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**DID YOU KNOW YOU ARE IN A MINEFIELD?**

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.

Do you have an administration need or questions about your:

- Pension or Retirement Plan
- COBRA Compliance and Administration
- Section 125/Cafeteria Plan
- Workers' Compensation/ERISA Plan
- FMLA Compliance
- ADA Compliance
- FLSA Compliance
- Job Descriptions
- Employee Handbook
- Policy & Procedures...?

**DAVID K. YOUNG CONSULTING  
TRENDS**

Volume XV No. 1 Winter 2008

**DEPENDENT CARE REGULATIONS UPDATE**

**HUMAN RESOURCES**

**NEWS & TRENDS**

**FOR THE CLIENTS**

**& FRIENDS OF**

**DAVID K. YOUNG,  
MPA, CEBS**

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On August 14, 2007, the Internal Revenue Service issued final regulations regarding the dependent care credit under Code §21 (typically referred to as the "Dependent Care Credit"). Dependent Care Flexible Spending Accounts (DCSA) are heavily impacted by these updates because Code §129, the statutory exclusion for employer-provided dependent care assistance, incorporates Code §21 and the Dependent Care Credit. Although the final regulations do not differ significantly from the proposed regulations issued

on May 24, 2006, there are important changes and clarifications that should be considered by plan sponsors. These final regulations are effective for taxable plan years beginning on or after August 14, 2007.

Expenses are considered eligible only when certain conditions are met, including the requirement that eligible expenses must be employment-related. The IRS considers "gainfully employed" individuals to be those who are employed full-time, attend school full-time or are actively seeking employment.

**Highlights of Changes**

**Education Expenses** – Expenses related to pre-school or similar programs below the kindergarten level may be employment-related expenses, even though educational activities may be a significant part of these programs. Expenses related to kindergarten and above are not employment-related expenses.

**Specialty Day Camps & Boarding School** – The rules provide that spe-

*(See "DCSA... on page 3)*

**ERISA REGULATIONS:  
PROHIBITED TRANSACTIONS**

Each year DKY has a plan sponsor who has strayed into the area of prohibited transaction regulated by the DOL. Below is a discussion on what transaction are prohibited by ERISA.

**Asset Transfers** : ERISA Section 406(a)(1)(D) does not allow a plan fiduciary to transfer plan assets to a party in interest, or otherwise use plan assets for the benefit of a party in interest to the

plan. Examples of disallowed asset transfers between a plan fiduciary and a party in interest are:

\* Plan fiduciaries not transmitting employee contributions in a timely manner to the plan violate the asset transfer prohibited transaction. DKY sees this more often than one might expect. We have had one plan sponsor that repeatedly failed to transfer the deferrals and matching con-

tributions. The plan was audited and the DOL issued sanctions against the Employer. By failing to transfer the contributions (plan assets) into the plan in a timely manner, the fiduciary in effect allowed those assets to benefit the company, a party in interest to the plan.

\* Plan fiduciaries transferring assets from the plan to a general account

*(See "Prohibited..." on page 3)*

**QUALIFIED DEFAULT INVESTMENT ALTERNATIVES**

The U.S. Department of Labor issued new final regulations relating to Qualified Default Investment Alternatives. Automatic enrollment is rapidly becoming popular with plan sponsors and the following overview should be kept in mind when moving towards this type of plan design.

The Department of Labor regulations provide fiduciary relief to plan fiduciaries of participant-directed plans that invest participant assets in certain types of default investment alternatives when there is no investment direction from the participant. Under the Department of Labor's final regulations, a plan fiduciary will be afforded relief from liability provided the following six conditions are met:

The plan's Qualified Default Investment Alternatives fit the investment types per-

mitted under the Department of Labor's final regulations.

Each participant is given an opportunity to direct contributions on his/her behalf but failed to do so.

The participant must be provided with a written notice 30 days in advance of the first investment in a Qualified Default Investment Alternative and an annual notice thereafter.

Participants are automatically provided investment information relating to the Qualified Default Investment Alternatives, such as a fund profile.

