

Summer 2008

Benefits Alert

for Tax Exempt and Government Entities

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Deadline for IRS Determination Letter Applications for Governmental Retirement Plans: **January 31, 2009**

The IRS is now accepting determination letter applications for individually designed defined benefit and defined contribution plans sponsored by governmental entities. Under IRS procedures, individually designed retirements plans must be updated for changes in the law and file requests for determination letters on a five-year staggered cycle. Governmental plans fall within "Cycle C," meaning

that the application must be filed no later than January 31, 2009, or else the plan sponsor will have to wait another five years to file for an updated letter.

The updated plans must reflect statutory changes under the Economic Growth and Tax Relief Reconciliation Act of 2001, the Pension Funding Equity Act of 2004, the American Jobs Creation Act of 2004, and other legislation.

Most governmental plans are individually designed plans. Given the size and importance of these plans, especially the defined benefit plans, it is highly recommended that the plan documents be updated for changes in the law and quickly submitted for new determination letters. Any governmental plan sponsor that has not made arrangements to have their plan updated and submitted for a new determination letter should contact Jim Kolan at (757) 624-3135 or Ann Bruce at (757) 624-3159.

Reminder to Update 403(b) Tax Sheltered Annuity Plan

The final regulations under Code section 403(b) will take effect on January 1, 2009. ***All tax-exempt employers, colleges, universities and public school systems that provide a 403(b) plan for their employees are required to have adopted written 403(b) plan documents on or before December 31, 2008.***

In addition, a 403(b) plan that allows for contract exchanges between different annuity vendors must enter into an information sharing agreement with the issuers of the annuity contracts. Under the information sharing agreements, the employer and the issuer will from time to time share employment status and other tax information necessary to satisfy the requirements of section 403(b).

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Kaufman & Canoles offers a prototype 403(b) plan document that is easy to implement, flexible, and cost effective. Plan sponsors with questions about implementing these requirements should contact Jim Kolan at (757) 624-3135 or Ann Bruce at (757) 624-3159.

Potential Impact on Schools and Universities of Recurring Part-Year Compensation

The IRS issued Notice 2008-62 on July 21, 2008 to provide an exception to new deferred compensation rules for “recurring part-year compensation” for employees of schools and universities. Without an exception, such arrangements would arguably result in a portion of the teacher’s salary being included as phantom income under section 457(f) of the Internal Revenue Code in a calendar year prior to the employee’s actual receipt of payment.

Recurring part-year compensation consists of the compensation a teacher earns during a school year of less than 12 months that begins in one calendar year and ends in the next calendar year. Employees who provide services over the entire 12-month service period are not subject to this rule.

The exception provides that none of the compensation paid to a teacher will be treated as deferred compensation if (1) the recurring part-year compensation is not deferred beyond the last day of the 13th month following the beginning of the service period, and (2) the amount the teacher earns during the first calendar year that is paid in the second calendar year does not exceed the dollar amount under Code section 402(g)(1)(B) applicable for the first calendar year (\$15,500 for 2008).

This exception will cover most employees of schools and universities except those earning, for example, more than \$186,000 for a ten-month service period beginning on August 1st or more than \$232,500 for a ten-month service period beginning on September 1st.

While the exception will cover most recurring part-year compensation, what about employees with deferred compensation above the \$15,500 limit in 2008? We recommend that public school districts and universities first determine whether any employees are affected by this rule. If there are, then schools and universities can “fix” this problem under any one of the following scenarios:

- Synchronizing the payment of wages with the service period – at least for those with deferred compensation greater than the \$15,500 limit. This may be a problem if cash flow is compromised or if similarly situated employees are now treated differently.
- Paying the amount that would be deferred compensation before the end of the 2008 calendar year. This may create administrative, fairness and payroll administration issues.
- Report the deferred compensation as taxable in Year 1 and tax-free when paid in Year 2. This solution results in the inclusion of compensation income without cash received to pay taxes. The public school district or university will have to increase the teacher’s income tax withholding without any corresponding increase in cash compensation.

Please feel free to call any member of the Employee Benefit Group if you have questions about how Notice 2008-62 applies to your employees.

Employee Benefits & Executive Compensation Team

The attorneys who practice in the firm's Employee Benefits Practice Group have established a full-time commitment to this practice. They offer clients the highest level of experience and sophistication in the area of employee benefits.

The benefits arena has become exceedingly complex with each new layer of state and federal regulation. Due to the continuing stream of complex and technical employee benefits litigation since ERISA, the federal government plays an active role in how you plan and administer your employee benefits programs. Every employee benefit program demands frequent evaluation in light of fast changing federal laws and regulations.

The Employee Benefits Practice Group works with the legal, financial, and human resource professionals of our clients to implement and maintain the most effective and cost efficient benefits programs.



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Rick Mapp has practiced in the area of employee benefits and executive compensation matters for 20 years. He is the Chairman of the firm's Employee Benefits Practice Group, where his practice includes pensions, profit sharing, ESOPs, and stock bonus plans, deferred compensation and other executive compensation programs and employee welfare benefit plans. His practice involves advising large and small businesses and government entities.



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James S. Kolan has an extensive background in tax planning and executive compensation plans. He is a certified public accountant and previously practiced with the firms of Ernst & Young and Deloitte & Touche. Jim is a member of the Tax Section of the American Bar Association. He received his J.D., *cum laude*, from the University of Pittsburgh School of Law and his LL.M. from New York University.



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Shad Fagerland's broad employee benefits background includes experience in pension and welfare benefit plan design as well as fiduciary and benefits litigation. He is a member of the Taxation Section of the American Bar Association and an active member of the District of Columbia Bar. Prior to joining Kaufman & Canoles, Shad practiced in the Employee Benefits group at a Washington, DC tax boutique.

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If you would like to be added to the Kaufman & Canoles mailing list
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