KUTAK ROCK LLP

EMPLOYEE BENEFITS NEWS

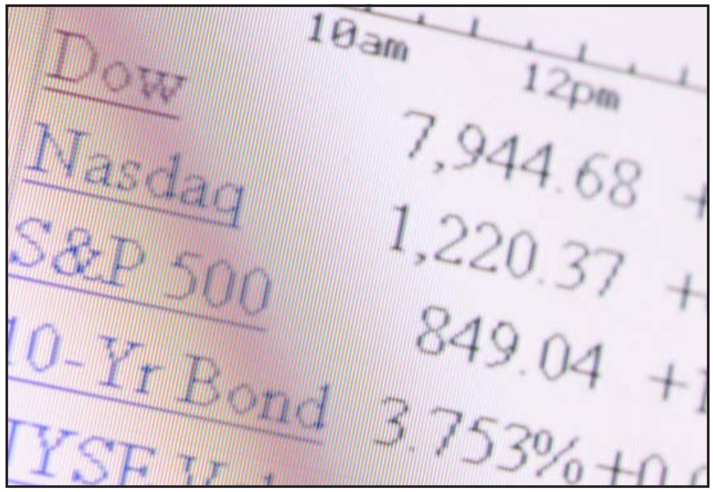
Fall 2004

IRS Issues Final Regulations On Incentive Stock Options

In August, the Internal Revenue Service (the "IRS") released its final regulations concerning incentive stock options. The final regulations include changes from the proposed regulations released in June 2003. Please refer to our September 29, 2004 Corporate Notes located on our Web site, **www.KutakRock.com**. Click on Practices, Corporate, Publications and Newsletters.

Overview of Statutory Stock Options

Statutory stock options is the collective term used in reference to incentive stock options ("ISOs") under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), and employee stock purchase plans ("ESPPs"), as permitted under Section 423 of the Code. Under these provisions, employers are able to offer employees the ability to purchase company stock without requiring the employee to include the value of exercising the stock option as income (in certain cases the option may be subject to alternative minimum tax ("AMT")). The employee is required to report as income any capital gains on the stock only after the stock is sold, so long as the employee retains the stock for a certain period of time and the employer complies with the Code's requirements.



The IRS's final regulations on stock options include changes from those proposed in June 2003.

The IRS initially issued proposed regulations in 1984 concerning incentive stock options. In June 2003 the IRS replaced the 1984 proposed regulations and issued new proposed regulations designed to incorporate tax law changes, update cross-references and propose new guidance. The final regulations pertain mostly to ISOs, with some of the provisions applying to ESPPs. Concurrently with the IRS's issuance of the final regulations, the IRS has requested comments on specific aspects pertaining to ESPPs. These comments will assist the IRS in determining whether to amend the final regulations under Code Section 423.

Highlights of the Final Regulations

- ***Employment Relationships.*** Only active employees or former employees with termination dates of three months or less may exercise statutory options.

  - ***Employees on Leave.*** Employees on leave covered by the Family and Medical Leave Act, the Uniformed Services Employment and

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2005 Cost–of–Living Adjustments

For your benefit, we have enclosed an updated COLA chart, which highlights selected employee benefit-related limits for 2005 and beyond.

Employees on leave covered by the Uniformed Services and Reemployment Rights Act will be considered actively employed for incentive stock options as outlined in the IRS's August 2004 final regulations.

Reemployment Rights Act or any similar statute or contract that provides for reemployment or continued employment rights will be considered actively employed.

- ***In Situations Involving Mergers/ Acquisitions.*** In situations involving mergers and acquisitions, a person who left employment with the acquired company is provided the same three-month period as a person who left just after the merger or acquisition (as long as the plan so provides).

- ***Maximum Aggregate Number of Shares.*** The regulations require that a plan permitting the grant of ISOs must specify the aggregate (or total) number of ISO shares that may be issued. In determining the number of shares to apply toward the aggregate amount, plans must use the net amount of shares issued as a result of the exercise of an option. Thus, a plan is required to count the number of shares issued as a result of an employee exercising an option. If a plan does not specify the maximum number of ISO shares that may be issued, then the plan must be amended and shareholder approval obtained.

- ***Corporate Transactions.*** The regulations provide guidance on shareholder approval requirements in situations where an ISO plan is assumed in a corporate transaction. The regulations provide that if a consolidation document (e.g., merger agreement) describes the ISO plan and that the plan will continue after the consolidation, then it will be considered to have been adopted and approved at the same time the consolidation document is approved. However, if the ISO plan is not described in the consolidation document, shareholder approval is required.

- ***Inadvertent Modifications.*** If an ISO or an ISO plan is inadvertently modified in such a way that disqualifies either the ISO or the ISO plan, and the modification is later cancelled before the earlier of the exercise of an ISO or the end of the calendar year of the modification, then the ISO is not disqualified. This inadvertent modification provision also applies to statutory options, including ESPPs.