Participants who are defaulted into the Qualified Default Investment Alternative are permitted to transfer

out of the Qualified Default Investment Alternative at least quarterly without financial penalty.

The plan offers a broad range of investment alternatives that satisfy ERISA Regulation section 404(c)-1(b)(3) requirements.

These six conditions are described broadly above; you can read highlights of the Department of Labor's regulations. If these six conditions are met, a plan fiduciary will not be liable under the ERISA fiduciary standards for any loss resulting from the investment in a Qualified Default Investment Alternative or for any investment decisions of the Qualified Default Investment Alternative manager.

## PROHIBITED TRANSACTIONS.....CONTINUED FROM PAGE 1

but were unable to provide any documentation supporting their claim that the transfer was intended to reimburse the company for administrative services it provided to the plan.

\* The fiduciary of a plan wants to purchase a retroactive retirement benefit for a long-term employee who had never participated in the plan.

\* A plan fiduciary transfers assets from the plan to an entity in which he was the sole shareholder.

**Employer Securities and Real Property:** ERISA Section 406(a)(1)(E) and ERISA Section 407(a) prohibit the sale, on behalf of a plan, of employer securities or employer real property, unless these meet the definition and requirements of Qualifying Employer Securities (QES) and Qualifying Employer Real Estate (QERP). Qualifying Employer Securities (QES) and Qualifying Employer Real Estate (QERP) usually are utilized in Employer Stock Ownership Plans and will not be discussed in detail in this article. The purchase of real estate as an asset in a plan is an almost sure way to be audited by the DOL.

**Self Dealing:** ERISA Section 406(b)(1) expressly prohibits a plan fiduciary from dealing with the assets of the plan in his or her own interest, or for his or her own account. Basically, Section 406(b)(1) makes illegal any plan transaction from which a plan fiduciary receives any kind of benefit. Examples of fiduciary self dealing specifically have been disallowed are:

\* Plan trustees authorize monthly payments to themselves as compensation for services they rendered to the plan in addition to re-

ceiving full time compensation from the sponsors of the plan.

\* A plan's fund trustee and his wife receive cash and loans from the founder of a bank while having the fund purchase certificates of deposit from that bank. To take this further, accepting a cruise or other kinds of trips/benefits from a service provider such as a stock broker or insurance company.

\* An insurance agent providing investment advice to the plan, advised plan trustees to invest plan assets in products from which he receives undisclosed commission.

\* A plan fiduciary delays transmitting employee contributions to a plan so that he could pay company expenses instead.

**Parties With Adverse Interests:** ERISA Section 406(b)(2) states that in no capacity whatsoever shall a plan fiduciary be involved in any transaction involving the plan where one of the parties involved has interests that are adverse to the interests of the plan, its participants or its beneficiaries. Examples of parties with adverse interests are:

\* Plan trustees, who are officers of the company sponsoring the plan, authorize plan loans to the sponsoring company.

\* An individual who is a trustee of two separate retirement plans whose participants and beneficiaries are not the same, authorize loans between the two plans without obtaining a prohibited transaction exemption.

\* A plan's investment manager invests the plan's assets in a speculative investment in which he holds a substantial equity interest. As a result the plan suffers substantial losses.

**Kickbacks:** The prohibited transaction regarding kickbacks is a somewhat ambiguous transaction, and there are not many examples provided in case law. Essentially, ERISA Section 408(b)(2) provides a prohibited transaction exemption allowing a plan to pay a party in interest for goods or services rendered if the services were necessary to the plan, were the result of a reasonable agreement, and the compensation paid was reasonable. ERISA Section 406(b)(3) basically states that if a party in interest receives compensation from a plan for any reason other than those defined in Section 408(b)(2), or if the compensation paid to the party in interest influenced his or her decisions with respect to plan expenditures, then the compensation could be considered to be a "kickback." Examples of transactions determined to be kickbacks are:

\* A plan fiduciary gives investment advice to a plan, and the plan invests plan assets in companies that the plan fiduciary either owns an interest or receives fees or other consideration.

