

2005 Health & Welfare Benefits Year in Review

CONTENTS		
<p>All employee benefit plans-Definition of “dependent” in IRC revised.</p> <p>Deferred compensation regulations under Code Section 409A.</p> <p>Health Plans-Medicare Part D prescription drug creditable coverage notices and retiree subsidy.</p> <p>Health Plans-COBRA Continuation Coverage</p> <p>Health Plans-HIPAA Security</p> <p>Health Plans-Guidance regarding use of unused vacation or sick pay for health benefits</p>	<p>Health Plans-HIPAA Portability Rules</p> <p>Cafeteria Plan-Grace Period (Initial Guidance)</p> <p>Dependent Care Assistance Plan-W-2 reporting guidance for plans with grace period</p> <p>Dependent Care Assistance Plans-Form 2441 revisions to accommodate grace period</p> <p>HSAs-Impact of grace period on HSA eligibility.</p> <p>HSAs-Treatment of contributions by partnership to partners’ HSAs</p>	<p>HSAs-clarification regarding the married couple rule set forth in Code Section 223(b)</p> <p>HSAs-Comparability Rules</p> <p>HSAs-Transition relief relating to state laws for plans with non-calendar year renewals.</p> <p>Hurricane Relief for victims Hurricane Katrina</p> <p>WHAT’S ON THE HORIZON FOR 2006</p>

<i>Item</i>	<i>Rule, Regulation or Guidance</i>	<i>Effective Date</i>	<i>Highlights</i>
<p>All employee benefit plans-Definition of “dependent” in IRC revised.</p> <p>Action: Review current plan dependent definitions; amend plans to incorporate new definitions. Communicate new definitions to participants. Impute taxes where appropriate for non-tax dependents.</p>	<p>Working Families Tax Relief Act passed by Congress in October of 2004.</p> <p>WFTRA revises the definition of dependent in the Internal Revenue Code for various tax purposes, including income tax, health care and dependent care credit and assistance.</p> <p>Pending technical correction will address, among other things, income limit for disabled adult dependents. (Note: In Form 2441 IRS has already assumed Technical Correction has passed).</p>	<p>Tax years beginning January 1, 2005.</p>	<ul style="list-style-type: none"> ▪ “Dependent” defined generally as either a qualifying child (new definition regarding child under the age limit (under 19 or under 24 if full time student) who resides with employee-no support requirement) or qualifying relative (old pre-WFTRA dependent definition with support requirement but with new income limit also imposed). ▪ Income limit (and certain other general dependent restrictions) removed for purposes of health plan definition under Section 105(b). ▪ Head of household requirement removed for purposes of Code Section 129 plan. Dependent definition revised to incorporate income limit. [Note pending technical Correction]

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<p>Deferred compensation regulations under Code Section 409A.</p> <p>Action: Review all welfare plan arrangements to determine whether impacted by 409A. Particular attention should be paid to severance arrangements and vacation/PTO banks to ensure fit 409A exceptions. Individual separation arrangements should be reviewed as well.</p>	<p>New section of the Internal Revenue Code enacted under American Jobs Creation Act of 2004 to codify rules and restrictions regarding nonqualified deferred compensation plans and other “deferred compensation arrangements”</p> <p>Further guidance and interpretation issued by Treasury in Notice 2005-1 (Dec. 20, 2004) and in Proposed Rule issued September 29, 2005 (published in Fed. Reg. Vol. 70, No. 191, p.57930, October 4, 2005).</p>	<p>Applies to all deferred compensation unless earned and vested prior to January 1, 2005, as well as amounts earned and vested prior to January 1, 2005 under a deferral arrangement which has undergone a “material modification” after October 3, 2004. Special transition rules in place.</p> <p>Comments to proposed rules being accepted until January 4, 2006.</p>	<ul style="list-style-type: none"> • Enacted to limit perceived abuses under deferred compensation plans and programs. • Affects areas not generally thought of as deferred compensation (term is defined very broadly to include any arrangement that defers taxable compensation where not subject to substantial risk of forfeiture) • Provides for immediate taxation plus 20% additional tax for amounts deferred under noncompliant plan (plus interest) • Affect on severance plans: Severance plans generally compliant where key employees do not participate or where collectively bargained. Other

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			<p>exceptions apply if payout is below a threshold amount or within a certain limited period of time..</p> <ul style="list-style-type: none"> • PTO/Vacation: Will impact plans which allow for carryover or banking of time and sale back to company of previously earned time at option of employee (arguably these did not comply with prior constructive receipt rules anyway) • Individual Employment Agreements: Any and all of the above can be implicated. Total value of all portions of individual arrangement taken into account.