- ***Nonvested Stock/Section 83(b).*** Normally a Section 83(b) election permits an individual to accelerate the inclusion of nonvested property as income before it vests. Under the final regulations, Section 83(b) elections made at the exercise of non-vested ISO shares will apply only for purposes of the Alternative Minimum Tax ("AMT") and will no longer apply for purposes of calculating regular income tax. By making an 83(b) election under the new regulations, the taxpayer reports the value of the option for purposes of calculating AMT, even though the option remains unvested. Later, when the option vests, the taxpayer is not required to include the value of the option as gross income for AMT purposes.

A person who left the employment of a company within 90 days of it being involved in a merger or acquisition within the same 90-day period may exercise statutory options.

Effective Date and Transition Period

The final regulations became effective on August 3, 2004; however, special transition rules permit taxpayers to rely on prior guidance. The transition period for ISOs and ESPPs that were granted prior to the issuance of the June 9, 2003 proposed regulations may continue to follow the 1984 guidance, the 2003 guidance, or the final regulations. With respect to ISOs and ESPPs that were granted after June 9, 2003 and before the first shareholders' meeting after February 2, 2005 (but no later than January 1, 2006), the taxpayer may follow the 2003 proposed regulations or the final regulations. Notably, the taxpayer may not pick and choose between the proposed and final regulations, but must consistently follow the provisions contained in the guidance selected. The final regulations become effective on the first regularly scheduled shareholders' meeting that occurs six months after final regulations are issued (February 2, 2005). However, on January 1, 2006 all taxpayers must comply with these final regulations.

Required Action

The new regulations likely require companies to amend existing stock option or employee stock purchase plans. Because of the rapidly approaching effective date for most companies and the need for shareholder approval to amend the plans, companies should begin planning for any necessary amendments as soon as possible.

COBRA Compliance Deadlines

In June, the DOL issued final regulations regarding continuation coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), which impacts the notice obligations of employers, plan administrators, employees and their family members. These regulations become effective on the first plan year beginning on or after November 26, 2004. For calendar plan years, the new regulations will apply on January 1, 2005. The proposed regulations were described in our Summer 2003 Employee Benefits Newsletter, which may be viewed on-line at **www.KutakRock.com** by clicking on Practices, Employee Benefits, Publications and Newsletters. The following provides a summary of the COBRA notice requirements as issued in the final regulations.

General COBRA Notice: Within 90 days after becoming covered under the plan, covered employees and their spouses must receive a general COBRA notice explaining their rights and obligations under COBRA. This notice may be provided with a single notice if both spouses live at the same address. This notice requirement is also satisfied if it is contained in the plan's summary plan description and is mailed to the home address.

Notices by Employees and Beneficiaries: When certain types of qualifying events occur, COBRA requires that covered employees or a qualified beneficiary provide notice to the plan within 60 days of the event. The final regulations provide that this obligation does not begin until the individual has been informed of his or her obligation to provide the plan administrator with notice. This requirement makes it very important that plans provide general COBRA notices to employees and their spouses. The final regulations require that plans establish reasonable procedures for individuals to follow in providing notice to the plan. If the plan does not have an established procedure, the notice is deemed to be given when the employee or beneficiary communicates such to the person who normally handles such employee benefit matters.

COBRA Election Notice: When a COBRA qualifying event occurs, the plan is obligated to provide an election notice to the affected participant and any qualified beneficiaries. In situations where the employer is the plan administrator, this notice must be provided within 44 days of the event. When an employee or covered beneficiary notifies the employer of a qualifying event (e.g., birth, divorce, etc.), an election notice must be provided by the plan administrator to the employee within 14 days after receiving such notice.

Two New Notice Requirements: (1) The final regulations also require that a plan must notify the participant or affected beneficiaries any time that it receives notice from them of a qualifying event that the plan administrator determines to be ineligible for COBRA continuation coverage. (2) The final regulations also require that individuals enrolled under COBRA must receive notice when their coverage is terminated. This notice must be provided when either the duration of coverage expires or coverage is terminated for failure to timely pay premiums.

In preparing for the upcoming effective date, plans should review their COBRA notices, SPDs and procedures to ensure that the plans comply with the final regulations.

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Internal Revenue Service's 'Top 10' Audit List

IRS Top 10

Although not as entertaining as David Letterman's Top 10 lists, the IRS's Top 10 Audit List is more practical for most retirement plan administrators. The following items contain the IRS's list of issues to be identified during a plan audit.

1. Termination or Partial Termination—Potential Vesting/ Distribution Issues
   - Large decrease in participants from beginning of year to end of year, or significant drop in participants when comparing multiple years to each other
   - Corporation may be downsizing even though no official statement
   - After acquired plan has merged with ongoing plan, not all participants from acquired plan are included in ongoing plan
2. Acquisitions
   - Proper employer allocations are made timely for employees of newly acquired companies
   - The acquiring employer might fail to offer all optional benefits on distributions from transferred assets from merged plans
   - Payroll-related errors—resulting in incorrect contributions
     - Using incorrect compensation data
     - Using incorrect participation dates
3. Deferral Percentage Tests
   - Include newly acquired employees in testing data
   - Incorrect ADP/ACP testing
     - Test performed incorrectly
     - Electronic data may be faulty
     - Third-party vendor errors

The IRS's Top 10 Audit List addresses a number of items for retirement plan administrators to address, including potential vesting and distribution issues, acquisitions, compensation, deferral percentage tests, plan documents, assets, contributions exceeding statutory limits and miscellaneous items.

