation earned or vested after December 31, 2004. On October 11, 2004, the Senate gave final approval to the Act. The House had passed the Act on October 7, 2004 and the President signed it into law on October 22, 2004. The Act's reach is not limited to employees making elective deferrals under non-qualified deferred compensation plans. Because the Act does not define what constitutes a "deferral" it is broad enough to reach employer only contribution plans. The Act only excepts from its reach qualified employer plans (such as 401(a) plans, 403(b) plans or 401(k) plans) or bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plans.

As part of the Act, the Treasury was required to issue guidance by December 21, 2004 to provide a limited time during which non-qualified plans adopted before December 31, 2004 may be amended without violating the new rules. On December 20, 2004, the IRS issued Notice 2005-1 that provided the first in a series of such guidance.

The implications of a nonqualified plan failing to meet the new regulations requirements can be severe. The new regulations provide that if a deferred compensation arrangement fails any of the Act's requirements, (1) all amounts deferred for the individ-

ual for whom the failure exists will be taxed to that individual immediately; (2) a 20% additional tax will be imposed on the amounts deferred; and (3) interest on the amounts of underpayments in prior years will be imposed at the standard underpayment rate plus 1%. The Act also includes reporting and withholding obligations when an amount becomes taxable and reporting obligations when amounts are deferred.

Existing plans that do not have a material modification after October 3, 2004, may continue but may not accrue any further benefits after December 31, 2004.

The Act generally affects compensation deferred after December 31, 2004. However, the Act also affects amounts deferred under a plan that is "materially modified" after October 3, 2004. In Notice 2005-1, the IRS provides the following guidance in regard to applying the effective date of Code Section 409A: An amount is considered deferred as of December 31, 2004 if: 1.) the employee has a legal binding right to be paid the amount, and 2.) the right to the amount is earned and vested.

A material modification will occur if: 1.) a benefit or right as of October 3, 2004 has been enhanced or an new benefit or right has been added (even if permitted under Code Section 409A); or 2.) the vested December 31, 2004 amount has been accelerated.

Employers many times create a nonqualified plan or arrangement without being aware that they have created such a plan in the

eyes of the IRS. For instance, deferred compensation can be found in many places including: executive employment agreements and compensation arrangements, severance practices, plans or arrangements, bonus plans and bonus deferral plans, payments made as part of a reduction in force, non-qualified deferred compensation plans, non-qualified cafeteria plans, paid time off plans, SERPs, excess benefit plans, 401(k) mirror or wrap-around plans, elective deferral plans, golden parachute arrangements, change in control agreements, discounted options, omnibus stock compensation plans, stock appreciation rights, restricted stock units, directors plans and compensation arrangements, consulting agreements, compensatory partnership interests, split dollar life insurance, bank owned life insurance, and corporate owned life insurance.

If you feel your company has an arrangement that fits one of the above mentioned "plans" it is important that it be addressed as soon as possible to prevent loss of the grandfathered provisions of the new law. In addition, the new election rules are critical because they affect the timing of when elections must be made and what must be contained in the election. Thus, elections for 2005 must be reviewed now before any deferral elections are made to assure compliance with the election requirements and the distribution rules.

This is a complex rule change and demands the attention of experts in the field.

## NEW ROLLOVER PROVISIONS .... CONTINUED FROM PAGE 1

cess of \$1,000 must be rolled over to an IRA, unless the participant elects otherwise. The requirement is effective six (6) months after publication of Labor regulations, March 28th 2005. Plan sponsors have until that time to "clean up" any former employee/participant accounts below the \$5,000 threshold but above \$1,000 before the regulations become effective.

Many retirement plan record keepers are currently developing solutions for plan sponsors to accommodate the new rule allow rollovers into qualified investment vehicles.

Until that time plan sponsors can take one of the following approaches in order to comply with these new requirements: 1.) Amend their retirement plans to comply with the new automatic rollover rules. 2.) Amend their retirement plans to reduce the cash-out distribution limit under the plan from \$5,000 to \$1,000. This will allow the plan to make a cash-out distribution if the amount of the distribution is \$1,000 or less without having to comply with the new automatic rollover rules. 3.) Amend their retirement plans to eliminate cash-out distributions completely.

Plan documents must be amended by the end of the first plan year ending after March 28, 2005 to comply with these automatic rollover requirements. For a calendar year plan, the plan document must be amended by December 31, 2005. However, the plan must be administered to comply with these requirements on a good faith basis as of the effective date of these requirements, March 28, 2005. Before making an automatic rollover, a plan must provide participants with a Summary Plan Description or Summary of Material Modifications that describes the plan's new provisions.

## 403(B) REGULATION CHANGES PROPOSED CONTINUED FROM PAGE 1

own plan for §415 purposes or, whose contracts are no longer part of an employer-run program because of transfers.

As stated earlier, the extent to which the written plan document requirements will cause §403(b) plans of employers normally exempt from ERISA to be subject to ERISA Title I rules is an open question. Currently, DOL regulations and rulings enable employers offering §403(b) programs to avoid application of ERISA Title I rules (such as requirements for reporting, vesting, coverage, fiduciary duties, etc.) by keeping their involvement in the funding and administration of the §403(b) plan to a minimum. The gist of the DOL position is that the employer can offer a program and facilitate its use through payroll deduction

savings opportunities, for example, as long as the employer does not endorse the plan. What constitutes "endorsement" at a level that brings a plan under ERISA is a case-by-case determination, according to the Preamble to the proposed §403(b) regulation. The Treasury Department has specifically requested comments on the ERISA implications of the proposed regulations.

Another area of concern is the expanded concept of who is an employer. Appended to the proposed rules is a two-page proposal to amend the regulation defining a "controlled group" under IRC §414(c). That proposal would expand the definition of "corporations, trades or businesses under common control" to include tax exempt organizations

that are affiliated but not linked by ownership, if one of the organizations can control the other by appointing at least 80 percent of its trustees or directors. This concept would apply to all tax-exempt and governmental organizations, not just charities and schools, effective January 1, 2006.

The reason Treasury is proposing these regulations is due to the fact that current regulations under §403(b) have not been updated in 40 years, although the governing rules have changed considerably during that time. Consequently, one important function of the proposal is to revise the regulations to conform to numerous amendments made to §403(b) by legislation (including GUST<sup>2</sup> and EG-TRRA<sup>3</sup>) and to incorporate a number of items of interpretative guidance issued by the IRS).