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<p>Health Plans-Medicare Part D prescription drug creditable coverage notices and retiree subsidy.</p> <p>Action: Make creditable coverage determination; issue creditable coverage notices and determine eligibility for subsidy. Consider possible plan redesign for prescription drug benefits.</p>	<p>Medicare Prescription Drug Improvement and Modernization Act of 2003 passed by Congress in October of 2003.</p>	<p>Creditable coverage notices required by November 15, 2005.</p> <p>Application for retiree subsidy required by October 31, 2005 and each year thereafter.</p>	<ul style="list-style-type: none"> ▪ Both active and retiree health plans required to determine if plan provides “creditable prescription drug coverage”, which is prescription drug coverage that is equal to, on average, Medicare prescription drug coverage. Notices of such determination required to be provided to all Part D eligible individuals covered under the plan by November 15, 2005 ▪ If coverage passes two part actuarial equivalence test, employer may apply for annual 28% tax free subsidy on certain retiree prescription drug costs for those not covered by Part D. Initial application for subsidy due October 31, 2005.

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<p>Health Plans-COBRA Continuation Coverage</p> <p>Action: Review/revise initial and qualifying event notices. Prepare new Notice of unavailability and Notice of coverage termination.</p>	<p>Final regulations issued by Employee Benefits Security Administration on May 26, 2004.</p>	<p>Notice obligations arising on or after the first day of the plan year beginning on or after November 26, 2004.</p> <p>For calendar year plans, the regulations apply to notice obligations arising on or after January 1, 2005.</p>	<ul style="list-style-type: none"> ▪ Model notices issued for both Initial and Election Notice ▪ Revised time period for providing initial notice ▪ Revised time period for providing notice of disability determination ▪ Qualified beneficiary notices not triggered until notice of obligation provided in SPD or Initial Notice ▪ 2 new notice requirements established: <ul style="list-style-type: none"> ○ Notice of unavailability ○ Notice of premature termination of coverage

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<p>Health Plans-HIPAA Security</p> <p>Action: Undertake security risk analysis, appoint security official, implement policies and procedures to adequately protect electronic PHI, amend health plans and update business associate agreements.</p>	<p>Final regulations issued on February 20, 2003.</p> <p>Regulations address safeguards afforded use and disclosure of electronic PHI by covered entities (e.g. group health plans).</p>	<p>Effective for “large health plans” on April 21, 2005. Effective April 21, 2006 for certain small plans.</p>	<ul style="list-style-type: none"> ▪ Covered entities required to conduct risk analysis of existing electronic safeguards ▪ Covered entities required to implement safeguards based on risk analysis and implementation standards set forth in regulations.
<p>Health Plans-Guidance regarding use of unused vacation or sick pay for health benefits</p> <p>Action: Evaluate planning possibilities associated with mandatory conversion of unused “banked time to health reimbursement arrangement.</p>	<p>Revenue Ruling 2005-24 issued April 18, 2005.</p> <p>Guidance addresses ability to transfer unused sick or vacation pay to health reimbursement arrangement.</p>	<p>Effective as of date of issuance.</p>	<ul style="list-style-type: none"> ▪ Allows employers to transfer accrued unused sick or vacation pay to health reimbursement arrangement without imposition of constructive receipt if transfer is mandatory (i.e. participants cannot elect to transfer such accrued pay to HRA). ▪ Guidance addresses transfer at retirement but transfer presumably permissible each year for actives as well

<i>Item</i>	<i>Rule, Regulation or Guidance</i>	<i>Effective Date</i>	<i>Highlights</i>
<p>Health Plans-HIPAA Portability Rules</p> <p>Action: Evaluate health plans under new HIPAA guidance. Determine whether “hidden pre-existing condition limitations exist; update certificates of creditable coverage; evaluate lifetime maximums and special enrollment procedures.</p>	<p>Final regulations issued December 30, 2004.</p>	<p>Effective for plan years beginning on or after July 1, 2005.</p>	<ul style="list-style-type: none"> ▪ Pre-existing condition exclusion notice required with enrollment material (where plan has pre-existing condition exclusion/limitation) ▪ Revised certificate of creditable coverage ▪ Clarification regarding definition of “loss” of coverage for special enrollment purposes and coverage options available upon special enrollment.