4. Compensation
   - Contributions exceed annual compensation limits
   - Deferrals calculated incorrectly by plans that allow the use of income resulting from a Section 423 employee stock purchase plan
5. Plan Document
   - Failure to timely adopt amendments, including GUST amendments
   - Failure to timely amend merged plans into others
6. Vesting
   - Participants age 65 or older should be 100% vested
   - Failure to properly calculate vesting percentages
   - Incorrect vesting schedule used in performing calculations
   - Failure to determine "service" properly
7. Distributions and Loans
   - Use of automated systems for plan loans, in-service distributions and hardship withdrawals may result in compliance issues if documentation is not properly maintained (e.g., spousal consents)
   - Failure to suspend employee contributions for participants receiving hardship withdrawals
   - Failure to report distributions for plan participants receiving premature distributions or defaulting on plan loans
   - Improper distribution codes used on Form 1099s
8. Assets
   - Large percentage of assets listed as other assets or as single investment on balance sheet
   - Large amounts of administrative expenses
   - Significant changes in types of investments from one year to next
   - Existence of large liabilities

9. Limits

- Exceeding Section 415 limits when participants are participating in more than one plan sponsored by the employer
- Exceeding 402(g) limits when employees can participate in more than one plan that allows employee contributions

10. Miscellaneous

- Insufficient controls to ensure accuracy of information provided to third-party record keepers and administrators
- Inaccurate dates of hire, termination, dates of birth, compensation, etc. resulting in inaccurate calculations
- Form 5500 data does not match actual payroll data

If you have any concerns regarding any of these issues (or others) regarding your retirement plan, you should take action now before the IRS notifies you of an audit. The Employee Plans Compliance Resolution System ("EPCRS") offers employers a cost-effective means of voluntarily correcting possible IRS defects. However, EPCRS is available only if the employer takes appropriate action before the IRS notifies the employer of an upcoming audit.

Employee Benefits Group Welcomes New Attorney

Kathryn M. Magli joined Kutak Rock's Employee Benefits Practice Group in September 2004 as an Associate. Ms. Magli graduated *cum laude* from Creighton University School of Law in 2004 and has worked as a summer associate and law clerk for the Employee Benefits Practice Group since May 2002. Prior to attending law school, Ms. Magli's career in human resources focused primarily on managing and administering employee benefit plans and compensation. Her 15 years of experience encompass three business sectors, including manufacturing, construction and nonprofit trade organizations. Ms. Magli will concentrate her practice primarily in employee benefits/ERISA law, including health and welfare plans, qualified and nonqualified retirement plans, employee stock ownership plans and executive compensation arrangements.

USERRA—DOL Issues Proposed Regulations

USERRA was enacted to protect the reemployment and benefit rights for those individuals required to leave their employment to perform military service.

On September 20, 2004, the DOL issued proposed regulations concerning the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"). USERRA was enacted to protect the reemployment and benefit rights of those individuals required to leave their employment to perform military service. USERRA also protects individuals from being discriminated against as a result of their military service.

In interpreting USERRA and prior laws, courts have followed the Supreme Court's admonition that "this legislation is to be liberally construed for the benefit of those who left private life to serve their country in its hour of great need." *Fishgold v. Sullivan Drydock and Repair Corp.*, 328 U.S. 275 (1946). The DOL provided this quote in the preamble of the regulations, stating that it has construed USERRA in light of the Supreme Court's guidance in *Fishgold*. The regulations, set forth in a question-and-answer format, are designed to provide guidance to employees and employers concerning their rights and obligations under USERRA. Topics addressed in the regulations include general provisions of USERRA; protection from employer discrimination and retaliation; eligibility requirements for reemployment; rights, benefits and obligations of persons absent from employment due to service in the uniformed services; reemployment rights and benefits; and compliance assistance, enforcement and remedies.

DOL Offers Guidance on Finding Missing Participants

Plan administrators often struggle with what to do when a participant has "vanished" and the administrator is unable to locate the missing participant. This becomes even more troublesome when a defined contribution plan is in the process of terminating. The DOL has issued Field Assistance Bulletin ("FAB") 2004-02 to provide guidance to plan fiduciaries caught in the conundrum of trying to comply with ERISA's requirements of distributing plan assets and the exhaustive search for missing plan participants.

The DOL provides four mandatory search methods and additional optional search methods for plan fiduciaries to use in their search for missing participants. The DOL also addresses the preferred distribution method for missing participants in the event that participants cannot be found after conducting a search.

Mandatory Search Methods:

Although first-class mail is sufficient in providing notification in most instances, the following additional steps must be taken to locate a missing participant regardless of the size of the participant's account: (1) using certified mail; (2) checking related plan records for current address (e.g., health plan); (3) contacting participant's designated beneficiaries; and (4) using either the Internal Revenue Service's or the Social Security Administration's letter-forwarding service.

