

## Michigan Sees Interplay of Constitution and Domestic Partner Benefits

A constitutional ban on same-gender marriage in Michigan is testing domestic partner benefits state and local governments provide. Todd A. Solomon, author of Thompson Publishing Group's *Domestic Partner Benefits: An Employer's Guide*, and his McDermott Will & Emery colleague Gladys C. Zolna, analyze recent court activity in the wake of that state's voter-approved constitutional ban on same-gender marriage. They also look at the reactions of the city of Kalamazoo and the University of Michigan to a state attorney general opinion declaring that the constitutional ban preempts them from providing domestic partner benefits. **Page 3**

## Proposed Regulations on Cafeteria and Dependent Care Plans

IRS watchers who view summer as the slow season may count this year as an exception to the rule. August saw the publication of a major overhaul of long-dormant cafeteria plan rules, and a final rule on dependent care plans.

On Aug. 14, the IRS finalized rules on dependent care plans first proposed in the May 24 *Federal Register*. Day camp reimbursements are qualified expenses, but those for summer school are not. The cost of sending your child to a day camp on a bus qualifies, but the cost of driving the child there does not. The final rule is added to the *Handbook* in App. B with this month's supplement. **Page 5**

With little fanfare the IRS released proposed regulations to replace the "temporary" rules on cafeteria plans that have been on the books for two decades. While overall change is limited, there are some differences to consider and the volume of text to pore through is respectable, weighing in at 31 pages of 9-point print in the *Federal Register*, not quite qualifying for tome status. **Page 9**

## Insuring Non-dependents Could Have Unanticipated Costs

Some states have begun requiring insured health plans to cover the children of plan participants up to age 30, surpassing the age limit the IRS uses in defining a dependent. The incongruity could cause some unanticipated costs for these employees — namely, imputed income. Michael Melbinger and Anne Schwaab analyze the unintended consequences of such state laws. **Page 6**

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■ Update discussion of qualified adoption assistance plans in ¶800.

■ Add IRS final rule TD 9354 to App. B.

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# Dear Reader

Across the country, youth by the millions suddenly find themselves sitting in hard chairs, looking at chalkboards, contemplating intellectually stimulating fare. They were just at the beach. How can this be?

At the same time, in countless offices across the country human resources (HR) personnel, benefits administrators and plan sponsors find themselves back behind desks, facing a challenging “In” box. They were just at the beach. How can this be?

Those hapless benefits and HR professionals, like the students who will one day take their place in the workforce, are looking at material others prepared for them while they were relaxing. Now it's time to face the music!

Like a teacher creating a syllabus, the IRS had plenty of material ready for benefits administrators to tackle once they came through the door fresh from their breaks.

On Aug. 6, the IRS issued new proposed cafeteria plan rules. This is the first major change since the rules were modified in 2001. The proposed rules the IRS just issued reflect changes made to the tax law since Ronald Reagan's first term as president. They are wide-ranging and generally cover qualified and nonqualified cafeteria plan benefits; benefits elections; flexible spending accounts (FSAs); and substantiation of expenses for qualified benefits.

They are not yet in final form, but employers can rely on them now. After the IRS issues the rules in final form, they will apply to plan years beginning on or after Jan. 1, 2009. Those who will rely on them now — or then — can find out more inside this newsletter.

But Cafeteria Plans 101 is not the only course for which the IRS prepared a reading list. Eight days after it issued the proposed cafeteria plan rules, the IRS issued final rules on dependent care expenses. They will help employers navigate the rapids of what constitute qualified dependent care expenses. Are day camp expenses qualified expenses? How about summer school? Tutoring? Educational programs at day camp? I'm not telling you here. You'll have to read the article.

Speaking of cafeteria plans, it's no secret that one cannot obtain coverage through them for children who are no longer minors. Yet, some states require that insurance offer coverage of policyholders' adult children — which spells the creation of imputed income for parents who opt such coverage. Michael Melbinger, the contributing editor of Thompson Publishing Group's *Flex Plan Handbook*, and his Winston & Strawn colleague Anne Schwaab, offer a discussion of the consequences of allowing adult children to continue to elect coverage under their parents' policies.

The tax treatment and availability of coverage through benefits plans for employees' domestic partners is another vexing issue, and it's hard to think of a place where that is more true lately than Michigan. Todd Solomon, the author of Thompson Publishing Group's *Domestic Partner Benefits: An Employer's Guide*, and his McDermott Will & Emery colleague Gladys Zolna provide an analysis.

Tax-favored benefits for domestic partners and care of adult children may be problematic; not so, however, for benefits that help parents add minor children to their families. Employees and employers can obtain tax breaks for qualified adoptions through adoption assistance programs. See inside for a look at what some employers offer employees who want to welcome children into their families that way.

The IRS was not the only federal organ that was busy this summer. The House is considering a bill that could affect long-term care insurance; the Senate is mulling legislation to encourage employee wellness programs.

## Employer's Handbook: Complying With IRS Employee Benefits Rules

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# Michigan Same-Sex Marriage Ban Affects State and Local Employee Benefits

By Todd A. Solomon and Gladys C. Zolna

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## Background

In 2003, Massachusetts became the first (and is still the only) U.S. state to legally recognize same-sex marriages. In *Goodridge v. Department of Public Health*,<sup>1</sup> Massachusetts' highest court held that the statute governing the issuance of marriage licenses, which did not permit same-sex couples to marry, offended the liberty, freedom, equality and due process provisions of the Massachusetts constitution. In the wake of the Massachusetts ruling, the mayor of San Francisco ordered the city clerk to begin issuing marriage licenses to same-sex couples in San Francisco.<sup>2</sup> The Massachusetts decision and the actions of the mayor of San Francisco brought the issue of same-sex marriage to the forefront in the United States (see ¶377 of the *Handbook* for more on same-sex marriages).

