

TECH FLEX

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HCFSA BALANCE DISTRIBUTION ENACTED FOR MILITARY PERSONNEL

On Tuesday, June 17, 2008, President Bush signed into law the “Heroes Earnings Assistance and Relief Tax Act of 2008” (H.R. 6081). Previously on May 20, 2008, H.R. 6081 was approved by the United States House of Representatives by a vote of 403 – 0. The bill was then passed on May 22, 2008 in the United States Senate by Unanimous Consent.

One of the provisions of H.R. 6081, specifically Section 114, allows individuals called up from the reserves for active military service for at least six months to take unused balances in their health care flexible spending accounts (HCFSA) as a taxable distribution. Generally, the cafeteria plan regulations require that unused HCFSA balances must be forfeited once the opportunity to incur or submit eligible claims for reimbursement has been exhausted. Further, the regulations prohibit the refunding of HCFSA contributions. However, H.R. 6081 allows an exception to the HCFSA forfeiture rules by permitting employees who are called up for military service to receive a taxable distribution of the HCFSA account balance rather than forfeit the account balance.

Under the newly enacted legislation, the following requirements need to be met in order for a taxable distribution to be made from the HCFSA:

- Employee must be a member of military reserves who is called to active duty.
- The employee must be called to active duty for a period of 179 days or more.
- Taxable distributions of unused HCFSA balances must be made between the period beginning on the date of the call up and ending on the last day that reimbursement could be made under the HCFSA plan for the year in which the call to active duty occurred.

It is important to note that the adoption of the rule by the plan to allow the distribution of unused HCFSAs as taxable income to military personnel meeting the requirements is an optional plan design.

H.R. 6081, Section 114 reads as follows:

SEC. 114. SPECIAL DISPOSITION RULES FOR UNUSED BENEFITS IN HEALTH FLEXIBLE SPENDING ARRANGEMENTS OF INDIVIDUALS CALLED TO ACTIVE DUTY.

(a) In General- Section 125 (relating to cafeteria plans) is amended by redesignating subsections (h) and (i) as subsection (i) and (j), respectively, and by inserting after subsection (g) the following new subsection:

(h) Special Rule for Unused Benefits in Health Flexible Spending Arrangements of Individuals Called to Active Duty-

(1) IN GENERAL- For purposes of this title, a plan or other arrangement shall not fail to be treated as a cafeteria plan or health flexible spending arrangement merely because such arrangement provides for qualified reservist distributions.

(2) QUALIFIED RESERVIST DISTRIBUTION- For purposes of this subsection, the term "qualified reservist distribution" means, any distribution to an individual of all or a portion of the balance in the employee's account under such arrangement if--

(A) such individual was (by reason of being a member of a reserve component (as defined in section 101 of title 37, United States Code)) ordered or called to active duty for a period in excess of 179 days or for an indefinite period, and

(B) such distribution is made during the period beginning on the date of such order or call and ending on the last date that reimbursements could otherwise be made under such arrangement for the plan year which includes the date of such order or call.

(b) Effective Date- The amendment made by this section shall apply to distributions made after the date of the enactment of this Act.

It is not clear whether "the period beginning on the date of such order or call and ending on the last date that reimbursements could otherwise be made under such arrangement for the plan year" refers to the last day of the 12-month plan year, the last day of the grace period if applicable or the last day of the plan run-out period. ADP will continue to monitor for any regulations or clarifications surrounding the newly enacted legislation.

GENETIC INFORMATION NONDISCRIMINATION ACT ENACTED

On May 21, 2008, the Genetic Information Nondiscrimination Act (GINA) was signed into law by President Bush. GINA establishes a national, uniform, basic standard to protect individuals from discrimination in health care and employment practices based on genetic information. In addition, GINA generally eliminates, with limited exceptions, access to "genetic information" by health plans, health insurers and employers. GINA consists of two parts: (1) genetic nondiscrimination in relation to health insurance; and (2) employment discrimination based on

genetic information. The provisions related to health insurance are effective for plan years beginning on or after May 8, 2009. The provisions related to employment nondiscrimination are effective on November 8, 2009.

Important Definitions

GINA provides a number of definitions that are important to be familiar with when analyzing the provisions of the newly enacted legislation. These include, “genetic information”, “genetic test”, “genetic services” and “family members.”