Additional Search Methods:

The DOL provides other search options that plan fiduciaries may use in trying to locate missing participants, including Internet searches, commercial locator services and credit reporting agencies.

Preferred Distribution Option:

The preferred distribution option if a missing participant cannot be located is to set up an Individual Retirement Account ("IRA") for the missing participant. FAB 2004-02 states that plan fiduciaries who set up an IRA for a missing participant using the DOL's automatic rollover safe-harbor regulation (see article below) should be treated as complying with their fiduciary duties. In the event that the fiduciary cannot establish an IRA, the fiduciary may consider opening a federally insured savings account or transferring the account to the state's unclaimed property funds. Either of these options will result in the account being subject to income tax and possibly a 10% early withdrawal penalty.

DOL Issues Final Regulations:

Safe Harbor for Mandatory Distributions

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") amended Section 401(a)(31) of the Code to require employee benefit plans that have mandatory distribution provisions to roll over participant distributions of $1,000 or more into an IRA. Many 401(k) plans contain provisions to distribute inactive participant account balances of $5,000 or less. Effective March 28, 2005, plans that contain such mandatory provisions are required to roll over mandatory distributions in excess of $1,000 into an IRA unless the participant affirmatively instructs the administrator otherwise. The DOL's Final Regulations, issued on September 28, 2004, provide a safe harbor for fiduciaries to follow when rolling over mandatory account distributions:

EGTRRA amended Section 401(a)(31) of the Code to require employee benefit plans that have mandatory distribution provisions to roll over participant distributions of $1,000 or more into an IRA.

The investment product must be offered by a state or federally regulated financial institution with accounts insured by FDIC, a credit union with accounts insured within the terms of the Federal Credit Union Act, an insurance company with accounts protected by state guaranty associations or by an investment company that is registered under the Investment Company Act of 1940.

1. The fiduciary enters into a written agreement with one or more IRA provider(s) that states:

- The investment product used for rolled-over funds shall be designed to preserve the principal amount while providing a reasonable rate of return, whether or not the rate of return is guaranteed, consistent with the liquidity of the investment;
- The investment product must be offered by a state or federally regulated financial institution (bank or savings association) with accounts insured by FDIC, a credit union with accounts insured within the terms of the Federal Credit Union Act, an insurance company with accounts protected by state guaranty associations or by an investment company that is registered under the Investment Company Act of 1940;
- All fees and expenses related to the IRA shall not exceed the fees and expenses charged by the provider to other IRA account holders; and
- The participant has the right to enforce the terms of the contractual arrangement with regard to the rolled-over funds of the IRA.

2. Plan participants have received a summary plan description ("SPD") or a summary of material modifications ("SMM") describing the plan's automatic rollover provisions. The SPD should also include an explanation that the mandatory distribution will be invested in a product designed to preserve the principal and provide a reasonable rate of return, as well as a statement explaining how fees and expenses will be paid.

3. The regulations provide that the safe harbor applies to mandatory distributions of $1,000 or less if the participant has not made an affirmative distribution election.

The final regulations state that the safe-harbor provisions are not the exclusive method by which a fiduciary can satisfy his or her responsibilities under ERISA pertaining to rollovers of mandatory distributions as required by EGTRRA. Plan sponsors who do not wish to comply with the obligations required by the regulations may elect to remove the mandatory distribution provisions from their plan documents by amending their plans.

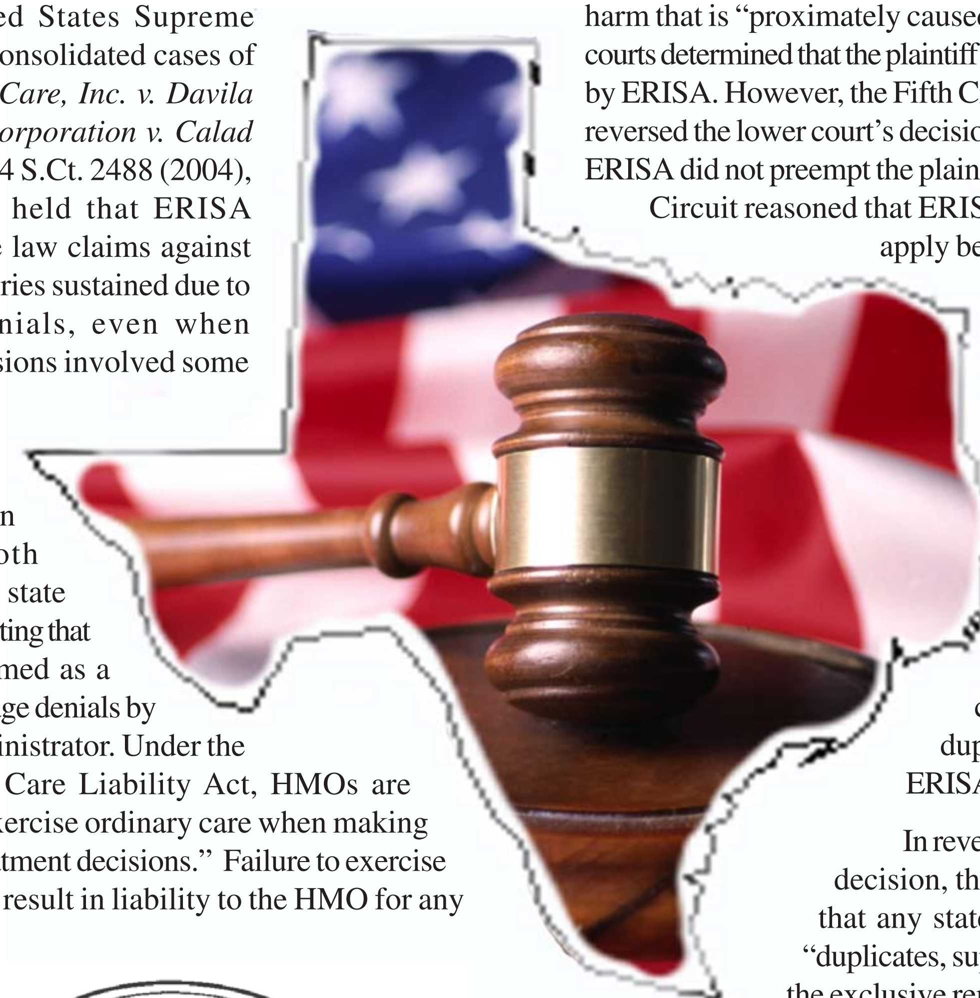
EEOC Addresses Retiree Benefits and the ADEA