In response, same-sex marriage opponents began putting constitutional amendments banning it on state ballots. While many of the resulting constitutional amendments that were enacted were relatively narrow,<sup>3</sup> some states enacted broader amendments that went beyond simply banning same-sex marriage.

One such state is Michigan. On Nov. 2, 2004, Michigan voters approved Proposal 04-2, which amended Michigan's constitution to provide "[t]o secure and preserve the benefits of marriage for our society and for future generations of children, the union of one man and one woman in marriage shall be the only agreement recognized as a marriage or similar union for any purpose."<sup>4</sup>

## The Dispute

Before enactment of the constitutional amendment banning same-sex marriage, many Michigan public employers had

policies or agreements that extended health care benefits to their employees' same-sex domestic partners (see ¶370). One was the city of Kalamazoo, Mich. After enactment of the amendment, a state representative requested an opinion from the Michigan attorney general as to whether the amendment prevented the city from offering such domestic partner benefits. The attorney general determined that it did.<sup>5</sup>

In response to the attorney general's opinion letter, nonprofit organization National Pride At Work, Inc., filed suit on behalf of various individuals whose benefits were or would be affected by the attorney general's opinion.<sup>6</sup> They sought a declaration that the amendment

See *Michigan Constitution*, p. 4

<sup>1</sup>*Goodridge v. Dep't. of Pub. Health*, 798 N.E. 941 (Mass. 2003)

<sup>2</sup>The San Francisco mayor's actions have since been found to be invalid. *Lockyer v. City and County of San Francisco*, 33 Cal. 4th (Cal. 2004).

<sup>3</sup>For example, the Kentucky amendment provides "Only a marriage between one man and one woman shall be valid or recognized as a marriage in Kentucky. A legal status identical or substantially similar to that of marriage for unmarried individuals shall not be valid or recognized." Ky. Const. 233A.

<sup>4</sup>MCLS Const. Art. 1, §25.

<sup>5</sup>Op. Atty. Gen. 2005, No. 7171, 2005 WL 639112.

<sup>6</sup>In addition to employees of the city of Kalamazoo, the suit was filed on behalf of state of Michigan employees and employees of various Michigan universities.

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## **Michigan Constitution** (continued from p. 3)

did not, in fact, bar public employers<sup>7</sup> from providing benefits to their employees' domestic partners and children. While the circuit court disagreed with the attorney general and held that the amendment does not preclude public employers from extending same-sex domestic partnership benefits, the Michigan Court of Appeals agreed with the attorney general and reversed the circuit court's decision.<sup>8</sup> The case is now before the Michigan Supreme Court.

The ultimate outcome of the case will likely depend on the answers to two questions:

- 1) What is included in the "benefits of marriage" that the amendment was intended to secure and preserve?
- 2) What does it mean to "recognize" an agreement as a marriage or similar union?

With respect to the first question, National Pride At Work argued that health insurance was not a benefit of marriage covered by the amendment as it was not among the statutory benefits of marriage.<sup>9</sup> The appellate court, however, focused on the part of the amendment that states that only a union of one man and one woman will be recognized as a marriage or similar union for *any purpose*. Therefore, according to the appellate court, the amendment precludes governmental entities from providing *any benefit* if doing so is conditioned upon the governmental entity recognizing a union that is not that of one man and one woman in marriage.

With respect to the second question, National Pride At Work argued that "recognized" refers to the state's conferment of a legal status or rights. In this case, because the public employers were not conferring any legal status or rights, the employers were not recognizing the union. The attorney general, however, argued that to recognize means only to acknowledge the existence of something. While the appellate court agreed with National Pride At Work that "recognize" was used in a legal sense and was meant to acknowledge the legal validity of something, the court nonetheless held that by officially recognizing a same-sex union through a domestic partnership agreement, public employers gave same-sex couples a status similar to that of married couples in violation of the amendment.

In reaching this conclusion, the court noted that the domestic partner benefit policies share eligibility criteria for covering domestic partners that are the same basic criteria as those for a legal marriage:

- 1) that the partner be of the same sex (opposite sex for marriage);
- 2) that there be an agreement concerning the relationship (such as a domestic partnership agreement or an agreement to be jointly responsible for basic living and household expenses);
- 3) that each partner not be a blood relation;
- 4) that the partner not be married to another or have a similar relationship to another person; and
- 5) that the partner be at least 18.

The court held that the requirement that an employee prove the existence either of a written domestic partnership agreement or an agreement to be jointly responsible for basic living and household expenses in order to establish eligibility for insurance coverage constitutes recognition by the public employer of a similar union for any purpose.

### **What Happens Next**

While other cases have been brought in Michigan seeking to prevent public employers from providing domestic partner benefits on the basis that doing so violates the Michigan constitution, these cases have thus far been dismissed for a lack of standing.<sup>10</sup> Therefore, it appears that the Michigan appellate court decision in *National Pride* remains the law, at least until the Michigan Supreme Court renders its decision.

In response to *National Pride*, the Ann Arbor school district has indicated that will not include domestic partner benefits in future union labor contracts, causing some employees to lose benefits when the existing contracts expire. In addition, union contracts covering employees of the state of Michigan will not have domestic partner benefits added to such contracts, as was planned before the appellate court's decision.

**See Michigan Constitution, p. 5**

<sup>7</sup>In rendering the opinion, the attorney general determined that the placement of the amendment in the section of the constitution that limits government conduct means that the amendment operates as a limit on government conduct, including both state and local government entities, but does not apply to private individuals.