\* A plan trustee receives gratuities from a plan service provider.

In concluding our examination of prohibited transactions, it is important for you to be familiar with the types of transactions prohibited by ERISA and to understand the reasons why they are prohibited. As a plan fiduciary, you must fulfill the standard of care required by ERISA and you must assess carefully every transaction in which the plan engages to ensure that the transaction does not violate any of the prohibitions. Otherwise, you fail to fulfill your obligations you owe the plan, and you face the possibility of causing harm to the plan participants and beneficiaries.

## IRS RELEASES MODEL 40(B) PLAN LANGUAGE

The IRS released Rev. Proc. 2007-71, providing model 403(b) plan language for public schools. The procedure also provides guidance on certain annuity contracts and custodial accounts issued before January 1, 2009.

**Model Plan.** The model 403(b) plan provided in the procedure is a deferral only (no employer contributions) plan for public schools. If an employer uses the model plan on a word for word basis or in format that is substantially similar, the plan has the status of receiving a favorable IRS private letter ruling. The model plan language does not provide and reliance for a tax-exempt employer.

### DCSA.... CONTINUED FROM PAGE 1

cialty day camps, even those with educational components, are eligible dependent care services. However, summer school and tutoring expenses, which are purely educational in nature, are ineligible services. Furthermore, with regard to boarding school, the day care aspect of boarding school is an eligible expense. Therefore, boarding school costs must be appropriately divided between day care and other ineligible expenses like food and education.

**Overnight Care and Overnight Camp** – In a situation where one spouse works during the day and the other works at night and sleeps during the day, overnight care for a qualifying child may be considered an employment-related expense. This should not be confused with an overnight camp, which is not considered an eligible expense.

**Room & Board** – Additional costs to provide room and board for an in-home caregiver in excess of usual household expenses are eligible for

Some of the key features the plan permits are: automatic enrollment, exclusion of student-teachers and employees who normally work less than 20 hours per week (the language does not include the other statutory exclusions), qualified organization and age 50 catch-up contributions, loans, cash-outs, hardship withdrawals, rollovers and transfers.

With respect to some of the key features (e.g., loans, hardship distributions, acceptance of rollover and transfers), the model plan provides the necessary language but leaves to the contract the decision as to whether such features are available. Therefore, custodians and annuity

reimbursement. However, the caregiver cannot be the employee's spouse, child under the age of 19 or other dependent.

**Transportation Expenses** – An employee's travel expenses to and from day care facilities are not eligible for reimbursement. However, the cost of transportation (e.g. transportation to an after-school program not on the school's premises) furnished by a dependent care provider may be an employment-related expense.

**Agency Fees & Applications** – Indirect expenses such as application and agency fees and deposits may be reimbursable only if the employee is required to pay the fees to obtain the care and only if the care is in fact provided.

**Short-term Absences** - Short, temporary absences from work may be disregarded for taxpayers who must continue to pay for dependent care expenses during the absence. Whether an absence is short and

providers ("vendors") that intend to use the model plan must make certain the contracts (or separate agreements) contain the necessary language to trigger the features.

The model plan also imposes some responsibilities on the vendors. For example, the vendors have an obligation to search for lost participants and make certain participants complete a beneficiary designation. Another provision may cause vendors to think twice before using the plan; the model language includes a provision which indicates that in the event of a conflict between the model language and the contract, the model language prevails.

temporary depends on the facts and circumstances of the situation; however the final regulations stipulate that an absence of up to two consecutive weeks due to brief illness or vacation is a short-term or temporary absence. An absence extending beyond two weeks may still be considered short-term if certain conditions apply, however the rules make clear that an absence of four months would never be considered short-term.

**Part-time Employment** - With regard to part-time employment, an individual working part time must apportion amounts for days worked versus days not worked. On the other hand, if the part-time employee is required to pay for care on a periodic basis (including non-working days), no apportionment is necessary.

**Payments to Related Individuals** - Payments to a taxpayer's spouse or to a parent of the taxpayer's child who is not the taxpayer's spouse are not qualified expenses.