The Equal Employment Opportunity Commission (the "EEOC") has voted to approve regulations which permit employers to reduce or eliminate retiree benefits when a retiree or a covered beneficiary becomes eligible for Medicare (or a comparable state-sponsored health plan) without violating the Age Discrimination in Employment Act ("ADEA"). These regulations will essentially overturn the Third Circuit's decision in *Erie County Retirees Ass'n v. County of Erie*, 220 F.3d 193 (3d Cir. 2000), which held that employers may not offer better benefits to pre-Medicare retirees.

The EEOC has voted to allow employers to reduce or eliminate retiree benefits when a retiree or a covered beneficiary becomes eligible for Medicare.

Please refer to Kutak Rock's Spring 2001, Fall 2001 and Summer 2003 Employee Benefit Newsletters for more information on the *Erie* case and how it has evolved over the past few years. The newsletters are available on-line at **www.KutakRock.com**. Click on Practices, Employee Benefits, Publications and Newsletters.

Supreme Court Decides Another Preemption Case: ERISA Preempts Patients' Right To Sue Under State Law



The United States Supreme Court, in the consolidated cases of *Aetna Health Care, Inc. v. Davila* and *CIGNA Corporation v. Calad* ("*Davila*"), 124 S.Ct. 2488 (2004), unanimously held that ERISA preempts state law claims against HMOs for injuries sustained due to coverage denials, even when coverage decisions involved some level of medical decision-making. In *Davila*, both plaintiffs filed state law claims asserting that they were harmed as a result of coverage denials by their plan administrator. Under the Texas Health Care Liability Act, HMOs are required to "exercise ordinary care when making health care treatment decisions." Failure to exercise such care may result in liability to the HMO for any harm that is "proximately caused." Both of the district courts determined that the plaintiff's cases were preempted by ERISA. However, the Fifth Circuit Court of Appeals reversed the lower court's decisions and determined that ERISA did not preempt the plaintiffs' claims. The Fifth Circuit reasoned that ERISA preemption did not apply because the basis for the claims was mixed eligibility and treatment decisions which were of a nonfiduciary nature. The Fifth Circuit further reasoned that because ERISA did not provide a tort remedy, the state law claim was not a duplicative remedy under ERISA.

In reversing the Fifth Circuit's decision, the Supreme Court held that any state cause of action that "duplicates, supplements or supplants the exclusive remedies provided under ERISA § 502 is preempted." The Court explained that if a participant could file a claim under ERISA and there was no additional independent legal duty, then ERISA preempts the state law. In the cases at issue here, the only way that liability under the Texas law could exist was because of the HMO's duty to interpret and determine coverage under ERISA benefit plans.

In reversing the Fifth Circuit's decision, the Supreme Court held that any state cause of action that "duplicates, supplements or supplants the exclusive remedies provided under ERISA § 502 is preempted."

In 2000, the Supreme Court determined that ERISA did not preempt state law claims pertaining to mixed eligibility and treatment decisions that were not fiduciary in nature (*Pegram v. Herdrich*, 530 U.S. 211). The Court draws the distinction between *Davila* and *Pegram* by indicating that ERISA remedies apply to coverage and payment decisions made by plans, even if some level of medical judgment is exercised, while state law medical malpractice remedies apply to medical treatment decisions.

New FLSA Overtime Exemptions Regulations

The Department of Labor ("DOL") issued new regulations this summer dealing with exempt and nonexempt employee classifications that became effective on August 23, 2004. These new regulations mark a complete overhaul of the existing overtime rules contained in the Fair Labor Standards Act ("FLSA") developed more than 50 years ago. For more information on these new regulations, please view Kutak Rock's July 2004 Corporate Notes located on our Web site. Go to **www.KutakRock.com** and click on Practices, Employment Law, Publications and Newsletters.