<sup>8</sup>*Nat'l Pride at Work, Inc. v. Governor of Mich.*, 732 N.W.2d 139 (Mich. App. 2007).

<sup>9</sup>Examples of statutory rights that spouses accrue upon marriage include certain property, pension and retirement benefit rights, and inheritance rights.

<sup>10</sup>*Rhode v. Ann Arbor Pub. Schs.*, 2007 Mich. LEXIS 1630 (Mich. July 25, 2007); *Am. Family Ass'n of Mich. v. Mich. State Univ. Bd. of Trs.*, 2007 WL 1696038 (Mich. App. June 12, 2007).

# Dependent Care Plans

## IRS ISSUES FINAL RULE ON CHILD AND DEPENDENT CARE TAX CREDIT

The Internal Revenue Service (IRS) published a final rule on child care credits on Aug. 14. The rule finalizes, with changes, proposed regulations published May 24 on tax credits for household and dependent care expenses necessary for gainful employment (see Tab 500 of the *Handbook* for more on dependent care plans). The federal tax code encourages dependent care assistance programs, but only employment-related dependent care expenses qualify for reimbursement under a Code Section 129-qualified dependent care assistance plan (see ¶510).

The final rule deems expenses for a day camp as allowed under a qualified dependent care plan. The cost of summer school and tutoring programs are not qualifying employment-related expenses because they are educational in nature. However, the final rule says the full amount paid for a day camp or similar program that focuses on specific educational objectives like reading, math or writing may be a qualifying expense if the camp meets the Section 21(b)(2)(D) definition of “dependent care center.” The final rule also says no portion of the expense for an overnight camp is eligible for reimbursement.

The final rule’s effective date was Aug. 14.

## Michigan Constitution (continued from p. 4)

On the other hand, some employers, such as Michigan State University and the city of Kalamazoo, which originally announced that they would cease providing domestic partner benefits have now come up with creative ways to continue to provide such benefits. The appellate court in *National Pride* stated that the amendment does not preclude the extension of employment benefits to unmarried partners. Instead, it appears from the decision that the amendment only restricts public employers’ recognition of domestic partner agreements as the basis for providing such benefits.

As a result, Michigan State University, which was sued for offering domestic partner benefits, has developed its “Other Eligible Individual” program, under which an employee who has not specified a spouse may select an individual to receive health and dental coverage. Under this program, the individual must not be related to the employee by blood, and the two individuals must have shared a residence for 18 months on a

## Finding out More

The final rule appears in the *Federal Register* at 72 *Fed. Reg.* 45338 (Aug. 14, 2007). For more information, call Amy Pfalzgraf at the IRS at (202) 622-4960. 📍

## Highlights of Final Rule on Dependent Care Plans

### Eligible for reimbursement:

- day camps;
- preschool expenses, including food;
- fees paid to an employment agency to obtain the services of an au pair; and
- the cost of bus service that delivers a child to a qualified day care facility.

### Not eligible:

- worker’s cost of driving his or her child to the day care facility, and
- dependent care expenses related to children in two-parent families in which only one parent works.

Source: Internal Revenue Service, Final Rule published Aug. 14, 2007. 📍

non-tenant basis. Similarly, the city of Kalamazoo has developed an “Other Qualified Adult” program, based on the University of Michigan program of the same name, which will offer benefits to employees’ domestic partners regardless of sexual preference.

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The amendment precludes governmental entities from providing any benefit if doing so is conditioned upon the governmental entity recognizing a union that is not that of one man and one woman in marriage.

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Although the constitutionality of these new, creative programs has not yet been tested, it is at least arguable that, by not conditioning coverage on the public employers’ recognition of a domestic partnership agreement, these approaches address the appellate court’s concerns. 📍

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# Cafeteria Plans

## Coverage of Non-dependents Could Cost Employees

By Michael S. Melbinger, Esq. and Anne Schwaab, Esq.

States that require continued health care coverage of adult children under their parents' insurance policies could be creating imputed income for these parents. Though the Employee Retirement Income Security Act of 1974 (ERISA) preempts state law — exempting an employer's self-funded health plan from state insurance regulation — insured health plans do not enjoy the same protection. Treasury regulations limit an employer's ability to funnel certain policy premiums through a cafeteria plan. Therefore, the employer that is forced to expand health care coverage offered to its work force, namely those who have insured benefits, must also be mindful of potential imputed income to employees and careful not to run afoul of the "qualified" benefits limitation for cafeteria plans.

This article explores these issues in the wake of recent state efforts to extend coverage to adult children who have reached a cut-off age or have graduated from school and therefore would be excluded from their parents' health plans. Though in theory the policymakers' goal — saving adult children of insured parents from the vagaries and added expenses of purchasing insurance on the individual market — is meritorious, in practice allowing these individuals to continue to elect coverage under their parents' policies may have some unintended and undesirable consequences.

### Where Do the Issues Arise?

Under the Internal Revenue Code of 1986 an employer must include in an employee's income any part of a health plan premium payment the employer made that is attributable to someone who is not an employee, a spouse or a dependent, as the tax Code defines those terms (see ¶602 of the *Handbook*). Further, because the benefits of such premium payments are not excludable from

gross income, they do not constitute the type of "qualified" benefit that can be offered under a cafeteria plan arrangement (see ¶601 for a discussion on permitted and prohibited benefits under cafeteria plans). The issue also has relevance for domestic partners, who may or may not be dependents under the tax code, and who have some legal protection in states that recognize same-sex marriage, civil unions and even heterosexual non-marital relationships (see ¶370).