Genetic Information

The definition of “genetic information” under GINA is information with respect to any individual in relation to the following:

- An individual’s genetic tests.
- The genetic tests of family members of any individual.
- The manifestation of a disease or disorder in family members or disorder in family members of any individual.

Genetic information also includes information related to any fetus carried by a pregnant woman and any embryo legally held by an individual or family member using assisted reproductive technology. Additionally, the term encompasses “any request for, or receipt of, genetic services, or participation in clinical research which includes genetic services, by such individual or any family member of such individual.”

However, genetic information does not include information relating to the sex or age of any individual.

Genetic Test

Under the provisions of GINA, “genetic test” means “an analysis of human DNA, RNA, chromosomes, proteins, or metabolites that detects genotypes, mutations, or chromosomal changes.”

Genetic Services

“Genetic services” include the following:

- A genetic test.
- Genetic counseling (including obtaining, interpreting, or assessing genetic information).
- Genetic education.

Family Member

The term “family “member” means the following in respect to an individual:

- An individual’s dependents under the group health plan.
- Any other individual who is a first-degree, second-degree, third-degree or fourth-degree relative of an individual or the individual’s dependents under the group health plan.

GINA Group Health Plan Limitations

All group health plans and group health insurers under GINA are prohibited from the practice of the following based on genetic information:

- Setting premium rates or minimum contributions.
- Requesting or requiring genetic testing of plan participants or their family members as a condition of enrollment in a health plan.
- Requesting, requiring, or purchasing genetic information for underwriting purposes (as noted in the law) or in connection with enrollment.
- Establishing eligibility rules or imposing pre-existing condition limitations or engaging in discriminatory pricing of policies based on genetic information by neither Medicare policy issuers nor individual policy issuers.

Although group health plans and group health insurers may not request or require an individual or a family member to undergo a genetic test, a plan may obtain and use the results of a genetic test, as necessary, to make determinations in relation to claims payment obligations. But, a plan and or insurer may only request the minimum necessary information to make such determination.

Further, insurers and plans are allowed to request, but not require, an individual to undergo a genetic test for research purposes if the conditions noted below are met.

- The request is made in writing and the research complies with federal law and any applicable state or local law pertaining to the protection of human subjects in research.
- The plan or issuer clearly indicates to each individual for whom genetic testing is being requested, that agreement to the request is voluntary and the declination of the request will not impact enrollment eligibility or premium or contribution amounts.
- The plan or issuer must communicate to the individual that any genetic information collected or acquired will not be used for underwriting purposes.
- The plan or issuer must notify the Secretary of Human and Health Services (Secretary) in writing that such research is taking place and a description of activities being conducted.

GINA Impact on HIPAA Privacy Rules

The legislation requires that the Secretary modify the Privacy Rule under the Health Insurance Portability and Accountability Act (HIPAA) to include genetic information as protected health information. Consequently, the use or disclosure of an individual's genetic information would generally be prohibited unless use or disclosure is authorized by the individual to whom the genetic information pertains.

Penalties for Violation of GINA Health Care Protections Provisions

Under the Employment Retirement Income Security Act (ERISA), which was amended by GINA, violations of GINA by a group health plan or insurer are subject to penalties of \$100 per day for each participant harmed. Additionally, the Department of Labor (DOL) may impose penalties not exceeding the lesser of 10% of the aggregate plan premium/expenses for the year or \$500,000 for failures due to a reasonable cause and not as a result of willful misconduct. However, if the violations are a result of willful misconduct, the DOL may assess penalties that range from \$15,000 per violation or higher. Finally, in addition penalties may be levied under the Internal Revenue Code and HIPAA.

GINA Employment Practice Restrictions

The provisions of GINA regarding employment discrimination prohibits employers (including federal, state and local government employers) employment agencies, labor organizations, joint labor-management committees and other employment organizations from discriminating against an employee based on genetic information. Specifically, employers may not refuse to hire or discharge or discriminate in any manner as to compensation or other benefits or employment in conjunction with knowledge of genetic information. Further, employment agencies may not refuse to refer a candidate and labor organizations cannot deny admission of an individual to apprenticeship or training programs, or cause an employer to discriminate against an employee/union member based on genetic information.

