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FINAL IRS REGULATIONS SIGNIFICANTLY IMPACT 403(b) PLANS OF TAX-EXEMPT ORGANIZATIONS

Many tax-exempt entities, such as hospitals, churches, public schools, etc., provide retirement benefits to their employees under 403(b) plans and arrangements. In July, 2007, the IRS issued comprehensive regulations (“Final Regulations”) governing 403(b) plans, which generally become effective in 2009. The Final Regulations make significant changes to these programs. As a result, tax-exempt entities should be reviewing their 403(b) arrangements for compliance with the new rules and reevaluating their programs in light of the

new requirements. In addition, many tax-exempt organizations adopted 403(b) plans long ago when 401(k) and other qualified plan alternatives were not available. Too often these 403(b) plans have been maintained on “automatic” without much thought or review. While the release of the Regulations creates a new burden, it also provides an excellent opportunity for employers to review and improve their overall retirement plan programs.

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ESOPs AND CHARITABLE REMAINDER TRUSTS – A VALUABLE COMBINATION

A business owner who wishes to generate liquidity for his ownership interest in his company can sell his stock to an employee stock ownership plan (“ESOP”). An ESOP is a qualified retirement plan established for the primary purpose of investing in employer stock. One of the significant tax benefits generally available on a sale of closely-held stock to an ESOP

is that the seller can defer and possibly eliminate capital gains arising from the sale of the stock. There are, however, a number of conditions that must be met in order to qualify for the tax deferral. They include, among others, that (1) following the sale, the ESOP must own at least 30% of the company stock; (2) the business owner

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ESOPs AND CHARITABLE REMAINDER TRUSTS – A VALUABLE COMBINATION

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must have owned the stock for at least three years prior to the sale; (3) the owner and certain family members and other 25% owners cannot participate in the ESOP; and (4) within a short period of time before or after the sale, the owner must purchase U.S. stocks and bonds (“qualified replacement property”) in an amount equal to the sale proceeds.

There is an alternative, however, for owners of C corporation stock that allows the business owner to avoid these restrictions and still achieve significant tax benefits. While this alternative has general appeal, it makes even more sense for philanthropic individuals. Under this alternative, the business owner contributes his stock to a charitable remainder trust (“CRT”) and then the CRT sells the stock tax-free to an ESOP. The CRT typically is designed to pay an annuity (generally a fixed percentage of the trust principal revalued annually) to the owner for his lifetime or to the owner and his spouse for their respective lifetimes and any amount remaining after death is payable to a desig-

nated charity or a charitable foundation. In order to qualify for the tax benefits, the charity must receive on an actuarial basis a minimum of 10% of the value of the property contributed to the trust. The owner receives a charitable deduction, subject to percentage limitations, equal to the actuarial value of the charity’s remainder interest. Any amount that the owner cannot deduct in the current year due to the percentage limitations can be carried over for five years. The annuity payments received by the owner during his lifetime generally are taxed to the annuitant when received, with a significant portion being taxed at favorable capital gains rates. The stock is removed from the business owner’s estate and, therefore, is not subject to estate tax.

A CRT can also be used in another creative way to achieve favorable tax results and avoid a planning problem. The owner of a corporation who meets the conditions described in the first paragraph above who sells his stock to an ESOP and purchases qualified replacement property cannot then engage in active trading and diversification of the ESOP sales

proceeds. The reason for this is that the sale of such assets will trigger the deferred capital gain from the sale to the ESOP. One way to avoid this problem is to sell the stock to the ESOP, purchase qualified replacement property with the sales proceeds, and then donate the qualified replacement property to a CRT. The IRS has ruled that this will not trigger the acceleration of the deferred capital gain. Furthermore, the tax on the gain from the sale to the ESOP can be permanently avoided because the CRT can sell the replacement property and reinvest the sales proceeds without any resulting tax liability. The owner can replace the gift to the charity by using some of the annuity income to purchase life insurance that will benefit his heirs upon his death. He can ensure that these replacement funds are also excluded from his estate by creating an irrevocable life insurance trust to purchase and own the policy.

Please contact Stanley E. Bulua, Esq. or Jay Fenster, Esq. if you have any questions about combining estate planning with ESOP transactions.

POST-EMPLOYMENT BENEFIT VALUATIONS DEADLINES

All public sector employers offering post-employment benefits (other than pensions) must comply with the Government Accounting Standard Board (GASB) Statement 45 requirements by the end of their 2009 fiscal year. GASB 45 requires these employers to display the related liabilities of those benefits in their financial statements, and include not only current retirees, but current active

employees who could become eligible.

Danziger & Markhoff LLP has performed many valuations for towns and municipalities over the past year. Our in-house actuarial staff is uniquely qualified to assist you and your clients with these matters.

Please call Andrew E. Roth, Esq. with any questions.

FINAL IRS REGULATIONS SIGNIFICANTLY IMPACT 403(b) PLANS OF TAX-EXEMPT ORGANIZATIONS

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Section 403(b) of the Internal Revenue Code permits organizations that are tax-exempt under Section 501(c)(3), such as hospitals, cultural institutions, churches and public schools, to provide their employees with tax-favored retirement benefits through use of tax-sheltered annuities or mutual fund custodial accounts.

