

Action Alert

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Important changes impacting the area of employee benefits

Alert No. 2

February 1, 2006

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Qualified Retirement Plans and Fringe & Welfare Benefit Plans

An e-publication from the Employee Benefits Practice Group at Damon & Morey LLP

By
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The following is a checklist of some of the recent developments in the area of employee benefits which you may need to address in 2006 with respect to the employee benefit plans that you sponsor:

Qualified Retirement Plans

Roth 401(k) Contributions. Beginning in 2006, sponsors of 401(k) plans may permit employees to make “Roth” deferrals to a 401(k) plan. Roth deferrals are made from after-tax pay and, unlike pre-tax 401(k) deferrals, distributions of Roth deferrals and the earnings attributable to the Roth deferrals are not subject to taxation.

Plan sponsors that implement Roth deferrals in 2006 must generally amend their 401(k) plans by December 31, 2006.

Final 401(k) Regulations. On December 29, 2004, the IRS has published final regulations under Sections 401(k) and (m) of the Internal Revenue Code (the “Code”). Compliance with these regulations is required for plan years beginning on or after January 1, 2006.

Some of the significant changes include:

- Elective and matching contributions may not be prefunded prior to the time that the participant performs the services for which the compensation would otherwise have been paid.
- An employer’s ability to use a bottom up correction method for making qualified nonelective contributions (“QNEC”) to enable the plan to pass the ADP and ACP tests has been severely restricted.

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- The hardship distribution rules have been expanded to include two permissible distributable events:
 - (1) funeral expenses for the employee’s deceased parent, spouse, children, or dependents; and
 - (2) expenses for the repair of damage to the employee’s principal residence that would qualify for deduction under Code Section 152.
- A 401(k) plan may provide for automatic enrollment if the employee does not affirmatively decline to participate.

Retirement Plan Dollar Limits. The adjustments to the dollar limitations for qualified plan contributions and benefits for 2006 have been announced by the IRS. Both the 2005 and 2006 annual limits are listed below:

Retirement Plan Limits	2005	2006
Section 402(g) limit on 401(k) deferrals	\$ 14,000	\$ 15,000
Section 414(v)(2)(B)(i) limit for catch-up contributions	\$ 4,000	\$ 5,000
Section 408(p)(2)(E) SIMPLE elective deferral limit	\$ 10,000	\$ 10,000
Section 415(c)(1)(A) annual limit on contributions to defined contribution plans	\$ 42,000	\$ 44,000
Section 415(b)(1)(A) annual benefit limit for defined benefit plans	\$170,000	\$175,000
Section 414(q)(1)(B) compensation used to determine highly compensated employee	\$ 95,000	\$100,000
Social Security Taxable Wage Base*	\$ 90,000	\$ 94,200
<i>*Provided by the Social Security Administration</i>		

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Fringe and Welfare Benefit Plans

Optional 2 ½ Month Grace Period. The IRS released a notice allowing employees participating in medical and dependent care flexible spending arrangements (“FSA”) a 2 ½ month period after the end of the plan year to incur eligible medical and dependent care expenses. Previously, amounts remaining in an FSA at year end were required to be forfeited.

Plan sponsors are not required to adopt the grace period, however, sponsors who choose to adopt the extended grace period must amend their flexible spending plans by the end of the plan year.

Military Leave. The Veterans Benefits Improvement Act of 2004 (“VBIA”) amended the Uniformed Services Employment and Reemployment Rights Act (USERRA) and with respect to veterans’ employment rights and on December 18, 2005, the Department of Labor issued final regulations under USERRA. Among the requirements, employers are required to provide an updated notice to employees of their rights and benefits under USERRA by January 18, 2006. A model poster can be found at www.dol.gov/vets/programs/userra/USERRA_Private.pdf.

Additionally, employers are now required to provide up to 24 months of continuing health coverage for employees on military leave. This period is six months longer than the 18-month period previously required.

Domestic Partnership. Employers offering health and welfare benefits for the domestic partner of an employee generally must impute the fair market value of the employer’s contributions toward the coverage in the employee’s federal gross income unless such domestic partner qualifies as a “dependent” under Section 152 of the Internal Revenue Code. Additionally, cafeteria plans may only be used to cover medical and dependent care expenses for a domestic partner that qualifies as a dependent under the Code. The state tax treatment varies by state, requiring employers with multi-state facilities that offer domestic partner benefits to be mindful of the payroll tax and withholding requirements applicable to these benefits. Plan documents and summary plan descriptions should be reviewed to insure that the definition of “spouse” or “domestic partner” is consistent with their plan’s intended definition.

Please call Pamela Fielding at (716) 858-3830 if you have any questions on this or any other Employee Benefits related matters.

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