In theory the policymakers' goal is meritorious; in practice allowing these individuals to continue to elect coverage under their parents' policies may have some unintended and undesirable consequences.

### Background on State Insurance Continuation Laws

Colorado, Massachusetts, New Jersey and Utah are among the states that have passed insurance continuation laws. New Jersey's law, for example, permits eligible dependents under health insurance plans issued in New Jersey to remain eligible for continued health insurance coverage until the dependent's 30th birthday. The law took effect on May 12, 2006, and applies to medical insurance contracts or insured plans that are "delivered, issued, executed or renewed, or approved for issuance or renewal" in New Jersey after that date. Accordingly, this law affects employers that provide employees with health care coverage through insurance policies issued in the state. The law does not affect self-insured plans. Note that without a residency requirement, such a mandated coverage law

See *Cafeteria Plans*, p. 7

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## **Cafeteria Plans** (continued from p. 6)

could affect employers and employees outside the state as well, if the determining factor for applicability of the law is strictly whether an insurance contract was issued in New Jersey.

To qualify as a “dependent” under the New Jersey law, an individual must be:

- 1) under 30 years of age;
- 2) unmarried;
- 3) without a dependent of his or her own;
- 4) a resident of New Jersey or enrolled as a full-time student at an accredited public or private institution of higher education; and
- 5) not covered under any other group or individual health benefits plan or entitled to Social Security benefits.

Compare this to the federal definition of “dependent.”

### **IRS Definition of “Qualifying Child” or “Relative” for Cafeteria Plans**

The Internal Revenue Code defines a “qualifying child” as a person who:

- is the taxpayer’s child, stepchild, foster child, brother, sister, stepbrother, stepsister or a descendant of any of them; and
- has lived with the taxpayer for more than half of the year; and
- did not provide more than half of his or her own support for the year; and
- was under age 19 at the end of the year (or was under age 24 at the end of the year and a student, or was any age and permanently and totally disabled).

The Internal Revenue Code defines a “qualifying relative” is a person who:

- lives with or is related to the taxpayer; and
- does not have \$3,300 or more of gross (total) income; and
- is supported (generally more than 50 percent) by the taxpayer; and
- is neither the taxpayer’s qualifying child nor the qualifying child of anyone else.

(See ¶602 of the *Handbook* for more on the definition of “dependent” within the context of plan qualifications.) 

The IRS defines “dependent” as a person, other than the taxpayer or the taxpayer’s spouse, for whom an exemption can be claimed. This dependent must be the taxpayer’s “qualifying child” or “qualifying relative.” (The exemption — \$3,300 for 2006 — can be subtracted from taxpayer’s income in calculating how much of the taxpayer’s income will be taxed. Exemptions generally are allowed for the taxpayer, the taxpayer’s spouse and dependents as defined under the tax code. See box.)

Note also that although a domestic partner does not qualify as a spouse for federal tax purposes, the IRS has ruled that a domestic partner may still qualify as a Code Section 152 dependent. For example, the IRS made this determination in Private Letter Ruling (PLR) 200108010 (see box). The IRS issued this ruling in response to an inquiry concerning extending employer-provided health care coverage of an employee to a domestic partner dependent under a self-insured multi-employer voluntary employees’ beneficiary association.

In PLR 200108010, the IRS said for any given tax year, such a domestic partnership may not violate any local law and the domestic partner must: (1) receive more than half of his or her support from the employee and (2) maintain himself or herself as a member of the employee’s household. The IRS further indicated that the plan may rely on a dependent certification as to support and residency “to establish that the domestic partner is a dependent of the participant for purposes of determining whether the domestic partner coverage is subject to income and employment taxes.”


### **Other Provisions of New Jersey Law**

Under New Jersey law, an eligible individual may elect the extended dependent coverage upon the occurrence of one of the following events:

- 1) within 30 days before “aging out” of plan coverage if the dependent is currently covered by a health insurance plan;
- 2) within 30 days after becoming an eligible dependent if the individual’s coverage previously terminated;

See *Cafeteria Plans*, p. 8

### **A Note About PLRs**

Private letter Rulings (PLRs) do not have the force and effect of law, nor do they constitute official IRS guidance. Nonetheless, employers should be aware of the views the IRS expresses in PLRs since they suggest how the IRS interprets the law with regard to a specific situation and how the IRS may apply the law in similar scenarios. 

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## Cafeteria Plans (continued from page 7)

- 3) during the employer's open enrollment period if the individual previously aged out of the plan's coverage and meets the requirements for dependent status during the open enrollment period; or
- 4) by May 12, 2007, to reinstate coverage that had been terminated before May 12, 2006.

A health insurer is legally prohibited from refusing a written election for coverage based solely on the fact that the dependent previously elected and lost coverage under the prior plan. An insurer also may not condition the extension of dependent coverage on evidence of insurability. The coverage provided to the dependent must be identical to the coverage he or she received before aging out of the plan.

Coverage will terminate when

- 1) the individual no longer qualifies as a "dependent";
- 2) the dependent or subscriber fails to timely make a premium payment; or
- 3) the subscriber loses coverage for any other reason under the health insurance contract.

### Conflict With Code

The problem with mandatory coverage laws is that they require continuation of coverage for a category of children who no longer qualify as "dependents" under the federal tax code. If an employer wishes to continue to pay premiums for an employee's dependent under the state-extended definition, the tax-free benefits that were previously available for the parents under federal law no longer apply.

Many employers offer health care coverage to their employees through a cafeteria plan, so it is important to address the premium issue in terms of permitted cafeteria plan benefits and welfare benefits that qualify for exclusions from gross income. (See Code Sections 105, 106 and 125, and related Treas. Regs. under §§1.106-1 and 1.125. See also Apps. A and B, and ¶¶601 and 602.)