The Final Regulations dramatically change the rules of the game by requiring all 403(b) programs, including those that are not subject to ERISA (because they do not provide for any employer contributions) to be maintained and operated pursuant to a written plan document. The plan must contain all material terms and conditions for eligibility and benefits, applicable limits, the time and form of benefit distributions, and the investment contracts (annuities or custodial accounts) available under the plan. In addition, the plan document must include any optional plan features that may be available to participants, such as hardship withdrawals, loans, and Roth features. Moreover, the investment contracts must also contain certain provisions, such as the limits on employee pre-tax deferrals and rules on

required minimum distributions and direct rollovers.

The Final Regulations confirm that with certain exceptions, 403(b) arrangements have to satisfy non-discrimination requirements. However, the Final Regulations fine-tune the rules so that certain arrangements that previously satisfied the requirements will not be compliant come next year. For example, prior to the Final Regulations, a 403(b) plan could be compliant even though union employees were not given the opportunity to defer compensation under the plan. This is no longer the case. Similarly, in the past, employer contributions could be tested using a transitional “safe harbor” set forth in IRS Notice 89-23 or by using “good faith compliance”. Next year those options will no longer be available.

Perhaps most significantly, the Final Regulations create new entity aggregation rules. Under the Final Regulations, two or more organizations will be treated as one employer for non-discrimination testing purposes if at least 80% of the directors or trustees of one organization are representatives of or are directly or indirectly controlled by another organization. Accordingly, exempt entities with overlapping boards or with other close con-

nections, which maintain different retirement benefit programs that do not take each other into account, may no longer be able to do so.

Tax-exempt organizations should have their 403(b) plan documents thoroughly reviewed to ensure that all required provisions are included and that there are no conflicts between the main document and any incorporated documents. In addition, plan administration should be reviewed to make sure that plans are actually operated in accordance with their terms. While some simple arrangements will only need expanding plan documents to cover required terms, (1) employers with multiple plans or multiple vendors, (2) employers that are potentially affected by the new related entity rules, and (3) employers that relied on a safe harbor or good faith interpretation that differs from current qualified plan rules, will have to carefully address potential problems and consider alternative solutions.

If you have any questions regarding 403(b)s or want assistance with reviewing your current program, kindly contact Ira Langer, Esq. or Jay Fenster, Esq.

YEAR-END DEADLINE FOR DEFERRED COMPENSATION COMPLIANCE

Final Regulations under Code Section 409A regulating non-qualified deferred compensation arrangements become fully effective at the end of this year. As a result, plans and agreements must be amended before year-end to avoid significant adverse tax results.

If you would like additional guidance in order to be in compliance by year end, kindly contact Jay Fenster, Esq. or Ira Langer, Esq.

HEALTHCARE PROVIDERS: "RED FLAG RULES" DELAYED UNTIL MAY 1, 2009

On October 22nd, the Federal Trade Commission announced that enforcement of the so-called "Red Flag Rules" would be delayed from November 1, 2008 until May 1, 2009. The rules require creditors to take measures to prevent identity theft; the FTC recognized that many of the organizations affected by the rules (including potentially healthcare providers as described below) were unaware of the applicability of the rules to them and that, accordingly, compliance with the original effective date would be unlikely.

The compliance problem arose because even though the rules were originally designed to apply to financial institutions and other commercial creditors, the definition of "creditor" in the rules is extremely broad and calls into question whether healthcare providers are subject to its application. The rules define a creditor as an entity that regularly extends, renews or continues credit or arranges for the

extension of credit. In a recent conference call, the FTC indicated that a healthcare provider would be covered by this definition if it does not regularly demand payment in full for its services at the time of service and that a determination of creditor status is to be made on a case-by-case basis. This interpretation could lead to the conclusion that a practice which does not collect co-payments at the time of service, or balance bills its patients after receipt of insurance company payments, could be extending credit to its patients.

If a practice is determined to be a creditor, the Red Flag Rules are applicable to it. The practice would then need to develop an identity theft program that contains "reasonable policies and procedures" to (i) identify activities which constitute "red flags" indicating possible identity theft; (ii) detect these activities; (iii) respond to any such detected activities to prevent and mitigate identity theft; and (iv) maintain

appropriate updating to the program. Similar to the governmental attitude towards compliance plans, the FTC recognizes that the identity-theft prevention program can be flexible and tailored to the size of a practice and the relative risks involved. It is expected that the FTC and /or other organizations will develop an identity-theft program template for use by creditors.

Almost 30 national medical associations have submitted a letter to the FTC questioning the applicability of the Red Flag Rules to healthcare providers. We will continue to monitor this situation and update you as developments occur.

*If you have any questions, please do not hesitate to contact
Joshua S. Levine, Esq.*

IN OUR FIRM

Harris Markhoff Included in Super Lawyer Magazine

Please join us in congratulating Harris Markhoff on his selection for inclusion in New York Super Lawyer magazine in the area of taxation. Only 5% of attorneys practicing in New York received this honor.

New Website

We are pleased to inform you that we have launched our new website. We hope you will find it helpful. Please go to www.dmlawyers.com.

Let us know if you would like to receive future issues of our newsletters by e-mail. All we need is your e-mail address. Please either fax your request to our office, attention: Paula Peck at (914) 948-1706 or e-mail Ms. Peck at Ppeck@dmlawyers.com.

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