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<p>Cafeteria Plan-Grace Period (Initial Guidance)</p> <p>Action: Prior to end of cafeteria plan year evaluate whether to adopt grace period; check with administrator to ensure grace period adjudication possible; address whether carryover claims will be re-processed if prior plan year balance exhausted by grace period claims; communicate changes to participants with sufficient time to take advantage of grace period. Note HSA impact discussed below.</p>	<p>Notice 2005-42 issued by IRS on May 18, 2005.</p>	<p>Effective for all plan years ending after the date the Notice was issued.</p>	<ul style="list-style-type: none"> ▪ Allows employers to amend plan to enable participants to use funds not used at end of the plan year for expenses incurred during a “grace period” following end of the plan year. ▪ Grace period cannot extend more than 2 ½ months after the end of the plan year (but may be shorter) ▪ Employer can choose which qualified benefit plans (such as Health or Dependent Care FSA) to apply the grace period; however, it must apply to all participants in the plan to which the grace period applies. ▪ Technically, the grace period applies to all qualified benefits. Therefore, salary reductions used in one plan year may be applied to coverage provided in the next year during grace period. This opens door for employees to use pre-pay option during leave beyond the end of the plan year.

<i>Item</i>	<i>Rule, Regulation or Guidance</i>	<i>Effective Date</i>	<i>Highlights</i>
<p>Dependent Care Assistance Plan-W-2 reporting guidance for plans with grace period</p> <p>Action: If adopt grace period, determine how to test DCAP carryover benefits for discrimination testing and key employee concentration testing purposes.</p>	<p>Notice 2005-61 issued by IRS on September 7, 2005.</p>	<p>Applies to W-2 reporting for 2005 tax year.</p>	<ul style="list-style-type: none"> ▪ Indicates that employer may report salary reduction amount on W-2 as amount of benefits provided during the year (in reliance on Notice 89-111) even if benefits are in excess of statutory limits due to carryover from prior year. ▪ Although not specifically stated, the guidance seems to indicate that carry over amounts are essentially treated as paid during the prior plan year. This would suggest that 129 discrimination testing is based on salary reduction amounts and not actual benefit amounts paid during the year.

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<p>Dependent Care Assistance Plans-Form 2441 revisions to accommodate grace period</p>	<p>IRS released revised Form 2441 and instructions</p>	<p>2005 tax years</p>	<ul style="list-style-type: none"> ▪ Pre-revised form did not account for carry over amounts, resulting in filers potentially showing tax due on DCAP carryover amounts properly reimbursed. ▪ Revised form treats carry over the same as forfeiture amounts, even if completely used for expenses incurred during the grace period.
<p>HSAs-Impact of grace period on HSA eligibility.</p> <p>Action: Health FSA plan sponsors that adopt grace period carryover should take steps to preserve HSA eligibility and communicate impact of grace period on HSA eligibility.</p>	<p>Notice 2005-86 issued on November 22, 2005.</p>	<p>Generally effective immediately; however, transition relief provided for plan years ending on or before June 5, 2006.</p>	<ul style="list-style-type: none"> ▪ General purpose Health FSA grace period disqualifies grace period participant from HSA until first day of first month following grace period, even if participant has no carry over funds or exhausts funds prior to end of grace period. ▪ Employer may amend plan for all participants in plans to convert grace period to limited purpose Health FSA. ▪ Transition relief indicates that otherwise eligible individual with no carry over funds or participant in plan amended by employer to exclude HDHP participants is not disqualified by virtue of grace period.

<i>Item</i>	<i>Rule, Regulation or Guidance</i>	<i>Effective Date</i>	<i>Highlights</i>
			<ul style="list-style-type: none"> ▪ Grace period participant is any participant covered under the plan on the last day of the plan year either as active employee or qualified beneficiary (presumably all qualified beneficiaries covered on last day of plan year are grace period participants) ▪ Employees who terminate prior to end of grace period are entitled to participate in remainder of grace period.

<i>Item</i>	<i>Rule, Regulation or Guidance</i>	<i>Effective Date</i>	<i>Highlights</i>
<p>HSAs-Treatment of contributions by partnership to partners' HSAs</p> <p>Action: Partnerships with HSAs should review this ruling.</p>	<p>Notice 2005-8 issued January 24, 2005</p>	<p>Effective immediately</p>	<ul style="list-style-type: none"> ▪ Clarified that contributions treated as distributions are not deductible by partnership and are included in the partner's gross income but not "net earnings from self-employment". ▪ Contributions treated as guaranteed payments are deductible by the partnership and are included in partner's net earnings from self employment".
<p>HSAs-clarification regarding the married couple rule set forth in Code Section 223(b)</p> <p>Action: Married HSA participants should review this ruling to determine impact on HSA eligibility and contributions.</p>	<p>Revenue Ruling 2005-24 issued April 18, 2005</p>	<p>Effective immediately</p>	<ul style="list-style-type: none"> ▪ Essentially clarified that the married couple rule in Code Section 223 does not operate to disqualify an individual whose spouse has non-qualifying family coverage so long as the individual is not covered under the spouse's plan (e.g. where the spouse has low deductible health coverage covering the spouse and children but not the employee).