Code Section 125(f) (see App. A) defines "cafeteria plan" as a written arrangement for employee participants, providing a choice of benefit between cash or qualified benefits. Section 125(e) defines "qualified benefit" (as offered under a Section 125 plan) as one that does not defer compensation and is not includable in the gross income of the employee by reason of an express tax code provision.

Health and accident plan premiums are qualified benefits under Section 106(a), which exempts employer-provided coverage under such plans from taxation. Under

Treas. Reg. §1.106-1, such coverage may include employees, spouses, and dependents as defined in Section 152. As stated above, Section 152 limits the definition of "dependent" to qualifying children and relatives. Also relevant to domestic partner benefits is the Defense of Marriage Act, which limits the definition of "spouse" for purposes of all federal laws to heterosexual couples.

### What This Means

At least according to the federal tax code, then, the non-Section 152 dependent premium payment is not prohibited; but it is *not* a qualified benefit that can be offered under a cafeteria plan. So, while employers are permitted to pay part or all of the premiums for non-152 dependents, only coverage for 152 dependents is excludable from taxable income and may be covered under the employer's cafeteria plan. (i.e., employees cannot pay on a pre-tax basis for employer-provided health premiums for non-152 dependents *and* the employer-paid portion of such premiums is income to the employee).

Therefore, an employer that wishes to include non-152 dependents under its employee health plan should be prepared for some additional administration — to account for the premium payments separately — and additional income tax reporting for employees extending their coverage to include non-152 dependents. 

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# Cafeteria Plans

## IRS Releases New Proposed Regulations on Cafeteria Plans

By Terry Humo, Esq.

*Terry Humo, Esq. is a benefits consulting attorney and co-author of Thompson Publishing Group's Guide to Consumer-Directed Health Care.*

The Treasury Department and Internal Revenue Service (IRS) have published long-awaited cafeteria plan rules, including guidance on non-discrimination requirements.

They issued the new proposed rules to replace the basic cafeteria and flexible spending account (FSA) rules published more than two decades ago (see Tab 600 of the *Handbook* for more on cafeteria plan rules and FSAs). Some of the old proposed rules remain unchanged, but many provisions have been updated to reflect changes in the tax code, such as authorization of health savings accounts (HSAs; see ¶390).

### What's New

Among new proposed rules are:

- change in the definition of “dependent” (¶603);
- addition of qualified benefits that can be offered through a cafeteria plan, such as adoption assistance (Tab 800);
- addition of deferred compensation benefits, health savings accounts (HSAs) and qualified HSA distributions from health FSAs;

- prohibition against long-term care insurance and long-term care services being included in cafeteria plans (see ¶601 for permitted and prohibited benefits and ¶360 for long-term care generally); and
- addition of the employee concentration test for non-discrimination testing (¶622).

The new proposed rules also include general rules on:

- qualified and nonqualified benefits (¶601);
- elections;
- non-discrimination;
- FSAs; and
- substantiation of expenses for qualified benefits.

### What's Not New

The old proposed rules provide the basic framework and rules for cafeteria plans and elections under those plans, as well as significant rules for FSAs. Among the latter are:

- that the maximum reimbursement be available at all times during the coverage period;
- the requirement for a 12-month coverage period;
- that only medical expenses be reimbursed;

See *Cafeteria Regulations*, p. 10

### How to Submit Comments to the IRS

The IRS must receive all written or electronic comments by Nov. 5, 2007. Outlines of topics to be discussed at the hearing, scheduled for Nov. 15 at 10 a.m., are due by Oct. 25. The public hearing will be held the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C.

**By mail.** Mail submissions to: CC:PA:LPD:PR (REG-142695-05), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

**By hand delivery** between 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-142695-05), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 🏠

### New Proposed Rules Can Be Used Now

Employers and plan administrators can apply the newly-issued cafeteria plan rules now, even though they are not yet in final form. Keep in mind, however, that since the IRS has invited public comments and will be considering them and any remarks and testimony at the hearing on the rules, it is possible that the proposed rules may be changed before they are issued in final form. A hearing is scheduled for Nov. 15. (see box, left, for details on how to submit comments to the IRS). 🏠

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# Adoption Assistance

## EMPLOYERS HELP BUILD FAMILY TIES WITH ADOPTION BENEFITS

Thousands of miles from home across the Atlantic, Scott and Michele Campbell stood on Ethiopian soil, waiting to meet the new addition to their family. The last time they were in Africa was for their honeymoon — now they were here to meet their adoptive boy. They were nervous about how the child would fit into the family, how to eventually tell him about where he came from.

Scott's company, CMP Technology, was behind employees who adopt children, providing paid time off and financial reimbursement. The Dave Thomas Foundation for Adoption ranks the company No. 1 in its industry and No. 2 in the United States in its 100 Best Adoption-Friendly Workplaces list.

"You can be a teeny tiny organization or a multimillion-dollar organization ... and you can have adoption benefits," said Rita Soronen, the foundation's executive director.

### **Cafeteria Regulations** (continued from page 9)

- substantiation by a third party before reimbursement;
- that expenses be incurred during the coverage period; and
- the use-it-or-lose-it rule (§603).


These rules remain substantially the same.

### **Effective Date**

The proposed effective date for the new proposed rules is for plan years beginning on or after Jan. 1, 2009, although the IRS says the new proposed rules may be relied on for guidance pending issuance of final rules.


### **Finding out More**

The text of the proposed regulations are available in the *Federal Register* at 72 *Fed. Reg.* 43938 (Aug. 6, 2007) and will be added to App. B of the *Handbook* in a future supplement.