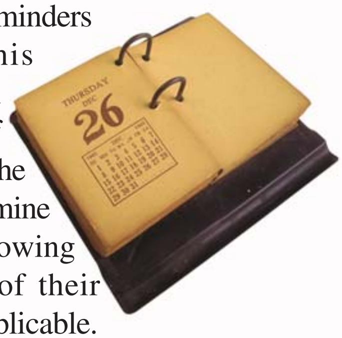
In general, the same categories of exemptions from overtime pay still exist, namely executive, administrative, professional, outside sales and some skilled computer workers. The tests to define these categories have been modified, however, with clarifications being added as to specific jobs and their eligibility to receive overtime benefits. The DOL has simplified the testing procedure used to determine whether a position is exempt from the overtime regulations. One test is now available for each exemption category, removing the prior regulations' "short test" and "long test." Also, workers earning less than $23,660 on an annual basis ($455 per week) will now receive overtime, regardless of their job responsibilities. In contrast, most employees earning over $100,000 are exempt for overtime purposes, as they are considered "highly compensated" under the new rules.

In light of the new regulations, employers may want to conduct a review of each exempt employee's job description to assure that the position satisfies the salary and duty requirements set forth by the regulations.

Below is a summary of the applicable testing requirements for each of the categories:

Type of Exemption	Primary Responsibilities
Executive Employees Salary Basis: Not less than $455/week	Manages enterprise in which employee is employed or of a recognized department or subdivision of business; Customarily and regularly directs the work of two or more employees; and Has authority to hire or terminate other employees or who has ability to suggest or recommend as to the hiring, terminating, promoting or any other change of status of other employees, and such suggestions are given particular weight.
Administrative Employees Salary Basis: Not less than $455/week	Performs office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers; and Primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.
Professional Employees Salary Basis: Not less than $455/week	Performs work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction; or Performs work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.
Outside Sales Employees No salary requirements	Primary duties include making sales calls or obtaining orders or contracts for services; employee customarily and regularly is engaged in work away from the employer's place of business.
Highly Compensated Employees Salary basis: At least $100,000 per year	Primary duty involves performing office or nonmanual work; the employee customarily and regularly engages in at least one of the exempt duties of an executive, administrative or professional employee.
Skilled Computer Employees Salary basis: Not less than $455/week or, if paid hourly, not less than $27.63/ hour	Computer systems analysts, computer programmers, software engineers and other similarly skilled workers in the computer field; The application of systems analysis techniques, which includes consulting with users to determine hardware, software and system specifications; and The design, development, documentation, analysis, creation, testing or modification of computer systems or programs or operating system.

Year-End Reminders



In addition to the year-end reminders discussed elsewhere in this newsletter, we wish to remind plan sponsors (particularly sponsors of calendar-year plans) that, before the end of the year, they should determine whether to take any of the following actions with respect to any of their employee benefits, as may be applicable.

Annual Notice by Safe-Harbor 401(k) Plans ✓

Safe-harbor 401(k) plans must provide an annual notice to eligible employees describing rights and obligations under the plan. For calendar-year plans, this notice must be provided after October 1 and not later than December 1.

Required Notices ✓

Confirm that all required notices have been or will be timely sent; i.e., for a group health plan, Summary of Material Reductions must be sent within 60 days of the adoption of the reduction; "reductions" include not only changes to benefits, but also material changes in premiums, copayments, coinsurance, etc.; i.e., for a pension plan, 204(h) notices; i.e., applicable to all plans, distribution of 2003 summary annual reports (SARs).

Actuarial Assumptions ✓

Sponsors and plan administrators of defined benefit plans need to review whether the actuarial assumptions for the year are appropriate.

Cost-of-Living Adjustments ✓

Determine whether retirement plans require amendment to reflect cost-of-living adjustments and when such amendments should be adopted. Provide appropriate notice to plan participants.

Open Enrollment ✓

Generally, fall means open-enrollment season for most employers. During open enrollment, employers solicit benefit elections from employees for the upcoming plan year. Employers may utilize open enrollment to:

- ✓ **Promote the Benefits Offered.** Inform employees of the benefits provided regardless of whether enrollment is required.
- ✓ **Satisfy Notice Obligations.** Include in open-enrollment materials all legally required annual notices, such as the annual Women's Health and Cancer Rights Act notice. Open enrollment also is an excellent time to remind employees in writing of plan rules that may be overlooked, e.g., remind employees to furnish proof of dependent's student status, to enroll in Medicare, etc.
- ✓ **Obtain Salary Reduction Elections.** As a part of the open-enrollment process, participant elections to pay for benefits on a before-tax basis should be obtained. These before-tax elections generally must be made before amounts are available for payment or prior to the plan's period of coverage. This rule applies to plans subject to Sections 401(k), 403(b) and 125 of the Code.
- ✓ **Obtain 2005 Deferral Election Forms for Nonqualified Plans.** Under the American Jobs Creation Act, participants must generally make any deferral elections before December 31, 2004 for compensation earned in 2005.