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<p>HSAs-Comparability Rules</p> <p>Action: Employers that contribute to HSA arrangements must carefully review contribution arrangement to ensure compliance with comparability rule or that cafeteria plan exception applies.</p>	<p>Proposed regulations issued August 26, 2005</p>	<p>Not yet effective</p>	<ul style="list-style-type: none"> ▪ Clarifies definition of “comparable participating employee” ▪ Clarifies definition of “comparable contributions” ▪ Establishes timing requirements for employer contributions under comparability rule. ▪ Clarifies when contributions are “made through cafeteria plan”.
<p>HSAs-Transition relief relating to state laws for plans with non-calendar year renewals.</p> <p>Action: HDHP sponsors of fully insured plans with non-calendar year plans have additional time to address state mandate issues.</p>	<p>Notice 2005-83 issued November 18, 2005.</p>	<p>Generally effective immediately</p>	<ul style="list-style-type: none"> ▪ (For insured plans that would qualify as HDHPs but for compliance with a state mandate) Insured plans with non-calendar year renewals beginning before January 1, 2006 are deemed in compliance with IRC Section 223 until the beginning of the next 12 month renewal period (so long as it begins before December 31, 2006)

<i>Item</i>	<i>Rule, Regulation or Guidance</i>	<i>Effective Date</i>	<i>Highlights</i>
<p>Hurricane Relief for victims Hurricane Katrina</p> <p>Action: Evaluate COBRA, HIPAA, and claims processing procedures to facilitate Katrina-required relief.</p>	<p>Various Internal Revenue Releases and jointly issued guidance by IRS and EBSA</p>	<p>Applies generally to deadlines falling between August 29, 2005 and February 28, 2006.</p>	<ul style="list-style-type: none"> ▪ IRS and EBSA issue guidance providing relief from August 29, 2005 through February 28, 2006 for the following time sensitive deadlines for certain victims of Hurricane Katrina: <ul style="list-style-type: none"> ○ 63 day break in coverage rules ○ 60 day COBRA election period ○ 60 day notice period of qualifying event ○ 30 day special enrollment period ○ 30 day period to enroll newborn in creditable coverage ○ COBRA premium payments ○ Times to file claims and appeals ▪ Plans affected by Hurricane Katrina issued relief for same period for the following: <ul style="list-style-type: none"> ○ Election notice period ○ Certificate of creditable coverage

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			<ul style="list-style-type: none"> ○ Optional: Use it or lose rule can be delayed until February 28, 2006 ▪ Form 5500 otherwise due during relief period due February 28, 2006. ▪ Form 5500 otherwise due between August 24, 2005 and February 28, 2006 for those in Florida affected by Katrina due February 28, 2006.
Hurricane Relief for those affected by Hurricane Rita	EBSA Press Release issued September 28, 2005	Relief period between September 23, 2005 and February 28, 2006	<ul style="list-style-type: none"> ▪ Forms 5500 otherwise due for plans affected by Rita during the relief period due February 28, 2006.
Hurricane Relief for those affected by Hurricane Wilma	EBSA Press Release issued October 31, 2005	Relief period between October 23, 2005 and February 28, 2006	<ul style="list-style-type: none"> ▪ Forms 5500 otherwise due for plans affected by Wilma during relief period due February 28, 2006.

WHAT'S ON THE HORIZON FOR 2006

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Health Plans-HIPAA Portability Rules	Final regulations issued December 30, 2004	Calendar year plans beginning January 1, 2006	<ul style="list-style-type: none"> ▪ See above
HIPAA Security	Final regulations issued February 20, 2003	April 21, 2006 for small health plans (less than 5 million in claims)	<ul style="list-style-type: none"> ▪ See above
Katrina Relief	Various releases and guidance	See above	<ul style="list-style-type: none"> ▪ Certain time sensitive deadlines that may have otherwise ended during relief period must be extended. See above for more details.
Other potential regulations and guidance for 2006			<ul style="list-style-type: none"> ▪ HIPAA non-discrimination rules ▪ Electronic Payment card guidance ▪ Final comparability regulations ▪ Tax reform measures