**For further information from the IRS** concerning the proposed regulations, contact Mireille T. Khoury at (202) 622-6080; concerning submissions of comments, the hearing or to be placed on the building access list to attend the hearing, contact Oluwafunmilayo Taylor of the Publications and Regulations Branch at (202) 622-7180. 

Wendy's restaurant founder Dave Thomas established the foundation in 1999, but 2007 is the first year of the list. Thomas, who was adopted at a young age and had long been an advocate for adoption, also established the Wendy's corporate adoption program in 1990. Wendy's made the list.

## The 100 Best Adoption-Friendly Workplaces List

The list, found online at <http://www.adoptionfriendly-workplace.org> by clicking on "View a chart of top 100," is based on the amount of financial assistance and paid leave an employer's adoption benefits policy provides. Company staff sizes range from 30 to 176,000 employees, while industries include transportation, nonprofits, retail and more. The foundation compiled company lists for those categories, which can be viewed at the main page via the "size and industry leaders" link. 

### **Concerns**

One of the biggest concerns for companies considering offering adoption benefits is cost, ranging from reimbursements to paid leave. But, Soronen said, the foundation shows them that adoption benefits are cost-effective, "[calming] their fears from a huge financial burden."

One way to calm fears is to show how inexpensive it is to offer adoption assistance, which the foundation illustrates in its Employer/Employee Toolkits packets. The foundation also shows the potential benefits to an employer of offering adoption benefits, including:

- an increase in company loyalty, productivity, goodwill, retention;
- an edge in recruiting new employees; and
- a demonstration that the company is family friendly (95 percent of Americans believe companies should offer adoption benefits, according to a national survey).

As the popularity of adopting has increased, companies have responded in turn. The foundation cites a Hewitt Associates report that says companies offering financial adoption benefits rose from 12 percent in 1990 to 45 percent in 2006. Also, of *Working Mother* magazine's 2006 top 100 companies, 91 offer financial assistance

See *Adoption Assistance*, p. 11

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## **Adoption Assistance** (continued from page 10)

for adoptions and 73 paid leave (the Family and Medical Leave Act requires companies with 50 or more employees and all public agencies to give 12 weeks of unpaid adoption leave).

Alice Faeth, benefits manager for United Business Media, the parent company of CMP Technology, offers proof that employers find adoption assistance to be beneficial. Faeth says it is very important economically to hire and retain good employees, so it makes good sense for CMP to continue to offer an adoption benefit because the rewards are definitely tangible. The company reimburses employees before the child even enters the home, since some adopting parents incur expenses from the start of the process.

Citizens Financial Group, ranked No. 1 overall on the 100 Best Adoption-Friendly Workplaces list, offers more than \$20,000 per adoption. During the past 10 years, a child has been adopted by a CFG employee at an average rate of almost one per month.


### **REGULATIONS**

Some companies — and employees — may be familiar with adoption benefits, but may not understand the tax laws and regulations that apply to them.

An employee can exclude payments or reimbursements made under an adoption assistance program for qualified adoption expenses of up to \$10,000 per qualifying child from the employee's wages subject to federal tax withholding, but they are subject to Social Security, Medicare and federal unemployment taxation (see ¶804 for plan qualification requirements and ¶820 for more about the tax credit). The adoption credit or exclusion cannot be taken for a child who is not a U.S. citizen or resident unless the adoption becomes final. The credit and exclusion for qualifying adoption expenses are each subject to a dollar limit and an income limit.

Information regarding the child tax credit should follow the rules regarding any qualifying child because IRS Publication 972 says an adopted child is always treated

### **What Does “Qualified Adoption Expenses” Mean?**

Code Section 23 defines “qualified adoption expenses” as reasonable and necessary adoption fees, court costs, attorney fees and other expenses directly related to the legal adoption of an eligible child and incurred for that purpose. 

as one's own child. It also says that if one is a U.S. citizen or U.S. national and one's adopted child lived as a member of the household all year, that child meets the citizenship of residency requirements by which a child qualifies for the child tax credit.

### **PROFILES OF EMPLOYERS OFFERING ADOPTION ASSISTANCE**

Some of the employers of the 100 Best Adoption-Friendly Workplaces list as well as experiences of employers that offer or have offered adoption assistance follow.

Employee: Wendy's International, Inc.  
Headquarters: Dublin, Ohio  
Number of employees: 47,500  
Financial assistance for adoption: \$7,500 (additional assistance for special needs adoption)  
Maximum weeks of paid leave for adoption: Six

Teenagers can be a handful. They can be even more of a handful when adopted into a family that already has kids. That was the scene for Michelle Kaiser, her husband and their two biological children in April 2006, when they adopted 16- and 15-year-old half-sisters.


“It was a little more difficult than we thought – a little bit challenging,” Kaiser said. “There was difficulty initially; the transition was not easy. They don't want to get attached.” In addition, Kaiser said her family's lifestyle is more structured than the teenagers were used to, whether it meant going to school or being home by a certain time.

So with the challenges one faces with adopting teenagers as opposed to infants, why do it?

“We had initially started with the age group of 5 to 6 years old É but the only kids we were finding in that age group had a lot of disciplinary problems. Why pass them

See *Adoption Assistance*, p. 12

### **What Is an “Eligible Child”?**

An eligible child must be under 18 years of age, or be physically or mentally incapable of caring for himself or herself. A child with special needs can be an eligible child if he or she is a U.S. citizen or resident and a state determines that the child cannot or should not be returned to his or her parent's home and probably will not be adopted unless assistance is provided. Under certain circumstances, one may increase the amount of qualified adoption expenses if the adoption is for an eligible child with special needs. 