Permissible Uses of Genetic Information

Employers, employment agencies, labor organizations, joint labor-management committees and other employment organizations are allowed under GINA to obtain genetic information under the conditions noted below.

- Where the employer inadvertently requests or requires family medical history of the employee or family member of the employee.
- Where an employer offers health and genetic services such as a wellness program and the following conditions are met.
 - The employee provides voluntary written permission.
 - Only the employee (or family member who is receiving the genetic services) and the health care provider or genetic counselor may receive information that specifically identifies the individual who is the subject of the genetic testing.
 - Any information that serves to identify the individual undergoing genetic testing must not be disclosed to the employer except in aggregate terms that do not identify the employee.

- In the event the employer requests or requires family medical history to comply with certification provisions under the Family Medical Leave Act (FMLA).
- Where an employer purchases documents that are commercially and publicly available. Examples of such documents include, newspapers, magazines, periodicals and books, but do not include medical databases or court records that include family medical history.
- Where the information involved is to be used for genetic monitoring of the biological effects of toxic substances in the workplace and the conditions noted below are met.
 - Employer provides written notice of the genetic monitoring to the employee.
 - The employee provides written authorization.
 - The genetic monitoring is required by federal or state law.
 - The employee is informed of individual monitoring results.
 - The monitoring complies with any federal or state monitoring regulations.
 - The employer receives the results in aggregate results that do not disclose the identity of specific employees.
- Where the employer conducts DNA analysis for law enforcement purposes as a forensic laboratory and requires such analysis for quality control purposes.

Records Retention Requirements

GINA requires that the genetic information obtained must be contained in medical files separate from employment files and must be treated as a confidential medical record. Organizations in possession of genetic information may not disclose such information except in the limited circumstances outlined below.

- Where the employee or member of a labor organization (or family members if the family member is receiving the genetic services) requests disclosure in writing.
- Where genetic information is released to an occupational or other health researcher and where such individuals comply with the applicable HIPAA rules in relation to protected health information.
- Genetic information may be released to the extent that such disclosure is made pursuant to the employee's compliance with FMLA certification requirements.
- The information may be released to public health agencies in the event that the genetic information being disclosed pertains to a contagious disease that presents an imminent hazard of death or life-threatening illness. The employee and/or family member whose information was released must be notified.

It is important to note that GINA does not make an exception to the disclosure limitations noted above in relation to a discovery request or litigation actions.

Remedies for Violation of GINA Employment Provisions

Individuals whose genetic information was compromised based on the employment discrimination prohibitions contained in GINA may file a complaint with the Equal Employment Opportunity Commission (EEOC) or any similar state agency. It is expected that EEOC will issue further guidance via regulations on this issue.

For a copy of the Genetic Information Nondiscrimination Act, please click on the link provided below:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h493ih.txt.pdf

GUIDANCE RELEASED ON HSA FULL-CONTRIBUTION RULE

On December 20, 2006, President Bush signed into law the Health Opportunity Patient Empowerment Act of 2006 (Act). The act was effective for taxable years beginning after December 31, 2006. This law which was part of the Tax Relief and Health Care Act of 2006 provided improvements to individual trusts commonly known as health savings accounts (HSA). One of the provisions of this enacted legislation provided modifications in relation to the amount of contributions to an HSA that may be made where an individual is not HSA eligible for the entire calendar year.

Prior to the 2006 legislation, HSA contribution maximums were pro rated based on the number of months that an individual during the year was an eligible individual. For example, if the individual became eligible to contribute to an HSA on the first day of the seventh month of the plan year, the individual would only be eligible to contribute 6/12 or 50% of the statutory maximum. The Act provided an exception to this rule that allows individuals who become covered under an HSA-eligible plan in a month other than January to make the maximum HSA contribution for the year based on their coverage in the last month of the year. However, if an individual does not stay in the HSA-eligible plan 12 months following the last month of the year of the first year of eligibility, the amount which could not have been contributed except for this provision will be included in income and subject to a 10 percent additional tax.

On June 4, 2008, the Internal Revenue Service (IRS) released via IRS Notice 2008-52, further guidance on the full-contribution rule. Specifically, the IRS discussed the method for calculating the maximum annual HSA contribution in case of mid-year HSA eligibility, the timing issues for HSA contributions and HSA establishment, and the adverse tax consequences if the individual does not remain HSA eligible for the required amount of time.