Use it or Lose it Under FSAs ✓

Remind Flexible Spending Account ("FSA") plan participants that the "use it or lose it" rule still applies and that any unused amounts/credits remaining at the end of the year will be forfeited. Plan administrators may want to issue this reminder before the end of the year so that employees can budget medical and dependent care expenses accordingly. At the same time, plan administrators can remind plan participants of the last day on which they can apply for reimbursement from the FSA plan (e.g., March 31, 2005).

Perform a Fiduciary Review ✓

Now is a good time to look back to determine if the plan has been operated properly. Among the items to review are:

- ✓ **Salary Deferral Deposits.** Confirm that the plan is receiving participant salary deferrals on a timely basis.

✓ **Plan Documents.** Has the plan been operated in accordance with the terms? Should the plan be amended to reflect the actual operation? Have therebeen updates to the law or regulations that make consideration of plan amendments appropriate (e.g., final DOL COBRA regulations, DOL Safe Harbor for Mandatory Distributions, Working Families Tax Relief Act impact on plan's definition of dependent, DOL's missing participant procedure)?

✓ **Fees.** Confirm whether the fees paid by participants under the plan are appropriate. Can a better deal be negotiated? Is the vendor providing what was promised?

✓ **Fidelity Bond.** Does the plan's fidelity bond coverage need to be renewed or increased? Was a new plan established that should be covered? ERISA generally requires that every fiduciary of an employee benefit plan and every person who handles plan funds or other property be bonded. The bond amount must be at least 10% of the funds handled (the minimum coverage amount is $1,000 and the maximum coverage amount is $500,000).

✓ **Beneficiary Designations.** Beneficiary designations on file should be reviewed for completeness to avoid confusion about the proper beneficiary of plan benefits. For tax-qualified retirement plans, confirm that spousal consent signatures are properly witnessed where applicable. Participants whose marital status changed during the year should be reminded to review existing designations.

✓ **COBRA Compliance.** Employers should confirm that their COBRA benefits are being administered properly. Ensure that COBRA notices comply with the DOL's new final regulations.

✓ **Forms 5500.** Confirm that all Forms 5500 that are required to be filed have been timely filed. Form 5500 filings are required for tax-qualified retirement plans. Nonqualified deferred compensation plans generally are not required to file Form 5500 if the one-time alternative notice was filed with the DOL. Most ERISA welfare plans (e.g., medical, dental, vision and long-term disability benefit plans) must annually file Form 5500. Form obligations should not be overlooked for other ERISA plans, such as life insurance, severance, health care spending account plans and, in some cases, employee assistance plans (EAPs). Consider whether any of the Form 5500 filing exemptions apply (e.g., insured welfare plans covering fewer than 100 employees on the first day of the plan year are exempt from any ERISA-required Form 5500 filings). Government and church plans are exempt from ERISA filing requirements. Remember that the Schedule F filing has been suspended for group legal services plans, cafeteria plans and educational assistance plans. If Form 5500 was not filed for a plan, the DOL offers reduced penalties for plan sponsors who submit the late filing on a voluntary basis and follow certain procedures.

✓ **Minimum Required Distributions.** Confirm that all minimum distributions that were required to be paid in 2004 have been paid or are scheduled to be paid. Confirm whether any minimum distributions must commence on or before April 1, 2005.

✓ **HIPAA Compliance.** Large health plans must comply with HIPAA's security requirements by April 20, 2005 (small plans have until April 20, 2006 to comply). With respect to HIPAA's privacy rules, both large and small health plans should ensure that their processes and procedures are in compliance.

Beneficiary designations on file should be reviewed for completeness to avoid confusion about the proper beneficiary of plan benefits.

Employee Benefits

Newly Signed AJCA Significantly Impacts NQDC Plans

On October 22, 2004 President Bush signed into law the American Jobs Creation Act ("AJCA"). As its name implies, this law is designed to create jobs for American workers by ending sanctions on U.S. exports, providing tax relief to manufacturers, providing the ability for American businesses and its workers to be more competitive globally, and addressing corporate tax abuses. The AJCA also includes significant provisions impacting nonqualified deferred compensation arrangements and generally applies to amounts deferred after December 31, 2004 (with some restrictions applying to previously deferred amounts). Because of the significant tax implications involved with the AJCA, it is imperative that employers review their nonqualified plans and implement any necessary changes to protect the deferred tax arrangements of current plans. Please view our October 25, 2004 Client Alert which focuses on the significant impact that the AJCA has on nonqualified deferred compensation plans. This Client Alert is available at **www.KutakRock.com**. Click on Practices, Employee Benefits, Publications and Client Alerts.