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## **Adoption Assistance** (continued from page 11)

up just because of their age?” she said. That attitude has helped this family of six get to where they are today.

But the process was not a short one. In February 2005, Michelle and her husband began to look into the adoption process. She found an agency through a co-worker and investigated what to look for and not to look for, kids who do not have a lot of issues, how adoptees interact with her biological kids (a boy and girl, 8 and 9 years old then) and other issues.

It wasn't just the Kaisers asking for information — the agency needed information from them, too, including fingerprints, paperwork and background checks. The Kaisers also had to take adoption classes. “It's a long process and I see how people are turned off; the process is so grueling,” Kaiser said. “I do see why they do it.”

Before the girls could move in, weekend visits were scheduled. They met a few times over a month before officially moving into their new home. “The caution was there because the county wanted to make sure it was a good fit,” Kaiser said. “You have to have a lot of patience.”

That patience was helped by the fact that Kaiser was able to take advantage of the six weeks of leave her employer offers. “Having the time off was really important because [the adopted children] don't know anything, they don't know anybody,” she said.

Employer: Citizens Financial Group, Inc. (Citizens Bank and Charter One Bank)  
Headquarters: Providence, R.I.  
Number of employees: 25,000  
Financial assistance for adoption: \$20,960  
Maximum weeks of paid leave for adoption: Two

Karen Pirigyi anxiously waited inside Newark Airport for the arrival of a passenger who would change her life. She had never met her, never heard her young voice, but was filled with excitement. When then-15-month-old Alta landed from Korea on Oct. 13, 2006 to meet her adoptive parents, apparently she felt the same. “She was actually running when we first met her,” Karen said. “She has an amazing personality but a bit of a temper.”

There were some initial challenges Karen, her husband, Tom, and Alta faced. Karen said the girl spoke some Korean words and there was a little bit of a language barrier for her. Alta had also been attached to

her foster mother, which may be why she adapted more quickly Tom.

Luckily, Karen was able to work from home for four weeks to spend more time with Alta. Even now she works from home two days a week to “make sure the bond we created stays,” she said.

“I had talked to my supervisor about working from home,” said Karen, a business analyst in the New York Retail Banking Department in Albany. “I'm fortunate that the job I do have can be done from home.”

The company's financial assistance adoption benefits also played a role. Her company provides nearly \$21,000 per adoption. What also helped was that Korea escorts children to the United States, making it less costly.

“I was very surprised [at the amount] offered,” Karen said. “Even when we were going through the process, my social worker said the same thing. She was amazed at the benefits.”

Karen said if the financial benefit wasn't there, it might have been difficult, quite possibly delaying their decision to adopt. “It really shows the company's commitment to me. It strengthens my commitment to the company,” she said.

Employer: South Mountain Company  
Headquarters: West Tisbury, Mass.  
Number of employees: 30  
Financial assistance for adoption: \$10,000  
Maximum weeks of paid leave for adoption: Four

For a company with less than 50 employees and no adoption policy, there was a good chance Derrill Bazy would have to adopt a child without any financial help or paid time off. Derrill wouldn't let that deter him from adopting, but it also didn't stop him from asking his company to start an adoption benefits program.

So that's what he did, proposing an idea based on materials from the Dave Thomas Foundation for Adoption. He kept the idea simple, suggesting that the company cover some of the expenses.

The result was the company's first adoption benefits (see page 13), helping his family, his wife, JoAnn Echer, and their adopted son, Jacob Antonio Bazy. “It's a huge help to get that kind of support for adoption because it can be expensive,” he said. “It really does show a clear commitment to the individual's aspirations.”

**See Adoption Assistance, p. 13**

# Washington Watch

## LONG-TERM CARE LEGISLATION INTRODUCED

On June 11, two members of the House introduced a bipartisan measure that would give a tax advantage to families and caregivers who pay directly for long-term care expenses. Reps. Earl Pomeroy (D-N.D.) and Nancy Johnson (R-Ct.) introduced the Long-Term Care Affordability and Security Act of 2007. On Aug. 3, H.R. 3363 was referred to the House Committee on Ways and Means (see ¶360 of the *Handbook* for more on the tax treatment of payments for long-term care insurance). 🏠

## TAX CREDIT FOR WELLNESS PROGRAMS

Sen. Tom Harkin (D-Iowa) introduced a bill that would provide tax incentives for employers to sponsor wellness programs. The Healthy Workforce Act, S. 1753, went to the Senate Committee on Finance the same day it was introduced, July 9. Under the proposal, companies that spend \$400 per employee on wellness would earn a tax credit of up to \$200 per employee for the first 200 employees and \$100 per employee for the rest of the company's work force. 🏠

## Adoption Assistance (continued from page 12)

That was five years ago, and Derrill says that a company of nearly any size, whether there are 30 or 30,000 employees, can have adoption benefits. Even though Derrill said he is basically the only one to have used the policy, there have been many questions from friends. “[The money and time] are important factors that allow us to focus on our kid,” he said.

Employer: CMP Technology  
Headquarters: Manhasset, N.Y.  
Number of employees: 1,200  
Financial assistance for adoption: \$15,000  
Maximum weeks of paid leave for adoption: Two

Scott and Michele Campbell went all the way to Ethiopia to adopt.

### South Mountain's Adoption Benefits

#### Maternity/Paternity

Each male employee is eligible for two weeks (80 hours) of fully paid paternity leave upon the birth of a child. Each female employee is eligible for four weeks (160 hours) of fully paid maternity leave upon the birth of a child. Additionally, she is eligible to receive disability benefits. The same maternity and paternity benefits will be extended to adoptive parents (except those adopting stepchildren). Maternity/paternity time is not counted as hours worked.