Calculating the Maximum Annual HSA Contribution

Under the full-contribution rule, an individual who is an eligible individual on the first day of the last month of the taxable year is treated as having been an eligible individual for the entire year. Consequently, an individual who is HSA eligible on the first day of the last month of his or her taxable year (December 1 for calendar year taxpayers) may contribute the statutory amount based on the limits for the entire calendar year. For example, if an individual first becomes HSA-eligible on December 1, 2008, and has family HDHP coverage, he or she is treated as an eligible individual and having family HDHP coverage for all twelve months in 2008. This full

contribution rule also applies to catch-up contributions. The full contribution rule applies without regard to whether the individual was an eligible individual for the entire year, had HDHP coverage for the entire year, or had disqualifying non-HDHP coverage for part of the year. However, a testing period applies for purposes of the full contribution rule.

Adverse Tax Consequences If Testing Period Not Satisfied

Individuals who contribute to an HSA based on the full-contribution rule must remain HSA-eligible throughout a 13-month testing period in order to avoid adverse tax consequences. This testing period generally begins on December 1 of the year for which HSA contributions were made based on mid-year HSA eligibility through December 31 of the following year. For instance, an individual who becomes HSA eligible on June 1, 2008, the testing period will run from December 1, 2008 through December 31, 2009. Should the individual fail to remain HSA eligible for the entire 13-month period, the portion of their HSA contributions for 2008 exceeding the sum of their monthly contribution limits for 2008 must be included in income for the year in which the individual lost HSA eligibility.

Example:

An individual becomes HSA eligible on July 1, 2008 and contributes the 2008 statutory maximum for self-only coverage in the amount of \$2,900. On March 1, 2009 (3 months into the 13-month testing period), the individual loses HSA eligibility. If not for the full-contribution rule, the individual would have been eligible to contribute 6/12 of the statutory maximum or \$1,450 (\$241.66 per month for 6 months of HSA eligibility). As a result of losing HSA eligibility within the testing period, the individual would be taxed on the excess amount of (\$1,450) in the year HSA eligibility is lost. Since the individual lost coverage in 2009, the \$1,450 would be taxed in the 2009 tax year.

In addition, the individual must also pay an additional 10% tax on that amount. These adverse tax consequences, including the 10% additional tax, apply regardless of age (i.e., even after age 65). However, earnings (HSA investments) on this taxable amount are not included in income or subject to the 10% tax.

HSA Establishment and Contributions

Even though individuals who first become HSA eligible on December 1 may be treated under the full-contribution rule as if they were HSA eligible all year, they cannot establish an HSA until they are actually HSA-eligible. Further, any expenses incurred before the HSA is established cannot be reimbursed on a tax-free basis by the HSA. For example, an individual becomes HSA eligible on July 1, 2008. The individual cannot establish or contribute to an HSA prior to that date. In addition, although the individual may contribute the maximum annual amount in effect (i.e. \$2,900 for 2008 self-only coverage), the individual is not allowed to be reimbursed on a tax-favored basis for any expense incurred prior to the establishment of the HSA (i.e. July 1, 2008).

For a copy of IRS Notice 2008-52, please click on the link provided below.

<http://www.irs.gov/pub/irs-drop/n-08-52.pdf>

PAYROLL PROVISIONS CONTAINED IN MILITARY TAX RELIEF BILL

As noted in the article above titled “HCFSA Balance Distribution Proposed for Military Personnel”, legislation has been passed in the House and Senate and if enacted by the President’s signature, would allow individuals called up from the reserves for active military service for at least six months to take unused balances in their health care flexible spending accounts (HCFSA) as a taxable distribution. This legislation, known as the “Heroes Earnings Assistance and Relief Tax Act of 2008” (H.R. 6081) also contains provisions that will impact the taxation of supplemental military pay.

As background, compensation paid by an employer to employees while on military duty that represents the difference between the employee’s regular pay and the pay provided by the state or government is known as supplemental (or differential) military pay. The taxation of supplemental military pay is dependent on the circumstances of the employee’s military service.

Under the current regulations, the following rules apply.