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SUMMARY OF SELECTED EMPLOYEE BENEFIT RELATED LIMITS

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
ELECTIVE DEFERRAL ANNUAL LIMITS										
401(k), 403(b) and SEPs	10,500	11,000	12,000	13,000	**14,000**	15,000	(a)	(a)	(a)	(a)
457 Plans	8,500	11,000	12,000	13,000	**14,000**	15,000	(a)	(a)	(a)	(a)
SIMPLE IRAs and 401(k)s	6,500	7,000	8,000	9,000	**10,000**	(a)	(a)	(a)	(a)	(a)
"CATCH-UP" CONTRIBUTIONS (bb)										
401(k), 403(b), 457 and SEPs	N/A	1,000	2,000	3,000	**4,000**	5,000	(b)	(b)	(b)	(b)
SIMPLE IRAs and 401(k)s	N/A	500	1,000	1,500	**2,000**	2,500	(b)	(b)	(b)	(b)
401(a)(17) MAXIMUM ANNUAL PLAN COMPENSATION	170,000	200,000	200,000	205,000	**210,000**	(c)	(c)	(c)	(c)	(c)
415 ANNUAL ADDITIONS										
Defined Benefit Plan Dollar Limit	140,000	160,000	160,000	165,000	**170,000**	(d)	(d)	(d)	(d)	(d)
Defined Contribution Plan Dollar Limit	35,000	40,000	40,000	41,000	**42,000**	(e)	(e)	(e)	(e)	(e)
414(q) HIGHLY COMPENSATED EMPLOYEE	85,000	90,000	90,000	90,000	**95,000**	(f)	(f)	(f)	(f)	(f)
KEY EMPLOYEE (Top Heavy)										
Officers	70,000	130,000	130,000	130,000	**135,000**	(f)	(f)	(f)	(f)	(f)
1% Owner	150,000	150,000	150,000	150,000	**150,000**	150,000	150,000	150,000	150,000	150,000
1 of 10 Owner-Employees	35,000	N/A	N/A	N/A	**N/A**	N/A	N/A	N/A	N/A	N/A
IRAs										
Annual Contribution Limit	2,000	3,000	3,000	3,000	**4,000**	4,000	4,000	5,000	(g)	(g)
Catch-Up Contributions (gg)	N/A	500	500	500	**500**	1,000	1,000	1,000	1,000	1,000
PBGC ANNUAL GUARANTEED BENEFIT	40,705	42,955	43,977	44,386	**45,614**	(h)	(h)	(h)	(h)	(h)
QUALIFIED TRANSPORTATION FRINGE										
Employer-provided parking (monthly)	180	185	190	195	**200**	(i)	(i)	(i)	(i)	(i)
Mass transit pass and vanpool (monthly)	65	100	100	100	**105**	(i)	(i)	(i)	(i)	(i)
TAXABLE WAGE BASE										
Social Security	80,400	84,900	87,000	87,900	**90,000**	(j)	(j)	(j)	(j)	(j)
Medicare	N/A	N/A	N/A	N/A	**N/A**	(j)	(j)	(j)	(j)	(j)
HEALTH SAVINGS ACCOUNTS										
Individual Contribution Limit	N/A	N/A	N/A	2,600	**2,650**	(k)	(k)	(k)	(k)	(k)
Family Contribution Limit	N/A	N/A	N/A	5,150	**5,250**	(k)	(k)	(k)	(k)	(k)
Catch-up Contributions	N/A	N/A	N/A	500	**600**	(k)	(k)	(k)	(k)	(k)

See reverse side for footnotes.

Unless subsequent legislation is enacted, EGTRRA provisions expire after December 31, 2010.

(a) Indexed for inflation in $500 increments.

(b) Indexed for inflation in $500 increments. With respect to governmental 457 plans, the elective deferral catch-up provision (reflected in this section of the chart) does not apply during the three years prior to retirement; instead, the IRC § 457 catch-up limit is 2x otherwise applicable elective deferral annual limit.

(bb) Catch-up contributions generally are excluded from plan limits (*e.g.*, IRC §§ 402(g), 415, 457(b), 408(p), 401(k)(11), 402(h), 404) and testing (*e.g.*, ADP/ACP testing, IRC § 410(b) coverage, IRC § 401(a)(4) nondiscrimination). Catch-up contributions must be available on a nondiscriminatory basis to eligible employees age 50 or older. Employers are not required to permit "catch-up contributions."

(c) Indexed for inflation in $5,000 increments.

(d) Indexed for inflation in $5,000 increments. Annual benefit limitations are actuarially reduced for benefit commencement before age 62 and actuarially increased for benefit commencement after age 65.

(e) Indexed for inflation in $1,000 increments. Effective for limitation years beginning after December 31, 2001, the 25% of compensation limitation under IRC § 415(c)(1)(B) is increased to 100% of compensation.

(f) Indexed for inflation in $5,000 increments.

(g) Indexed for inflation in $500 increments.

(gg) The IRA deductibility rules have not changed. The IRA catch-up contributions apply to individuals age 50 or older.

(h) Indexed for inflation. Chart number has been rounded to nearest dollar. PBGC News Release 05-14 (12/06/2004).

(i) Indexed for inflation in $5 increments. Rev. Proc. 2004-71 (11/19/04).

(j) Indexed for inflation.

(k) Indexed for inflation. Rev. Proc. 2004-71 (11/19/04).

Sources: IR 2004-127 (10/20/04); Social Security Administration Press Release dated 10/19/04.