#### Adoption Bonus

Adoptive parents will receive a bonus of 50 percent of their documented adoption expenses (including expenses relating to the adoption of stepchildren). 🏠

Scott remembers his visit to the African country to meet his adopted son, Jason. The Campbells were one of five couples adopting at the same time. They stayed at a guesthouse the agency provides for adoptive parents. One of the most remarkable parts of the trip was near the end when they visited a man who had found the abandoned boy near a river.

Though such a trip can take a toll financially and take time away from one's job, but thanks to their work adoption benefits, it was not a problem. At CMP, where Scott works as an assistant news editor, employees don't have to wait to have a child come home to be reimbursed. Filling out the form is “easier than an expense report,” he said.

Scott and his wife were also able to take time off from work. “I didn't go back right away. Initially, bonding time was important,” Scott said.

It also helped that Michele used to work at CMP and remembered a couple of people there who adopted. “It certainly made things a lot easier,” he said.

Scott said a lot of people have asked about it privately. Since more employers have taken advantage of the adoption benefits, it may not be surprising. In fact, most recently, employees have adopted from Russia and China – and Africa, just like the Campbells.

#### Finding out More

The IRS provides additional information about adoption credit at <http://www.irs.gov/taxtopics/tc607.html>, and on the child tax credit and relevant forms at <http://www.irs.gov/newsroom/article/0,,id=106182,00.html>. 🏠

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# Fringe Benefits

## OMB GUIDES FEDERAL AGENCIES IN CRACKING DOWN ON TRANSIT SUBSIDY ABUSE

The White House Office of Management and Budget (OMB) wants to make sure federal agency heads are on top of transit benefit fraud among federal employees.

OMB Associate Director for Management Robert Shea met with more than 200 agency officials on July 31 to discuss that issue.

In April, the Government Accountability Office (GAO) reported fraudulent activity by federal employees in the Washington, D.C. area who had signed up for the commuter benefit program, which provides vouchers to employees to help cover their commuting expenses. The GAO reported that employees were auctioning off their vouchers, called Metrocheks, on popular Internet auction sites like eBay (see June newsletter) and estimated that employees were bilking the government out of \$17 million a year through the transit program.

In May, Shea sent a memorandum to all federal departments and agencies stating that they must confirm by June 20 that they had implemented internal controls that he outlined in an attachment (see box).

See *Fringe Benefits*, p. 15

## Excerpt From White House E-mail About Commuter Benefits

Below is an excerpt from a White House e-mail to employees regarding their transportation subsidy benefit. This printout was attached to OMB Associate Director for Management Robert Shea's May 14 memorandum to federal agency and department heads, designed to provide minimal internal controls over the program.

- This is a reminder to all employees who receive the transportation subsidy that it is a benefit and may only be used to pay the costs of YOUR public transportation to and from work, which may include Metro subway/bus, Virginia Railway Express (VRE), MARC trains, and other eligible commuter buses and vanpools. The amount of the transit benefit will equal the actual amount paid for public transportation, not to exceed \$110 per month.

Source: Executive Office of the President, Office of Management and Budget, May 14, 2007.

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## **Fringe Benefits** (continued from page 14)

While Congress weighed in with its own recommendations on tightening the program, OMB outlined specific measures that must be taken. Shea said the U.S. Department of Transportation Office of Management and Transportation will administer the new policies.

Private employers can follow the government's lead in implementing measures designed to minimize (or even prevent) fraud and abuse of their qualified transportation fringe benefit plans. (See ¶916 of the *Handbook* for more on transit passes under qualified transportation fringe benefits.) 

### **DOT PROPOSES INCREASE IN DENIED BOARDING COMPENSATION**


The U.S. Department of Transportation (DOT) is soliciting comments on a proposal that would increase penalties airlines must pay passengers who are denied boarding at the gate of an oversold flight. Under current rules, airlines can overbook flights to ameliorate the effects of “no shows.” Any frequent flyer knows that when too many passengers show up for a flight, airlines first seek volunteers to take alternate flights. If there are too few takers, the airline must deny boarding and pay a penalty to “bumped” passengers. The DOT proposal,

published on Jul. 10, would increase the penalty to as much as triple the current amount. Currently, airlines must pay up to \$200 a passenger. That doubles if the airline fails to meet requirements to keep the delay under two hours (four for international flights). The DOT has requested public comments on five proposals:

- 1) Increase the \$200 compensation limit to \$624 and the \$400 limit to \$1,248;
- 2) Increase the compensation limits to \$290 and \$580, respectively;
- 3) Double the compensation limits to \$400 and \$800;
- 4) Eliminate all limits and make compensation equal to the value of the ticket with the payment doubling for longer delays; or
- 5) Leave the current limits in place.

The deadline for submitting comments is Sept. 10.

#### **Finding Out More**

For instructions on how to submit comments, see the DOT's notice of proposed rulemaking in the *Federal Register* at 72 *Fed. Reg.* 37491 (Jul. 10, 2007) or visit the DOT's Web site at <http://dms.dot.gov>. Follow the instructions for submitting comments on the DOT electronic docket site. 

## **Subject Index, Vol. 18**

This index covers the *Handbook* newsletter for Vol. 18, Nos. 1-9. It is arranged by subject. The numbers following each entry refer to the volume, issue and page num-

bers of the newsletter in which information on that topic appears. For example, the designation “18:1/3” indicates Vol. 18, No. 1, page 3. Court cases relating to a topic appear under that topic's entry.

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