- If the supplemental military pay is provided while on the employee is on temporary assignment (30 days or less) with the state National Guard or the Armed Forces Reserve, it is considered wages subject to federal income withholding or social security, Medicare and federal unemployment tax act (FUTA) taxes.
- If the supplemental military pay is provided while the employee is on active duty (more than 30 days) with the United States Armed Forces or on an indefinite assignment with the state National Guard, the Internal Revenue Service (IRS) considers the employment relationship to be broken. The result of the IRS position is that military supplemental pay received while on active duty is not subject to federal income tax withholding, or social security, Medicare or FUTA taxes.

In cases where the military duty is temporary, the supplemental military pay is considered wages and must be reported on the employee’s Form W-2. However, if the military service is active or indefinite, the supplemental military pay is not considered wages and if the amount paid is \$600 or greater must be reported on Form 1099-MISC in Box 3 titled “Other Income.”

Should H.R. 6081 be enacted, the definition of wages would be amended for purposes of federal income tax withholding to include any supplemental military payment made by employer to an employee. This would include payments made to employees on active duty with military. In addition, an individual receiving supplemental military pay would be treated as compensation for retirement plan purposes.

It is important to note that the bill does not change the current rule in relation to social security, Medicare or FUTA taxes. Therefore, an employee on active duty receiving supplemental military pay would not be subject to these employment taxes.

If enacted, the wage withholding rules will be effective to supplemental military pay paid after December 31, 2008.

For a copy of the “Heroes Earnings Assistance and Relief Tax Act of 2008”, please click on the link provided below.

IOWA EMPLOYERS MUST SEND PAY BY MAIL IF EMPLOYEE REQUESTS

Effective July 1, 2008, Iowa employers must send wages to employees by mail upon receipt of a written request from the employee. Under the enacted legislation (SB 2222), employers are required to keep a copy of the request for as long as it remains effective, PLUS an additional two years. An employer who fails to pay wages on time, regardless of the payment method is liable for any overdraft charges incurred by the employee as a result of the late wage payment.

Generally, Iowa requires that wages be paid no later than 12 days from the end of the pay period, excluding Sundays and holidays.

Iowa SB 2222 modified the current regulations as noted below. The underlined language represents what was added to the rules and the stricken language represents what was deleted.

Section 1 Section 91A.3, subsection 3, paragraph a, unnumbered paragraph 1, Code Supplement 2007, is amended to read as follows:

“The wages paid under subsection 1 shall be ~~sent to the employee by mail or be paid at the employee's normal place of employment during normal employment hours or at a place and hour mutually agreed upon by the employer and employee, or the employee may elect to have the wages sent for direct deposit, on or by the regular payday of the employee, into a financial institution designated by the employee.~~ Upon written request by the employee, wages due may be sent to the employee by mail. The employer shall maintain a copy of the request for as long as it is effective and for at least two years thereafter.”

For a copy of Iowa SB 2222, please click on the link provided below.

<http://coolice.legis.state.ia.us/CoolICE/default.asp?Category=BillInfo&Service=Billbook&ga=82&menu=text&hbill=SF2222>

MAINE RAISES MINIMUM WAGE

Effective October 1, 2008, the minimum wage in Maine will be increased from \$7.00 to \$7.25 per hour. The Maine tipped employee minimum hourly percentage will remain at 50% of minimum wage. Therefore, the tipped employee minimum hourly rate will be changing from \$3.5000 per hour to \$3.6250 per hour in cash wages. Consequently, the maximum tip credit will be changing as of October 1, 2008 from \$3.5000 per hour to \$3.6250 per hour ($\$3.6250 + \$3.2650 = \$7.2500$).

As of October 1, 2009, the minimum wage in Maine will again be adjusted upward from \$7.25 per hour to \$7.50 per hour. The tipped employee minimum hourly percentage will remain at 50% of minimum wage. Therefore, the tipped employee minimum hourly rate will be changing from \$3.6250 per hour to \$3.75 per hour in cash wages. Consequently, the maximum tip credit will

be changing on October 1, 2009 from 3.6250 per hour to \$3.75 per hour (\$3.75 + \$3.75 = \$7.50).

Please Note: Where the highest federal minimum wage is increased in excess of the minimum wage in effect for Maine, the Maine minimum wage will be increased to the federal minimum wage amount, effective on the same date as the increase in the federal minimum wage occurs. However, the state minimum wage may not be adjusted upwards in excess of \$1.00 based on an increase to the federal minimum wage.

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